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***DISCLAIMER: I am still among those who want our new president to succeed, especially in rescuing the economy from its deepening malaise.***



***WARNING: If you are among those so enthralled by Mr. Obama's rhetorical gifts that your critical intelligence remains stuck in the 'off' position, READ NO FURTHER. The mounting evidence suggests to me that the president has already made a major, possibly catastrophic economic mistake. The remaining question is whether he can correct course in time to contain the damage....***

## ***THE GREAT CROSSROADS: WHITHER OBAMA***

Today in the New York Times, **David Brooks** FINALLY addresses the need for conservative fiscal restraint without cloying deference to the cohort that got us in the current mess. In "The Great Unwinding", he makes this observation:

"Consumption as a share of G.D.P. stood at around 62 percent in the mid-1960s, and rose to about 73 percent by 2008. The baby boomers enjoyed an incredible spending binge. Meanwhile the Chinese, Japanese and European economies became reliant on the overextended U.S. consumer. It couldn't last.

"The leverage wave crashed last fall. Facing the possibility of systemic collapse, the government stepped in and replaced private borrowing with public borrowing."

**Followed by this nugget:**

“The members of the political class face a set of monumental tasks. First, they have to persuade a country to postpone gratification for the sake of rebuilding the country. This country hasn’t accepted sacrifice in 50 years.

“Second, political leaders will have to raise taxes and cut spending to get the federal fiscal house in order, and they will have to do it at a time when voters are already scaling back their lifestyles.

“Third, they will have to refrain from doing anything that might further damage America’s fiscal position, which is extremely fragile. That means not passing a health care reform package unless it is really and truly paid for.”

**LINK:**

[http://www.nytimes.com/2009/06/12/opinion/12brooks.html?\\_r=1&ref=opinion](http://www.nytimes.com/2009/06/12/opinion/12brooks.html?_r=1&ref=opinion)

**A note to David Brooks: I wouldn’t hold your breath on that last injunction. Our president is so far unwilling to endorse a health care plan that is “pay as you go’ for the simple reason that in the first 120 days of his administration, ALL OF THE MONEY WAS PRE-SPENT.**

I’ve repeatedly made the point that previous modern presidents (Reagan and Clinton come immediately to mind) did their best work when forced to deal with a non-compliant Congress, one controlled by the opposite party. I believe that the current triumvirate - POTUS, House and Senate, all firmly in the control of a single party, will be this administration’s undoing. Put differently, a strong push back by conservatives in both parties in November 2010, preceded by a growing wave of public support for restraint, may work to save Mr. Obama’s legacy.

**LINK:**

[http://www.rasmussenreports.com/public\\_content/business/taxes/june\\_2009/53\\_say\\_more\\_government\\_spending\\_hurts\\_the\\_economy](http://www.rasmussenreports.com/public_content/business/taxes/june_2009/53_say_more_government_spending_hurts_the_economy)

The wave has already begun. The highly respected pollster, Scott Rasmussen, reported today that:

**“Most voters (53%) believe increases in government spending hurt the economy, according to a new Rasmussen Reports national telephone survey. While that result is unchanged from [last month](#), it’s up five points from 48% in [January](#).”**

**That’s one percentage point higher than Mr. Obama’s electoral win and it is a trend.**

**“IP-LIBERALISM”**

Let me coin a term here: “**IP-Liberalism**”.

**IPL** is the discipline-eroding virus that has infected both parties. It is the reason that GOP leaders endorsed a budget-busting, not-means tested entitlement, the Medicare Drug Benefit, and that the democrats immediately and uncritically endorsed Mr. Bush’s banking system bailout **and** Mr. Obama’s pork-clotted Stimulus Package.

We’re dealing now with the consequences of the quintessential a Boomer mindset, something that goes all the way back to the misguided child-rearing practices endorsed in the 1960’s by the now, almost-forgotten, Dr. Spock.

**Indulgent Parent Liberalism** produces spoiled children, politicians unable to say NO and stick with it, undisciplined borrowing and HUGE fiscal deficits. The current mess is the consequence of IP-Liberalism, the virus that weakens parental authority and has deprived both chambers of congress of adult supervision. The country needs to jettison Dr. Spock in favor of Mr. Spock, the coolly rational science officer on the USS Enterprise.

