

# The Economic Contradictions of Obama-ism

He needs growth to fund his radical expansion of government, but is pursuing policies that will make expansion unlikely at best.

By John Steele Gordon

**O**N FEBRUARY 9th, President Obama visited Elkhart, Indiana, the American community with the country's highest unemployment rate, 15.3 percent. (It had been only 4.7 percent the year before.) He was there to sell his stimulus bill, then moving through Congress and since signed. He noted that the bill would provide help for the workers who had lost their jobs and, more important, help them get their jobs back by reviving the economy.

The jobs that have vanished in Elkhart are predominantly in the recreational-vehicle industry, which is concentrated in the city of 52,000. With the severe recession the country is now experiencing, it is hardly surprising that this industry has been devastated. Af-

ter all, an RV is expensive both to purchase and to operate and is hardly a necessity. But when the economy recovers, will those jobs come back as demand for RV's returns? Or, in the meantime, will new environmental regulations championed by Obama work to impede the sales of vehicles that get only a few miles to the gallon and thereby make job growth in Elkhart an impossibility?

The latter seems to be the case. In its proposed budget for fiscal year 2010, the Obama administration has also said it would inaugurate a "cap-and-trade" program to reduce the emission of carbon dioxide into the atmosphere. This program would require all companies to buy at auction the right to emit the gas, which all fossil fuels—oil, gasoline, coal, natural gas, etc.—do, in varying amounts. The total amount of emissions allowed would be strictly limited.

While billed as a program to reduce greenhouse gases, cap-and-trade is, inescapably, a tax on virtually all economic activity, as fossil fuels are an input in nearly all economic outputs. Even a lawyer, after all, has to use electricity to have the lights on in his office

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and power his computer. And electricity is mostly generated by fossil fuels, especially coal, the biggest emitter of carbon dioxide.

This will be no small tax. The Obama budget estimates that the carbon tax will bring in revenues of \$78.7 billion in 2012. The Congressional Budget Office estimates that it might net as much as \$300 billion. The administration says that in 2019 this carbon tax will be the sixth-largest source of federal revenue, after personal and corporate income taxes, payroll taxes for Social Security and Medicare, and excise taxes.

Cap-and-trade will have a profound impact on the recreational-vehicle industry in Elkhart, whose pain Obama professed to feel. The cost of manufacturing the vehicle will rise because of the new tax, which will in turn increase the retail price of RV's and thus inevitably decrease sales. The cost of operating them will also rise substantially as the tax raises the price of gasoline, further limiting demand. Nor will the tax's effect on Elkhart and its environs be limited to RV's. The entire mid-section of the country, where Elkhart is located, will be especially hard hit, because the region is far more dependent on manufacturing and coal-fired electric generating plants than the continent's two coasts.

Limiting carbon-dioxide emissions may (or may not) be a worthy goal, but a cap-and-trade system to further that goal will take a disproportionate toll on the sort of people who are now out of work in Elkhart, Indiana and not the bicoastal elite, whose members can more easily afford the tax.

The Obama budget envisions an explosion of economic growth as the country recovers from the current recession—more than four percent a year from 2011 through 2013. This will supposedly be sufficient to halve the \$1.75 trillion deficit it projects for 2009. But there is something off here. Many of the policies Obama and his team are pursuing, cap-and-trade being the most obvious, are likely to interfere with growth in exactly the sectors in which the United States will need it. If the goal is growth, as it should be, the role of government should be to determine ways in which its conduct can fuel that growth. And that is precisely what Obama is *not* doing.

The cap-and-trade tax will inescapably and adversely impact the economic recovery and future growth rates. If passed, it will act on the economy as a whole exactly the way a governor acts on a steam engine, increasingly resisting any increase in revolutions per minute. With the supply of licenses to emit carbon dioxide fixed, the price of the permits will inevitably rise as economic activity picks up. That means that any increase in overall demand will increase the price of

energy, and thus, in a feedback loop, nearly everything else. That will damp down demand. The more the economy tries to speed up, the more the carbon tax will work to prevent it from doing so.

