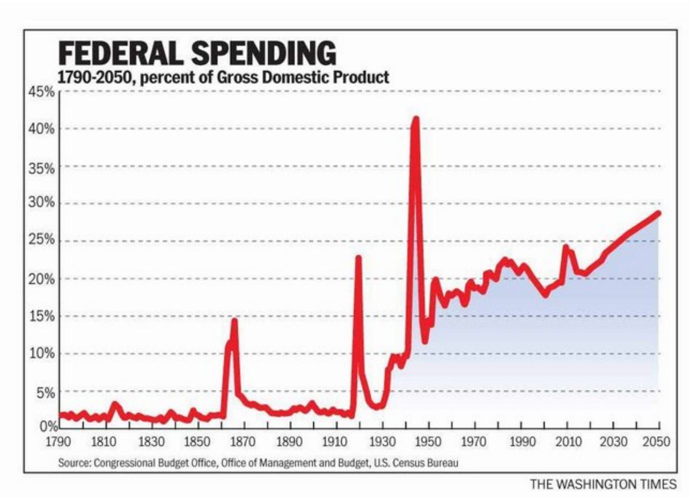

Bankrupt Ideas Lead to Bankrupt Governments

by Richard W. Rahn

BEWARE OF POLITICIANS WHO THINK EVERY PROBLEM CAN BE SOLVED WITH MORE SPENDING

"There is nothing left to cut," said House Minority Leader Nancy Pelosi last week when referring to the federal budget. Again, she displayed a complete disconnect with reality — a disconnect reinforced by all those other fantasyland souls who make her their leader.

As we listen to the budget battles among the political class over the next few weeks, it is important to keep in mind that federal spending is at record levels in nominal terms and near the all-time high as a percentage of gross domestic product (GDP), except during World War II. During the second Clinton administration, federal spending was about 20 percent lower as a percentage of GDP than it is now. Yet I do not recall starvation among the American people, nor the acutely ill being thrown out of hospitals because they could not pay, nor children not finding schools to attend. It did not happen, nor did it happen from the end of the Civil War until World War I, when federal spending was only about 3 percent of GDP, in contrast to today's 22 percent.

Outside of government, almost every good or service becomes better and less expensive in real terms each year. Government, though, is most heavily involved in education and health care. In both cases, costs have risen far faster than inflation for decades. With education, there has been almost no measurable improvement in quality as measured by what students know. The teachers unions love to talk about how much is being spent per pupil, while ignoring the fact that there are many high-spending school districts with lower achievement levels than many lower spending districts. The private sector — unlike government — constantly reduces costs and improves its products because of competitive pressures, and that creates real wealth. Those in the public sector measure success by the amount spent, not by what is accomplished.

Mrs. Pelosi may think there is nothing more to cut, but her own government continues to find huge waste. Medicare fraud and abuse alone now costs more than $115 billion per year, and even though the problem is well known, it persists decade after decade, as Mrs. Pelosi and her colleagues do nothing to stop it. But then, again, it is not their money that is wasted. According to the Congressional Research Service, the U.S. government has 77,000 unused or underused buildings that cost taxpayers $1.67 billion annually to operate and maintain. The list goes on and on.

It is not only the fraud and waste that needs to be eliminated, but also the endless duplicative and counterproductive programs. It is worth noting that when good economists carefully analyze any given federal program as to its costs and benefits, and properly include the extraction of costs of taxing and borrowing to fund the program, they most often find that the costs outweigh the benefits.

Regulatory costs have been soaring, yet the benefits of many of the regulations are questionable at best. The great Nobel Prize winning economist, Ronald Coase, who just passed away at age 102, gained his reputation, in part, by showing that almost all government regulations could be better and more effectively handled by private parties.

The accompanying graph shows how federal government spending has grown as a share of GDP over the past two centuries. My Cato colleague Chris Edwards, a budget and tax expert, notes in his article "Spending Freezes in History" that "[t]he budget was balanced every year from 1866 to 1893," and "[a] fiscal champion during this period was President Grover Cleveland, a Democrat." Oh, how things have changed.

As can be seen in the graph, federal spending as a percentage of GDP is likely to decline slightly over the next couple of years, mainly owing to sequestration, but then begin a continual rise, according to Congressional Budget Office projections, owing to the growth in entitlement spending, such as Social Security, Medicare, Medicaid and Obamacare. The unfunded liabilities of these programs make it a mathematical certainty they will fail without major changes. None of this was, or is, necessary.

The United States could have adopted and should now adopt a market-based system for Social Security that would let workers make their own investment decisions about where to place their retirement contributions. As Investors Business Daily reports, in 1981, "Chile Labor Minister Jose Pinera replaced the country's bankrupt social security system with this famous system of private accounts." A new study shows that Chile's "private retirement accounts provide workers pensions worth 87 percent of their salaries, 73 percent of that from profits on savings. So much for the canard about the perils of markets."

The great tragedy is that for three decades, think tanks like the Cato Institute (where Mr. Pinera is now a distinguished senior fellow) have been advocating a Social Security system with private accounts. Thirty countries have adopted a Chile-like system for the simple reason that it gives workers higher returns with less risk. Similar programs can be created for medical insurance. Social Security and the medical entitlements are unnecessarily headed for insolvency — all because too many Washington politicians, like Mrs. Pelosi, are intellectually bankrupt when it comes to fiscal responsibility.

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