

Why the Economy Must Remain Job One

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Wartime can be bad times for economic policy. It's not just that military mobilization imposes heavy burdens on the private economy. The larger problem is that the political demands of war can cause government to grow across the board. This tendency has been conspicuous in the first years of the war on terror.

Since September 11, U.S. government spending and regulating unrelated to the war on terror has grown dramatically. Domestic discretionary non-security spending grew by 15 percent from 2001 through 2003 and will probably increase by more than 25 percent during President Bush's first term—a much faster growth rate than at any time during the Clinton administration. This spending category is limited to such things as unemployment benefits, education, grants to state governments, and a variety of energy, agricultural, commercial, and regional-development subsidies. It doesn't count higher spending on national defense, homeland security, and September 11-related projects such as victim compensation and physical rebuilding, nor does it count the Social Security and Medicare entitlements.

Total federal spending now exceeds \$20,000 per household, the highest inflation-adjusted level since World War II. And it is bound to grow mightily in the coming years as the baby-boom generation begins to cash in on Social Security and newly expanded Medicare benefits. The December 2003 prescription-drug expansion of Medicare, the first major entitlement bill enacted without any taxes to pay for its benefits, adds at least \$10 trillion more to the federal government's unfunded liabilities.

Government economic controls have also grown. Burdensome new regulations of the financial and energy sectors, and of management-shareholder relations, were imposed after the Enron scandal. A new independent agency has been created to regulate business accounting, with unilateral authority to set and collect taxes on all publicly held corporations. In the critical telecommunications sector, deregulation initiatives have been countermanded by Congress, and regulators are poised to restrict the growth of dynamic technologies such as Internet telephony. The new Medicare law extends federal regulation of the health-care sector in important respects, and will almost certainly lead to price controls on pharmaceuticals. America's deregulation movement, which since the late 1970s had steadily abolished New Deal-era controls, has yielded to a new era of re-regulation.

Finally, U.S. leadership in trade liberalization—a bipartisan project since the early days of the Cold War—has essentially collapsed. The Bush administration's most

important trade initiatives have foundered amidst rancorous international disputes. All but one of the Democratic Party's 2004 Presidential hopefuls (emphatically including Senator John Kerry) have been adamant protectionists, a sharp departure from the free-trade policies of Democratic Presidents from Bill Clinton on back. In response to attacks over "outsourcing," the Bush White House has distanced itself from defenses of free trade.

These developments have prompted some sharp criticisms of President Bush by his conservative supporters. Yet George Bush is, philosophically, a strong conservative and free-market man—as are most of the members of the House of Representatives, which has collaborated in the surge of federal spending and regulating in vote after vote. Although President Bush came to office committed to new spending initiatives in education and health care, his proposals were much more temperate, and much more infused with free-market reforms, than the programs that have been enacted.

In truth, government growth has resulted not from any change in Republican Party doctrine but rather from the necessities of political mobilization following the attacks of September 11.

First, the onerous demands of mounting the counterterrorism campaign, the wars and occupations in Afghanistan and Iraq, and the new homeland-security programs, have absorbed most of the time and energy of the Administration. Domestic spending and regulating are naturally shaped by the pressures of innumerable interest groups—representing farmers, teachers unions, business firms, veterans, environmental causes, etc.—each extracting a subsidy here, a regulatory advantage there. The special-purpose Congressional committees and administrative agencies easily become accommodating forums for these groups unless there is countervailing leadership from the top that asserts the public interest over the multitude of parochial claimants. But since September 11, the President and the White House have been preoccupied. Other than the 2003 tax reform, Congress and the bureaucracies have mostly been left to their own devices.

Second, emergency mobilization is not merely distracting—it requires positive accommodation of many individual legislators and constituencies. When the President has an urgent priority, such as a big appropriation for rebuilding Iraq, everyone in Washington knows it. To get what he needs, a President must acquiesce in much that he regards as incidental or even obnoxious. The price of necessary legislation includes the building of many unnecessary dams and other pork-barrel projects.

