Greece’s descent into financial ruin and social unrest is serving as a cautionary tale of the consequences of excessive government debt. A decade ago, Argentina experienced similar trauma, finally defaulting on its debts altogether and suffering a years-long economic collapse and horrific crime wave as a consequence. Last summer, according to some news sources, the U.S. national debt surpassed 100 percent of its GDP for the first time since World War II, scant hours after Congress caved in to the clamor to “keep the government running” by authorizing additional debt (although, according to other sources, the federal debt-to-GDP ratio may have surpassed 100 percent as early as 2009). Americans increasingly wonder whether Greece’s (and the entire EU’s) present may be America’s future, and whether there is any hope of reversing our country’s slide into terminal indebtedness.

America has always been a debtor nation, so it is perhaps not surprising that our elected leaders are so willing to run up the federal tab. That debt was sometimes unavoidable was acknowledged even by the Founding Fathers. George Washington, in
his farewell address, counseled his contemporaries and their posterity to “cherish public credit” inasmuch as it was a “very important source of strength and security.” But this did not mean borrowing at whim; Washington saw borrowing as a last resort in times of emergency, whose obligations should be discharged as soon as possible thereafter:

One method of preserving public credit is to use it as sparingly as possible, avoiding occasions of expense by cultivating peace, but remembering also that timely disbursements to prepare for danger frequently prevent much greater disbursements to repel it, avoiding likewise the accumulation of debt, not only by shunning occasions of expense, but by vigorous exertion in time of peace to discharge the debts which unavoidable wars may have occasioned, not ungenerously throwing upon posterity the burden which we ourselves ought to bear.

Interestingly, Washington associated debt with war; today’s massive federal debts, incurred by numerous welfare programs, subsidies, and wealth redistribution schemes generally, would have been incomprehensible to his generation.

Washington went on to remind his readers that government debts must always be repaid, and that the means of repayment would always be taxation — which in any form would be “more or less inconvenient and unpleasant.”

Discharging Debt
This fact — that government debts need to be discharged via taxation — has always acted as something of a limiting factor on the disposition of politicians to borrow money. During the American Revolution, the Continental Congress tried to pay for crushing war expenses by printing money rather than levying taxes directly, but soon discovered that that new money — paper Continental dollars — promptly swooned in value, causing the catastrophic price increases that we now associate with inflation. In the end, the war debts were paid for by taxation, but by a different, more dishonest form of taxation that Americans quickly grew to loathe: inflation, the subtle theft of private assets by deliberate depreciation of the currency.

As of January 1791, the fledgling United States had accumulated more than $75 million in debt from the Revolutionary War and Articles of Confederation period. From the inauguration of George Washington onward, the federal debt declined significantly, only to skyrocket during the War of 1812. Relative to the Gross Domestic Product (GDP), the debt stood at roughly 20 percent in 1800, fell to about eight percent by 1810, but was back above 20 percent by 1820.

The determined efforts of several American Presidents over the next 20 years, especially Andrew Jackson, drove the national debt down to near zero by the early 1830s, where it stayed — except for an astonishingly shallow uptick to about four percent of the GDP to pay for the Mexican War — until the onset of the Civil War.

The War Between the States and its aftermath, Reconstruction, were financially, socially, and politically ruinous for the United States. By the late 1870s, the national debt had surpassed 40 percent of the GDP for the first (but unfortunately, not the last) time. Interestingly, the debt peaked more than a decade after the war ended, prolonged not only by the costs of Reconstruction but also by the consequences of inflationary policies instituted by Lincoln during the war. For the first time since the American Revolution, the U.S. government had resorted to issuing large amounts of paper money, unleashing anew the demons of inflation.

When the economic distortions of the war finally dissipated, the national debt began another phase of sharp decline, bottoming out at around four percent of the GDP by 1910.

The events of the second decade of the
20th century changed the complexion of the national debt completely. The creation of the Federal Reserve, America’s first true central bank in the modern sense of the term, allowed the government to introduce on a permanent basis the evil of inflation. In “the Fed” Washington now had the means to print money it could not raise by direct taxation, making inflation a permanent part of the American economic landscape. And the means, employed by the Federal Reserve in conjunction with the Treasury Department, of creating new money was the issuance of government debt, which the Federal Reserve had the power to bankroll by creating money out of thin air.

