Policy Analysis

Cato Institute Policy Analysis No. 194: How to Balance the Budget by Reducing Spending

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Executive Summary

The federal budget can and should be balanced by the end of the decade without any increase in taxes. The Clinton budget, however, which includes increases in taxes and fees that are several times the proposed spending cuts, still leaves a projected deficit of about $300 billion in fiscal year 2000.

In the past decade, we should have learned that the federal deficit leads to some combination of reduced U.S. investment and increased borrowing from other nations, in effect increasing the tax burden on future generations; economic growth will not be sufficient to reduce the deficit without a major change in current federal fiscal policies; an increase in taxes is likely to be counterproductive because it would reduce economic growth and invite an increase in federal spending; and major changes in the main federal programs are necessary to reduce the growth of federal spending.

President Clinton is correct to challenge critics of his proposed budget to identify an effective alternative. This paper summarizes an alternative budget that would be balanced by the end of the decade without any increase in taxes. The major elements of this budget include a substantial reduction of U.S. military forces and the defense budget, two reforms to stabilize the Social Security system without reducing the real benefits of current retirees, several alternative reforms of medical care programs to reduce the increase in the relative prices of and expenditures for medical care, and 50 specific reductions in discretionary domestic programs. A serious effort to balance the budget must sort out our fiscal priorities and constrain federal spending to a level that is broadly supported.

Introduction

The federal budget can and should be balanced by the end of this decade by reducing spending. President Clinton, however, has proposed a budget in which the increases in taxes and fees are several times the spending cuts and that still leaves a deficit of about $300 billion in fiscal year 2000. This analysis summarizes a budget strategy and the specific spending cuts necessary to balance the budget by the end of the decade without any increase in federal taxes.

Most American families, firms, and governments have recently restrained their spending in response to a lower- than-expected growth of income. Most, that is, other than the federal government; real federal domestic spending during the Bush administration increased at a higher rate than during any administration since that of Kennedy. The combination of a rapid growth of federal spending and a slow growth of tax revenues increased the federal deficit from $153 billion in FY89 to an estimated $319 billion in FY93.

Moreover, the long-term projections are even more discouraging. The Clinton administration forecasts a baseline deficit of $390 billion in FY98 and nearly $600 billion in fiscal year 2002 in the absence of major changes in federal fiscal policy or an increase in economic growth. That huge level of federal borrowing would have to be financed in a world where U.S. private saving is expected to stay low and the net saving by other nations is expected to decline.

One might have hoped that this issue would have been addressed in the 1992 campaign, but that did not happen. Both President Bush and Governor Clinton promised to finance their new proposals by offsetting changes, but neither major party candidate offered any substantial proposals to reduce the baseline deficit. Only Ross Perot made a major issue of the federal deficit, but he did not defend the specific proposals of the plan that was prepared for him. The issue will not go away. Several new movements are pressing candidates for Congress for a commitment to reduce the deficit. And only a few more votes in Congress are necessary to approve a balanced-budget/tax-limitation amendment for subsequent ratification by the states.

We should have learned the following lessons from the economic and fiscal record of the past decade:

> A federal deficit does not lead to a corresponding increase in private saving. As a consequence, the federal deficit leads to some combination of reduced domestic investment and increased borrowing from other nations. In effect, we are placing an unjust tax burden on future generations, who had no role in undertaking the debt. This may be appropriate to finance a major war or a temporary increase in public investment, but it is not a viable long-term fiscal policy.

Economic growth will not be sufficient to reduce the federal deficit without a major change in current fiscal policies.

An increase in federal taxes is likely to be counterproductive, by reducing economic growth and inviting an increase in federal spending.

Major reductions in the main federal spending programs are necessary to reduce the growth of total federal spending. There is plenty of "waste" and "pork" in the federal budget, but reducing such waste is neither sufficient nor easier than reducing the major programs. For the most part, wasteful expenditures exist because someone in authority wants them.

The primary implications of those lessons is that we cannot long avoid a major reduction and restructuring of the major federal spending programs. Major state governments have already made such hard choices. The task will not be very much fun for our federal politicians, but if they are not willing to make such hard choices, they are part of the problem and should be replaced.

This analysis makes the case that the federal budget can and should be balanced by the end of the decade by spending reductions, not tax increases. We describe the program changes and the magnitude of the spending reductions that should be considered to achieve this goal. Our proposed changes, of course, are not unique, and other combinations of spending reductions would also meet the goal. The specific set of spending reductions that we propose is based on the following general criteria:

> Maintain mandatory spending. The only types of spending that we regard as fixed obligations of the federal government are interest payments on the federal debt, payments for other goods and services previously supplied, deposit insurance expenditures, and the real pension benefits of retired federal employees and current recipients of Social Security.

Respond to changed conditions. The most important changed condition, of course, is the end of the Cold War. That has primary implications for the appropriate size of the defense budget.

Correct unsustainable conditions. For some years, spending for medical care has increased at roughly twice the rate of GDP. That cannot be sustained, and it is better to correct the condition early.

