Bill Bonner & Addison Wiggin present
THE DAILY RECKONING

The Entitlement Cliff

By Bill Bonner | 12/20/12

The Welfare States of the Developed World are “long growth.” Without it, their finances are doomed.

First, a little background…

Generally, investors will pay more for a dollar’s worth of earnings from a stock than from a bond. Stocks are riskier than bonds, in the sense that share prices tend to go up and down more, depending on company results. But investors believe this ‘risk premium’ is worth it, because there is more ‘upside’ in stocks; they will grow with the economy. Over the long run, therefore, the rate of return on stock market investing should more or less reflect the stream of dividends received, plus the rate of growth in the economy. If the economy doesn’t grow, however, the risk premium becomes a costly artifact of an earlier age.

Pension and insurance funds, too, count on growth. They collect money. They invest it and make projections based on what they consider a likely rate of return. The difference between what they collect in premiums…and what they need to invest to cover their costs and payouts…is profit. As of 2012, the typical pension fund — such as those operated by state and local governments — was banking on a rate of investment return as much as four times higher than the GDP growth rate. If growth does not pick up, these funds will go broke.

Private households, pension and insurance funds all are on one side of the trade, betting that growth rates will recover to those of the ’80s or ’90s. If so, disaster might be averted. Higher growth rates will permit governments to keep the rate of debt growth in line with revenue increases. But if growth doesn’t recover, public finances all over the planet are doomed.

Over the last 4 years the number of people on disability has risen more than 7 times faster than the number of people with jobs. The number of people on food stamps has increased by 17 million during Obama’s term in office. From the beginning of Obama’s first term to the end of it, approximately 4.6 million jobs disappeared. But the number of additions to food-stamp and disability roles jumped 21.2 million.

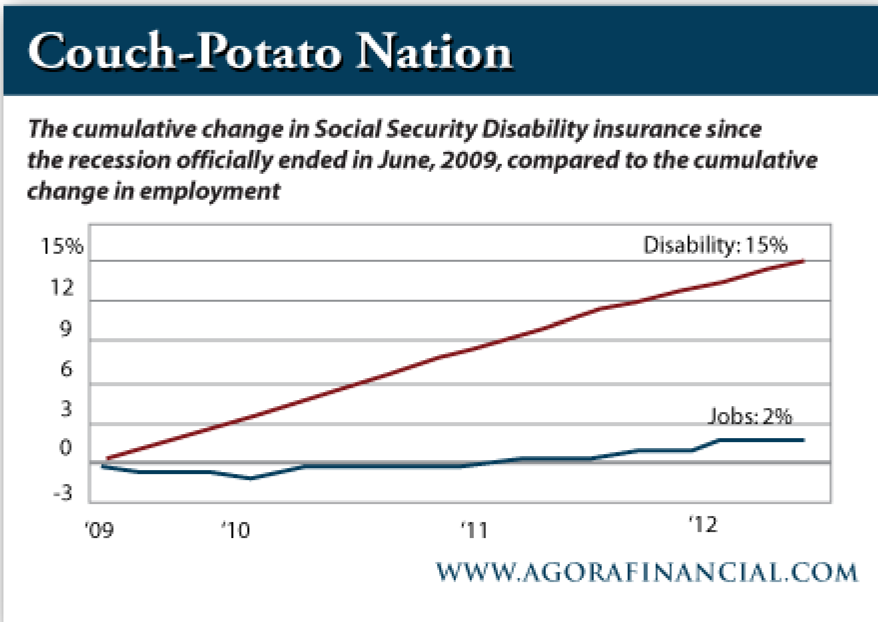
Why were so many more people suddenly disabled? Was there a plague that struck the nation? Were millions crippled in a nationwide auto pile-up? Of course not. Instead, in a low-growth economy, $1,000-a-month without working had begun to look pretty good.

“You get what you pay for,” said Milton Friedman. You pay people to be disabled. You get plenty of them.

Everybody’s worried about the fiscal cliff. But there’s a much bigger cliff coming up, and it’s the **“Entitlement Cliff.”** In the four years since Obama took office, entitlement participants have grown exponentially.
Driving through East Baltimore recently, I saw slews of billboards with ads by shyster lawyers encouraging poor people to get in on disability payments or to sue their employers or their landlords. Here’s one of the billboard ads:

DENIED DISABILITY? Call THE FIRM. The Cochran Firm.

