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It's time to shift spending to states

By Jeffrey A. Miron July 20, 2010 Email This Post Print This Post Post a comment

The U.S. fiscal path is unsustainable, primarily because of out-of-control entitlement spending.

Social Security, Medicaid and Medicare, which currently equal about 10 percent of U.S. gross domestic product, will expand to more than 30 percent by 2085, according to recent projections from the Congressional Budget Office and the Office of Management and Budget. The national debt is estimated to jump from the current 60 percent of GDP to several times the GDP.

The exact numbers depend on a range of assumptions. But under every plausible scenario, both debt and debt service explode under current policy. At some point, therefore, the economy is due to crash unless Washington reins in spending.

One way to avoid this outcome would be to transfer entitlement programs to the states.

This suggestion might seem odd, since states are also in dire fiscal straits. But if the federal government were to eliminate programs, states could collect that tax revenue themselves.

To the question of which level of government should choose the size and shape of entitlement programs, the clear answer is the states. Competition among them would generate better programs and limit the excesses of federal spending.

Conventional wisdom has long held that the federal government must operate welfare, retirement and health programs. Otherwise, the argument goes, states would engage in a "race to the bottom," in which each adopts minimal benefits to keep taxes low and avoid becoming a "welfare magnet." This would, allegedly, leave the poor, sick and elderly without a reasonable safety net.

The reality would be different.

States routinely pursue policies that are more generous than required by federal law. Some set minimum wages well above the federal level, pay higher-than-required unemployment and Medicaid benefits, fund basic research that spills over to other states and impose more restrictive environmental policies.

Thus, states exhibit altruism, contradicting the race-to-the-bottom theory. Thus, most states would, in fact, provide welfare, retirement and health benefits even without federal provision or compulsion.

Before the federal government created Social Security in 1935, 30 states had adopted their own old-age assistance programs. These were far less generous than Social Security and restricted eligibility to the poor who were long-term state residents. True, states might offer less generous programs than the federal government now offers, as occurred when welfare was transferred to the states in 1996. But that exactly is the desired outcome. Why? Because the U.S. safety net is excessive.

Independent of affordability, current levels of entitlement spending are neither fair nor efficient. Washington is operating not a safety net but a golden parachute.

Most entitlement spending goes to recipients who are middle class or higher and could replace entitlement benefits with their own resources — assuming their taxes were not supporting these entitlements. From the efficiency perspective, retirement benefits discourage work effort, and health benefits distort incentives in health care markets.

Slashing entitlements would not just be expedient, given the looming fiscal meltdown; it would be fair and productive.

Cutting benefits is not complicated. A gradual increase in the age of eligibility for Social Security and Medicare beyond 65 would go a long way to restoring fiscal sanity. At the inception of Social Security, average life expectancy was 63 — two years before eligibility began. Now, life expectancy is age 78.

Similarly, higher co-pays and deductibles in Medicaid and Medicare would improve efficiency and lower costs.

The key problem is finding the political will to adopt these policies.

Politicians seem to choose their positions based on the next election cycle. Thus, they typically resist cuts and kick the can down the road. This behavior is understandable, because many voters seem to exhibit the same myopia — simultaneously bemoaning rampant spending while resisting specific cuts.

That is why transferring entitlement programs to the states makes sense. If states were to run their own welfare, retirement and health programs, they might worry that excessive generosity might attract the poor, the sick and the elderly. So they might moderate — but not gut — these programs.

From a political perspective, transferring entitlements to the states seems less draconian than explicitly cutting federal programs — so it has a better chance of adoption.

Scaling back the safety net under state provisions would be gradual and varied, as occurred with welfare reform after 1996.

While nothing can guarantee that states will shrink entitlements to appropriate levels, state provision at least instills a mechanism for moderation. An added benefit would be that state-by-state provision allows variety and experimentation regarding what kind of safety net works best.

Those who believe that current levels of entitlement spending are desirable will probably not find state-level provision attractive — precisely because they agree that it could lead to reduced benefits.

But failure to slash entitlements could mean a bankrupt economy. When that happens, it’s sure to be the poor who suffer the most.

About the Author

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