



A Ladder to Nowhere

Why WWII-level deficits won't work today.

by Andrew B. Wilson

THE STORY IS TOLD OF THREE SCIENTISTS stuck at the bottom of a deep well. The physicist is forced to admit that none of the laws of physics will lift them out of the well. The engineer admits that he, too, is at a loss because he has no tools or materials to work with. Only the economist is undaunted. "Gentlemen," he says, "let's begin with the *assumption* that we have a ladder."

We now have the assumption that a huge fiscal stimulus, created out of the illusory elements of massive public borrowing and boundless money creation, will provide the ladder that allows us to climb out of today's economic crisis.

To listen to some prominent liberal economists who believe in Keynesian-style "demand management," the only thing wrong with this confabulated ladder is that it should be even taller. And truly, if money is no object, why not build it right up to the sky? Why stop where we are now—with a federal deficit expected to reach 13.5 percent of GDP under the current stimulus package?

That question will take on real weight and urgency if the economy continues to be mired in a deep recession entering 2010. At the point, the cry will go out for *higher* deficits and *more* spending.

If there is a model of what a really robust stimulus package should look like, the Nobel Prize-winning economist Paul Krugman has argued, it is not the Depression-era New Deal but the much bigger deal that followed it: World War II. "What saved the economy," he wrote in the *New York Times*, was "the enormous public works project known as World War II, which finally provided a fiscal stimulus adequate to the economy's needs."

The U.S. did experience phenomenal growth during World War II, and it is true that the federal

deficit, which peaked during the Depression at 5.9 percent of GDP in 1934 and fell to zero in 1937, subsequently soared to 30.2 percent at the height of the war. That said, the notion that it is within the power of a free-spending peacetime government to replicate the dynamics of the greatest war in human history—and to stimulate the economy in the same way that the U.S. war effort did in the 1940s—is more than fanciful. It is breathtakingly absurd.

Here are some critical differences between World War II and the 1930s and between World War II and today.

1) *Contra* Krugman, World War II was *not* a huge public works project; it was an all-out war against a deadly enemy. As such, it energized the nation and focused the population's attention on a single overriding objective in a way no peacetime jobs-creation program possibly could.

War-related production skyrocketed from just 2 percent of U.S. GNP at the outset of the war to 40 percent in 1943. In telling an important part of that story in his book *The American Aircraft Factory in World War II* (2006), Bill Yenne noted that the U.S. became the "largest producer of airplanes the world had ever seen, or will almost certainly ever see again." Annual production of military airplanes produced in the U.S. increased from 921 in 1939 to 96,318 in 1944—a hundredfold increase in sheer units, to say nothing of equally amazing advances in aircraft performance.

None of this immense (and immensely innovative) production of planes, ships, tanks and other munitions bore the taint of make-work silliness and pork barrel politics that characterized many of the public works projects launched during the 1930s, and which are abundantly evident in many of the projects included in today's stimulus package.

In turning the U.S. into the “arsenal for democracy,” World War II production played a critical role in winning the war. It was integral to the tasks of preventing the slaughter of millions of American and Allied soldiers in the field, overpowering a ruthless and demonic enemy, and ensuring the survival of freedom and democracy.

2) Though they expected to go their separate ways after the war, government and the private sector were on the same page during the war. Through a combination of forced and voluntary austerity, people limited their purchases to necessities during World War II, and companies refrained from making investments not related to the war effort. There was a fundamental unity of purpose. In supporting the war effort, the private sector rose to new heights of innovation and productivity (which had the hugely positive, if unintended, consequence of setting the stage for the long postwar economic boom).

None of this applies in the present situation. In setting out to borrow unprecedented sums of money, today’s government is seeking not to restrict but to stimulate consumption. And in aiming to take direct control of investment in many areas, through the force-feeding of banks and auto companies and the encouragement of “green” industries or technologies with negative rates of return, the government is preempting the normal functioning of the marketplace in ways that can only hurt productivity and discourage the creation of real jobs and wealth.

3) The contrast between how the 1940s government financed the war effort and how today’s government is handling its spending bonanza is highly instructive.

As incomes rose during the war years, the government increased income taxes through the ingenious device of a withholding tax on payroll checks. From 1940 to 1945, there was a fivefold increase in federal tax receipts from \$8.2 billion to \$41.5 billion. That still left huge deficits, as there was an eightfold increase in federal expenditures over the same period from \$8.5 billion in 1940 to \$70.6 billion in 1945.

