Barron's Prescription for U.S. Economic Growth

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December 24, 2016

"Waste, fraud, and abuse all over the place," intoned candidate Donald J. Trump early this year about government spending. "Look at what's happening with every agency—waste, fraud, and abuse. We will cut so much, your head will spin."

Barron's would like to take the president-elect at his word. So let the head-spinning begin. Our prescription for cutting $8.6 trillion out of the budget starts with the 10-year projections for revenue and outlays from the August report of the nonpartisan Congressional Budget Office (CBO). Against that, we phase in an aggressive plan to reduce that "waste, fraud, and abuse," with striking results.

The CBO's so-called baseline projection shows a flood of red ink over the next decade, with trillion-dollar deficits emerging as the new normal. In contrast, the cuts we apply to baseline expenditures would be enough to balance the budget by 2024, with revenue actually exceeding outlays by a small sum. In 2026, our path would generate a surplus of $64 billion for that year, compared with a $1.2 trillion shortfall resulting from the CBO's baseline.

Our fiscal fix would be achieved without an increase in taxes. That's because, as the CBO makes clear, it "constructs its baseline projections under the assumption that current laws governing taxes and spending will generally remain unchanged." Revenue would rise each year only because the agency assumes continued economic growth, with real gross domestic product climbing at a modest, but steady, pace. In fact, we reduce the CBO's baseline revenue forecast by assuming a tax reduction, since the elimination of spending associated with the Affordable Care Act (ACA) would also require ending ACA-related taxes.

ALL THE HEAVY LIFTING TO ACHIEVE a balanced budget therefore occurs on the spending side. Our wish list requires nearly $8.6 trillion of cuts in outlays over 10 years, of which more than $7.8 trillion would be actual reductions in spending, together with a "dividend" of $725 billion from the lower cost of debt-servicing.

With deficits shrinking, growth in Treasury debt would slow. The CBO projects a 10-year cost of debt-servicing at nearly $4.8 trillion, assuming an increase in the average interest rate on the debt

to a still-low 3.1% by 2026 from 1.8% today. At the same interest rates, our spending cuts trim that cost to a little more than $4 trillion.

In other words, U.S. Treasury debt held by the public will have grown, but far more slowly than the CBO's baseline projection. Instead of rising to 85.5% of gross domestic product by 2026, from 76.6% today, the debt as a share of GDP will have fallen to 58%.

That 58% would still be well above the 39% average over the past 50 years, which means it will still be a source of concern. That's why incoming President Trump should pay heed to former President Bill Clinton's warning at the 2012 Democratic National Convention: "We've got to deal with this big long-term debt problem, or it will deal with us."

Dealing with the problem requires recognizing the path we are on, and why it must be reversed. According to the Long-Term Budget Outlook published by the CBO in July, the debt will reach 141% of GDP by 2046. That's way above its World War II high, and it's expected to continue climbing from there if nothing is done. Indeed, an earlier CBO report compared the risk faced by the U.S. to the debt-related crises in Argentina, Ireland, and Greece.

The agency foresees that "investors would lose confidence in the government's ability to manage its budget." In response, interest rates on government debt could spike abruptly, setting off destabilizing rises in private-sector rates that could cause a financial crisis, which would in turn destabilize the global economy.

That scary scenario looms if the current business-as-usual approach is allowed to continue.

AS A SHARE OF NOMINAL GDP, the CBO's baseline forecast projects widening deficits over the next 10 years (see chart above).
Barron's adjusted the agency's projected baseline revenue by backing out the loss of revenue due to the elimination of ACA-related taxes. But since outlays will have fallen even more, there will be small surpluses beginning in 2024 (see chart above).
In terms of dollar outlays, our $8.6 trillion in cuts will mainly slow the growth of spending, so that revenue eventually catches up and then finally overtakes them. From spending of $3.9 trillion in 2016, we project $4.7 trillion by 2026—still far below the baseline projection of $6.2 trillion.