This revolutionary new monetary system, emancipated from the limits of a domestic gold standard by FDR in 1933-1934, meant that the very existence of American currency depended crucially on debt. As then-Fed Chairman Marriner Eccles told House Committee on Banking and Currency Chair Wright Patman in candid testimony in 1941, “If there were no debts in our money system, there wouldn’t be any money.” And Robert Hemphill, credit manager of the Federal Reserve Bank of Atlanta, writing in a foreword to a book on money written by economist Irving Fisher, explained the matter more fully:

If all the bank loans were paid, no one could have a bank deposit, and there would not be a dollar of coin or currency in circulation. This is a staggering thought. We are completely dependent on the commercial banks. Someone has to borrow every dollar we have in circulation, cash, or credit. If the banks create ample synthetic money we are prosperous; if not, we starve. We are absolutely without a permanent money system. When one gets a complete grasp of the picture, the tragic absurdity of our hopeless situation is almost incredible — but there it is.

Besides the creation of the Federal Reserve, the second decade of the 20th century was a decade of international war, a debilitating conflict that all but bankrupted Europe. The United States was a late entry, but World War I still propelled the national debt back to more than 30 percent of the GDP. The Great Depression drove it higher still, to well over 40 percent by 1940. This marked the first time the U.S. national debt grew significantly during peacetime — in stark contrast to the various peacetime economic “panics” of the 19th century, which generally led to or came amidst declining government spending.

The Federal Reserve’s printing presses certainly bore a large share of the blame for the steep rise in government indebtedness during the 1930s, but so did FDR’s New Deal, the first peacetime attempt to create a centrally managed economy in the United States. The regimentation and massive redistribution of wealth — reminiscent of wartime austerities — were economically ruinous, stifling productivity and entailing gargantuan new expenses for American taxpayers to defray, sooner or later.

But even the federal excesses of the Great Depression paled beside what was to follow. When the United States entered World War II, FDR put the entire country on a war footing unlike anything Americans had seen since the Civil War. Vast sums were expended to erect new fleets, build squadron after squadron of airplanes, and produce the other tools of total war, including tanks, guns, uniforms, and, of course, well-trained military personnel. Billions more were spent to fuel the ships and planes, to erect the military bases, and to devise revolutionary new weapons, cul-

Countries like China quietly divest themselves of U.S. debt holdings. The Chinese are concerned that the United States may try to print its way out of debt, and no longer want exposure to dollar-denominated assets that may depreciate significantly.
The tab for the Second World War was immense, mitigated only by the fact that America — unlike her allies and enemies in Europe and Asia — did not suffer the ravages of war on her own soil. Nevertheless, by war’s end, the national debt hovered near 120 percent of the GDP, a figure not approached at any other time in American history, until now.

Less Spending, More Spending

Such a debt would have forced most nations into insolvency, but the United States made massive postwar cuts in government expenditures and rolled back much of the prewar New Deal economic regimentation. According to Dom Armentano, professor emeritus in economics at the University of Hartford and contributor to the New York Times, the Wall Street Journal, and many other major news publications, the years 1945-1950 saw extraordinary cuts in government expenditures — to the dismay of the Keynesian champions of Big Government and economic planning:

The period 1945-1950 is (almost) a scientific test of the Keynesian hypothesis. Despite repeated warnings by most mainstream economists that cutting government spending at the conclusion of WW 2 would bring back the Great Depression, the Congress dramatically lowered government spending between 1945 and 1950. Federal government expenditures fell from $106.9 billion in 1945 to $44.8 billion in 1950. Defense spending took the biggest hit falling from $93.7 billion in 1945 to just $24.2 billion in 1950. In just 5 years, government spending (as a % of GDP) fell from 45% in 1945 to just 15% in 1950 and the annual federal budget deficit fell from $53.7 billion in 1945 to only $1.3 billion in 1950.

But what happened to overall economic output and unemployment? Despite the massive economic transitions from wartime to domestic production, GDP actually increased (confounding all of the Keynesians) from $223 billion in 1945 to $244.2 billion in 1947 and then to $293.8 billion by 1950. And despite millions of returning servicemen and women, the unemployment rate averaged a very low 4.5% between 1945 and 1950. Economic disaster? Hardly.