But here the government was able to tap the savings of the American people. Despite rising incomes, the war years were a time of real austerity marked by price controls, the rationing of many consumer goods, and genuine frugality. People home-grew their vegetables in “victory gardens” and accepted the removal from the marketplace of consumer durables such as new cars and refrigerators. Even

with much higher levels of taxation, the American people saved a phenomenal 20.5 percent of their disposable personal income from 1941 through 1945.

As a result, the government was able to fill most of the financing gap by borrowing money from the American people (or from banks holding their deposits) through the sale of war bonds bearing very low rates of interest and sold as patriotic investments in the war effort. No one got rich on war bonds, but they were repaid in postwar years, with fairly modest losses to bond holders due to the effects of inflation.

In contrast, the U.S. savings rate has turned negative in recent years. Proponents of a string of trillion-dollar Keynesian-style deficits are content with the idea that the United States, as a debtor nation, will be able to rely on the continued willingness (and ability) of other nations, such as China, Japan, and Saudi Arabia, to invest huge sums of money in low-yielding U.S. Treasuries. That is a very large assumption that will be undone by rapidly rising interest rates if foreign nations begin to doubt U.S. solvency or our willingness to repay debt without resorting to massive inflation.

4) It is worth citing some of Keynes’s own words. Keynes famously spoke the importance of “animal spirits.” He wrote: “If Enterprise is afoot, wealth accumulates whatever may be happening to Thrift; and if Enterprise is asleep, wealth decays whatever Thrift is doing.”

What happened to put Enterprise back on its feet in this country at the end of the Depression? Clearly it was the rude awakening provided by the bombing of Pearl Harbor and the threat to freedom here and abroad. Certainly it wasn’t any public works project dreamed up by geniuses in Washington, D.C.

Indeed, nothing captures Keynes’s notion of Enterprise asleep any better than old pictures from Roosevelt’s WPA of writers, stock brokers, and other white-collar types leaning on their shovels as they pass the time of day in idle chatter.

Putting more shovels into the wrong hands through hastily contrived, government-sponsored projects won’t do any more good today than it did back in the 1930s.

To try to stimulate the economy in this way is truly to build a ladder to nowhere. ❄

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Senator Survivor

by John H. Fund

POLITICAL ANALYST STUART ROTHENBERG once said of Arlen Specter: "He's an intimidating senator and very successful at any game of 'Survivor.'" Indeed, Arlen Specter might as well have been born to be champion of that reality show. He's beaten cancer, a brain tumor, and overcome long odds to win five terms in the U.S. Senate. In April, faced with the almost certain prospect of losing to Pat Toomey, his 2004 GOP primary challenger, Specter pulled his ultimate Houdini trick and switched parties to once again become the Democrat he used to be.

The good news for Democrats is that they certainly got some assurances from Specter that he would be more cooperative with their agenda than he has been to date. "We don't know what assurances he got from the Democratic leadership," Democratic consultant Richard Goldstein told Fox News. Indeed, I've no doubt that Democratic leaders offered to help clear the field for him in the 2010 Democratic primary as well as direct key contributors to him.

That said, Specter will not be an automatic vote for the Democratic battle plan. He is notoriously resistant to lobbying and possesses a personality so alienating that it has led many in the state to dub him "Snarlin' Arlen" or "The Arlenator." He has always been a fierce proponent for open debate and amendment in the Senate, and is therefore unlikely to support parliamentary moves by Majority Leader Harry Reid to shut down extended debate and push through a radical health care plan with a bare majority of Senators behind it.

Indeed, Specter's standing with Democrats back home may give him some leeway to continue his independent course. A recent Quinnipiac University poll showed him trailing badly in his GOP primary against Toomey but scoring a 71 percent favorable to 16 percent unfavorable approval rating from Democrats. He is likely—but not certain—to win the Democratic primary, but then will likely face a

tough general election against either Toomey or another Republican.

The secret of Specter's success is his dogged work ethic, his utter lack of political shame, and his ability to steer money back home. When he was chairman of a key appropriations subcommittee he personally earmarked hundreds of millions of federal dollars every year for home-state projects while telling conservative donors he believed in ending the earmark process "because it's gotten out of control." The reality is that Specter loves pork so much that critics joke he might be loath to kill off animals infected with swine flu. "My adversaries accuse me of voting for pork, but I call it bringing home the bacon," he told me last year.

Indeed, so zealous is Specter in securing grants for the National Institutes of Health that he was once chastised on the Senate floor by then senator Pete Domenici, a former chairman of the Budget Committee. Domenici, a well-known advocate of greater science funding, nonetheless said the NIH had "turned into pigs. You know, pigs! They can't keep

