Politics et Cetera
A publication from The Political Forum LLC
Tuesday, October 5, 2010

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In this Issue

THEY SAID IT

I dub this **Reynolds' Law**: "Subsidizing the markers of status doesn't produce the character traits that result in that status; it undermines them." It's easy to see why. If people don't need to defer gratification, work hard, etc., in order to achieve the status they desire, they'll be less inclined to do those things. The greater the government subsidy, the greater the effect, and the more net harm produced.

This law is thus a relative to Murray's third law in Losing Ground, the Law of Net Harm: "The less likely it is that the unwanted behavior will change voluntarily, the more likely it is that a program to induce change will cause net harm." But Reynolds' Law rests on a different and more secure foundation. It focuses on character as fundamental.

Since the time of Woodrow Wilson, Democrats—but not only Democrats—have fretted that the middle class is shrinking due to the power of large corporations, and that only government action to "level the playing field" can save the middle class. The "middle class is being more and more squeezed out by the processes which we have been taught to call processes of prosperity." Obama? Hillary? No, that's Woodrow Wilson in 1913 (The New Freedom). It's striking to realize that progressives have been playing the same tune for a century, no matter what's actually taking place in the economy—indeed, in the midst of the greatest expansion of affluence in the history of the world—with the same set of proffered solutions: greater government power, regulations, higher taxes, and subsidies for the markers of affluence.

Blogger "Philo of Alexandria," "Reynold's Law," September 25, 2010.

CONSUMPTION, CREDIT, AND THE ILLUSION OF PROSPERITY.

For the better part of a decade now, and from two different presidents, Americans have been told constantly about the beauty and splendor of sacrifice. After 9/11, as the nation's armed forces toppled dictators in two far-off lands, President Bush spoke often of the sacrifices that this country, and especially its young men and women, were making – indeed, *had* to make – to preserve liberty and human dignity, both at home and abroad.

In the aftermath of the Great Recession, President Obama has asked all Americans to make sacrifices for the benefit of the nation. He has urged them to sacrifice for a greener future, has pushed new graduates to sacrifice wealth for "public service," and has insisted that the affluent sacrifice for the cause of more equitable wealth distribution. Everywhere and at all times, the idea of sacrifice dominates the political rhetoric.

But it only dominates the rhetoric. It never goes beyond "mere words," to borrow from Obama himself. Sacrifice is peddled to the point of ridiculousness but never actually expected.

After 9/11, Bush told Americans to get on with their business, to "Get down to Disney World in Florida . . . Take your families and enjoy life, the way we want it to be enjoyed." Obama too has urged Americans to take vacations. Indeed, he has led the way. And like Bush, he has urged consumers to "do their business" and help enhance the economic recovery. Sacrifice shmacrifice. Go shopping!

This is all well and good, we suppose. And it is certainly understandable given the important role that consumers play in the American economy and the role that the economy plays in American politics. But it also demonstrates rather clearly the contradictions that lie at the heart of the American condition today.

One party rhetorically urges austerity for austerity's sake; because thrift and probity are the essence of a reasonable and conservative temperament and, at least in theory, the foundations of long-term prosperity. The other party urges austerity for the sake of "the children;" because resources are finite and the wanton misuse of them damages the planet, damages its issue, and precludes the enjoyment of nature by future generations.

Yet, at the same time, both sides promote, through politics and policy, massive and conspicuous consumption, the end of goal of which is the superlative enjoyment of all the pleasures and comforts that modern civilization can provide. Indeed, the nation's entire economic order, as it has evolved at least since the Great Society and possibly since the New Deal, is premised on the idea of superfluous consumption on the part of both individual consumers and the government itself, fueled by massive borrowing, and dedicated to the enjoyment of luxuries that were once afforded only to the super rich.

Let us start with the most important component of this indulgence, that which caused the crash, drove the country into the deepest recession in more than half-a-century, and which still, apparently, mystifies policy makers. Naturally, we refer here to the ownership of property – homes specifically – which was once the preserve of the upper middle class and wealthy alone. Until government got involved.

