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Needed: An Armey Commission on the Budget

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by Murray Weidenbaum

Voting to approve the general idea of a balanced budget is a fine start on the path of fiscal sensibility, but only a start. The really tough job is ahead — to identify the specific spending cuts that should be made and to attract sufficient public support for such tough action. Each of us wants to cut the other guy's pet projects.

We surely know how the United States arrived at this situation. Powerful interest groups push very hard for the particular spending programs that benefit them. Few legislators — or presidents — want to stand up against a strong one-issue group of voters that promises to have a long memory. And for good reason. Cutting or even eliminating any specific program will not close the gap between federal revenues and expenditures. Yet the attempt to do so could well result in the defeat of those identified with the foolhardy effort.

Is there a way out? Perhaps. The solution may lie with the innovative concept designed by Congressman Dick Armey to eliminate obsolete military bases. Under that approach, a bipartisan blue-ribbon commission recommends an array of facilities to be closed, and the Congress has to take an up-or-down vote on the entire package. In this spirit, a bipartisan commission on federal expenditures should develop comprehensive federal program reductions and terminations for the decade ahead. The Congress should be required to vote on the entire proposal, making no exceptions for individual programs.

There would be a great deal of practical advantage to the comprehensive budget-cut approach. It appeals to our basic sense of fairness. When everybody's ox is getting gored, nobody can say that they are being picked on. To put it somewhat more elegantly, we can cite an old Budget Bureau maxim: good budgeting is the uniform distribution of dissatisfaction.

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It would be helpful if the commission proposal was accompanied by a commitment by the Congress not to cancel the planned reductions or to initiate offsetting new spending programs except by a two-thirds vote. My colleague (economist) Richard Vedder notes that, in effect, fiscal policy would be turned over to the blue-ribbon commission in the way monetary policy is assigned to the Federal Reserve System.

Guidelines for Budget Cutting

Let us assume that we have the assignment of preparing guidelines to assist the members of the commission in their arduous task. As someone who has participated in quite a few efforts to cut deficit spending, I know that the most popular formula — eliminating waste, fraud, and abuse — just will not work. Of course, there are numerous individual examples of fraud or waste or abuse. The reports of prisoners who illegally receive social security checks are surely upsetting, and such abuses should be promptly eliminated. Attempts by companies to sell the government shoddy and dangerous products should be dealt with severely. Surely there is no basis or need to contend that everything the feds do is efficient and high-minded.

However, I have not found very significant differences in the level of integrity between the public and private sectors. Each has a full quota of rogues and slackers. The more relevant point is that there simply are not enough proven instances of waste, fraud, and abuse to make a real dent in the budget.

The guidelines for fundamental budget cutting should be substantive and relate to fundamental priorities. Here is one for starters. *For a nation with the low saving and investment levels of the United States, reductions should focus on the large consumption part of the federal budget rather than the small investment component.* Such an emphasis would curb the present tendency for federal deficit financing to be a powerful mechanism for converting private saving into public consumption. There is no need, however, to give a free ride to every item labeled "investment;" my fifth guideline provides some help on that score.

A second guideline is to target the many subsidy programs that provide special benefits to limited — and not especially worthy — parts of the national population at the expense of the national taxpayer.

A third guideline is to avoid funding expenditure programs that are designed to offset problems created by other federal activities, such as regulation. Surely, a more cost-effective way of dealing with the problem is to change the original regulation, etc., that created the problem. To maintain the status quo is to ensure fiscal perpetual motion.

A fourth guideline is to privatize activities which should properly be the responsibility of the private sector. The need here is to go beyond the useful notion of having the private sector produce items under government contract. Although an improvement over relying on government arsenals, this now conventional approach to privatization still leaves the activity in the federal budget. Many goods and services should no longer be paid for by the taxpayer no matter who produces them.

A fifth guideline for sensible budget cutting is to introduce basic economic efficiency considerations in the budget preparation and review process. The key to success is to enforce the use of this guideline. For example, benefit-cost analysis has often been used to sanctify the pork barrel. This has been done by overly generous estimates of benefits and niggardly estimates of costs. As has been done in the case of proposed regulations, the calculations should be reviewed by an independent agency, such as the Office of Management and Budget.

Let us take up each of the five guidelines.

Reducing Federal Consumption-Oriented Outlays

To this economist, deficit financing per se may not always be sinful. At least in theory and like private enterprises, governments can borrow to make useful investments with an attractive future payoff. On occasion, the federal government actually does make worthwhile investments. Many in my generation benefited from the post-World War II GI Bill. The federal government's outlays for our education helped us to achieve careers in which our added incomes generated added tax payments that more than repaid the government's original investment.

