

DO BALANCED BUDGETS CAUSE DEPRESSIONS?

BY FREDERICK C. THAYER



During the loud and widely accepted argument asserting that balancing the federal budget and reducing the national debt will bring an era of prolonged prosperity, little attention has been given to the consistently startling historical record.

At the end of World War I, Democrats and Republicans alike concluded that it was time to return to the "normal" situation of balancing the federal budget and reducing a national debt that had increased markedly during the war. While President Warren Harding used "return to normalcy" as a successful campaign slogan, it was the prior administration of President Woodrow Wilson that actually reduced the national debt in 1920. From that year through 1930, the annual budget remained in surplus and the national debt was reduced by 36%, to \$16.2 billion.

The Great Depression began in August 1929. The question to be asked is whether the anti-public-spending crusade of the 1920s had anything to do with its onset and with the fact that Depression did not end until the onset of World War II.

Even though the sequence that begins with budget balancing and ends with depression has been common in American history, the question of a linkage has been ignored. The following paragraphs include all the basic data:

1817-21: In a period of 5 consecutive years, the national debt was reduced by 29%, to \$90 million. The first acknowledged depression began in 1819.

1823-36: In a period of 14 consecutive years, the national debt was reduced by 99.7%, to \$38,000, a virtual wipeout. This didn't help either. A major depression began in 1837.

1852-57: In a period of 6 consecutive years, the national debt was reduced by 59%, to \$28.7 million. A major depression began in 1857.

1867-73: In a period of 7 consecutive years, the national debt was reduced by 27%, to \$2.2 billion. A major depression began in 1873.

1880-93: In a period of 14 consecutive years, the national debt was reduced by 57% to \$1 billion. A major depression began in 1893.

1920-30: In a period of 11 years the national debt was reduced by 36%, to \$16.2 billion. The sixth real depression — the Great Depression — began in 1929.

As opposed to many less important downward "business cycles" or recessions, these six collapses have been the only major depressions in U.S. history. The batting average is perfect — six sustained periods of reducing the national debt followed by six major crashes.

Since 1791, these debt reduction crusades have colored 57 of the 93 years in which the national debt was reduced. The debt was increased in each of 112 years, an indication that federal deficit spending has been anything but unusual. We have had almost chronic deficits since the 1930s, and there has been no new depression since then — the longest crash-free period in our history.

What does the record prove? According to the rules of science, no single proposition ever can be "proved" beyond question. So the repeated sequences outlined above may be only coincidences — not correlations, not valid associations, not clear evidence of cause and effect. But myths should be subject to similar skepticism. There is no evidence at all that balancing the budget and paying down the national debt has ever sustained national prosperity even in the most perfect situation imaginable — one with no national debt at all. There is simply no empirical support for one of America's most dominant myths.

The defenders of the myth engage in obvious violations of intellectual ethics. To begin with, they simply ignore the record of history. In so doing, they imply that the record is unworthy of attention.

The second violation is to insist that those who question the balanced budget ideal must provide overwhelming evidence to support such challenges, while defenders of the myth are subjected to no such standard.

The third violation is to use absolute numbers ("hundreds of billions!" "trillions!") as a scare tactic when only relative comparisons make sense. Relative to the Gross National Product, or GNP (now replaced by the Gross Domestic Product, or GDP), recent annual federal deficits have been similar to the highest deficits of the 1930s (2% to 5% of GNP), but are trivial when measured against those of the 1940s (20% to 31% of GNP). The overall national debt, now about 65% of GNP, is only half the size of the debt in the years immediately following World War II.

Admittedly, any possible cause-and-effect relationship can be argued in either direction. Wars — the Revolution, the Civil War, World Wars I and II — can be said to cause deficit spending that, while undesirable on economic grounds, is necessary and in the national interest. The same can be said of the huge cost of the long Cold War, which continued for 45 years following World War II.

Depressions can also be considered as justifications for deficit spending; projected revenues fall short of predictions even while the government eliminates enough services to put budgets into balance.

Yet the record suggests that deficits *never* have triggered depressions but that crusades to reduce the national debt have *always* been followed by depressions.

Claim 1: *We should relieve our children and grandchildren of the crushing burden of debt.*

This suggests that the altruistic will lift great sacrifices from the backs of our descendants. The claim has the unusual, even unpatriotic, effect of appearing to characterize the U.S. victories in World War II and in the Cold War as tragic mistakes that now threaten future generations.

Obviously the *crushing burden* could have been avoided by not responding to the attack on Pearl Harbor and by ignoring the post-World War II challenge of the Soviet Union. One might ask: Where were all of today's obsessed budget-balancers when we needed them?

The Concord Coalition, with Senators Warren Rudman (R-N.H.) and Paul Tsongas (D-Mass.) as its designated cheerleaders, puts considerable effort into mobilizing young people in an all-out assault on the cost of Social Security, Medicare and other "entitlements."

The assault is attractive to many young people, especially those whose wages and purchasing power have been declining for two decades. But if these young people find themselves saddled with the requirement to keep their aging parents alive and healthy, they will be much less able to support their immediate families, a problem that the Concord Coalition studiously avoids discussing.

The sequence of a balanced budget followed by a depression has had unhappy consequences for young people. So many Americans were underfed and unhealthy in the 1930s that physical examination rejections of 40%-50% were common when it came time to build an army of draftees in World War II. The original postwar purpose of school lunches was to keep kids healthy enough to pass military draft requirements if that became necessary.

