Samuelson Ponders Unthinkable: U.S. Govt Default

In Robert J. Samuelson's latest op-ed piece for the Washington Post, "Could America Go Broke?", the longtime editor and economic and business writer — who can normally be counted upon to prescribe the usual Keynesian claptrap for our sundry economic woes — actually flirts with common sense. In his piece, Samuelson dares to ponder the unthinkable: What if the rest of the world lost confidence in the viability of the dollar, and America could no longer service her fourteen-figure national debt by printing more money?

What if, in a word, fiscal reality finally overwhelmed the mass delusion encouraged by the modern inflationary money system, and America were forced once again to live within her means? Such a turn of events would no doubt be catastrophic in the short run, and for the first time, even an establishmentarian like Samuelson is giving the matter serious thought. "The idea that the government of a major advanced country would default on its debt — that is, tell lenders that it won't repay them all they're owed — was, until recently, a preposterous proposition," Samuelson asserts. Well, not really, at least among those of us who do not hew to the childish notion that printing money somehow allows governments to nullify the laws of economics and common sense. What Samuelson really means is that economists he deems respectable would not have considered it.

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He continues:

> Argentina and Russia have stiffed their creditors, but surely the likes of the United States, Japan or Britain wouldn't. Well, it's still a very, very long shot, but it's no longer entirely unimaginable. Governments of rich countries are borrowing so much that it's conceivable that one day the twin assumptions underlying their burgeoning debt (that lenders will continue to lend and that governments will continue to pay) might collapse.

Actually, Great Britain, once upon a time, did stiff its creditors, when — after repeatedly promising not to do so — it unilaterally repudiated its promises to redeem pounds Sterling in gold in 1931. Great Britain had printed an enormous amount of money to finance World War I, and the debonair Governor of the Bank of England, Montagu Norman, rather than allowing the pound to be devalued after the war to reflect the new reality, insisted on reinstating the gold exchange rate at the prewar par — and then printing money all through the Roaring Twenties, in lock-step with the American Federal Reserve, to try to avoid the shock of a currency devaluation. When Britain finally surrendered to the laws of economics, the result was an unprecedented international currency crisis that lasted through the '30s and provided the political cover for the Bretton Woods conference.

It is probably not a coincidence that Great Britain was never the same after going off the gold standard. Within 20 years, her empire was lost and her economy a shambles, and only partly because of the Second World War.

The closest the United States has come to repudiating its own debts was in 1971 — 40 years after the British went off the gold exchange standard — when President Nixon “closed the gold window,” that is, told the rest of the world that, despite the Bretton Woods agreement, U.S. dollars would no longer be redeemable abroad in gold. The United States had printed fantastic sums of money to finance the Vietnam War, and could no longer back its currency with gold.

The consequence of the U.S. repudiation of its gold obligations was a “lost decade” much like the current one, in which stock markets crashed and then stagnated, recession repeatedly reared its ugly head, and national confidence soured.

But now Samuelson is pondering a scenario even more dire: that the United States or some other major power could repudiate a portion of its debts altogether, much as Argentina chose to do at the beginning of this decade. For the nonce, at least, it appears that confidence in the dollar is still strong enough to allow the Great Shell Game to continue; “despite huge deficits,” Samuelson points out, “interest rates on 10-year Treasury bonds have hovered around 3.5 percent. In time of financial crisis, investors have sought the apparent sanctuary of government bonds.” But this does not necessarily mean that the game can go on forever:

> The correct conclusion to draw is not that major governments (such as Japan and the United States) can easily borrow as much as they want. It is that they can easily borrow as much as they want until confidence that they can do so evaporates — and we don’t know when, how or whether that may happen.

That such as Samuelson are now professing alarm at unprecedented levels of indebtedness is a welcome change. But it is unlikely that Samuelson or any of his ilk would consider the one course of action that could stave off eventual financial Armageddon: reduce the size of the federal government to within Constitutionally-authorized limits, restore the gold standard, and pay down our debts.

For most economists and politicians, however, the economy is merely another human activity to be managed, a game of benevolent brinksmanship in which bankers and political leaders run up debt and print money for our own good, while trying to avoid riling national confidence.

The system to which Samuelson and his epigones are wedded depends crucially on the maintenance of public confidence by deception. But even the powers that be cannot hold at variance the laws of nature and human behavior forever. As Samuelson warns, “the odds may be against a wealthy society tempting … fate, but even the remote possibility underlines the precariousness and the novelty of the present situation. The arguments over whether we need more ‘stimulus’ (and debt) obscure the larger reality that past debt increasingly constricts governments’ economic maneuvering room.”

And when that “economic maneuvering room” finally runs out, what then? Après nous, la déluge.