The Endless Spending Spree

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James Grant
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From George Washington to Dwight D. Eisenhower, the national debt tended to grow in wartime and shrink in peacetime. Because the dollar was generally convertible into gold or silver at a fixed and statutory rate, the central bank, when there was a central bank, couldn't just materialize money as the Federal Reserve does today. You had to dig the metal out of the Earth, or entice it into American vaults with money-friendly financial policies. The Treasury could borrow, all right, but not without limit. Wars aside, the government paid its way like a man with a debit card.

Washington, D.C., got its credit card on Sunday, Aug. 15, 1971. Pre-empting the horse opera "Bonanza," President Richard Nixon told a national television audience that the gold standard, or what little of it remained, was kaput. No more would the dollar be defined in law as 1/35th of an ounce of gold. It would rather be anchored by the good intentions of the people who printed it.

There has never been a credit card quite like the nonmetallic dollar. We Americans, consuming much more than we produce, finance our deficits with the dollars that we alone may lawfully print. Our Asian creditors not only accept this money in payment for goods and services but also turn right around and invest it in U.S. Treasury bonds and federally insured mortgages. It's as if the greenbacks never left the 50 states.

The Nixon gambit marks a great divide. In the 10 years before 1971, the "gross" public debt (counting even those obligations held by the government itself) had climbed to $408 billion from $293 billion. This increase amounted to a compound annual rate of only 3.4%, the Great Society and the Vietnam War notwithstanding. In the next 10 years, till 1981, the gross debt jumped to $995 billion from $408 billion—a compound annual rate of 9.3%, the close of the Great Society and the end of the Vietnam War notwithstanding. Not until fiscal 2001 did the debt reach $5.8 trillion. Yet it expanded by an identical $5.8 trillion in the four short years between 2007 and 2011. Now the grand total stands at $15.6 trillion.

Herbert Hoover, who learned a thing or two about debt and adversity, warned in his memoirs that, unless the dollar was convertible into gold, the people would lose control of the public finances, "their first defense against tyranny." Simon Johnson and James Kwak, the authors of "White House Burning: The Founding Fathers, Our National Debt, and Why It Matters to You" could not seem to disagree more. To them, the problem today isn't paper money but a government that hovers too little and taxes too lightly. More regulation—especially financial regulation—and selectively higher taxes are the answers, they contend.

Mr. Johnson, a professor at MIT's Sloan School of Management, was the chief economist for the International Monetary Fund. He consults for both the Congressional Budget Office and the Federal Deposit Insurance Corp. Mr. Kwak is a law professor at the University of Connecticut and a fellow at the Harvard Law School Program on Corporate Governance as well as the co-founder of a software company. They are the résumé champions of the world.

Writing with the authority appropriate to that high station, they prescribe for the American future after limning their version of the American past. The fire to which the title of the book alludes was the one that the British set in 1814. It happens that the Treasury was broke in 1814—the State Department

couldn't even afford to buy stationery. Let that be a lesson, the authors suggest. The government must be able to levy taxes. It must be able to borrow.

Following a survey of American fiscal and monetary history, Messrs. Johnson and Kwak remind us what the 21st-century federal government does for a living (not their most scintillating chapter). Then they get down to brass tacks with a policy to-do list that incorporates suggestions on fields as diverse as health care, energy, finance and Social Security.

These wonky, seemingly clinical, policy prescriptions do not come from nowhere. Messrs. Johnson and Kwak are special pleaders. Human life being uncertain, they wish to protect us from it. How much risk of sickness, unemployment or indigence do you, a mere individual, wish to bear on your own? "The question we leave you with is this," the pair write: "Are you and your family willing to face these risks alone, not knowing what will happen in the future, or do you want to live in a society that will protect you from misfortunes that lie beyond your control? For that is what the debate over the national debt boils down to, and its outcome depends on you."