Reduce high-income benefits. A significant part of federal spending generates benefits for higher income people. Congressional Democrats and President Clinton have made a case for increased taxes on higher income families, but those families already bear a huge share of the federal tax burden. We do, however, propose to reduce the benefits received by higher income people.

Eliminate low-priority programs. This criterion applies to hundreds of unnecessary domestic programs that should be abolished or financed by state and local governments.

Any serious proposal to reduce the deficit, we suggest, should address the implications of each of those criteria. The case for balancing the budget by spending reductions, rather than tax increases, is based on a judgment that the federal government has grown too large and that most people do not get their money's worth from the current level of spending. The popular vote for the presidential and gubernatorial candidates of the incumbent party, for example, generally declines in response to an increase in real per capita spending and taxes since the prior election. Similarly, net migration among the states is generally from high-tax to lower tax states.

Those two patterns are strongly inconsistent with a belief that an increase in government spending is broadly popular. Total government spending is now over $20,000 per household; we doubt that most Americans value the benefits of government spending as much as that cost. Moreover, each additional dollar of federal tax revenue now reduces the output available for private use by over $1.50; we doubt whether there are more than a few federal programs for which the value of the last dollar of spending is worth the additional cost. Ask yourself: should the budget be balanced by reducing government spending or by increasing taxes? We doubt whether many Americans value most federal programs enough to support higher taxes. For that reason, this analysis outlines a plan to balance the budget by scaling down federal spending to a level that would be broadly supported.

The Federal Budget Outlook

Table 1 summarizes the (February 1993) Clinton administration estimate of the FY93 budget and the proposed budget through FY98.

Table 1
The Federal Budget Proposed by President Clinton (Billions of Dollars)

	Fiscal Year					
	93	94	95	96	97	98
Outlays						
Defense	293	277	272	265	249	253
Social Security	305	321	337	351	367	383
Medical	238	265	296	329	362	399
Other	467	469	478	481	495	512
Total	1,303	1,332	1,383	1,426	1,473	1,547
Deposit insurance	7	8	-4	-13	-11	-7
Offsetting receipts	-37	-39	-41	-43	-46	-46
Net interest	202	212	227	243	257	273
Total outlays	1,475	1,513	1,565	1,613	1,678	1,767
Revenues	1,143	1,251	1,323	1,408	1,471	1,526
Deficit	332	263	242	205	207	241
Debt	3,034	3,297	3,539	3,744	3,951	4,192

First, it is important to recognize that the Clinton budget projection probably underestimates future outlays and the deficit. Some of the proposed outlay reductions are dubious, the proposed budget does not include the major health policy package expected in May, and Congress is likely to add other spending in later years. Moreover, total revenues are likely to be lower than projected because the - proposed tax increases would probably reduce economic growth and increase tax avoidance. Table 1, however, is sufficient to convey the magnitude of the spending reductions necessary to balance the budget. Assuming, as a first approximation, that changes in federal spending do not affect economic growth, inflation, and interest rates, total outlays in fiscal year 2000 must be reduced by nearly $300 billion more than in the Clinton budget to balance the budget by the end of the decade. Total program outlays need not be reduced quite that much, because an early reduction of those outlays would also reduce the growth of net interest payments.

Table 1 also makes it clear that a substantial reduction of the major federal programs is necessary to balance the budget by spending restraint; as of FY98, for example, three programs--defense, Social Security, and medical care-- are now expected to be about two-thirds of total program outlays. In the absence of a substantial reduction in the major programs, the level of real spending for all of the other activities of the federal government would have to be reduced by more than 50 percent to balance the budget. And finally, Table 1 illustrates that several dimensions of the federal budget are not sustainable. Medical care, net interest payments, and the total federal debt held by the public are each expected to increase as a percentage of total national output. A "politics as usual" approach to the federal budget would only defer the necessary hard choices, increasing the fiscal problems of the next administration.

This is not the place for a thorough analysis of the Clinton budget. We have yet to see the detailed budget and the major health policy package. And Congress will work its wondrous ways on whatever Clinton proposes. Several major patterns in the Clinton budget, however, should be recognized.

The proposed "stimulus program" would increase the deficit by about $12 billion in FY93; accepting the administration's estimates at face value, that program would cost taxpayers about $50,000 per job created, in a year when total employment is expected to increase by about 2 million.

Through FY97, total defense spending would be reduced by about $76 billion and total domestic spending would be increased by about $36 billion, both relative to the revised baseline. Over the same period, however, total revenues from taxes and fees would increase about $248 billion, again relative to the revised baseline. The proposed increase in taxes and fees, thus, is about $6.20 for every $1.00 reduction in program spending. Moreover, most of the tax increases are front loaded in the early years of the program, and most spending reductions are deferred to later years.

President Clinton is correct to make deficit reduction a major priority of his proposed budget. The primary effect of his budget, however, would be to reduce private spending, not government spending. Total outlays would increase about $300 billion by FY98 plus the amount proposed in the forthcoming health policy proposal. The federal deficit would be about $240 billion in FY98 and would continue to increase in subsequent years. President Clinton has not yet proposed the major changes in the major federal programs that would be necessary to avoid an increase in the relative federal tax burden.

