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## Destructive 'Solutions'

By Richard W. Rahn

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### *Why increasing size of government won't work*

For at least a century, the Washington political class has been correctly known for creating more problems than solving existing ones. This tendency to enact destructive, rather than constructive, solutions for problems (most often created by government) has now gone into hyper-drive.

Many who see this situation often blame it on "excessive partisanship," where the real problem is caused by a bipartisan lust for power that breeds too much accommodation, rather than questioning and resistance to bad ideas. The American Founding Fathers understood that a balance of power and endless struggles within government were necessary to preserve individual liberties. Liberties (and economic prosperity) are most endangered when one party and/or an accommodating opposition controls the administration, both houses of Congress, and much of the judiciary.

It is probably no accident that the United States experienced its most recent high growth period in the late 1990s when there was a moderate Democrat in the White House (Bill Clinton) and a very aggressive Republican controlled Congress (Newt Gingrich and company).

During this period, the federal government actually shrank as a share of gross domestic product - which accounted for much of the prosperity. Yet, in just a decade that was mostly characterized by one-party rule - first by the Republicans and then by the Democrats - there has been a record rise in the size of government, not only in absolute but also in relative terms, so the federal government is about one-third larger than it was a decade ago.

The failure of either political party to get serious about reining in the growth of government has caused despair among small government conservatives, libertarians and others who believe in limited government. And this despair is contributing to the list of "destructive solutions" now infecting Washington.

This month, Bruce Bartlett, an early supply-sider, former aide to Jack Kemp - when Kemp was in Congress - and a Treasury official in the first Bush administration, published a new book "The New American Economy" (Palgrave 2009).

Mr. Bartlett, a friend of three decades, has become so pessimistic because of the growth in government that he now advocates a value added tax (VAT), much as House Speaker Nancy Pelosi and other leading Democrats have supported.

Mr. Bartlett argues that the failure of both Republicans and Democrats to get serious about government spending and, in particular, curtailing the growth of entitlements - notably, Social Security, Medicare and Medicaid - means the government must have more revenue, and thus he argues a VAT is the least destructive way of financing the much bigger federal government he thinks is inevitable (even though he would personally prefer a smaller government).

Some of us who disagree with Mr. Bartlett argue that his proposal is a "destructive solution," because any major new tax will slow economic growth even further, making it increasingly likely that government will continue to grow more rapidly than the economy, which eventually will lead to complete economic stagnation or worse. It is not possible to tax a country out of a problem of excess spending growth.

All the bills Congress and the administration are now trying to combine in one health care "reform" bill are "destructive solutions" because they fail to deal with an essential problem of health care, which economic Nobel laureate Vernon L. Smith has put so well: "The health-care provider, A, is in the position of recommending to the patient, B, what B should buy from A. A third party - the insurance company or the government - is paying A for it. The structure defines an incentive nightmare."

Until, the powers in Washington start dealing realistically with health care incentives, health care will become more costly (even if the cost is partially disguised by increased taxes and subsidies). Anyone who thinks any health care proposal that can pass this Congress and (as the president has claimed) will insure the uninsured, reduce costs and not add to the deficit is delusional.

Another example of a currently proposed "destructive solution" is the administration proposal for a resolution authority to unwind large nonbank financial institutions. Peter Wallison, former general counsel of the U.S. Treasury and now a senior fellow at the American Enterprise Institute, has said it best in his new study. "The plan's fundamental flaw is its failure to explain how this or any other government will distinguish in advance between companies whose failure would cause a systemic breakdown and those whose failure will cause only an economic disruption of some kind. Without a way to make this distinction, the resolution authority will simply become a permanent Troubled Asset Relief Program. Other conceptual flaws in the administration's plan are its effect in creating moral hazard, enhancing the competitive advantages of large nonbank financial firms, increasing the uncertainty faced by creditors of nonbank financial institutions, and adding yet another burden for the taxpayers."

As long as government grows faster than the economy, real problems will only get worse; but once government starts growing slower than the economy (as it did during much of the 1980s and 1990s), many problems just go away or are made manageable. And as other countries have shown, the growth in entitlements can be reduced, and even reversed, when the proper incentives are put in place. The situation will get better when the voters finally say they have had enough and replace most of the current actors in Washington, and when judges start having enough backbone to say to Congress and the administrative agencies, "You cannot do that because a proper reading of the Constitution shows that 'you do not have the authority.' "

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