In a piece earlier this month, Roghuram Rajan, a professor of finance at the University of Chicago and a former chief economist at the IMF, explained how and why the government's plans, schemes, and good intentions ended up costing so many so much. In reference to the essential stagnation of the middle class since at least the 1970s, the consequent expansion of economic inequality, and the political responses to those phenomena, Rajan wrote thusly:

> The political response to rising inequality – whether carefully planned or the path of least resistance – was to expand lending to households, especially low-income households. The benefits – growing consumption and more jobs – were immediate, whereas paying the inevitable bill could be postponed into the future. Cynical as it might seem, easy credit has been used throughout history as a palliative by governments that are unable to address the deeper anxieties of the middle class directly.
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> Politicians, however, prefer to couch the objective in more uplifting and persuasive terms than that of crassly increasing consumption. In the US, the expansion of home ownership – a key element of the American dream – to low- and middle-income households was the defensible linchpin for the broader aims of expanding credit and consumption . . . .
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> The left favored flows to their natural constituency, while the right welcomed new property owners who could,

> perhaps, be convinced to switch party allegiance. More low-income housing credit has been one of the few issues on which President Bill Clinton's administration, with its affordable-housing mandate, and that of President George W. Bush, with its push for an "ownership" society, agreed.
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> In the end, though, the misguided attempt to push home ownership through credit has left the US with houses that no one can afford and households drowning in debt.

Fannie Mae, of course, was created by the Roosevelt administration in 1938, for the express purpose of expanding the secondary mortgage market and thereby increasing the number of lenders and loans available for the purchase of homes. Freddie Mac came along in 1970, and the Carter administration really got the ball rolling downhill in 1977 with the Community Reinvestment Act, which essentially compelled federally insured banks to "help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound operations." In the 1990s, at the urging of the Clinton administration, Fannie Mae eased credit requirements to expand lending in lower income areas and, as the *New York Times* put it, to "encourage . . . banks to extend home mortgages to individuals whose credit is generally not good enough to qualify for conventional loans."

From the Great Depression onward, government has been deeply involved in attempting to expand the "American dream" to everyone, at all income levels. And its involvement has only increased with time. Certainly, it's true that these extended interventions served a noble purpose and expanded credit to new segments of the population for the purpose of property ownership; but it is also true that there was a reason why some segments of the population had been denied credit prior to government participation, namely the fact that they were poor credit risks. As *The Economist* put it, "this is a story about how policies intended to reduce inequality had the unintended consequence of precipitating America's worst economic slump since the Depression."

But the story doesn't end there. And property ownership is not the only erstwhile luxury the American people have been encouraged to buy with credit.

In 1958, at the height of the Cold War fear of Soviet world domination and in response to the launch of the Sputnik satellite, Congress passed and President Eisenhower signed the National Defense Education Act, which provided the first federally guaranteed student loans (now distributed under the Federal Perkins Loan program). Throughout the next decade, the government expanded its reach into "financial aid," and in 1965, enacted the Guaranteed Student Loan program, which provided loans for middle class students through private banks. These two programs in particular, expanded educational opportunities to much of the population, but also encouraged higher education to be financed through credit.

The sentiment here again was noble. And the end – a better educated population with a greater number of college graduates – was unquestionably desirable. But the means used to achieve those ends, namely credit and government intervention in the credit markets, produced some manifestly undesirable and largely predictable consequences.

For starters, the availability of unlimited capital to fund the payment of tuition has, predictably, increased the level of tuition – unspeakably. In the last decade alone, tuition at universities (public and private) has increased by nearly a third, *after controlling for inflation*. According to The College Board, since the academic year 1979-80, inflation adjusted tuition and fees at public universities have more than tripled, and private, not-for-profit institutions are only slightly behind. At many schools, tuition continues to skyrocket, even as enrollment drops and even in the midst of the economic meltdown. For example, the *Boulder Daily Camera* reported last week that:

> The University of Colorado filed a formal request with the state Friday seeking to increase its in-state tuition by up to 9.5 percent next year, and outlined plans for four more years of hikes as high as 9 percent . . . .
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> If in-state tuition were to increase at the maximum rate outlined in CU's five-year plan, it would reach about $10,850 by the 2015-16 school year. That's 55 percent more than tuition now.

Enrollment at CU, by the way, is down 6.5% this year and, according to local news reports, is the lowest it has been since 2005.

