

Approaches to Cutting Federal Spending

Statement of Chris Edwards, Cato Institute,

to the National Commission on Fiscal Responsibility and Reform

June 30, 2010

Mr. Chairman and members of the committee, thank you for inviting me to testify today regarding the nation's fiscal future.

Unless today's massive deficit spending is reduced, the nation is headed for a fiscal calamity. The freedom and prosperity of young people will be crushed by debt piling up at over \$1 trillion a year.

Both parties are responsible for the deep fiscal hole we are in. The last president presided over the fastest annual average real growth in federal spending since Lyndon Johnson.¹ The current president has embraced short-sighted and dangerous Keynesian economic theories, which favor large deficit spending.

Policymakers need to reverse course and begin cutting the budget to stop the massive flow of red ink. Cato is building the website www.downsizinggovernment.org to describe ways to cut spending in every federal department.

There are four types of reform we should pursue in cutting the budget: restructuring the big three entitlements, terminating unneeded programs, reviving federalism, and privatization. This testimony provides examples of each type of reform.

Restructuring the Big Three Entitlements

There are straightforward ways to slow the growth of Social Security, Medicare, and Medicaid. For Social Security, initial benefits could be indexed to the growth in general prices, not wages, as under current law. If we were to make that change, it would reduce Social Security spending by roughly \$60 billion annually by 2020 and rising amounts after that. That reform would encourage younger Americans to increase their personal savings, which would be beneficial for the nation's economic growth. Congress could support such a policy change with pro-savings reforms to the tax code.

For Medicaid, a simple and dramatic reform would be to convert the program into a block grant for the states. Block granting was the successful approach taken with federal welfare reform in 1996. A block grant would encourage the states to trim their Medicaid programs, combat fraud and abuse, and pursue cost-effective health care solutions.

Turning Medicaid into a block grant and freezing spending at the 2011 level would save federal taxpayers about \$190 billion annually by 2020.

For Medicare, I like the approach developed by Rep. Paul Ryan (R-WI) to fund elderly health care by way of vouchers.² The Ryan plan would provide retirees with a voucher averaging \$11,000, which would be adjusted based on age, health status, and income level. The voucher would grow in value over time based on the blended growth rate of general inflation and medical inflation. That would restrain Medicare's growth compared to the baseline and generate large savings over time. The reform would help reduce waste and fraud in Medicare, while creating a range of incentives to improve efficiency and quality in the overall health care system.

Terminating Unneeded Programs

The Cato website www.downsizinggovernment.org lists dozens of major programs that should be terminated, including business subsidies, housing subsidies, energy subsidies, and other inefficient hand-outs. One high-priority area for cuts is agricultural subsidies.

The extensive federal welfare system for farm businesses is costly to taxpayers and it distorts the economy.³ Subsidies induce farmers to overproduce, which pushes down prices and creates political demands for further subsidies. Subsidies inflate land prices in rural America, and they can damage the environment and harm our international trade relations. The flow of federal subsidies also hinders farmers from innovating, cutting costs, diversifying their land use, and taking other actions needed to prosper in the global economy.

Farm subsidy programs effectively tax average families to fund a small group of well-off farm businesses. The largest 10 percent of recipients receive about 72 percent of all subsidy payments.⁴ Furthermore, federal data for 2007 show that the average income of farm households was \$86,223, or 28 percent higher than the \$67,609 average of all U.S. households.⁵ We should end this welfare program for the well-to-do and save about \$30 billion annually.

Reviving Federalism

Under the Constitution, the federal government was assigned specific limited powers and most government functions were left to the states. The Tenth Amendment to the Constitution embodies federalism, the idea that federal and state governments have separate areas of activity and that federal responsibilities were "few and defined," as James Madison noted.

Unfortunately, policymakers and the courts have mainly discarded federalism in recent decades.⁶ Congress has undertaken many activities that should be reserved to the states and the private sector. Grants-in-aid are a primary mechanism that the federal government has used to extend its power into state and local affairs. Grants are subsidy

programs that are combined with federal regulatory controls to micromanage state and local activities.

The number of different federal grant-in-aid programs for the states soared from 463 in 1990 to more than 800 today.⁷ The federal government spends more than \$500 billion annually on aid to the states. State aid programs are notoriously bureaucratic and inefficient, and they stifle local innovation. Furthermore, by involving all levels of government in just about every area of policy, the federal aid system creates a lack of government accountability.

The federal government should start shedding properly state and local activities. A good place to start would be the Department of Education.⁸ The department funds about 150 different subsidy programs, which come with an array of regulations that extend federal control over local schools, as under the No Child Left Behind law.⁹

Despite an enormous increase in federal K-12 spending in recent decades, national academic performance has generally not improved. Math and reading scores have been largely flat, graduation rates have stagnated, and researchers have found serious shortcomings with many federal education programs.

Having quality K-12 education is a concern of most Americans, but that does not justify having a federal Department of Education. Canada provides an interesting comparison. It is a high-income nation with an advanced economy, yet it has no federal department of education. Public education in Canada is the sole concern of provincial and local governments. That decentralized approach has resulted in experimentation and innovation, including school vouchers and charter schools. International achievement data suggest that Canadian students generally outperform U.S. students in reading, math, and science.¹⁰

The states need to recognize that federal aid is ultimately funded by the taxpayers who live in the 50 states, and thus it provides no free lunch. There is no important policy reason for the federal government to be involved in K-12 education and other local activities. Ending federal K-12 education spending would save about \$60 billion annually.