Alas, such examples of effective federal investment outlays are rare. Numerous public works projects barely show a favorable benefit-cost ratio even when an unrealistically low cost of capital is used in the estimation process. But that overlooks a more basic point. Virtually the entire increase in federal outlays since 1980 has been in the form of consumption-type spending — aside from defense expenditures and interest on the national debt. As a result, consumption outlays dominate the federal budget. In 1992, federal civilian investment outlays were estimated at only $83 billion out of a total budget of $1.381 billion.

Under these circumstances, large reductions in the budget deficit would seem to be economically beneficial. Generally, a lower deficit should foster economic growth by making more funds available for private investment at the expense of publicly financed consumption.

If that is a hanging offense in the eyes of the proponents of a larger public sector, so be it. Let us suffer the consequences of diminished deficit financing quickly. The Congressional Budget Office makes the same point in somewhat more restrained prose: "The progressive elimination of the federal government's competition for funds in private capital markets would lower interest rates and slightly increase the potential growth of the economy over the next decade."

To carry out a comprehensive reordering of budget priorities, it is necessary to proceed from the general to the specific. By far, the dominant segment of federal consumption outlays consists of transfer payments. I find it interesting to note that the layman's reference to these items has moved from handouts to entitlements.

It is perhaps too harsh to ask why anyone is entitled to a handout from the national Treasury. Unfortunately, in the largest such programs — social security and medicare — the recipients have been led (or should we say misled) to believe that they have earned the money they receive. Each of them has a social security card supposedly representing their individual accounts in the U.S. treasury.

The truth is more complicated. The typical beneficiary has indeed contributed a substantial share of the monthly check issued to him or her by the Treasury. However — a fundamental but universally overlooked "however" — the total of such contributions plus matching employer payments plus interest does not begin to cover the monthly benefit payments. The balance is a gift from the working population. While I was still in the White House, I had the audacity to label that gift as the economic equivalent of welfare. There were immediately calls in the Congress for my impeachment. Ronald Reagan, bless him, ignored such ill-considered responses to telling the truth.

As a private citizen, I feel obliged to repeat that accurate point — that there is a large but hidden welfare component in the major middle class entitlements. It will take an Armey-type blue-ribbon commission on the budget to wrestle with this problem. There are many ways to proceed. Virtually all of them involve facing the hard fact that the customary annual cost-of-living increases (COLAs) which each recipient now expects as a matter of right is nothing that he or she has earned. The COLAs violate the insurance principle that, on average, you get what you pay for.

As a practical matter, it seems impossible to eliminate the annual COLA payments. However, some reduction in their size would make a major contribution to bridging the long-term gap between federal income and federal outgo. A "diet COLA," for example, could be limited to the annual inflation in excess of 2 percent. In explanation, we should note that the average working person is not protected as completely from the effect of inflation as are the beneficiaries of federal entitlements.

A more modest — but not trivial — way of curbing federal consumption-oriented entitlement spending is to eliminate the array of "income-in-kind" benefits, such as food stamps and public housing. It is fascinating to behold the inconsistent positions taken by advocates of these programs. On the one hand, they vociferously oppose any attempt to slow down their growth. On the other hand, they attack any effort to include such income in kind in the official measurement of the number of people living in poverty. The advocates point out — quite accurately — that a dollar of federal spending for these social programs does not generate a dollar of benefits to the recipients who, if they could, would rather spend some of the money on something else.

One champion of these programs admits that food stamps "certainly aren't worth their face value in cash." He suggests that, if these items are included in any measure of poverty, they should be discounted by 20 percent or even 40 percent. For starters, why not give the beneficiaries the cash value and save the Treasury the difference? If that were done, the major complaints would arise from the program administrators rather than from the recipients.

Curbing Special Interest Subsidies

Contrary to widespread belief, especially in the business community, the word "farm" does not always precede the term "subsidy" in the federal budget. Subsidies to agriculture *are* the largest component of the subsidy category. Nevertheless, subsidies to business, labor, and other interests are also provided and often on a generous scale. From the viewpoint of fairness, it is hard to justify subsidy programs which typically provide benefits to above-average income people, quite a few of whom are truly wealthy.

In the cases of direct payments to farm operators (including deficiency and conservation reserve benefits), the wealthiest group of farmers receives an average of more than $61,000 a year each while the poorest group receives less than $500 each. Despite the traditional justification of helping the family farm, 64 percent of farm operators do not receive any such payments. Similarly, 40 percent of the sugar price support program benefits the largest 1 percent of sugar farms; the 33 largest plantations each receive more than $1 million.