Most, if not all of these increased fees have, of course, been financed using credit. This spring, writing in his "Your Money" column, *The New York Times's* Ron Lieber introduced the nation to the poster-child for college debt and the consequences of the government-encouraged desire that many Americans harbor to receive an "elite" education, the likes of which was once reserved for those who could afford it. Lieber told us the sad, sad story of a young woman named Courtney Munna.

> Like many middle-class families, Cortney Munna and her mother began the college selection process with a grim determination. They would do whatever they could to get Cortney into the best possible college, and they maintained a blind faith that the investment would be worth it.
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> Today, however, Ms. Munna, a 26-year-old graduate of New York University, has nearly $100,000 in student loan debt from her four years in college, and affording the full monthly payments would be a struggle. For much of the time since her 2005 graduation, she's been enrolled in night school, which allows her to defer loan payments.
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> This is not a long-term solution, because the interest on the loans continues to pile up. So in an eerie echo of the mortgage crisis, tens of thousands of people like Ms. Munna are facing a reckoning. They and their families made borrowing decisions based more on emotion than reason, much as subprime borrowers assumed the value of their houses would always go up.
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> Meanwhile, universities like N.Y.U. enrolled students without asking many questions about whether they could afford a $50,000 annual tuition bill. Then the colleges introduced the students to lenders who underwrote big loans without any idea of what the students might earn someday . . . .

Lieber, apparently, is a comedian. He noted wryly that "Ms. Munna and her mother, Cathryn, have spent the years since her graduation trying to understand where they went wrong." But he doesn't mention until near the end of the story that Munna can't figure out why her studies, which earned her an "*interdisciplinary degree in religious and women's studies*," [emphasis added] are proving of little value in the job market.

Oy.

Again, according The College Board, in the school year 2007-08, roughly 10% of undergraduate students graduated with $40,000 or more in student loans. Additionally, "The median debt for all bachelor's degree recipients in 2007-08 was $11,000. Among the two-thirds who borrowed, median debt was about $20,000." Among professional school graduates, nearly half – a full 45% – graduated with more than $80,000 in student debt.

All of this is, not to put too fine a point on it, insane. As the long-term earnings benefits of a college degree continue to fall; as the education granted to students in this nation's liberal arts colleges continues to be embarrassingly exposed as a sick joke; as the job market continues to dwindle for entry-level college grads – the price continues to go up and, more to the point, so does the potentially life-wrecking debt that many young people are encouraged to take on, in the name of "education." As the historian and classicist Victor Davis Hanson noted recently:

> Most of what we are told about universities is untrue. America's reputation for higher learning excellence (in business, sciences, medicine, engineering, and finance) is despite not because of the humanities and social sciences. Current research in the liberal arts (the portfolio the English or sociology prof is tenured on) increasingly has almost no relevance to the general public or applicability to teaching or even scholarly merit.

And still we pay and borrow to do so.

Now, you'll note that this massive and unprecedented private debt burden, while shocking, is still incomplete, as it does not include revolving debt or auto loans. Most Americans these days drive cars; many, perhaps most, drive newer cars, which cost far more than their parents or grandparents could ever have imagined. Every American, it seems, owns a big-screen TV. And a cell phone. An MP3 player. A Laptop. And any of a dozen more gadgets and gizmos. And like the homes at which these cars are garaged and these big screens are displayed, much of this ostentation is "paid for" with credit.

According to data compiled by the Federal Reserve, between 1980 and 2001, total consumer debt more than quintupled, to $1.7 trillion. As of last year, total consumer debt stood at $2.5 trillion, with the average American household holding more than $5,000 in credit-card debt. Shockingly, credit-card debt accounts for only just over a third of total consumer debt (with the rest being car loans, student loans, etc.). As of last year, the average car loan was more than $30,000. All of this, we remind you, is *in addition* to mortgage debt. And yet there are those in government who continue to wonder why the middle class is struggling.

Not that the denizens of the middle class – or even the lower and upper classes, for that matter – are the only ones who have a debt problem related to their desires to enjoy luxuries and their inability to afford them. Obviously, the government itself suffers from excessive debt as well – and it too is related to the financing of opulence formerly reserved for the richest of rich.

Once upon a time, when life spans were shorter, men and women generally worked right up until they died, or, when they couldn't, they relied on their families to tend to them in their old age and infirmity. Only the truly wealthy could spent years, even decades, enjoying unadulterated leisure in the twilight of their lives. And then came Social Security. And pensions. And life-extending medical breakthroughs. And suddenly everyone believed that they had a right to a long and comfortable retirement.