Privatization

Governments on every continent have sold off state-owned assets to private investors in recent decades.¹¹ Airports, railroads, and many other assets have been privatized. The U.S. government privatized some activities during the 1980s and 1990s, but we lag behind other nations in realizing the potential of this type of reform. Germany and the Netherlands, for example, have privatized their postal services, while Chile, Australia, and other nations have privatized their Social Security systems.

The Department of Transportation is a good target for privatization reforms.¹² Rising federal control over transportation has resulted in the political misallocation of funds,

bureaucratic mismanagement, and costly one-size-fits-all regulations on the states. The solution is to devolve DOT activities back to state governments and the private sector.

The federal government should end highway aid, and the states should seek private funding for their highways. Virginia is adding toll lanes on the Capitol Beltway, which are partly privately financed, and that state is also home to the Dulles Greenway, a 14-mile private highway in operation since 1995. Ending federal highway aid would accelerate the trend toward such innovative projects.

The federal government should end subsidies to Amtrak and high-speed rail. Amtrak has a poor on-time record, its infrastructure is in bad shape, and it carries only a tiny fraction of intercity passengers. Politicians prevent Amtrak from making cost-effective decisions regarding its routes, workforce policies, and capital investments. Amtrak should be privatized to save money and give the firm flexibility to operate efficiently. As for high-speed rail, even in countries such as Japan and France virtually all high-speed rail lines are money losers, and they carry only a small fraction of intercity passengers.

The federal government should end aid to airports, which are owned by state and local governments. State and local governments should be encouraged to privatize their airports and have them operate without subsidies. In recent decades, many airports have been partly or fully privatized in major cities such as Amsterdam, Auckland, Frankfurt, London, Melbourne, Sydney, and Vienna.

Finally, the air traffic control system should be privatized. The Federal Aviation Administration has a poor record in implementing new technologies in a timely and cost-effective manner. Many nations have moved towards a commercialized ATC structure, and the results have been very positive. Canada privatized its ATC system in 1996 in the form of a nonprofit corporation, NavCanada, which has a very good record on safety and innovation.

Conclusions

To some policymakers, the sorts of cuts discussed here will seem drastic. But rising debt will eventually force policymakers to make radical budget changes whether they like it or not. However, it would be better to make needed reforms now before the federal government's debt grows even larger.

Policymakers may hesitate to make budget reforms because of concerns regarding possible negative effects. But experience shows that we usually underestimate the ability of individuals and communities to adjust after the withdrawal of government subsidies. Before the 1996 welfare reform, for example, opponents in Congress made apocalyptic warnings about the supposed harm that would come to low-income families. Yet the 1996 welfare reform turned out to be a huge success, as most policymakers now concede.

Other nations have made dramatic fiscal reforms, and they emerged stronger for it. New Zealand, for example, ended virtually all its farm subsidies in 1984, which was a bold

stroke because the country is far more dependent on farming than the United States.¹³ The changes were initially met with resistance, but New Zealand farm productivity, profitability, and output have soared since the reforms.¹⁴ New Zealand's farmers have cut costs, diversified their land use, and developed new markets.

Another example is Canada, which allowed government spending to soar to 53 percent of gross domestic product in the early 1990s. The high spending in turn caused government debt to jump to more than 70 percent of GDP. But policymakers changed course and undertook dramatic reforms, which caused government spending and debt to fall rapidly.¹⁵ The Canadian government cut programs, privatized assets, consistently balanced its budget, and began to pre-fund its retirement system.

There is no reason why America can't undertake similar reforms. Budget cuts would strengthen the U.S. economy and expand personal freedom to everyone's benefit. America became so prosperous because of our system of limited and decentralized government—not because of federal subsidy programs.

Thank you for holding these important hearings. I am happy to help the committee on these issues.

Chris Edwards
Manager of www.downsizinggovernment.org
Cato Institute
cedwards@cato.org

¹ www.cato-at-liberty.org/2009/12/19/george-w-bush-biggest-spender-since-lbj.

² Rep. Paul Ryan (R-WI), House Committee on the Budget, "A Roadmap for America's Future, Version 2.0," January 2010.

³ www.downsizinggovernment.org/agriculture/subsidies.

⁴ Environmental Working Group, Farm Subsidy Database, www.ewg.org/farm. This is a nine-year average, 1995 to 2003.

⁵ www.ers.usda.gov/briefing/wellbeing/farmhouseincome.htm.

⁶ www.downsizinggovernment.org/fiscal-federalism.

⁷ Chris Edwards, "Federal Aid to the States: Historical Cause of Government Growth and Bureaucracy," Cato Institute Policy Analysis no. 593, May 22, 2007.

⁸ www.downsizinggovernment.org/education/k-12-subsidies.

⁹ Chris Edwards, "Number of Federal Subsidy Programs Tops 1,800," Cato Institute Tax and Budget Bulletin no. 56, April 2009.

¹⁰ The 2006 Progress in International Reading Literacy Study included five Canadian provinces, and four outperformed the United States. The 2006 Program for International Student Assessment tested Canadians as a whole, and the nation finished ahead of the United States in science, reading, and mathematics.

¹¹ www.downsizinggovernment.org/privatization.

¹² www.downsizinggovernment.org/transportation.

¹³ Chris Edwards and Tad DeHaven, “Save the Farms—End the Subsidies,” op-ed, *Washington Post*, March 3, 2002.

¹⁴ Vaudine England, “Shorn of Subsidies, New Zealand Farmers Thrive,” *International Herald Tribune*, July 2, 2005.

¹⁵ Chris Edwards, Jason Clemens, and Niels Veldhuis, “Great Right North,” *Washington Post*, May 17, 2009.