THE SURGE IN SPENDING foreseen by the CBO is driven by the increase in mandatory programs, "mainly attributable to the aging of the population and rising health-care costs per person, which substantially boost projected spending for Social Security and Medicare." That need not inform our proposed cuts, however—and in fact, more than 40 cents of each dollar of our reductions comes from programs other than Social Security and health care. For example, we propose a decrease of nearly $1 trillion in defense spending over 10 years out of planned outlays on defense of $6.5 trillion.
Barron's projections are also meant to provide some budgetary room for the cost of introducing an alternative to Obamacare. The Republican promise to "repeal and replace" the ACA is only partially reflected here. The cost of the ACA is backed out of total expenditures, for a 10-year saving of $1.8 trillion, and we assume no replacement. However, we also reduced baseline revenue by factoring in full repeal of ACA-related taxes, which comes to a revenue loss of $1.4

trillion over 10 years. Those sums might be restored on the revenue side to cover the cost of a trimmed program—hopefully in the form of taxes that don't include the ACA's excise tax on the makers of medical devices.
One possible replacement might be a program that would be limited to subsidies for purchasing high-deductible insurance for catastrophic care. Such care is designed to help pay for infrequent major expenses, while leaving routine coverage alone.

It's irrational that the ACA has effectively outlawed insurance plans for catastrophic care only. By forcing insurers to cover treatments and procedures that many buyers wouldn't need, the ACA has made such low-cost plans illegal. An insurance plan for catastrophic care might begin to cover costs that exceed $2,500 in any given year. According to one estimate, such a plan would cost a relatively young person less than $100 a month.

The objection might be raised that a government program limited to covering catastrophic care is less than desirable. Indeed it is. But economics, along with politics, is all about the art of the possible. Policies that aim higher will eventually prove too costly to benefit anyone, and would thus be even more undesirable.

IN HIS 1999 STATE OF THE UNION ADDRESS, President Clinton warned: "With the number of elderly Americans set to double by 2030, the baby boom will become a senior boom," leaving the government "unable to pay the full benefits older Americans have been promised." Even if the full benefits could be paid, the cupboard would be bare when the millennials become seniors, prompting Boston University economist Laurence Kotlikoff to brand the baby boomers "the greediest generation."
But since this generation is already advancing in years—the boomers currently range in age from 52 to 70—only so much can be done to scale down benefits without blindsiding them unfairly.

Our cost-cutting proposals, scored in consultation with Cato Institute scholars Chris Edwards and Benjamin Friedman, attempt to root out the waste, fraud, and abuse that largely accrues to entrenched interests such as the garden-variety congressmen who logroll to bring pork-barrel projects to their districts. But we assume our incoming president will pursue aggressive reform, entrenched interests be damned. Our suggestions go after low-hanging fruit from a wide range of programs, departments, and agencies.

Of more than $4 trillion in cuts over the decade in mandatory programs, there is also the previously mentioned $1.8 trillion savings in ACA-related costs. There is a relatively small cut of $170 billion in retirement benefits paid by Social Security, and more than $2 trillion from disability payouts and other health-care programs.

THE FREE-MARKET ECONOMIST Milton Friedman fairly characterized Social Security as consisting of a regressive tax that falls on the first dollar of wages, combined with a pension plan favoring high earners. Accordingly, Friedman marveled that Social Security still had sacred-cow status. Friedman wanted to abolish the system and turn it into a minimum guaranteed income plan for the elderly poor, in the form of a negative income tax—a radical reform that would be a huge cost-saver over the long run.
Instead, we limit ourselves to a plan outlined by the CBO to raise the age of eligibility for full benefits to 67 at a faster pace, and to index initial benefits to prices, rather than wages. As the

system works now, benefits, once granted, are adjusted each year according to a price index, but initial benefits are indexed to wages, which generally rise faster than prices. Applying a price index will slow the growth of initial benefits.

Raising the retirement age more quickly to 67 is also a fairly modest step. When Social Security was inaugurated in 1935, life expectancy was 62 and full benefits were granted at age 65. By that metric, since life expectancy in the U.S. now exceeds 75, the age for full benefits could be pushed to 70 or higher.

