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The Wolf at the Door

BY RICHARD W. RAHN

A SPENDING FREEZE COULD HELP TRUMP DEFANG THE BITE OF PUBLIC DEBT

Donald Trump is very lucky that Paul Ryan is speaker of the House. Mr. Ryan is a very serious policy wonk, which President-elect Trump is not. Mr. Ryan has spent the last several years developing sound solutions to deal with the problem of the "wolf at the door" — which is the never-ending growth of government and the attendant debt. For years, politicians have been ranting against the federal deficit and some of the spending, but doing little in substance about it — often with the assertion that they will deal with it before it becomes a damaging problem or, even worse, claiming that more spending is beneficial.

The fact is big-spending government is already causing considerable damage. Most savers receive near zero or worse on their savings after taxes and interest, and there has been a massive shrinkage in the labor force participation rate. Many studies have shown that once total government spending (federal, state and local) is more than roughly 25 percent of gross domestic product (GDP), economic growth tends to slow, reducing job opportunities and real incomes. Total U.S. government spending at approximately 38 percent of GDP is well above the optimum.

Even though it is true that there are many useless spending programs, as well as fraud and incompetence that need to be eliminated, the biggest spending disaster is in the "entitlements" — Social Security, Medicare and Medicaid.

Mr. Trump has said his focus will be on economic growth and that he will get the economy growing at "more than 4 percent per year," and that he will balance the budget. It is indeed true that with massive rollbacks of counterproductive regulations, the right type of tax cuts, and limiting spending (assuming a nondestructive money policy on the part of the Federal Reserve), 4 percent or more economic growth is very achievable — and the tax, spending and regulatory reform plans that Mr. Ryan and his colleagues have set forth may well do it.

The Congressional Budget Office (CBO) projects that with no major spending program changes, real federal spending as a percentage of GDP (assuming approximately an average annual 2 percent real growth in GDP) will grow roughly 30 percent over the next 30 years, and that virtually all of this growth will come from "mandatory" entitlement programs and interest. CBO projects real cuts in defense spending and other "discretionary programs." It also projects the federal debt held by the public to rise from the present 75 percent of GDP to 141 percent, and interest on the debt to grow from the current 1.4 percent of GDP to 5.1 percent (or $1 trillion before inflation). These numbers are clearly unsustainable.

Mr. Trump is going to have to deal with this reality but, again, the good news is there are solutions. Bush 41 ran for president in 1988 on a platform of "no new taxes" and a "flexible freeze" on government spending (I was one of his economic advisers in 1988 and '89). Unfortunately, soon after being elected, he reneged on his promises, and the economy performed poorly. Under the second Clinton administration and a Newt Gingrich-led Republican Congress, there was a spending freeze and a capital gains tax rate cut, which led to more than 4 percent real growth and not only a balanced budget but a budget surplus.

Reputable think tanks have developed sound proposals for reining in the growth of entitlement spending, so there are off-the-shelf solutions. More than 35 years ago, Chile was confronted with a bankrupt social security system. Fortunately, Jose Pinera, who was then the labor minister, came up with a solution whereby workers were required to save for retirement by contributing to an individual account (much like a 401(k) account) to be managed by a financial services company.

As reported in The Wall Street Journal a couple of weeks ago, "The system boosted economic growth with the savings that developed Chile's capital markets, making it Latin America's richest nation." Those who have contributed for more than 30 years now have obtained an average annual rate of return of more than 8 percent above inflation. More than 30 countries, including Sweden and Australia have adopted Pinera-type plans. Such a plan could be phased in over a number of years in the United States in a manner that would not reduce benefits to all of those who are retired or will retire in the next few decades.

There are equally good solutions for reversing the upward trend in medical entitlements; all that it takes is the political willingness to do what must be done. Americans, as well at the Europeans, Japanese and others, are faced with two alternative routes. The first is ever-growing government and public debt that results in economic stagnation or worse.

The other road is the high-growth route that will to lead more and better jobs and a rising standard of living for almost everyone. It requires keeping the growth in government spending to less than the growth in the private sector, and eliminating destructive regulations and taxes, as in the Ryan plan. And, best of all, it has been shown to work where it has been tried.

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