The Path to a Balanced Budget

Surely we can do better. President Clinton has challenged the critics of his proposed budget to be specific about their proposed alternatives. We understand why that is difficult for members of Congress. We are not politicians, however, and are not so constrained.

We propose to balance the budget by the end of the decade by reducing federal spending to a level consistent with the amount of federal taxes that Americans have paid for over 30 years, about 19 percent of GDP. We propose a five-step approach to balance the budget, based on the criteria summarized at the beginning of this analysis:

1. Reduce the level of the defense budget in response to the end of the Cold War.

2. Reduce the rate of increase of real Social Security benefits for future retirees.

3. Sequester 4 percent of the outlays for all other domestic programs in the second half of FY93 and freeze the level of total real outlays for those programs from FY94 through FY98.

4. Reduce the rate of increase in medical programs consistent with the sequester and freeze.

5. Reduce the level of outlays for other domestic programs consistent with the sequester and freeze.

The following subsections make the case for each of those steps and present rough estimates of the consequent budget savings.

National Defense

The Cold War is over. We won. And the Soviet Union has collapsed. We do not now face any substantial military threat to our vital national interests except one, a missile attack on the United States, for which we have no defense. No more dramatic change in conditions could be imagined, but the Department of Defense has been busy fantasizing new missions rather than reducing forces to a level consistent with the new realities. Moreover, the level of real defense spending proposed by President Clinton maintains a much larger military force than is necessary to meet the plausible threats to our vital interests. And Congress has resisted the cancellation of some contracts and the closing of some bases because of concern about local employment. One of the primary reasons for a commitment to balance the budget is to overcome the bureaucratic and political resistance to reducing programs and budgets even when there is a substantial decline in the demand for those programs.

For over 40 years, U.S. military forces have been designed to deter or simultaneously counter one major adversary (the Warsaw Pact) plus one or two minor adversaries in other regions. There is reason to question whether U.S. and allied forces ever had that capability, but fortunately the issue is now moot. The basis for U.S. force planning should now be changed in response to both the collapse of our major adversary and the substantial increase in the capability of allied forces.

Several responsible groups of defense analysts have recently developed proposed U.S. defense programs that would reduce the real defense budget to about one-half the FY92 level by the end of this decade.[1] The proposed programs differ in some details, but they share the general characteristics outlined in the following subsections.

Strategic Forces

Eliminate the land-based multiple-warhead missiles.

Limit the B-1B to carrrying cruise missiles.

Limit purchase of B-2s to the 20 now authorized.

Deploy 17 Tridents, only 9 with D-5 missiles.

Reorient Strategic Defense Initiative research and development to large-area defense against small attacks.

General Purpose Forces

Reduce active ground forces to 6 Army divisions and 2 Marine divisions.

Reduce active tactical air forces to 12 Air Force wings, 6 carriers, and 2 (double) Marine air wings.

Phase out all combat units in other countries.

Substantially reduce the rate of equipment modernization.

Increase the relative reliance on Reserve and Guard forces.

Research and Development. Maintain an active R&D program to assure technological leadership and the ability to deploy new weapons in response to increased threats.

Budget and Active Military Personnel

Reduce Department of Defense budget authority to $175 billion by FY98.[2]

Reduce active military personnel to 1.1 million by FY98.

The proposed forces would maintain a survivable strategic nuclear force, sufficient active forces to meet the types of minor threats that might arise with short warning, and a sufficient mobilization base to respond to a major threat that could only develop over a period of years. The proposed force would not be enough to maintain a global military presence and deploy a force the size of Desert Shield, but there are strong reasons to question whether either of those capabilities is now worth the large cost. American weapons would continue to be the best in the world. And the proposed defense budget would be higher than that of any other nation and much higher (adjusted for inflation) than in any peacetime year prior to the Cold War. The dramatic change in global military conditions since 1989 should make the defense budget a major source of the savings necessary to balance the budget. We propose a graduual phase-down of forces and the defense budget because conditions in the former Soviet Union are too uncertain to allow us to be confident that a major threat will not arise again from that source. The emergence of a major threat from any source, of course, would change this outlook and the appropriate level of U.S. forces. The program changes described above would reduce total outlays for defense (including a small amount by other agencies) to a level about $78 billion below that Clinton proposed for FY98.

Medical Care

For many years, the government has subsidized the demand for and restricted the supply of medical care. The consequence has been a rapid growth of both medical care prices and expenditures. In 1991, for example, the relative price of medical care increased 5.8 percent, and real per capita expenditures for medical care increased 5.2 percent. The cost of health insurance is the most rapidly increasing component of private payrolls. And payments for public medical programs are the most rapidly growing component of government budgets. The Clinton administration forecasts that real federal expenditures for medical care will increase at an 8 percent annual rate for some years.

Our political system, however, appears ready to increase the problem by broadening health insurance to cover the roughly 35 million Americans who are now uninsured. President Bush endorsed a combination of new tax credits and deductions for private health insurance. As a candidate, Governor Clinton endorsed a proposal by congressional Democrats for a "play or pay" system that would require all employers to either provide health insurance or pay an additional 7 percent payroll tax to finance a public plan. Either of those plans would increase the demand for medical care, augmenting the current pressures for an increase in medical care prices and expenditures. Neither candidate proposed a credible plan to reduce the rapid increase in medical prices and expenditures.