Another $400 billion can be saved by phasing in a 25% reduction in spending on disability programs known as SSI, for Supplemental Security Income, and SSDI, for Social Security Disability Insurance, with nearly $300 billion of the savings coming from the latter program. Over the past few decades, the general health of the population has been improving; a smaller percentage of people are doing dangerous work; and the work that is dangerous is getting safer. If anything, then, a smaller share of the population should be on disability.

The opposite is true, however, within each age group. So the surge in disability payments cannot be explained by the aging of the population. The SSDI program "creates a very strong incentive against meaningfully participating in the formal labor market," says Massachusetts Institute of Technology economics professor David Autor, author of the 2011 study, "The Unsustainable Rise of the Disability Rolls in the United States."

As Autor also points out, "There is a very powerful kind of for-profit advocacy component to getting people onto SSDI." Law firms that represent claimants are given a percentage of the take, much like personal-injury lawyers. That might seem reasonable, but the sums involved are large enough to create a special-interest group that has a stake in perpetuating the system. As Autor puts it, "The Social Security Administration each year pays more than $1 billion directly to attorneys that prevail against it on behalf of claimants."

Medicare—medical care targeted mainly at those over 65—is another troubled system. Because it is based on third-party payments, in which the government, rather than the patient, picks up most of the tab, there is an "absence of the normal skepticism we all have when we're the ones paying for something," as David Goldhill observes in his book, *Catastrophic Care*. The result is a plethora of excess care that might actually harm patients.
As Goldhill points out, "30% of spending for colon cancer screening covers people over 75, although the government recommends against testing these people because of the risk of severe complications." Goldhill also notes that "Medicare even pays for screenings for the terminally ill; 15% of terminally ill men were screened for prostate cancer, while a similar share of terminally ill women received mammograms." He observes: "I'm not sure what's scarier—that these suffering people were given tests or that they may have been further treated in response to the results."

NOTHING CAN BE DONE about scary excess care unless there is wholesale reform of the system of third-party payments. But Medicare is rife with "improper payments." Those include funds paid out without proper billing, for uncovered services or patients, or payments in excess of what is legal. Medicare itself estimates that the "improper payment rate" in 2015 was 12.1%.

But that's probably a low estimate, because fraud by its very nature tends to be hidden by its perpetrators.
We assume that, on a phased-in basis, the improper-payment rate can be cut in half, yielding a 10-year saving of more than $400 billion. We also propose increasing the premiums on Medicare Part B (covering physicians' and other outpatient services) and Part D (the prescription drug benefit), to 35% of per capita costs from the current 25%. Boosting the premiums, for which low-income enrollees are subsidized, would yield a 10-year saving of a little over $400 billion. Additional savings of $150 billion could come from boosting the deductibles paid on Medicare coverage.

Another $600 billion would be saved by turning Medicaid, the program that provides health coverage for the poor, into a system of federal block grants—which states could use for a wide array of services—with the funds growing at fixed rate of 2% per year. Currently, the states have a fairly open-ended deal with Washington, which has picked up most of the additional cost of Medicaid spending.

The CBO has pointed out that block grants would lead to greater uncertainty for the states. The Cato Institute's Chris Edwards counters that the welfare-reform bill President Clinton signed into law in 1996 also involved fixed block grants to the states, and gave the states more flexibility in making reforms and cutting costs.

With a similar block-grant structure, states would find a way to allocate the money to the poor who need medical aid. Such incentives are practically reversed under the current system, in which states draw money from Washington almost automatically.

"BILLIONS OF DOLLARS can and will be saved on military (and other) purchases after Jan. 20," Donald Trump recently wrote on **Twitter.**
Our plan trims $950 billion from military spending over 10 years and covers programs such as the one for the F-35 fighter jet, which has suffered cost overruns that are helping to make it the most expensive weapon of its kind. To bring that project under control, for a 10-year saving of $31 billion, we adopt a CBO proposal to cancel the remainder of it and instead build less costly "F-16s and F/A-18s with improved capabilities…that would be able to defeat most of the threats that the U.S. is likely to face in the coming years."