Johnnie Cochran was the lawyer who successfully defended O.J. Simpson. Now his firm has 30 offices around the country helping people get on disability. Apparently, he’s been pretty successful at this too.



More and more people are finding ways to get paid without contributing to useful output. This is just another part of the reason that growth slows: much of the society's energy is diverted to unproductive uses.

I had not gone to East Baltimore for pleasure. I was going there to waste energy. Specifically, the state of Maryland required me to have my auto emissions checked. Practically everyone with an automobile is now required to drive where he doesn't really want to go…wait in a line he doesn't really want to be in…and pay $14 to have his auto emissions checked.

As Bastiat reminds us, there are always unseen consequences as well as those that are obvious. For every 'bad' auto the test uncovers — whose emissions are unnecessarily noxious — many more good autos are forced to drive miles and miles they didn't otherwise have to drive, just to take the test. At the test station I used there were six lines of traffic…about six cars in each line…and each idling its motor while waiting to move forward.

"It's worse than that," my secretary volunteered.

"The test doesn't work on newer cars, or at least some models of them. So, you get there…they take your $14 and they just waive you through."

But emissions testing is now a part of the complex economy. Entire industries are devoted to it. Employees are trained to do it. And lobbyists work hard to keep the whole thing going, whether it really makes any sense or not. Once again, it was Milton Friedman who pointed that "there is nothing as permanent as a temporary government program."

And so, a part of the nation's energy — time, money, fuel, capital, engineering ability — is now taken up by emissions testing. Little of this shows up as government spending. It is the private sector that spends the money. You may think of the security checks in airports if you want to find a parallel. Millions of people spend millions of hours per year — an immense 'investment' of energy — merely keeping people who had no intention of blowing up airplanes from doing so. Or, think of filling out your tax forms. It is a cost imposed by government, but not included in the federal budget.

How much of the economy's energy is sapped by these unproductive activities?

Nobody knows. But it must be a lot. Every business now has its own overseers and regulators. Every one spends time and money complying with complex regulations — many of which did not exist a few years ago.

According to the latest estimate, Americans spend 6.1 billion hours just complying with tax legislation. And think of the new paperwork blizzard Obamacare has imposed. Think of the law firms and accountants who work full time trying to figure out how to comply with Fatca, Dodd-Frank and other financial regulations.

Google Dodd-Frank and you get 5,460,000 hits. Each one is an attempt to understand, influence, implement or comment on this legislation. And most of this activity occurs in the private sector of the economy, where it is recorded as positive increments to the GDP! But it is a huge diversion of resources, taking them away from what might otherwise be useful and productive activity.

An article in Cato Institute's "Regulation" magazine, Fall 2012, shows the cost of the 10 Top Regulations Affecting Small Businesses. These are: Energy Conservation Standards, Affordable Care Act Menu Labels, Transportation's Hours of Service Rule, Affordable Care Act Vending Machine Labels, NLRB's Union Notification Standards, Education's Gainful Employment Rule, EPA's Fracking Regulations, Dodd-Frank Regulation Z, Affordable Care Act Physician Fee Schedule, Dodd-Frank Regulation E. Together these cost small businesses $3.5 billion annually, according to the study. And they add 28.7 million hours of paperwork.

We don't have to decide whether Dodd-Frank or emissions testing or airport screening is good or bad…necessary or unnecessary…we only have to recognize that much of our energy is now spent on things that reduce output. As another measure of how much time and energy is wasted, data from the Mercatus and Weidenbaum centers show that budgets for the main federal regulatory agencies multiplied 14 times between 1960 and 2007, in constant dollars. The payoff from all this extra investment is hard to measure; most likely it is starkly negative.

Nor do we have to single out the US as particularly wasteful. France is worse, with more than 50% of the nation's GDP spent by the government. But all mature economies drift towards unproductive activity like old elephants heading for the burial ground. Either they don't know what happens there. Or they feel compelled to go in that direction anyway.