The current American system of financing and supplying medical care cannot be sustained. Total expenditures for medical care have increased from about 5 percent to 14 percent of GDP over the past 30 years. The primary reason for that increase is that the direct patient payment share of personal health care expenditures has declined from about 50 percent to about 20 percent over that period. Moreover, the rapid increase in medical expenditures does not appear to have had any significant effect on average health status and life expectancy. There are strong reasons to believe that the value of the additional medical services to the patients is not worth the additional costs. Something must give. Given the dominance of third-party payments, neither patients nor physicians have an adequate incentive to con trol the costs of medical care. No claim on GDP can increase relative to GDP indefinitely. And it is better to correct such unsustainable conditions sooner rather than later.

The demand for medical care will continue to increase in response to an increase in real incomes and the relative size of the elderly population. The primary focus of public policy should be to reduce the growth of demand attributable to tax-subsidized private and public health insurance. Any measure to broaden health insurance to cover those who would otherwise be uninsured should be part of a more comprehensive plan to reduce the average amount of tax-subsidized insurance and to change the nature of that insurance.

What to do? The first lesson is that a substantial part of the tax-subsidized health insurance accrues to higher income people. Higher income people are more likely to be covered by private insurance, and the value of the tax deduction increases with their marginal tax rate. Higher income people on Medicare are more likely to live longer, and the value of that insurance also increases with their marginal tax rate. The implication of this lesson is that the amount of tax-subsidized health insurance could be substantially reduced without much change in the insurance available to the poor.

The second lesson is that the common term "health insurance" is a double misnomer. The event that is insured is not some adverse change in health status; it is the use of some type of medical care. Moreover, most plans are not accurately described as insurance. The basic concept of insurance is to reduce the variance of costs among those with the same prior risks. Most plans, however, include people with very different prior risks in the same premium pool. Such plans are best described as medical prepayment plans rather than health insurance. In effect, those plans redistribute income from people who use few medical services to people who use more medical services, regardless of the prior risks or income of either group.

In summary, a reduction in tax-subsidized medical prepayment plans is necessary to reduce the growth of demand for medical care. The amount of that subsidy should be reduced primarily for higher income people to ensure that they bear a part of the burden of balancing the budget. And third, health plans should be restructured as indemnity insurance, more like auto insurance, under which patients are paid a fixed amount per illness or accident but bear the full cost of compensating providers for whatever medical care they elect. One or more of the following measures should be considered as means to those objectives:

> Limit or eliminate the tax deduction for private health insurance. A limit could be set at some rate, such as $100 a month, that would be sufficient only for a policy with a high annual deductible. In either case, reduce the payroll tax by a corresponding amount; elimination of the tax deduction, for example, would permit a 2.2 percentage point reduction in the payroll tax for all workers and have no net effect on federal revenues.

Replace the tax deduction for private health insurance with a refundable tax credit for a medical IRA.[3] Funds from this account could be used either to purchase a private health insurance policy or to pay out-of-pocket medical expenditures. Any amount in this account that was not spent would continue to accumulate with interest on the balance. After the account reached some balance, say $20,000, the excess funds could be spent for any purpose. In any case, any funds in this account would be private saving and would be included in one's estate at death.

Establish an income-tested deductible for the sum of payments under Part A and Part B of Medicare. This deductible, for example, could first be set at 1.5 percent of adjusted gross income (AGI) in the prior year and then increased 1.5 percentage points each year for four years; beginning in the fifth year, thus, the deductible would be 7.5 percent of the prior year AGI, the same rate as now in the individual income tax code. Payments above the deductible, in most cases, would be fixed payments to the patient per illness or accident. This plan should probably be augmented to pay for one physician visit a year to encourage periodic examinations.

Establish a similar plan with a high income-tested deductible for all Americans, including those who would otherwise be uninsured. This comprehensive catastrophic health insurance plan would replace the current tax deduction for private insurance and the outlays for both Medicare and Medicaid. This plan should probably be augmented to pay for several physician visits a year for pregnant women and infants.

In all cases, firms and individuals would be allowed to buy any other amount and type of health insurance but only with after-tax income.

Each of those measures would reduce the growth of the demand of medical care, the relative inflation of medical services, and total private and public expenditures for medical care. The measures are listed in the order of increasing budget saving. We have not estimated the specific budget savings attributable to each measure, but even the first two measures would generate substantial budget saving, without changing the federal insurance programs, by reducing the relative increase in the price of medical care.

Any of those measures would reduce the growth of outlays for medical care by at least one percentage point a year, so a $55 billion annual saving by FY98 is a reasonable goal. Each of those measures would also reduce the pressure on state budgets for Medicaid that has been due to the rapid increase in the relative price of medical care. Even with such savings, outlays for those programs would increase at a higher rate than for any other major federal program. The more fundamental reforms will someday prove necessary to stabilize total expenditures for medical care as a share of GDP.