Now, certainly we don't begrudge anyone a happy and restful retirement. We certainly look forward to such ourselves one day – one of us much, much sooner than the other. But the idea that everyone is entitled to a long and comfortable stint of economic inactivity at the end of one's life is a relatively recent development. And in order to pay for this "advancement," governments have had to borrow.

In the case of Social Security, governments have had to do worse than borrow; they have had to establish what amounts to a Ponzi scheme, taking from workers today to pay for current retiree benefits, with the promise that all that was taken will, eventually, be repaid – by taking from future workers. This is a serviceable, if morally objectionable arrangement, we suppose, but only as long as workers continue to outnumber retirees by a significant number. And, as every school boy knows, because of demographic factors and the ongoing extension of life, we, as a nation, are rapidly approaching the point at which the arrangement breaks down and is no longer serviceable. In fact, over time, the arrangement will be downright untenable. As *The Weekly Standard's* Jonathan Last recently noted:

The Baby Boom was notable not just for its magnitude but for its longevity—it lasted an entire generation, creating a population bulge that still bloats our demographic profile. Yet despite its impact, the Baby Boom was temporary. In the cultural moment that followed during the 1960s and 1970s, the fertility rate in America—and indeed around the world—went bust. In Canada, the United States, Japan, and Western Europe, in every single Western industrialized nation, the fertility rate plummeted.

From a combined TFR [Total Fertility Rate] of 3.7 in 1960, U.S. fertility halved to 1.8 in 1980. It has rebounded slightly during the last few decades, but that upward movement has more to do with Hispanic immigration than with increased native fertility. In 2006, the fertility rate of non-Hispanic whites was 1.77; the fertility rate of blacks was 2.0. Of America's major demographic groups, only Hispanics are above replacement, with a TFR of 2.3. Yet even the Hispanic population has seen its fertility rate fall some 8 percent in the last decade. Indeed, the problem with immigration as it relates to fertility isn't the old complaint that the newcomers are out-breeding the natives. Rather, the problem is that the newcomers start behaving like natives too soon, with their TFR regressing quickly to the mean. If we are to maintain even our modest 2.06, we need an ever-greater supply of immigrants.

Today there are 26.6 million legal immigrants living in America and roughly 11.3 million illegals. We need these workers to prop up the entitlement programs we're no longer having enough babies to fund. In order to keep Social Security and Medicare running, we need a stable ratio of workers to retirees. If we were to keep the ratio at the present level of three workers for every retiree—already lower than it has ever been—America would need to add 44.9 million new immigrants between 2025 and 2035. If we wanted to keep the ratio at 5.2 workers for every retiree—about what it was in 1960, before the collapse of our fertility rate—we'd need to import 10.8 million immigrants every year until 2050. At which point the United States would have 1.1 billion people, 73 percent of whom would be the descendants of recent immigrants.

Unfortunately, when it comes to government funding of long and happy retirements, Social Security is, relatively speaking, the success story. Public-sector pensions, by contrast to the comparatively solvent Social Security Ponzi scheme, are massively underfunded, require massive borrowing, and will require even more massive borrowing going forward. A recent CNN/Money article touched on the scope of the problem:

> Earlier this year the Pew Center on the States calculated a $1 trillion shortfall between the $2.35 trillion states set aside in 2008 for employee retirement benefits and the $3.35 trillion committed. Economists like [American Enterprise Institute fellow Andrew] Biggs say the gap is far bigger because the states use overly optimistic projections on investment returns. "If you calculate public pensions by private standards, it would be a disaster," he says.
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> Struggling states like Ohio and Illinois face the biggest crisis, as a percentage of GDP, with unfunded commitments totaling about half of those states' economies.

For nearly two decades now, since the health care "reform" debate began in earnest with the inauguration of the Clinton administration, supporters of reform have always insisted that, "in a country as rich as this one," health care coverage for everyone is a moral imperative. Or words to that effect. President Obama himself took this tack countless times, insisting that the wealth this country possessed could and should be used to provide health insurance and, by extension, the best health care in the world for everyone.

But he and the others were wrong. This country is not wealthy enough to afford coverage and care for all. And it's not even close.