As critics of defense spending have long pointed out, there is a motivation to make weapons systems ever more complex, since complexity justifies greater cost. And there is generally a crony-capitalist relationship between weapons manufacturers and legislators, as part of what President Dwight D. Eisenhower famously dubbed "the military-industrial complex."

"New weapons systems," according to a 2010 letter sent to members of President Obama's now-defunct Bowles-Simpson Deficit Commission, "cost three to 10 times more to buy and operate than the weapons they are replacing." As a direct result, "The cost explosion in new weapons dooms the military services to being unable to buy as many weapons as they had."

This letter, signed by eight men with military backgrounds, including four retired officers, went on to call "the Pentagon's books" a "bureaucratic system that thrives on corrupted, unaudited

accounts," and referred to the "commendable goal of saving money by identifying waste, fraud, and abuse."

One clear case of waste, fraud, and abuse has been the Pentagon's use of half the funds earmarked for Overseas Contingency Operations (OCO)—to be used in the event of war—for base budget operations. By eliminating this misappropriation, we save more than $300 billion over 10 years, while leaving the half of OCO to be used for purposes actually intended.

Another proposed reduction: A phase-out of military bases that protect countries that have long been able to protect themselves, including Germany, Italy, South Korea, and Japan. When candidate Trump spoke of the "military costs" of these bases, he was criticized for not recognizing that the countries being protected do contribute to some of those costs. Factoring in those contributions, Cato's Benjamin Friedman still finds that a phased-in closing would yield a 10-year saving of $121 billion.

Reduced civilian personnel and operation and maintenance costs commensurate with these other cuts could save the substantial sum of $370 billion, according to Cato's Friedman. As Friedman notes, the Pentagon now employs some 55 civilians for every 100 military personnel on active duty, the highest ratio ever.

OTHER PROPOSALS FOR slimming down discretionary spending include the 10-year phase-out and eventual elimination of the Education Department and the Department of Housing and Urban Development, for total savings of $700 billion.
Schooling is not the business of the federal government. The Education Department, created in 1979, was one of Jimmy Carter's worst ideas, and should have been abolished by Ronald Reagan, who spoke of doing so, but did not.

As for the Department of Housing and Urban Development (HUD), nothing very good comes from government involvement in the housing market. HUD was a major contributor to the housing bubble, which battered the U.S. economy and disproportionately hurt the poor.

Cato's Edwards, keeper of the Website DownsizingGovernment.org, also proposes cuts in a whole range of government subsidies of individuals and businesses, for an overall 10-year savings of nearly $1 trillion. The idea that farmers should receive government subsidies makes no more sense than that supermarkets and restaurants should. Yet this form of corporate welfare goes back many decades, with agribusiness receiving about $25 billion a year, along with aid for research, loans, and insurance.

The federal government funds more than 2,300 subsidy programs, Edwards notes, more than twice as many as in the 1980s. He would cut, although not eliminate, subsidies in a range of programs that include agriculture, foreign aid, commerce, energy, and housing. "Government subsidies are like an addictive drug," Edwards observes, "undermining America's traditions of individual reliance, voluntary charity, and entrepreneurship."

Edwards would also cut grants-in-aid from the federal government to the states, for a 10-year saving of more than $500 billion. "The theory behind grants-in-aid," he notes, "is that the federal government can operate federal programs in the national interest to more efficiently solve local problems." In practice, however, the aid system has unleashed waste and abuse—and perhaps

even fraud—as federal legislators scramble to maximize subsidies for their states, with issues of efficiency and fiscal prudence all but forgotten. These cuts would put more of the burden on states and localities to fund their own projects.

DOES TRUMP'S APPOINTMENT of fiscal conservative Mick Mulvaney as director of the Office of Management and Budget indicate that the president-elect plans to put taxpayers' money where his mouth is? "Families across the nation make disciplined choices about how to spend their hard-earned money," Mulvaney stated soon after he learned of his appointment, "and the federal government should exercise the same discretion that hard-working Americans do every day."

To expect politicians to exercise such discretion with other people's money sounds impossible, but laudable. Our proposals are meant as a step toward that goal.