Social Security

Social Security has been interpreted as a political contract between the working-age population and those who are now retired. We accept that implicit contract and do not propose to reduce the real pension benefits of those who are now retired. That eliminates the possibility of any substantial saving in Social Security outlays in the near term but should not defer attention to the serious long-term problems of Social Security.[4]

The new administration should consider two major reforms to put Social Security on a sustainable basis. First, the increase in the retirement age that is already scheduled should be accelerated. Beginning in 1994 the retirement age (and early retirement age) should be permanently lifted by two months per year for the next 30 years. That would mean that the age for full retirement benefits would be 66 in the year 2000, 67 in 2006, 68 in 2012, and so on. That would be a substantial step toward cushioning the impact of the demographic time bomb that will explode in the next 20 years when the baby-boom generation begins to retire. Without such a change, the ratio of workers to retirees is expected fall to less than 2 to 1 by the year 2030. Such a dependence ratio would place considerable strain on the economy and a larger burden on today's children--the next generation of workers. If the retirement age had risen at the same pace as life expectancy since the inception of Social Secu rity in the mid-1930s, the retirement age would be about 70 today.

The other recommended change to Social Security is to index the growth in future benefits (technically called the bend points and the earnings history) to the consumer price index rather than wages. The benefit formula determines the starting cash benefit level of each Social Security recipient. If the formula were indexed to inflation, future retirees would still receive increasing real benefits over time, but at a slower rate than is currently projected. Real benefits under the formula would double rather than triple over the next 70 years. That would gradually transform Social Security benefits from a floor on relative benefits to a floor on real benefits, protecting the poor but increasing the incentive of others to save for a higher level of retirement income.

Together, those two reforms would yield only minor savings of $5 billion to $10 billion by the year 2000. But the magnitude of the resulting savings would be hundreds of billions of dollars by the third decade of the next century. Both reforms are essential to avoiding the rapid increase in Social Security tax rates that would otherwise be necessary to finance the system over the next 40 years. Implementing the reforms early is important to give current workers a long time to adjust to the changes.

At some time, it would also be valuable to address a more fundamental reform of Social Security. The next generation of workers will earn a very low rate of return from Social Security, with or without the above reforms. Allowing workers to opt out of the Social Security system in favor of a private pension plan would increase the return on their saving and increase the private saving rate.[5] This proposal, however, would require some general revenue financing to finance the benefits of Social Security retirees, and the case for such reform depends on the amount by which the additional saving increases economic growth.

A Sequester and Freeze

The federal domestic budget has increased rapidly during the past four years. Notwithstanding the rhetoric of savage Republican budget cuts, the rate of growth of the real domestic budget after 1989 was more than 7 percent per year. That was the fastest four-year expansion in the budget in 30 years. Some areas, such as health care and social welfare spending, have grown faster than others, but every domestic program other than agriculture shared in the domestic spending build-up of the Bush years.

Clearly, the 1990 budget deal failed to restrain domestic expenditures. On reason for that failure is that all of the spending reductions were to occur in 1993, 1994, and 1995. Without a new budget strategy for the next four years, Congress may choose to evade the budget ceilings from the 1990 budget deal for 1994 and 1995 or shift savings from the military portion of the budget to the domestic budget.

Domestic programs can and should be cut substantially in the next four years. In contrast to the strategy of the 1990 budget deal and the Clinton budget, our proposed spending reductions should take place sooner rather than later. We recommend that the most realistic approach for long-term spending restraint is for the new administration to adopt the following strategy.

First, President Clinton should call for an immediate 4 percent across-the-board spending reduction, or sequester, effective in the second half of FY93. The sequester should cover all programs, projects, and activities in the domestic budget except Social Security and net interest on the debt. That would require 4 percent reductions in the benefit levels of formula-payment programs. For discretionary programs the sequester would be carried out in much the same manner as the 1986 Gramm-Rudman sequester. The benefits of the sequester would be the following:

The sequester would reduce domestic expenditures by $14 billion in FY93.

The sequester would permanently lower the baseline spending levels for every domestic program other than Social Security. Hence, the savings would magnify in every future year, thus setting a solid foundation for balancing the budget by the end of the decade.

The sequester would signal to the public, Congress, and the financial markets that President Clinton is serious about reducing deficit spending during his administration.

Second, a ceiling on all domestic outlays (other than Social Security) should be established at the projected inflation rate of 2.7 percent per year from FY94 through FY98. Congress would have discretion in allocating funds among programs under the cap. To enforce the overall ceiling, any excess in spending in one year would require a reduction of equal magnitude in the spending ceiling in the next year. That approach would have several benefits. First, since overall spending would be allowed to increase at the rate of inflation, the package may be politically viable. Second, the overall cap would force programs to compete with each other for funding. Congress would be forced to curtail the growth of medical care and other formula-payment programs because if those programs are allowed to grow unimpeded, this portion of the budget will crowd out other domestic spending. During the Gramm-Rudman era of 1986-89, when a similar cap on expenditures existed, formula-payment programs increased at only 1 percent above inflation.

Many changes in current programs, of course, would be necessary to stay within the limits of the proposed freeze on real domestic outlays. The remainder of this section describes the types of changes to the medical programs and other domestic programs that would be sufficient to implement the proposed freeze.