**Over the last several weeks, I’ve been addressing what I am calling a needed conservative renaissance, a coalition of Blue Dog democrats and fiscally sane republicans. Recently I made this challenge:**

There are the four rules for any freedom-friendly game-changing alternative that will actually work:

1. It must be a new game.
2. It must be better than the old game for the productive people and institutions that generate real goods and services.
3. The larger electorate must understand and agree to try the new game.
4. The sacrifices needed to change games must be realistic, but short term enough that the benefits of the new game become evident within three years or less.

I’ll return to that at the very end of this piece, and in more detail in a later posting.

## ***THE LEFT TURN: LOST IN SPACE***

This president’s lofty rhetoric still ascends to the skies, seeking a wider and wider audience, while the prospect of a robust recovery in the US economy is rapidly falling into the well of impossible dreams.

Mr. Obama was brought to power by the perfect storm of politics, the kind that sweeps through a political system like a tornado through fall leaves. The shockingly abrupt collapse of the financial system was a decisive break in a conservative trending campaign. Just before the crash, the Obama campaign was losing momentum and the McCain insurgency was gaining, in spite of the drag of the Bush legacy.

[Republicans](#) bolted out of the convention ready to win, and it showed in the polls. The week of September 8-14 McCain was ahead for the first time – [but by only one point](#). Obama reclaimed a one-point lead the following week. Basically the race was tied going into the last six weeks of the campaign. Then on September 15, the 158-year-old [investment](#) banking firm of Lehman Brothers filed for bankruptcy protection, marking the largest bankruptcy in U.S. history. The bursting housing bubble had hit Wall Street. Other firms fell like dominoes, and the resulting “financial meltdown” dominated the front pages. LINK: [http://www.rasmussenreports.com/public\\_content/politics/election\\_20082/2008\\_presidential\\_election/mccain\\_s\\_fortunes\\_fell\\_with\\_the\\_stock\\_market](http://www.rasmussenreports.com/public_content/politics/election_20082/2008_presidential_election/mccain_s_fortunes_fell_with_the_stock_market) .

The momentum break was made even more dramatic by President Bush’s urgent appeal for a blank check in the amount of 800 billion dollars, John McCain’s mercurial fiscal about face and Mr. Obama’s strategic aplomb.

In the end, a center-right country voted for a seemingly center-left candidate, a man whose earlier ties to the paleo-left of the revolutionary 60’s were conveniently forgotten in the glow of his unquestioned charisma. His was a campaign founded on the Grand Gesture and driven by the contrast effect: Just as a disgruntled lover tends to become uncritically infatuated with the opposite type, the American people were drawn to a man whose soaring eloquence and seeming humility contrasted vividly with the cocky mal-eloquence of the former Texas governor. Forgotten, too, were the hockey-mom jibes of the Alaska governor about Mr. Obama’s over-the-top Hollywood stagecraft. Governor Sarah Palin actually drew blood in her acceptance speech, which is why the press, egged on by the Obama campaign, drew blood in turn. But all that became irrelevant when the crash became center stage and John McCain blew the opportunity to become the calm voice of fiscal sanity.

I was going to begin the next sentence (about Mr. Obama) with “*to be fair*,” but that just isn’t the appropriate test for someone who has actively sought the presidency for several years. It would be like using that phrase to excuse a new pitcher, brought up from the minor leagues, who badly blows several games in a row. As JFK reminded us, “Life is not fair.”

The new administration arrived in the middle of a crisis with a decisive victory, the wind at its back and a compliant congress. The financial meltdown presented an extraordinary challenge and an opportunity of equal magnitude. A large scale binge in private borrowing had overleveraged almost every part of the economic system, from families to Fortune 500 companies, from banks to brokerages. Like all binges, this credit blowout came to an end as abruptly and catastrophically as the Bernie Madoff pyramid investing scam did. Overnight, the glut in too-easy credit became an ice age.

Several factors had converged:

- (1) Post-911, low interest lending by the fed headed off a major post-attack recession, but that only postponed the eventual reckoning.

- (2) Political pressure continued to encourage risky mortgage loans to economically challenged borrowers, eventually leading to new forms of financial trickery and balance sheet puffing. The foreclosure time bomb had been set and armed.
- (3) A Faustian bargain between the high spending, high borrowing developed economies and the high production, high lending Chinese economy traded first world debt and eroded manufacturing capability for a massive influx of second world, under-priced goods. This sopped up the inflationary pressures from the USA's money factory at the cost of a huge outsourcing of our manufacturing base and an eventual credit crash.

None of this was unsustainable long term.

