Armchair Economics

Perspectives from an economic everyman

Newtonian Economics

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Newton's Third Law: For every action there is an equal and opposite reaction.
Sir Isaac Newton (1643-1727)

Sir Isaac Newton was an English physicist, mathematician, theologian, astronomer and author. He was one of the most influential scientists of all time and a key figure in the scientific revolution whose discoveries gave way to the Industrial Revolution.

Newton's third law suggests that in every physical interaction, there exists a pair of forces acting on two directly related things. The size of the force on the first thing equals the size of the force on the second thing. The direction of the force on the first thing is opposite to the direction of the force on the second thing.

To apply this to socioeconomics, consider a change in social or economic policy as a force of action. That action—the policy change—moves the direction of our socioeconomy.

Policy changes tend to originate from two sources.

Change occurs when socioeconomic elites, which includes government, academia or big business, think new policy is warranted. These elites generally push policy that improves the circumstances of the institution they represent. Policy changes also happen after some perspective has worked its way into the collective consciousness of society. When enough people are highly concerned over something, political leadership is motivated to change policy in order to win votes.

But all policy changes have consequences, most of which are unintended. These consequences can remain hidden from view for years until they escalate to a point of creating a new problem. This is where Newton's Third Law comes into play.

Consider Social Security. The Social Security Act was signed into law by President Franklin D. Roosevelt in 1935. It was originally intended as a support system of old age benefits for workers, benefits for victims of industrial accidents, unemployment insurance and aid for dependent mothers and children, the blind and the physically handicapped. During the Great Depression, who wouldn't have supported this new policy?

When Social Security was enacted, the old age benefits for workers kicked in when they turned sixty-five. But in 1935, the average life expectancy in the United States was 61. Today the average life expectancy is 78.7 years old.

Under current conditions, the costs for Social Security are expected to exceed its income in 2020, and then the system will totally run out of money in 2035. No longer just a safety net, according

to a recent Gallup poll, six in ten American retirees suggest Social Security is a major source of their income.

What was Newton's third law reaction, the consequence of Social Security? Lower private sector savings and more people dependent on government.

The story is similar for Medicare. In 1965, President Lyndon B. Johnson enacted Medicare, a health support system for the elderly. Today there are 60 million Americans on Medicare. Its current hospital trust fund is set to run out of money in 2026.

Combined **projected costs** of Social Security and Medicare that **currently have no funding mechanism** amount to around $120 TRILLION dollars.

That's money we don't currently have and won't have given current projections of tax receipts and benefit payments. To put this number into perspective, annual U.S. GDP today is approaching $20 TRILLION. It would take six years of 100% of GDP generation to pay for our projected Social Security and Medicare programs.

To give another perspective, we could also think of this in terms of tax receipts. Annual tax receipts right now are about $3.5 TRILLION. That means it will take 34 years of 100% of our annual tax receipts to make up our future Social Security and Medicare obligations as currently promised. This is an unintended consequence of policy. For every action there is a reaction.

Let's look at the "free trade" policy of the last 40 years.

It all started in the 1970s when American goods producing companies were being squeezed by significant cost increases. Labor costs were growing as the union movement reached its zenith. Environmental costs had been rising since Rachel Carson's 1962 book, *Silent Spring*, inspired the country to tackle environmental challenges. Then an explosion in fuel and transportation costs followed the OPEC oil embargos. Those embargos drove up the cost of oil from around $3.50 a barrel in 1973 to around $35 a barrel in 1981.

These cost pressures worked their way into increased prices of almost everything. The Federal Reserve calls this the Great Inflation Period. Annual inflation reached almost 15% in the early 1980s. Goods producers were drowning in escalating costs. Consumers were plagued by high inflation. Something had to give. The ground was fertile for globalization.

American goods producers began to embrace the opportunity to lower their labor costs by offshoring goods production. They were also able to offshore their environmental costs to less environmentally concerned countries. These lower costs helped U.S. goods producers weather the explosion in overall domestic costs. Inflation subsided significantly.