Other Programs

Once a cap on federal expenditures is in place, the president and Congress will need to set priorities in spending. There are hundreds of programs in the federal budget that serve no general interest and should be terminated or financed by state and local governments.[6] Yet in the Bush years, not a single program was eliminated. Only a small handful of programs have been closed down since 1980, despite a growing bipartisan consensus that tens of billions of dollars of savings could be generated by program terminations.

What follows is a detailed list of 50 program terminations and reforms that would yield the savings necessary to produce a balanced budget by the end of the decade. We have chosen these budget reductions not only because they are desirable on policy grounds, but because we believe that they may be politically achievable. For instance, many of the budget changes we list have been recommended in full or in part by former House Budget Committee chairman Leon Panetta, now the director of OMB. Others have been suggested by nonpartisan groups, such as the Congressional Budget Office and the General Accounting Office. The table in the appendix summarizes our proposed list of discretionary budget reforms. It also notes which of those budget cuts have been recommended by Panetta or the CBO. Each recommendation would save at least $1 billion by 1998.

1. End additional U.S. financial support for the International Monetary Fund and the World Bank. The mission of the IMF and the World Bank is to promote international development in less developed countries. After tens of billions of dollars of U.S. investment in those multilateral organizations, there is no evidence that they have had any success in promoting growth in the countries they supposedly are assisting through their lending programs. Often, they give countries precisely the wrong advice, as when they urge tax increases to balance the budget or provide funding for government public works projects.

2. End U.S. foreign aid to Israel and Egypt. Israel and Egypt each receive more than $1 billion in U.S. taxpayer support each year. Considering the huge military budgets of those two nations, and the elimination of the Soviet threat in the Middle East, the case for massive U.S. assistance has been substantially reduced. The United States can and should assist the economies of those countries through free-trade arrangements with both.

3. Eliminate U.S. funding of the Agency for International Development and the Export-Import Bank. Development economist Peter T. Bauer of the London School of Economics has written that the major impact of U.S. international aid programs has been to reward wasteful and irresponsible economic policies in less developed countries. Bauer has found that AID funds often discourage free enterprise, free markets, and local entrepreneurship. But those are precisely the keys to development. Since there is no evidence that AID promotes development, it should be closed down. Similarly, the Export-Import Bank subsidizes exports of major U.S. firms, including Boeing Co., General Electric Co., and Westinghouse Electric Co. A report by the Federal Reserve Bank of Minneapolis concludes that, instead of offsetting other nations' trade distortions, the bank's activities add to them.

4. Cancel the super collider and the space station. The super collider is quickly becoming one of the most expensive public works projects in U.S. history. Increasingly, the scientific community is calling into question the super collider's scientific importance, and almost none of its supports can justify its multi-billion-dollar price tag. Every year the cost estimates for the project have risen-- from an original estimate of $6 billion in 1987 to $11 billion today. Similarly, the scientific benefits of the space station are not expected to come close to matching its $10 billion-plus five-year price tag. The space station has come under criticism from the CBO, the National Research Institute, the Office of Technology Assessment, and many private research groups. It should be scuttled.

5. End Bureau of Reclamation water projects. The Bureau of Reclamation was formed in 1902 to promote the economic development of the arid west. After 90 years, that mission has been accomplished--all too often to the detriment of the environment. There are very few free-flowing rivers left in the West, thanks to the bureau's agricultural irrigation projects. John Baden of the Foundation for Research on the Environment and the Economy says that the government's below-market pricing for bureau water fostered huge inefficiencies in the use of scarce water resources in California and other states.

6. End any net federal land acquisition. The federal government owns more than one-quarter of all the land in the United Sates. Yet each year the Forest Service, the National Park Service, the Bureau of Land Management, and other government agencies spend roughly $1 billion buying tens of thousands of additional acres of land. Well over half of the government's land holdings have no environmental or recreational significance. Massive landholdings by the government are inconsistent with a nation founded on the premises of free enterprise and respect for private property. President Clinton should place an immediate moratorium on any net increases in land holdings and require an orderly auctioning of federally owned land that does not serve any national interest.

7. End all U.S. Department of Agriculture conservation programs. U.S. farmers are far and away the most productive and enterprising in the world. They do not need the federal government's encouragement or subsidies to safeguard the value of their most important asset: their land and soil. Yet each year the federal government spends roughly $1.5 billion to pay farmers to remove erodible land from production. Cato Institute adjunct scholar James Bovard has found that in some cases the taxpayer reimburses farmers as much as three times the rental value of their land if they participate in government conservation programs.[7] The real agenda of those programs is to provide yet another subsidy to farmers, not to promote sound resource management.

8. Terminate all federal wastewater treatment subsidies. For the past 20 years the federal government has provided grants and loans to local governments to build wastewater treatment facilities to comply with federal clean water statutes. That has had two perverse effects. First, the Congressional Budget Office reports that cities have often delayed building such facilities on their own, because they prefer to wait for federal support, even while their wastewater is violating clean water standards. Second, the program has shifted the burden of paying for water cleanup from local polluters to federal taxpayers. Such subsidies thus encourage more pollution, not less.