This new economic climate allowed the United States to pay down its vertiginous national debt over the next three decades; by the early 1970s, it was back down to near 20 percent of the GDP.

But while Big Government was dramatically scaled back after World War II, it was not done away with altogether. Many New Deal programs, like Social Security, persisted, and a few new ones, like the postwar G.I. Bill that ushered in the subsidization of higher education, continued to encourage the notion that the federal government could fund welfarist schemes outside its constitutional purview, as long as the alleged greater good was being served. Even as much of the original New Deal was repealed, we had become a nation of New Dealers philosophically, a cultural and moral shift that was to exact a heavy price in latter years.

The 1960s saw the Great Society programs of Lyndon Johnson, which added healthcare, in the form of Medicare, to the growing list of activities that absolutely had to be under the control (and hence, in the pay of) the federal government. Prior to the Great Society, healthcare costs had been more or less stable; subsequent to it, they took off for the stratosphere, providing the convenient rationale for more and more federal interference in the health sector — and correspondingly greater and greater expenditures. In 1971, the crippling costs imposed by the Vietnam War prompted President Nixon to abolish the last remnants of the old gold standard. From that time forward, the U.S. government has been able to inflate the money supply essentially without limit, conjuring up permanent, intractably high debts and deficits into the bargain.

By the early 1990s, the federal debt was around 50 percent of the GDP. The Clinton tax hikes held the debt in check for a few years, but with the arrival of the new millennium, it resumed its upward climb with a vengeance. Now, with the expenditures on two lengthy hi-tech wars, the nationalization of healthcare under President Obama, and trillions of dollars in federal bailouts during the Great Recession, federal government debt has once again exceeded 100 percent of the GDP. While not yet at post-World War II levels, the debt is bidding fair to surpass them within a few more years (according to some estimates, as soon as this fiscal year), unless something in Washington changes drastically. And after that, what? Will America follow the example of Japan, now the world’s most indebted country, to levels of indebtedness north of 200 percent of the GDP? How much more debt can America shoulder, and how — if at all — can it ever be paid off?
Consequences of Bad Credit
As the history of postwar America shows, debts of such magnitude can be paid down without resorting to such dishonest practices as default or currency debasement. Tempting as it is for political leaders to simply print their way out of debt, this expedient is not to be thought of. It is destructive even to the credit of the most powerful nations, and can quickly lead to refusals for further credit. Borrowing, after all, is only possible when there are those with capital willing to lend. As several EU countries have discovered in recent months, merely making an offering of debt does not guarantee finding someone to purchase it. The financial world was dismayed last November 23, for example, when Germany managed to sell only 3.64 billion euros’ worth of 10-year bonds out of a total offering of six billion euros. The message was unmistakable: So grave was the sovereign debt crisis in the EU becoming, that investors were starting to question the financial health even of Germany. And lesser economies in the EU, like Italy and Greece, have already been the beneficiaries of the European Central Bank’s quiet purchasing of their debt at below-market yields — debt that other investors refused to buy.

For now, the United States has no trouble finding buyers for its debt, still perceived as a relatively safe haven in turbulent economic times. But there are already signs the global love affair with American “treasuries” and the American dollar may be coming to an end, as countries like China quietly divest themselves of U.S. debt holdings. The Chinese are concerned that the United States may try to print its way out of debt, and no longer want exposure to dollar-denominated assets that may depreciate significantly.

Nor is outright default an honorable option, even if it were possible to do so without destroying international confidence in American finances. As every nation that has defaulted has discovered, there is no surer recipe for wreaking severe, short-term political, economic, and social havoc than to refuse to honor debts. When Argentina made that fateful choice a decade ago, the results were devastating. Credit dried up and the Argentine government was forced to devalue its currency, confiscate private bank accounts, and generally extort money any way it could from the Argentine people in order to survive (which, incidentally, is what governments always do as a final resort, putting the lie to the popular notion that they can be trusted to put the welfare of citizens first). Stripped of most of their wealth by a grasping and desperate state, many Argentines turned to plunder to survive. Robberies and violent crime — especially kidnappings for ransom — soared, and shantytowns housing the newly dispossessed sprang up all over what had been (at least on the surface) one of South America’s most modern and prosperous nations. Ten years later, Argentina has recovered — but now, her creditors of decades past are demanding anew that she repay the debts she once reneged upon as a condition for fully restoring her creditworthiness.