The same is true of many of the other policies embedded in Obama's budget. He will raise taxes on high earners rather than lowering them to give those earners an incentive to put their money into the private markets. He intends to increase the number of federal regulations on private business and industry, rather than reduce the number of those regulations for the purpose of eliminating barriers to growth. Taken together, these counterproductive actions will make job creation in the private sector difficult, because they will make it more expensive to hire new workers. The Obama plan will, in general, make it more expensive to do business at a time when one would think he and the nation as a whole have every reason to make it as inexpensive as possible to do business.

There is, it appears, a contradiction between the economic growth Obama says he wants and has promised to produce, and the goals his policies actually indicate he wants to achieve. Those policies suggest there are financial goals he values more highly than economic growth. But can he succeed without growth? And what, at this moment, could be more important?

**T**HE MODERN DEMOCRATIC PARTY was founded by Andrew Jackson, the dominant American political figure from the 1820's until the 1840' s. Jackson was the classic self-made man who fought the "money men" and the old Eastern aristocracy to prevent them, in Jackson's view, from establishing a plutocracy that would prevent the rise of strivers like him. Jackson believed that government's job was to restrain the power of the rich so that those at the bottom would not be prevented from moving upward by their own efforts. He was a liberal in the classic definition, a *laissez-faire* man.

Seventy years later, the leading turn-of-the-century Democrat, William Jennings Bryan, also wanted to restrain the rich to enable the poor to rise. Creditors in his day liked the gold standard—the basis of the world financial system at the time—because it prevented inflation. But most farmers were debtors and Bryan advocated policies (particularly the free coinage of silver) that would, inevitably, cause inflation. This would allow farmers to pay off their debts with cheaper money and thus more easily rise to prosperity by their own efforts.

By the time of Bryan's ascension, the antagonist of the "little guy" had changed somewhat from the individual entrepreneur to the corporation, a newly

powerful and soon-to-be central player in the economy. The corporate form of organization allowed the concentration of unprecedented amounts of capital that could be controlled by the dominant stockholder. Thus the so-called robber barons, such as John D. Rockefeller, Andrew Carnegie, and J.P. Morgan, became extraordinarily powerful and, to many, threatening. Even the *Wall Street Journal* wondered if things were getting out of hand when J.P. Morgan announced the formation of United States Steel, the first billion-dollar corporation, in 1901. That year the entire federal government spent only \$524 million.

Like Jackson, Bryan was motivated by a populist hostility based in a classic free-market view. He feared the free market was being overtaken, and those who were determined to manipulate it had to be made to behave like responsible economic players. Something had to be done

to ensure that the power of the industrial corporation was used for the good of the whole, not just the benefit of its stockholders. Initially, this was done in the name of market efficiency—to promote competition, for example—and not because markets themselves were considered unfair or immoral.

But in the 1910's and 1920's, the idea that government should not just police the marketplace and prevent a plutocracy from developing, but should also use the power of government to benefit the people directly, had begun to take hold, especially among intellectuals. At its core was the belief that the ordinary worker could not rise through his own efforts because "the system" was stacked against him. This concept was very different from the ideas of Jackson and Bryan. Indeed, it had arisen not in America, populated by people who had crossed an ocean to seek a better life for themselves and their descendants, but in the Europe they had left, where the class structure was far more rigid and privilege more entrenched.

Indeed, while Germany and other countries began implementing government-run social programs in the late 19th century, there was little chance of such a program being developed in the United States, and certainly at the federal level, until the advent of the Great Depression. But that calamity changed everything.

**T**HE FIRST ITERATION of Franklin Roosevelt's New Deal included the National Recovery Administration (NRA), essentially a government-run cartel to fix prices and divide markets. This was the

most radical shift in the relation between government and the private economy in American history, and the Supreme Court unanimously struck down the NRA as a violation of the Constitution's Commerce clause in 1935.

After that, a "second New Deal" was developed. It dealt less with the immediate emergency that Roosevelt had faced in 1933 and more with transforming American society by government programs to help individuals. What emerged was an ever-growing number of farm programs to help raise crop prices; the Wagner Act, which radically altered the balance of

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power between capital and labor to labor's benefit; and most especially Social Security, which came into being in 1937. These efforts were more modest ideologically than the NRA, but their effect was transformative. The Second New Deal and policies that followed in its line over time had the effect of transforming the ordinary worker's standard of living and his opportunities to improve that standard further for his children.