More than likely, the outcome does not depend on you, whoever you are. It rather turns on the intellectual climate in which the people at the top frame public choices. One choice in particular is pertinent to the fiscal debate, and it is just as meaningful for Rep. Paul Ryan's budgetary ideas as it is for scholars of the Johnson and Kwak persuasion. Forty years ago, Congress came into possession of that magic credit card, the pure paper dollar. Gone was the necessary and wholesome constraint on spending imposed by a convertible currency. As there was only so much gold, there could be only so many dollars.

By cutting the dollar loose from its ancient anchor, the buttoned-down men of the Nixon administration perhaps felt a rush of countercultural liberation. Federal spending and borrowing duly proceeded to levitate. Now and then, Congress, aghast at its own profligacy, has taken remedial steps—establishing the Congressional Budget Office in 1974 or passing the Gramm-Rudman-Hollings Balanced Budget Act in 1985 or the Budget Control Act of 2011 (there were innumerable such attempts in between). But still debt piles on debt, as Hoover would not be surprised to learn. Of paper money, there is no end.

Some will chafe at the authors' proposals for raising the gasoline tax or reducing the mortgage-interest deduction or increasing the Medicare Part B premium. Myself, I take umbrage at their interpretation of the American past. In money and banking, and therefore in debts and deficits, the way forward is through the constructive adaptation of a history they never quite acknowledge. Here's an idea: Let's try capitalism for a change.

Rather than the bureaucratic monstrosity called the Dodd-Frank Act, for instance, why not hold the bankers personally accountable for the solvency of the institutions that employ them? Until 1935, bank stockholders would get a capital call if the company in which they had invested became impaired or insolvent. It was their problem, not the government's. In the same spirit, suggests the New York investor Paul J. Isaac, let the bankers forfeit a portion of their past compensation—say, that in excess of 10 times the average manufacturing wage—if they steer their employer on the rocks. And let them surrender not just one year's worth but rather seven year's worth—after all, big banks don't go broke all at once. Proceeds would be distributed to the creditors, as in days of yore. Bankers should not only take risks. They should also bear them.

For another thing, let us stop treating the Great Depression as the one and only slump from which a public-policy lesson might conceivably be drawn. Messrs. Johnson and Kwak, who draw the usual

conclusions from 1929-33, fail to mention the depression of 1920-21. Yet this cyclical downturn was as instructively brief as it was ugly. Peak to trough, nominal GDP plunged by 23.9%, wholesale prices by 40.8% and the CPI by 8.3%. Unemployment, as it was then inexactly measured, soared to 14% from a boomtime low of 2%. And how did the successive administrations of Woodrow Wilson and Warren G. Harding, along with the Federal Reserve, meet this national disaster? Why, they balanced the budget and raised interest rates. Yet for reasons never examined in the pages of this book, that depression promptly ended and the 1920s roared.

As for the gold standard, the authors are against it but do not say which gold standard they are against. They lump together the true-blue, classical gold standard of 1880-1914 with the corrupted variation instituted after World War I (a conflation of gold and paper) and the still weaker Bretton Woods variant of 1944-71 (in which the ownership of gold was reserved for foreign governments and denied to ordinary Americans). The lack of distinction makes you suspect that it's the metal they don't like rather than the elegant and successful monetary system of which the metal formed the nucleus.

For Albert Gallatin, America's longest-serving Treasury secretary (1801-14), the authors express unalloyed admiration. But they neglect to quote, as I will now do, his wise words on the eternal nature of money. "Nations," Gallatin wrote in 1831, "differing in language, religion, habits and on almost every other subject susceptible of doubt, have, during a period of near four thousand years, agreed in one respect; . . . that gold and silver have, uninterruptedly to this day, continued to be the universal currency of the commercial and civilized world."

I suspect that the Founding Fathers—dragged into the argument in support of the book's statist agenda—will be looking forward to buttonholing Messrs. Simon and Kwak in odd moments during the afterlife. "Trash" was Thomas Jefferson's word for paper money unsecured by gold or silver. Not for the first time, the author of the Declaration of Independence hit the nail on the head.