It’s worth noting that, over the decades, Argentina first tried to print her way out of trouble. But that policy led eventually to hyperinflation and to the realization that, sooner or later, she would have to confront directly her crippling debts.

The lessons for the United States could not be clearer. We may, owing to the privileged status of our currency worldwide, be able to postpone the day of reckoning longer than Argentina or Greece, but we will eventually have to deal with the consequences of our political leaders’ profligacy — and it’s better to deal with it through debt repayment than default.

Recipe for Reducing Debt
The recipe for reducing debt differs little between households and nations: cut expenses, live within your means, and systematically pay down your debt. Many politicians would claim that raising taxes is a necessary part of the process, but this need not be so. After all, few households, confronting a need to reduce debt, have the power to increase their income at a whim. Having a more or less fixed level of income to work with, householders can always find ways to live more cheaply, shop more wisely, eliminate luxuries, and avoid waste.

History shows plainly that whenever politicians are allowed to avoid responsibility for government waste by raising taxes, they always increase expenditures correspondingly. Existing tax revenues are more than sufficient to fund the federal government. In fact, were significant cuts in the size of government to be made, taxes could be cut correspondingly and the budget could still be balanced. It is easy — at least on paper, in isolation from political passions — to find trillions of dollars in cuts from terminating or phasing out unnecessary, unconstitutional government programs and from ending America’s enormously costly military commitments overseas — the bases, fleets, and manpower employed to police the globe in the name of benevolent globe-engirding interests.

Of course, millions of Americans now
depend upon the federal government in one way or another for their livelihood, and cannot imagine earning a livelihood outside the public sector. They see their government-sponsored work, whether it be as an employee in a subsidized industry, a federal research grant recipient, a member of the military, a bureaucrat, a park service employee, an IRS apparatchik, or whatever, as noble, essential, and high-status. By comparison, private-sector work would offer neither the pay grade, nor the job security, nor the benefits. This is the reason so many Americans clamor to keep their federal government jobs, grants, subsidies, and other handouts.

Yet as the aftermath of World War II showed, the private sector will pick up the slack, putting former government workers to work and — in the long run at least — offering prospects for far greater rewards than the bureaucratized, stifling work government tends to provide its own.

That, in a nutshell, is what happened after World War II, in countless towns and cities all over the land — millions of Americans learned anew to work hard in the private sector, save money, and build a better future for their children and grandchildren. The economy swelled and the peacetime culture of the late '40s through the early '60s may yet be remembered as the high ebb of American — and Western — civilization.

Caught Up in Cultural Challenges

Unfortunately, our culture has changed dramatically since the mid-'60s and the inauguration of the sexual revolution and the age of self-gratification. The so-called “Baby Boomers,” born during those halcyon and optimistic postwar years, came of age in the '60s and ushered in a counterculture that has since become mainstream. People in increasing numbers began living for themselves, repudiating marriage and family, and embracing a neo-hedonistic ethos that emphasized the avoidance of responsibility, the postponing of adulthood, the pursuit of instant gratification, and the privileging of self over all else. The epidemics of divorce, drugs, pregnancy out of wedlock, abortion, and venereal disease, among other things, were predictable outgrowths of the “new morality.”

So were the rise in personal indebtedness and the decline in savings. Since living within one’s means and saving for the future require postponing self-gratification, many in the rising generation abandoned their parents’ frugality and embraced the modern culture of debt: credit cards, college loans, mortgages that lasted most of one’s adult life, and reckless borrowing and spending to finance luxury items that previous generations would have saved for rather than purchased on credit. It is hardly surprising that our elected leaders soon adopted this same “buy now, pay later” mentality.

At the same time, the “me first” mentality fostered a broad-based belief in entitlements that could only be furnished by government: a college education, subsidized healthcare, and a right to employment, to name just a few. In a word, the prewar culture of self-reliance, moral restraint, and family values was muscled aside by the Cult of the Self — of which Big Government is the political consequence.

