TIME TO CUT GOVERNMENT SPENDING*

The old bromide that citizens elect Presidents for protection from other people's Congressmen was reversed last November when a Congress was elected for protection from the President. Continued funding and debt ceiling debates will be the first skirmishes in a long battle over the growth of the American welfare state. After jamming through an expansion of spending to levels not approached since World War II, President Obama now calls for increased spending he claims will create jobs and growth (e.g. on infrastructure), and a freeze on nondefense discretionary spending (18% of the budget). He pays lip service to deficit reduction and entitlement reform, ignoring his own Commission's proposals. With the deficit projected at $1.5 trillion, Mr. Obama is on course to add as much debt in one term as all 43 previous Presidents combined in over 200 years. S&P warns of a Treasury downgrade.

A freeze leaves non-defense discretionary spending 20% higher than already-elevated 2008, the level to which Republicans seek a return, and cements in place a huge expansion of government originally sold as a temporary emergency response to the economic and financial crisis. Mr. Obama's Budget Director Jacob Lew asserts the President has made tough choices, pointing to $775 million of proposed cuts here – one-tenth of one percent. The President and his supporters dubiously claim higher spending will quickly strengthen the recovery and generate jobs, the proposed "draconian" cuts will derail them; higher spending, deficits and debt are future problems and, even then, higher taxes (especially on "the rich") won't harm the economy.

A successful society needs an effective government providing functions such as national defense, a social safety net, and large scale disaster response. When it tries to solve every problem, it likely will solve few well. The lazy habit of equating more spending with better outcomes is central to the problem. The federal budget includes immense fiscal cross-hauling, e.g. shipping federal taxes back to the states (after administrative leakage) to spend on things the same taxpayers wouldn't vote state taxes to pay for and collecting taxes and sending transfer payments to the same people at different points in their lives. We pay vast sums to people and firms to do nothing (farm subsidies to take crops out of cultivation) or with harmful effects outweighing any good (ethanol subsidies driving up food prices and damaging the environment). Another look is overdue.

Government spending usually does little to boost the economy in the short run, despite large costs from the eventual higher taxes to pay for the debt. Exhibit number one is the failed 2009 stimulus bill (ARRA). The strongest stimulus case occurs with increased military spending during recessions. The proposed budget cuts this year and next are a fraction of one percent of GDP, mostly nondefense, over two years into recovery, so spending that is not productive on its own is not justifiable.

Infrastructure spending, as the President proposes, is poorly designed for anti-recession job creation policy. Harvard's Ed Glaeser notes that the Obama stimulus (ARRA) transportation spending was not directed to areas with the highest unemployment or the largest housing busts (and therefore the most unemployed construction workers). "It is impossible to create infrastructure quickly and wisely. Good planning takes years." Indeed, the controller of Los Angeles reports receiving $2 million of transportation stimulus per job.

Modern large public infrastructure projects are less labor-intensive, using massive equipment, than historically (WPA workers digging ditches with shovels in the 1930s) or than home building. Federal transportation stimulus spending was just $4 billion in 2009, leaving two problems with claims of "shovel-ready" projects: shovels and ready.

The nation certainly has infrastructure investment needs, but federal infrastructure spending should be based on rigorous national cost-benefit tests. Local officials are happy to have the rest of the country pay for spending on virtually any project, however modest the local benefits. Even so, several states have rejected high-speed rail stimulus subsidies as requiring unwise state spending despite the subsidies (California's estimates have soared).

CBO's more realistic alternative ten-year projection would take the debt/GDP ratio to an astounding 100%. Several recent studies (detailed in my "Why the Spending Stimulus Failed", these pages, December 1, 2010) conclude: 1) such high debt would severely damage growth, so fiscal consolidation at a modest level is essential; 2) it is likely to be far more effective on the spending than the tax side of the budget; 3) substantially higher tax rates and spending cause a permanently lower income many times the temporary fall in the severe recession. **Thus, spending control is vital before debt levels or tax increases risk severely damaging growth for a generation, what would come to be called Amerisclerosis.**

In the 1980s and 1990s federal spending was reduced by over 5% of GDP, to 18.4% in 2000 (a level sufficient to balance the budget at full employment while making the Bush tax cuts and AMT relief permanent). While both cause and effect, it was a remarkable period of sustained economic growth. Mayors and governors, from New York's Rudy Giuliani in the 1990s to New Jersey's Chris Christie today, reform government services while reducing spending. In addition to rolling back Obamacare and rolling up remaining TARP and stimulus funds, core spending control should include these big reforms:

Consolidate, eliminate, voucherize, defederalize with flexible block grants. I pointed out in 2007 that 42% of Federal civilian workers were due to retire in the coming decade. Replacing half (with exceptions for national security and public safety) with technology could improve services and save hundreds of billions of dollars. [The numbers have only grown since then and versions were in the 2008 Presidential campaign, Deficit Commission and Republican Study Group proposals.] Beyond the savings, it would force focus on efficiently targeting services. For example, the many separate job training programs should be consolidated and voucherized to enable citizens to obtain commercially useful training.

Adopt successful business practices where possible and desirable. For example, leading technology executives suggest consolidating IT infrastructure, streamlining supply chains, using advanced business analytics to reduce improper payments, and migrating off expensive custom code to standardized software applications could save more than $1 trillion over a decade while upgrading and improving federal support and information services.

Gradually move from wage to price indexing of initial social security benefits, which would eliminate the entire projected social security deficit without cutting anyone's benefits or raising anyone's taxes. Raise the retirement age in several decades, preserve early retirement and disability, and

strengthen support for the poorest. On Medicare, former Clinton Budget Director Alice Rivlin and House Budget Committee Chairman Paul Ryan propose gradually moving to fixed government contributions to purchase insurance, for large savings and more informed care.

The immense growth of government spending and soaring public deficits and debt are the major sources of systemic economic risk, here and abroad, threatening enormous cost by higher taxes, inflation, or default. The problem is not just one of public debt. A much higher ratio of taxes to GDP trades a deficit problem for sluggish growth. In recent decades, the large advanced economies with the highest taxes have grown most slowly. And the high-tax economies did not have smaller budget deficits; rather, the higher taxes merely enabled higher spending.

Elected officials too often ignore long-run costs to achieve short-run benefits and wait to act until forced, yet government policies can neither revoke the laws of arithmetic nor circumvent the laws of economics. The time to start reducing spending is now.

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* A condensed version of this op-ed was published in The Wall Street Journal on February 11, 2011:
http://online.wsj.com/article/SB10001424052748704843304576126421734322078.html?mod=ITP_opinion_0