Large manufacturing companies also participate in federal subsidy programs. In 1991, taxpayers financed generous overseas advertising programs for selected products: $2.9 million for Pillsbury muffins and pies, $10 million for Sunkist oranges, $465,000 for McDonald's Chicken McNuggets, $1.2 million for American Legend mink coats, and $2.5 million for Dole pineapples, nuts, and prunes.

Labor unions are not exempt from the list of special interest subsidies. The Davis-Bacon Act is a multibillion dollar assist to construction unions which want shelter from competition with lower-cost nonunionized firms. As is true for most nonagricultural subsidies, the benefits are hidden in larger federal appropriations (public works construction, in this instance). The elimination of these subsidies — hidden and visible — would reduce federal spending substantially. Dropping subsidy programs from the federal budget would also raise the efficiency and productivity of the U.S. economy by widening the array of economic activity that is subject to competition in the marketplace.

Regulation Begets Expenditure

An obvious example of the shortcomings in one government activity generating pressure for an offsetting federal expenditure is regulation of the workplace. We can begin by cataloging the different ways in which government rule-making reduces employment. The examples constitute a long list:

1. Equal employment and affirmative action programs. The advertising requirements alone often mean that jobs remain unfilled even in the presence of qualified applicants.

2. Wrongful termination lawsuits which, albeit unintentionally, discourage employers from expanding their work forces.

3. Government-mandated fringe benefits, statutory minimum wages, and compulsory personal leave requirements, which result in higher costs of labor that inevitably reduce the demand for workers.

4. Federal disability insurance, which reduces the supply of labor by making it attractive for injured people to stay on the benefit rolls. Less than one-half of 1 percent of the beneficiaries return to work. This federal expenditure has become an early retirement system.

These regulatory and mandated burdens on the employment process are rarely considered in relationship to the expensive array of government programs that offset their adverse affects by trying to increase the supply of workers or to reduce the direct labor costs to employers. Yet the record of these offsetting programs — ranging from job training to unemployment compensation — is not heartening. The society would be far better off with a combination of regulatory reform and expenditure reductions. Such a targeted and combined effort would also contribute to reducing the gap between federal income and outlay.

Truly Privatizing Federal Activities

National Airport (in Washington, D.C.) and Dulles Airport (in suburban Virginia) are two examples of the federal government's commercial activities which should be sold to the highest private bidder. There is no reason why the federal government should continue operating these airports, especially in view of the worldwide trend of privatizing airports. Likewise, the air traffic controller functions of the Federal Aviation Agency should be privatized. The commercial airlines are willing to pay the fees — likely higher than at present — to have more efficient service. The resultant reductions in congestion and airplane-and passenger-waiting time would more than pay for the transition.

Using Economic Analysis

The use of some basic economic efficiency tests would surely improve the overall effectiveness of federal spending and likely lower the aggregate level. Here are a few examples of what is possible:

Charge competitive, market interest rates for all federally provided credit. That one change will quickly reduce the many demands for federally subsidized lending. Under the status quo, numerous borrowers who could obtain credit on their own are given an incentive to seek federal aid simply because the federal government charges a lower interest rate than commercial banks and other private lenders. Such government competition with the private sector makes no sense.

Use the comparable market rates of interest when evaluating proposed federal investment projects. Unrealistically low interest rates are more than a statistical concern. They result in pulling potential investment funds from the private sector to lower-yield public projects. By definition, such federal spending is inefficient and a poor use of the taxpayers' money.

Include the government's generous fringe benefits in computing "comparability" of pay between federal employees and private workers. The compensation of state and local government employees should also be included in the calculations. The present system biases the calculation of pay standards against the taxpayer.

Conclusion

The federal budget contains a hodgepodge of special benefits, inefficient programs, and low-return outlays. A blue-ribbon commission, like the Armey base-closing commission is needed to objectively identify the low-priority expenditures that should be weeded out. Like the successful base-closing commission, the Congress should decide on the commission's full package of recommendations by a single up-or-down vote. This innovative procedure would prevent the logrolling and attachment of riders, which have resulted in the status quo.

The following five guidelines are suggested for the use by an Armey-style commission:

- Focus reductions on the large consumption part of the federal budget rather than the small investment component.
- Eliminate the many subsidy programs that provide special benefits to limited — and not especially worthy — parts of the population at the expense of the taxpayer.
- Avoid funding expenditure programs that are designed to offset problems created by other federal activities, such as regulation.
- Fully privatize activities which should properly be the responsibility of the private sector.
- Introduce — and enforce — basic economic efficiency in the budget preparation and review process, starting with benefit-cost analysis.