Our story was replicated in greater or lesser ways throughout the first world economy. The common thread was hugely overvalued real estate, forming the speculative bubble that undergirded the whole fragile business of trying to make something out of nothing. All bubbles break. The challenge to the incoming Obama administration was to contain the damage to the persons and institutions that had behaved imprudently and irresponsibly and to help those that were still strong to recover quickly and fill in the gaps left by the failures. This would have not only been more effective, it would have been far, far less expensive. Not all banks were burdened by bad loans and phony assets. Not all businesses were poorly run. In general the market mechanisms of capitalism do a brilliant job of picking winners and losers, so long as they are allowed to operate rationally and without undue political interference. Politicians are prone to prop up losers at the expense of everyone else.

The sheer scale of the meltdown has so far exceeded the annual budgets of all levels of government that any attempt to bail out the failures was doomed from the outset. At this early juncture, it is sadly apparent that the incoming administration simply doubled down on failure, squandering all of its assets and those of the next generation in a futile effort to stop a runaway train. This was more than mere "wasted money." It was a quixotic attempt to repair a private credit binge with a **public** credit binge. In the attempt, POTUS has created a boulder-sized recovery roadblock. As a result, those hoping for a prosperous end to this 'recession' might be waiting the arrival of a new administration. [See my footnotes below.] Unless, external political forces persuade this president to change course, we can expect more oratory and grandiose gestures in an effort to sooth and distract us from the impending disaster.

**Footnotes:**

As Arthur Laffer, the economist who is credited with the Laffer Curve, writes in yesterday's *Wall Street Journal* {LINK: <http://online.wsj.com/article/SB124458888993599879.html>}

"Here we stand more than a year into a grave economic crisis with a projected budget deficit of 13% of GDP. That's more than twice the size of the next largest deficit since World War II. And this projected deficit is the culmination of a year when the federal government, at taxpayers' expense, acquired enormous stakes in the banking, auto, mortgage, health-care and insurance industries.

"With the crisis, the ill-conceived government reactions, and the ensuing economic downturn, the unfunded liabilities of federal programs -- such as Social Security, civil-service and military pensions, the Pension Benefit Guarantee Corporation, Medicare and Medicaid -- are over the \$100 trillion mark. With U.S. GDP and federal tax receipts at about \$14 trillion and \$2.4 trillion respectively, such a debt all but guarantees higher interest rates, massive tax increases, and partial default on government promises.

“But as bad as the fiscal picture is, panic-driven monetary policies portend to have even more dire consequences. We can expect rapidly rising prices and much, much higher interest rates over the next four or five years, and a concomitant deleterious impact on output and employment not unlike the late 1970s.”