Social Security, Medicare and Medicaid are devices that keep the elderly and poor healthy. Social Security was also designed in part to remove the elderly from a labor market that could not hire them in the 1930s.

Economists often compare federal deficits and debt with "imprudent" individual spending habits. They seem unfamiliar with the fact that many solid individuals buy homes priced at 300%-400% of their annual incomes, a rough equivalent of an individual GNP. By this logic, a national debt of double or even quadruple the current amount should be no problem at all.

Claim 2: *A balanced budget would reduce interest rates, encourage borrowing for investment in new plants and equipment to produce consumer goods, and increase productivity and wages.*

This collection of pies-in-the-sky rests upon overlapping and contradictory premises and an apparently deliberate avoidance of public policies that are calculated to get in the way.

When they are not engaging in rationalizations, economists acknowledge that the Federal Reserve Board has considerable power over interest rates, and that some of its interest rate decisions are explicitly intended to slow down economic growth, create fewer jobs and depress wages in order to control inflation. The White House, Congress and the Federal Reserve have agreed on such policies for two decades, so it is nonsense to claim that there is widespread interest in raising wages.

This policy has led to a comic opera surrounding the issue of welfare reform. The bipartisan public policy is to maintain an unemployment rate of somewhere around 6% in order to curb inflation. That has been about the actual rate for a year or so. But the unemployed are blamed for being jobless and on welfare even though they are unknowingly performing patriotic duty that public policy has assigned to them. They are performing the job of not working.

Claim 3: *Government deficits and overspending cause inflation. Public borrowing and spending are wasteful and damaging because they do not produce goods that will be sold in the marketplace.*

A publicly financed bridge is considered "wasteful" because it has no market value. According to official wisdom this is *not* an investment. A privately financed brewery is "wealth" because it is considered to be worth at least the cost of building it. But this ignores the likelihood that the bridge may be necessary for the operation of the brewery. Officially only the brewery is an investment.

Why is it that deficit spending and increases in the national debt are widely considered legitimate only in connection with wars? Is this the only public purpose that justifies such spending? Isn't it possible that other needs of society might be similarly legitimate?

The unemployment rates of young people range from 20%-40%. How can we expect them to become model citizens when not enough legitimate jobs are available or when the jobs they can find keep them in minimum wage poverty? The policy of compulsory unemployment creates criminals that we must then warehouse in prisons.

At this point the needs of society are for more public goods, financed by public spending. Why are we determined to begin again the sequence of disaster without examining history?

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THE REAL AGENDA

Lester Thurow, a professor at the Massachusetts Institute of Technology and one of the few economists who consistently make sense, has called the Republicans' balanced budget crusade a return to the "survival-of-the-fittest capitalism" promulgated 100 years ago by Herbert Spencer.

Spencer was a 19th century English philosopher who believed, as Thurow puts it, "that it was the duty of the economically strong to drive the economically weak to extinction." According to Spencer — and his Republican disciples today — this social trash removal process is the secret of capitalism's strength.

"Until recently Spencer's suggested solution was roundly rejected," Thurow wrote in the *New York Times Magazine* (11/19) in one of the few published analyses of the Gingrichian-GOP balanced budget scam that reveals its hidden ideological agenda.

"A state-financed safety net," he explained, "protected the weak (the old, the sick, the unemployed, the poor) from economic extinction. Social investments in education, infrastructure and research and development helped raise the earning power of the middle class. The capitalist's power to exploit his work force was legally limited and a combination of social and legal pressures insured that the rising output was shared with the work force."

"The Republicans' balanced-budget plan," stated Thurow, "essentially offers a return to Spencer's survival-of-the-fittest capitalism. It raises taxes on working Americans and lowers them for the wealthy. It shreds the safety net, apparently on the theory that individuals facing starvation will knuckle down and work. Fear will make them hold on so tightly to the economic trapeze that they won't fall off."

Did Thurow exaggerate? When House Republicans voted devastating cuts in antipoverty programs this fall, Representative Christopher Shats (R-Conn.) said that "what we have shown is that we are a caring country. Instead of giving the food, we are going to help the people grow the food."

And Speaker Newt Gingrich said, "What we are doing to the poor in America is destructive and immoral." Gingrich was trashing the 40 years of Democratic-sponsored antipoverty programs that the Republicans want to make disappear. But he could just as well have been talking about his own ideas about the spiritual rejuvenation — or perhaps ultimately the extinction — of the underclass.

As a *Washington Post* editorial on the budget bungle puts it, "Rule One should probably be not to believe very much of anything you see or hear for a while."

But it is becoming more evident that the balanced budget is really a cover for Spencerian ideology. The Republicans know that fixing welfare requires *more* money to subsidize jobs — even if the work is "growing food." Money is needed to provide child care for the single mother whose support will be cut off, as they are required to work at jobs which everyone knows will be hard to find.

The Clinton White House calls it "a values debate." The President vetoed the GOP budget on December 6 with the pen that Lyndon Johnson used to sign the Medicare program into law in 1965. "I would gladly, gladly terminate my tenure here if the price of continuing it was just shelving everything I believe in about this country," he said. More vetoes seem certain but will merely prolong the struggle. What is uncertain is the outcome in the months ahead. It is possible that it will become the essence of the 1996 elections.

~BEN A. FRANKLIN

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