These developments are highly worrisome not only for their economic effects but also for our prospects in the war on terror. During our last period of extended security mobilization, the Cold War, America's "anti-statist" political ethos—our skepticism toward government, and preference for personal freedom, low taxes,

free trade, and a growing consumer economy—was critical in keeping pressures for government growth at bay. Presidents from Eisenhower to Kennedy to Reagan firmly resisted demands for economic regimentation and “military protectionism.” The result was high rates of economic growth and technological innovation and a social resilience that eventually overwhelmed the lumbering Soviet juggernaut.

The period of the late 1960s and ’70s was the exception that proved the importance of U.S. anti-statism. The “guns and butter” policies of Presidents Johnson and Nixon, in which the expenses of a major war were combined with costly Great Society initiatives, contributed to a decade of high inflation, low growth, social division, declining military budgets, and a succession of communist victories. Then, of course, anti-statism returned in full force in the 1980s with the election of Ronald Reagan; by decade’s end, the Soviet Union was no more.

The first two years of the war on terror have again been a time of guns and butter—not out of deliberate political calculation as during the Vietnam War, but as an unintended consequence of ad hoc accommodation to new political circumstances. The terrorist attacks and responses by public officials have generated popular appreciation for government in general, not just our armed services. For the time being, American anti-statism is in abeyance.

Although the growth of government bodes ill for American economic welfare, the costs may seem to be manageable as a security matter. The societies that threaten us with radical Islamism and terrorism are very backward economically; they have squandered their oil wealth rather than investing it in productive human and physical capital. Despite our recent sloppiness and indiscipline in economic policy, America is likely to remain the world’s richest and most market-oriented nation. Economically, the Free World seems to possess invincible advantages over the Terrorist World.

Yet the war on terror is different from anything we have faced before. It is a clash of civilizations, not economic systems, and it is likely to be long, nasty, and punctuated with harsh reversals. Organizations such as al-Qaeda and Hezbollah, although socially and economically primitive, are nevertheless able to assimilate and deploy modern technology and organizational methods successfully. Unencumbered by the bureaucratic sloth and economic perversities of communist states, the most proficient terrorist groups are themselves fiendishly “market oriented” and entrepreneurial.

In operations and tactics, the terrorists borrow from the West’s civic and commercial freedoms with the purpose of undermining and eventually destroying those freedoms. And they possess, for the time being, an intrinsic advantage: the technologies that now enable small, cohesive groups to execute surprise massacres of large numbers of people. The September 11 ratio of 19:2,978 was

by no means the theoretical limit. Despite the Bush administration's energetic anti-proliferation diplomacy, nuclear technology will almost certainly continue to spread and find uses in unpredictable places.

Prevailing over such threats will require more than technological fixes. We also must be prepared to maintain our morale, self-confidence, and will to prevail. In response to a single attack claiming about 200 lives, Spain has already sued for peace. England, Italy, and Poland may be the next targets, and America could find itself friendless at key moments, even as we remain the ultimate target. Maintaining social morale is surely a complex and subtle thing, but a strong and growing economy is an important component. From Germany in the 1930s to America in the 1970s to Germany and France today, the worst cases of political decomposition have come at times of economic weakness.

At a minimum, a robust, growing economy will be essential for financing a "generational commitment" to military action that will be largely ours to pay for. In addition, great economic limberness will be required of the U.S. as we finance and manage the introduction of economic and technological modernity to former Middle Eastern enemies like Iraq.

These circumstances suggest a more profound relationship between economic policy and security policy. Our initial tactics have consisted of hunting down terrorist groups, reforming or replacing terror-supporting governments, and, at home, imposing new government surveillance and controls over communications, transportation, finance, and other aspects of commerce. These tactics, while essential, will almost certainly be less important over the long run than piling up our natural advantages—our market-driven capacities for continuous innovation, spontaneous adaptation to changing circumstances, and resilience in the face of unexpected reversals. Our success at promoting the institutions of political freedom and economic opportunity in the homelands of terrorism will depend to a significant degree on our maintaining those institutions in our own nations, both as exemplars and as engines of economic power.

It is often said that the Islamist radicals hate America not for its sins but for its virtues—the virtues of freedom, prosperity, and cultural dynamism. They fear as well as hate us for these virtues, and we should take them seriously. To the long list of good reasons for confronting the many wasteful and counterproductive policies that are holding our economy far below its potential, we may now add urgent reasons of national security.