Besides helping drive down domestic production costs and consumer inflation, globalization opened prosperity to many parts of the world. But it also produced its own Newton's Third Law reaction: stagnation of U.S. wages, decline of the U.S. middle class, growth of U.S. debt, loss of intellectual property and a global explosion of carbon emissions and other waste streams.

Did you put two and two together on that last Newtonian reaction to globalization? If climate change is real, then globalization created it by bringing billions of people into the world of consumerism. Who would have thought one reaction to the early domestic environmental movement, offshoring production, would years later lead to a growing environmental problem?

Now let's consider health care. "Oh, health care!"

Is health care affordable to anyone in the U.S. these days? Is it affordable to the average individual? It's close to unaffordable to companies. It's certainly not affordable to small business. It's not even affordable to the government (see Medicare discussion). Just a few days ago an insurance broker told me, "Health insurance rates are increasing at 1% to 2% a month." Huh? What? How can that be possible?

How did health care get so out of hand?

It all started in the 1940s when tax policy allowed companies to deduct the cost of health insurance. Previously people had to pay for health care out of their own pockets. A policy change made individuals no longer directly responsible for or privy to their health care costs. What was the Newtonian reaction, that unintended consequence that would show up decades later?

The result has been a significant increase in health insurance costs as well as a significant increase in health care spending overall. Health care costs have grown much faster than overall consumer goods inflation and even faster than the growth in wages.

Social Security influenced individuals to save less. Globalization led to stagnant wages and bigger environmental problems. Health care policy drove costs higher. For every action there is a reaction.

Now let's look at some of the policy ideas on the table today.

The Green New Deal suggests we should eliminate carbon producing resources entirely from our economy in a decade. Let's consider the consequences.

If hydrocarbons (oil, gas, coal) are going to be eliminated from our world, then who is going to pay for the cost of decommissioning the trillions of dollars in our current hydrocarbon-dominated infrastructure?

Who is going to dismantle the coal power plants? Who is going to dismantle our refineries? Who is going to dig up the pipelines? Who is going to properly plug and abandon about two million active oil and gas wells in the continental U.S.? What happens to a refinery after years of sitting idle? What happens to oil and gas wells if they are not properly plugged and abandoned? If we don't dismantle the existing hydrocarbon infrastructure, won't this produce very large environmental problems?

Can we expect companies like Exxon to shoulder these costs? Well, if you destroy Exxon's business model, where will it get the money to pay for decommissioning its assets? Destroy the hydrocarbon value proposition and there is no one to maintain or decommission the hydrocarbon infrastructure.

This cost will naturally fall to taxpayers. Shall we add a few trillion dollars more atop our obligations for Social Security, Medicare, public pensions and…? Or, if there's gridlock over who is to pay, then what environmental challenges will surface from letting these assets fallow?

Let's consider one more policy idea on the table—forgiving all student loans.

Who wouldn't vote for that if they had a student loan? Currently, 44.7 million people in the U.S. have student loans, representing over $1.5 TRILLION dollars of outstanding obligations.

Think of all the other stuff these people could buy if they didn't have to pay back their student loan debt. Wouldn't we sell more cars, more houses and more home furnishings if this debt was forgiven? Wouldn't that be economically stimulating to our economy? Wouldn't that make all those people feel a bit more comfortable economically? Absolutely!

But if this is such a smart idea, then why not also forgive all the auto loans out there? Might as well forgive all the credit card loans, too. And why not mortgages? If you don't have to pay back a student loan, then why do you have to pay back any loan? The Newtonian reaction? The consequence? Forgiving student loans creates a public desire to forgive more debt. Does forgiving student loans not create a huge behavioral problem that turns into ever larger financial problems?

The moral of this story—we must be VERY careful when making ANY policy decisions.

For every action there is a reaction. For every policy there is a consequence. As we've seen, most consequences are either unknown or poorly projected when a policy is put in place. Looking at policies from recent decades and popular policy ideas today, we see and can imagine many Newtonian economic consequences where the cure may be a lot more expensive than the disease.

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