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Principles for lasting federal budget reforms

Long-term balance and growth are within reach.

By Jeffrey Miron

As Democrats and Republicans debate the U.S. debt situation, both sides seem more concerned about pandering to their respective bases than reining in the debt. Worse, much of the discussion addresses only the debt per se, not the broader question of what policies are good for the economy. These conditions are likely to yield only cosmetic fixes, some of which will make things worse over the long haul.

Congress and President Obama should consider the following 10 principles and guidelines for avoiding that outcome.

The debt problem is substantial and pressing: Congressional Budget Office projections show America's debt is exploding. Expenditures are growing much faster than the gross domestic product and tax revenues possibly could. Under the CBO's most plausible projections, the debt would reach 109 percent of GDP by 2023, and 190 percent of GDP by 2035. This is not a problem we can ignore or address with minor adjustments.

Raising tax rates is a bad idea: By reducing the income of households and the profits of businesses, higher tax rates discourage consumption and investment, slowing the economy in the short run. By reducing hiring, savings, and investment, they reduce economic growth in the long run. And higher tax rates are undermined by tax evasion and avoidance, making them an inefficient way to raise revenues.

Reducing tax "expenditures" is a good idea: When the tax code favors particular kinds of consumption or specific industries, it reduces productivity by distorting market forces, just as government spending can. Those who support economic efficiency should therefore oppose such tax expenditures, regardless of how they affect revenue or whether they are paired with reductions in tax rates. Important examples include the mortgage-interest deduction, special tax treatment of employer-paid health insurance premiums, and tax breaks for both conventional and green energy.

Health care is the greatest driver of expenses: The CBO's analysis also indicates that rapidly increasing expenditures on Medicare, Medicaid, and insurance subsidies under Obamacare are the most important factors behind the exploding debt. Serious attempts to control the debt must reduce these programs' growth rates.

Higher deductibles reduce health spending: Slowing the growth of health expenditures is crucial, but not all fixes are created equal. Price controls and rationing, for example, generate huge inefficiencies.

Higher deductibles are a better approach. They not only reduce spending directly; they also

encourage consumers to economize and comparison shop, generating competition, efficiency, and lower costs. This moves Medicare toward insuring against catastrophic costs and away from reimbursing all expenses.

Much spending hurts the economy: The federal budget includes numerous programs that ought to be eliminated regardless of the deficit. Slashing them will not eliminate our debt woes, but it will reduce harm to the economy. Examples include federal spending on agricultural subsidies; Amtrak, high-speed rail to nowhere, and Big Dig-style boondoggles; arts, humanities, and public broadcasting; the Department of Education; the Small Business Administration; NASA; drug prohibition; foreign aid; and more.

The defense budget must be on the table: Federal expenditures should produce benefits in excess of costs. By that measure, it's hard to see how our continuing presence in Iraq, Afghanistan, or Libya makes sense, or why the United States should foot the bill for Western Europe's defense. We could save hundreds of billions of dollars a year without affecting our national security.

Reducing spending won't harm the recovery: Spending on Medicare, Medicaid, and Obamacare should be slowed gradually over decades, not in the next year. In any case, there's no evidence that wasteful spending helps the economy.

The debt is only part of the problem: The United States could improve the economy in many ways independent of the debt outlook. These mainly involve scaling back regulatory excesses that hamper innovation and entrepreneurship. That won't solve the debt problem, but a more efficient economy means a bigger economic pie, which would help.

Cuts don't have to gut the safety net: None of these proposed policy changes would harm the truly needy. They do not touch Social Security, welfare, unemployment insurance, or disability insurance, and they suggest slowing, not gutting, Medicaid spending. The debate is not about the poor; it's about whether Washington or the citizenry controls spending.

The good news here is that there are many ways the United States can shrink its debt and improve its economy. Special interests aside, that would be a victory for everyone.

Jeffrey Miron is a senior lecturer and the director of undergraduate studies at Harvard University, a senior fellow at the Cato Institute, and the author of "Libertarianism, from A to Z."

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