We have spent three-quarters of a century living under the auspices of the Second New Deal; Democratic and Republican presidents alike, not to mention mainstream conservatives and liberals, have accepted the general philosophical concept of the social safety net and a federal government that is supposed to keep an eye on capitalists and offer protections for the little guy.

Over that time, we have become overwhelmingly a country not of haves and have-nots but, one might say, of haves and have-yachts (including the land-yachts called RV's). Over 3.5 million families today have net worths in excess of \$1 million. Three-fifths of American families own financial securities in their own name. Millions more count on pension fund investments to make their old age comfortable. Only about 10 percent of non-farm families owned their own homes in 1936. Today more than 60 percent of American families do. This gives them the substantial financial assets that only the "rich" possessed in the 1930's. The sort of desperate, grinding poverty seen in the FDR-era photographs of Walker Evans has simply disappeared. Today, even people of modest means enjoy a level of comfort, security, and even luxury

undreamed of when Roosevelt was president. It is not the bicoastal elite that buys RV's. RV's are the vacation homes of the lower middle class. Plumbers talk about their 401-K's and factory workers send their children to medical school.

But while the second New Deal had transformed the country immensely for the better, many liberals thought it had not gone far enough. What might be called the "Third New Deal" was attempted in the 1960's, under the name of the Great Society. It sought both to eliminate poverty and to end the racial discrimination that prevented millions of Americans from pursuing the vast opportunities that had become available to their fellow countrymen.

In the latter case, the Great Society was an unalloyed success. Indeed, less than fifty years after the Civil Rights Act of 1964, a black man is President of the United States and a black man is chairman of the Republican National Committee. The civil-rights movement of the mid-20th century was one of the true triumphs of American democracy. It was widely supported by both parties at the time (only six Republican senators voted against it, as did 21 Democrats) and is now supported by all but the lunatic fringe.

The same cannot be said of many of the other Great Society programs. Medicare and Medicaid have proven to be ravenous consumers of the public fisc, riddled with waste and fraud, and seemingly impervious to reform. Other programs in education and transportation greatly enlarged the scope of the federal government to a degree that would have horrified Jackson and Bryan. While federal outlays in 1930 were about 3 percent of GDP, mostly for the military and debt service, they were nearly 7 percent by 1940. By 1970 they were over 19 percent. Today federal outlays are over 20 percent and are estimated to top 27 percent in 2009, thanks to the economic crisis.

That is far and away the highest peacetime percentage in American history. If President Obama's plans are fully implemented, outlays will never return

to the modern norm. A whole new norm will be set. And the purpose of the new norm will be to fix in cement government policies—relating to the environment, health care, education, and energy use—designed to interpose themselves between the citizenry and the marketplace.

**M**ARK TWAIN once said that "history doesn't repeat itself, but it rhymes." That goes double for economic history, especially in the industrial era when the economy has evolved so quickly from generation to generation. But certain patterns are clear. In modern times, the more that government has controlled the economy, the more bureaucrats, politicians, and intellectuals get to choose winners and losers instead of the marketplace, the less economic growth and innovation there is, the more persistent unemployment is, the slower the improvement in the standard of living.

If you want a vivid example, just compare post-war Britain, which both moved in a socialist direction and became the sick man of the Great Powers, with Margaret Thatcher's Britain, in which the welfare state was pared back, socialism was reversed, and the forces that had made Britain great were unleashed once again.

It is worrisome in the extreme to realize that Obama's policies have much more in common with those of Clement Attlee, the prime minister who took over from Winston Churchill when the Second World War ended and put it on the socialist track, than with those of Thatcher, who took charge in England at a time of desperate economic straits. At a time when the United States needs dynamism more than ever, the nation's voters have chosen to be led by a president whose animating philosophy has led him to adopt policies that will make that dynamism impossible to achieve. If the contradiction proves costly to the American economy, as history suggests, it will exact a profound tribute of its own from Obama's political future as well. 