The cost of Obamacare already exceeds $1 trillion for the first decade, and that's using various budgeting gimmicks, overly-rosy scenarios, and other assorted tricks – the most substantive of which is that benefits don't actually kick in until 2014, despite the fact that the tax provisions designed to defray some of the costs begin immediately. All of this health care – again, once a luxury – will be purchased, naturally, with credit, money borrowed from the Communist Chinese, among others.

As things stand today, fiscal 2011 will be the third year in a row in which the federal budget deficit will be measured in the "trillions" of dollars (as opposed to the hundreds of billions). The federal debt now exceeds $13 trillion. The President's budget for fiscal 2011 totals nearly $4 trillion by itself. And outside of defense and a handful of other absolute necessities, a great percentage of that will be spent on what amount to middle class entitlements.

For all the talk about Obama being a "socialist," the charge rings utterly and completely false. Obama – like the entirety of the "liberal" establishment – is, for the most part, completely unconcerned about the plight of the "workers" or of the truly poor. Most of his energies are expended on defending the middle class and, specifically, on defending the benefits provided by the government to the middle class that allow it to live as only the upper classes once lived.

Way back in 2000, when we were still working for a now-bankrupt and defunct big-shot brokerage house, we caught some flack for noting that the Democratic Party had evolved (or devolved) into the party dedicated expressly to preserving the status quo and preserving it for the benefit of the middle class, allowing its occupants to live beyond what would otherwise be their means. "Emma Goldberg," we noted, "Hillary ain't." And the same can most definitely be said of Obama. The man is many things – a statist among them – but he is anything but a socialist. Like the rest of his party, and the political establishment in general, he is a middle class fetishist, devoted principally to the promotion of middle class entitlements and comforts, irrespective of the costs, financial or otherwise.

In his new book (co-authored with Peter Navarro), Glenn Hubbard, the former Chairman of President Bush's Council of Economic Advisors and the current Dean of the Columbia Business School, argues that the economic policies of the federal government, and specifically the government's massive borrowing, have brought the nation "very close to a destructive tipping point." Hubbard decries Bush's profligacy, particularly with regard to the establishment of the aforementioned Medicare drug benefit (Part D). But he reserves his harshest criticism for Barack Obama, who, Hubbard says, has taken the destructive spending and borrowing "to a whole other level." He continues:

> We must change how we conduct our politics and economics . . . . or we will inevitably go the way of all once-great nations and suffer an irreversible decline . . . . We as a nation cannot resolve what have become deep and systemic structural imbalances in our economy simply by throwing more money and more and more regulations and more and more taxes at the problem.

Once upon a time in this country and throughout the West, the idea of societal prosperity was premised on the values of collective hard work, thrift, creativity, and savings. Today, our understanding of prosperity hinges entirely on the notion of collective consumption. GDP is principally consumer driven and individual wealth is measured in terms of gadgets, baubles, and trophies collected. That all of this "prosperity" is, in turn, dependent upon the acquisition and abuse of credit is itself a reminder of the futility and recklessness of government's attempts to counterfeit economic progress and to conceal its role in stifling true economic growth and prosperity.

The "law" that constitutes today's "They Said It" quote at the top of this piece is a restatement of a sentiment expressed by Glenn Reynolds, the blogger known as Instapundit and a law professor at the university of Tennessee. Reynolds' actual statement, which reads as follows, is a nice summation of the inherent dangers that dominate the economic life of a nation when government involves itself in promoting standards of living that are largely unsustainable:

> The government decides to try to increase the middle class by subsidizing things that middle class people have: If middle-class people go to college and own homes, then surely if more people go to college and own homes, we'll have more middle-class people. But homeownership and college aren't causes of middle-class status, they're markers for possessing the kinds of traits — self-discipline, the ability to defer gratification, etc. — that let you enter, and stay, in the middle class. Subsidizing the markers doesn't produce the traits; if anything, it undermines them.

Since the dawn of the Progressive Era at the start of the last century, government has made a concerted effort to lead the "moral evolution" of the people to whom it is supposed to be answerable. The current economic malaise, the recent Great Recession, the financial collapse of 2008, and what Glenn Hubbard calls "the systemic structural imbalances in our economy," are, in many ways the direct results of this government effort to foster that which is, by and large, un-fosterable.

And that is a prescription for failure. Writ large.