9. Phase out all agricultural crop subsidies over five years. In the 1980s farm subsidies were the fastest growth area in the entire budget--growing at an even faster pace than Reagan's defense build-up. The U.S. Department of Agriculture

budget ballooned from $4 billion to 1980 to $21 billion in 1989. Those funds subsidize a whole range of commodities: cotton, wheat, wool, and corn. Most Americans continue to believe the popular folklore that crop subsidies benefit struggling family farmers. In fact, most of the money subsidizes huge million-dollar-plus agribusinesses. The USDA concedes that two-thirds of the payments are made to the wealthiest 15 percent of all farmers. Moreover, the net worth of the average farmer today is twice as high as the net worth of the average U.S. family, and the average income of commercial farmers is 25 percent higher. Farm supports are such a vital element of farmers' incomes today that it has become a truism that many farmers now produce for the government, not the market. All major crop subsidy programs should be reduced by 20 percent per year through 1998 then permanently canceled.

10. End federal dairy subsidies. Since 1980 dairy subsidies--which artificially raise the price of milk, cheese, butter, and so on--have cost U.S. consumers an estimated $40 billion. Meanwhile, the federal government has spent $17 billion purchasing excess dairy products--much of which eventually rots in massive government warehouses. The Office of Technology Assessment estimates that because of new technologies and increased productivity, by the end of the century there could be as few as 5,000 commercial dairy farmers left in the United States. If the current program is not ended, taxpayers will soon be providing over $200,000 support per dairy producer in order to pay higher prices for dairy products at the store.

11. End the Export Enhancement Program, the Market Promotion Program, the Agriculture Extension Service, and other obsolete USDA programs. Both the Export Enhancement Program and the Market Promotion Program are intended to increase U.S. agricultural exports. In practice they are simply a taxpayer subsidy to foreign consumers to buy U.S. agricultural products. Moreover, most of the U.S. companies that have benefited form those programs are in no need of federal support. They include McDonald's, Pillsbury Company, Sunkist, and the Ernest and Julio Gallo Winery. Rep. Charles Schumer (D-N.Y.) calls those programs "corporate welfare." The Agriculture Extension Service was formed in 1914 to provide technical farming assistance at a time when more than a third of all Americans lived on farms. Today only 2 percent of Americans are farmers, yet few of the 3,000 field offices have been closed. The agencies now provide courses in such vital fields as home economics, urban gardening, sewing, and gourmet cooking.

12. Reform Farmers Home Administration (FmHA) lending policies. The FmHA administers an array of direct and guaranteed loan programs for housing low-income families in rural areas. It has a woefully poor lending record, even for a government agency, with accumulated losses estimated by the GAO at $60 billion. The delinquency rates on several loan programs reach over 40 percent. Meanwhile, the program continues to encourage further home building in rural areas even though the problem in most rural areas is a surplus, not a shortage, of housing. All FmHA housing lending should be immediately terminated. The FmHA's fast-growing inventory of defaulted properties should be sold. Very poor rural residents in need of housing assistance should be served through a housing voucher program.

13. End all Rural Electrification Administration (REA) lending and subsidies. The REA is the federal government's ultimate anachronism. Created in 1935 to bring electricity and telephone service to rural America, the agency has fulfilled its mission. More than 98 percent of all rural homes now have access to electric and phone service. Yet the agency continues to loan out over $2 billion at subsidized rates to rural electric coops each year. The Treasury is now owed over $8 billion in those low-cost loans. That costly subsidy continues only because of the political clout of the rural electric cooperatives.

14. Terminate Community Development Block Grants (CDBGs), the Economic Development Administration (EDA), and the Appalachian Regional Commission (ARC). After 25 years, federal community development grants and loans have had little success in promoting urban renewal. Some areas, such as Gary, Indiana, have received more than $1,000 per resident in federal aid to build a convention center and other new municipal facilities, yet those areas continue to lose people and businesses. The CDBG and the EDA were supposed to help only distressed areas, but both have been criticized by the CBO for increasingly funneling money to more wealthy and politically powerful areas. The ARC has spent almost $6 billion and built some 2,500 miles of new roads, yet high poverty still persists in the region. The federal government should get out of the business of providing funding for local programs. With few exceptions, the cost of local government activities should be borne entirely by local taxpayers.

15. End Social Security Block Grants (SSBGs), Community Service Block Grants (CSBGs), and Title X Family Planning Grants. The CSBG and SSBG programs are offshoots of President Lyndon Johnson's War on Poverty. They

fund a wide range of job training, employment, health, energy, and child-care services. Virtually all of those are local and state responsibilities and should be funded by those entities, if at all. The primary beneficiary of the funds has been a huge and politically strong human services industry. It not only lobbies for additional funding; it also helps create regulatory barriers, such as licensing or certification requirements for day care and may forms of anti-poverty assistance, that lock out much less costly alternatives for human service delivery. After 20 years, several studies have shown that Title X Family Planning grants have had no success in reducing unintended pregnancies. An estimated $50 million of those grants goes to only a handful of groups, including the National Family Planning and Reproductive Health Association and Planned Parenthood of America. Those groups could certainly raise the funds they need privately.