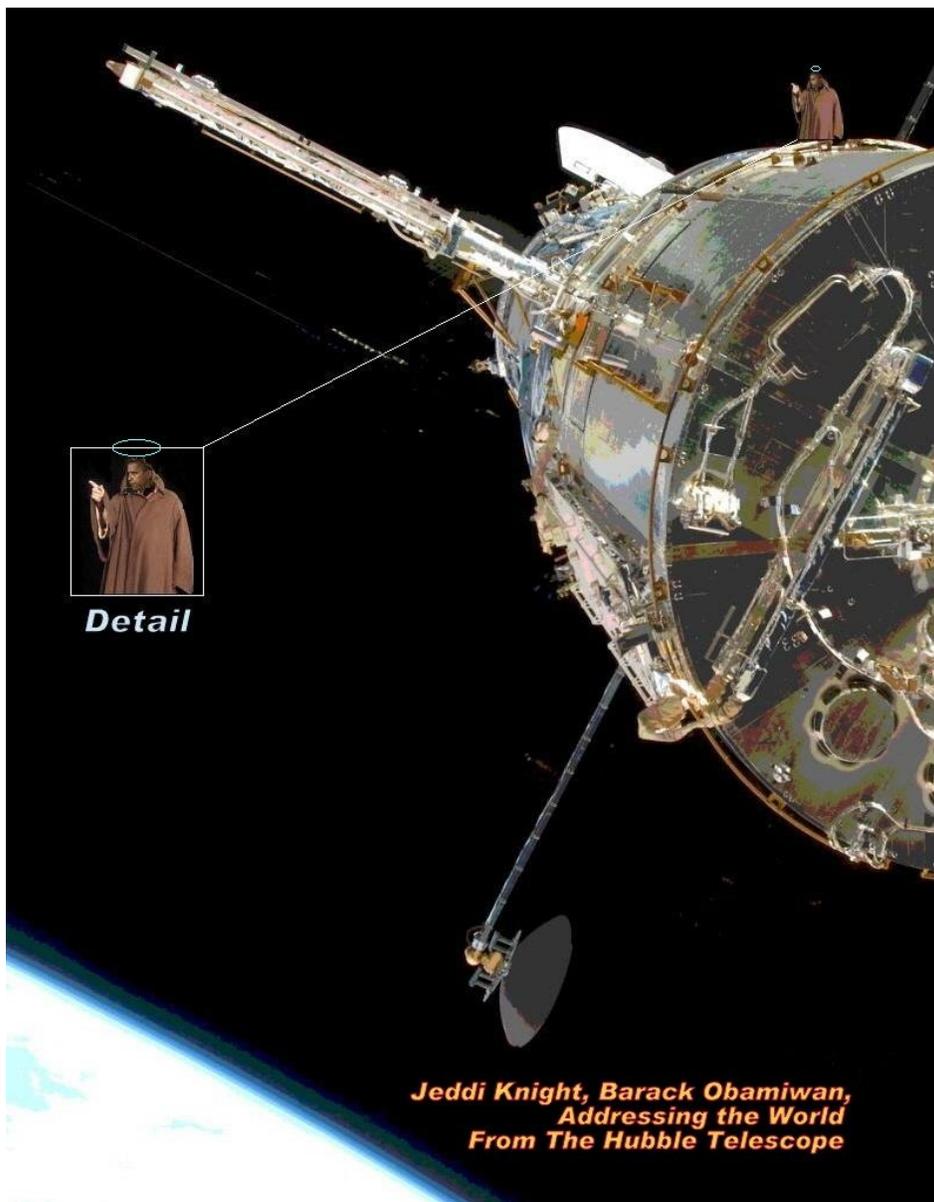
And Tuesday, *The New York Times*, hardly a mouthpiece for the Obama opposition, ran a “yes, deficits are serious” piece that contained this:

“Obama advisers acknowledge as much. They say that changes to the system would probably have a big effect on health spending starting in five or 10 years. The national debt, however, will grow dangerously large much sooner. ...

“Your taxes will probably go up, and some government programs you favor will become less generous.”

“That is the legacy of our trillion-dollar deficits. Erasing them will be one of the great political issues of the coming decade.”

LINK: <http://www.nytimes.com/2009/06/10/business/economy/10leonhardt.html?scp=1&sq=June%2010%20deficits&st=cse>



If Mr. Obama pursues his lofty, orbital course, this is what we can expect. Mr. Obama has already used his rhetorical gifts in Berlin and on the Al-Arabiya news channel to

inspire Europeans and to assuage the Islamic world. If his present course continues, he will try to recover popular acclaim by seeking ever larger oratorical platforms. If the US economy actually tanks, his next major address will be delivered from the Hubble Space Telescope.

## **MR. OBAMA'S OTHER COURSE**



**Let me make four quick points here, notions that will be spelled out in my series about the “ReCon” movement (fostering “renaissance conservatives” in both parties).**

### **ONE**

**The economy cannot endure continued bureaucratic strangling via a vast network of municipal, state and federal regulations that impose a crushing political burden on any new commercial venture. Space limits do not allow elaboration. Ask Joe the plumber’s friends in your neighborhood. If Mr. Obama is attracted to leadership on a grand scale, then I invite him to consider the story of Alexander of the Gordian Knot.**

### **TWO**

**The economy can no longer endure the current legacy of mandated entitlements, let alone new ones. Don’t even go there. This includes carbon regulation and subsidized health care. Sorry, but the cupboard is bare and the kids are hungry.**

### **THREE**

**One cannot attempt to restrain private compensation without doing even more to cut the compensation of public officials and workers at all levels.**

## FOUR

**Any tax increases must meet four criteria:**

**(a) FLAT & COMPREHENSIVE:** They cannot differentially burden economic success.

**(b) SPENDING CUT LINKED:** They must be absolutely coupled with drastic, large scale spending cuts (absolute cuts, not mere reductions in growth) that exceed the dollar amount of any new taxes in both absolute and relative terms.

**(c) SUNSET:** They must be rigorously time limited in the same way that the Bush tax cuts were.

**(d) DEBT PAYBACK LINKED:** No games allowed. 100% of the spending cuts and new taxes are used to pay down existing public indebtedness.

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**The fork in the road is obvious. Take the center-right branch, Mr. President, before it's too Late....**

**JBG**