This is the reality of early 21st-century American culture, and it is the most formidable obstacle to making the kinds of sacrifices required to pay down the national debt again. The last time such a level of debt was tackled, Americans were grateful to have emerged victorious from modern history’s worst depression and war, and were, for the most part, willing to embrace a return to the days of smaller government and more self-reliance. This time around, while we have been embroiled in war for more than a decade and in economic crisis for around five years, it is far from clear whether Americans are sufficiently motivated — yet — to let go of their Big Government idolatry.

While it may be reassuring to blame the mess we’re in on the big banks and our political leadership, it is we the people who must ultimately bear the responsibility. Nothing prevents us from electing more Congressmen who truly understand limited constitutional government and free-market economics and would vote in accordance with the Constitution once

Inflationary toll: The car on the right cost around $1,558 in 1950, but the one on the left costs more than $47,995 in 2012. The soaring cost of commodities, such as oil, grain, and precious metals, and of high-ticket items, such as houses, cars, and college educations, are a consequence of decades of inflationary policymaking in Washington.
in office. Yet electoral cycle after electoral cycle, in district after district, voters choose to elect “safe” candidates of both parties who can be relied upon not to rock the boat. After all, it’s one thing to talk about cutting Big Government, but few of us — of the millions of Americans who have allowed ourselves to become dependent in one way or another on government money — are willing to let our own ox be gored.

What must occur is a dramatic and fairly rapid cultural change — a repudiation, in effect, of the regnant counterculture-turned-orthodoxy of the last 50 years or so — before the politics of government borrowing and spending will change.

Assuming that Americans do come to recognize the need to make meaningful cuts in government, what steps will have to be taken to pay down the debt? For one thing, the scaling down of American military commitments so as to reduce our armed forces to their original mission of national defense. This would certainly involve shutting down hundreds of overseas bases and mustering out hundreds of thousands in military personnel. It would require the national humility to acknowledge that the rest of the world is capable of managing its own affairs without our meddlesome military oversight. But in a cultural climate where invading and occupying a nation that has never posed any kind of threat to the United States is equated with “defending our freedoms,” it is clear that we have a ways to go before we are ready to re-embrace the non-interventionist instincts of our Founding Fathers.

Domestically, we shall have to shut down — not scale back, shut down — the many federal departments that the Constitution does not authorize, including Education, Labor, Agriculture, Housing and Urban Development, Health and Human Services, and Homeland Security. Hundreds of unconstitutional government agencies — OSHA, the EPA, FEMA, the FDA, the TSA, the ATF, and all the rest — will have to be shuttered. Government subsidies and welfare payments, including student loans, mortgage subsidies, research grants, farm subsidies, unemployment payments, Medicaid, and foreign aid, among many others, must be ended. And yes, those two most sacred of bovines, Social Security and Medicare, will have to be wound down eventually.

Moreover, the Federal Reserve System must be phased out and replaced with — noth-

Societal meltdown: A police station near Buenos Aires was burned down in 2002 by a mob angry at the death of a kidnapping victim. After defaulting on her debts, once-prosperous and stable Argentina endured a years-long wave of crime and poverty — a terrible price to pay for the profligacy of several generations of failed leadership. Is Argentina’s past and present America’s future?

ing. Much of our nation’s most spectacular, nearly debt-free economic growth took place during those blessed decades between the Jackson presidency and the creation of the Federal Reserve in 1913, when America had no central or national bank whatsoever.

At the same time, we will have to return to the gold standard and (for good measure) re-institute silver coinage, thereby choking off the power of the federal government to inflate its way out of debt.

Finally, we will have to cut taxes deeply (and eventually eliminate the income tax and many other obnoxious imposts altogether) and clear away all of the millions of rules, regulations, and controls that act as such powerful disincentives to business startups and capital formation on American soil.

Such a revolutionary set of changes would re-incentivize self-reliance, risk, initiative, and savings. It would prompt Americans to return to the private sector and shake off the fetters of several generations of government dependency. It would lead to unexampled economic growth and restore fully America’s predominance. It would invite the good will of other nations and encourage them to follow our example. And it would soon see our debts melt away like the morning dew and the body politic, confined to its proper functions, revive and return to the popular respect it once enjoyed.

Since the alternative to this vision is national ruin, let us hope that one day soon, Americans will choose to bring to pass such a brighter future.