16. Eliminate the Small Business Administration. The best way for the federal government to help U.S. small businesses is to cut wasteful spending and the excessive taxes that pay for it. The SBA loan programs assist fewer than 1 percent of all small businesses. To qualify for an SBA loan a business must have been turned down for a loan by at least two banks. Not surprisingly, the SBA has a terrible record in selecting businesses to support--as many as 20 percent of its loans go sour in any given year. The SBA does not, of course, create an additional pool of capital for small businesses; rather it redirects capital from enterprises that are likely to succeed to enterprises that are likely to fail.

17. Terminate all earmarked highway demonstration projects. The 1991 highway bill contained $5 billion in highway funding for "highway demonstration projects." There is almost one of those pork-barrel projects for every congressional district. Their only apparent purpose is to get members of Congress reelected. They include funding for a parking garage in Chicago to "demonstrate" that parking facilities reduce on-street parking problems, a new road in rural West Virginia to reduce congestion, and a highway access ramp to an amusement park in Toledo, Ohio. Those projects violate an 80-year-old congressional rule that highway bills should never fund any specific road. That decision is supposed to be made by each individual state. The new Congress in 1993 should wipe the slate clean by defunding every one of those costly and indefensible projects.

18. End subsidies for urban mass transit. Since 1965 the federal government has spent nearly $50 billion on urban mass transit, yet ridership has consistently declined. The 1990 Census reveals that in virtually every city that built an expensive new rail project in the 1980s with federal support, mass transit had a declining share of the commuter market. Two prominent examples of costly failures include Miami's Metrorail, which cost federal taxpayers more than $1 billion to build but carries only 15 percent of the projected riders and is losing over $100 million a year, and Detroit's People Mover, which received $200 million in construction funding from Washington and yet is almost bankrupt today from underuse. In the mid-1980s then-senator William Proxmire gave urban transit subsidies his Golden Fleece Award because he said that they had proven to be a "spectacular flop" and served no purpose other than "playing Santa Claus to America's cities." The program is no better today.

19. Terminate federal airport grants. The federal government should not be subsidizing airline travel. More than 3,000 airports receive federal assistance each year. That spending is paid for primarily through the airline ticket tax. Most of the assisted airports are in small cities, and the major beneficiaries are owners of small private planes-- hardly a financially stressed class of citizens. The grants should cease, and airports that cannot survive without taxpayer subsidies should be closed down or privatized.

20. Reduce Amtrak subsidies by 20 percent per year and then privatize the railroad in 1998. The federal government should not be in the business of running the railroads. Federal subsidies to Amtrak average roughly $25 per passenger trip. Train travel is 20 to 100 times more heavily subsidized on a per passenger mile basis than is travel by automobile, bus, or air. When Amtrak was taken over by the federal government in 1972, it was supposed to receive a temporary infusion of federal funds and then be moved back to private ownership. Now, 20 years later, it is still federally subsidized and is requesting a multi-billion-dollar infusion of additional federal funds for capital expenses. That request for funds should be declined, and Amtrak should be given five years to reduce its costs--by renegotiating outmoded labor rules, by shedding money-losing routes, by improving marketing plans, and by raising ticket prices. Then the railroad should be sold in full or in part through an auction.

21. Reform the student loan program to minimize taxpayer losses. The federal student loan program has quickly

mushroomed into one of the federal government's largest middle and upper income subsidy program. College loans are now a broad-based program available to virtually all students. That explains the program's broad base of support. Today, students can receive student loans for going to bartending school, or for learning hairdressing and cosmetology. The program is taxpayer subsidized because the federal government offers below-market interest rates and does not fully charge for the risks of nonpayment. Default rates on student loans are typically 10 to 15 percent, and the current portfolio of bad loans exceeds $11.5 billion and is mounting. Those losses can be minimized in the future by charging market interest rates on student loans once the student leaves or finishes school, reducing the federal payments to lenders by one-quarter percentage point, and exempting high-school dropouts from student loans. To reduce future demand for the program and place financing responsibilities back on the shoulders of families, a new tax-free college savings account should be established by the federal government.

22. Cut elementary and secondary education funding by 50 percent. The problem with America's schools is not that they are underfunded. In constant 1990 dollars, the schools spent roughly $1,500 per student in 1950, $3,000 per student in 1970, and $6,000 per student in 1990. Moreover, the federal share of elementary and secondary school funding is much larger today than it was in 1950 when the schools were better. Increased federal funding of the schools has been a double-edged sword for the schools, as they have had to subject themselves to more federal guidelines and regulations while sacrificing local autonomy. Federal elementary and secondary education funding should be cut in half, and all remaining funds should be rechanneled to low-income parents in the form of vouchers. School choice is the reform that offers the most hope for innovation and increased productivity in the schools. Federal aid currently inhibits rather than encourages that change.

23. End funding for the National Endowment for the Humanities (NEH), the National Endowment for the Arts (NEA), and the Corporation for Public Broadcasting (CPB). Art and culture play an important role in society. But that is not an argument for government financing of such activities. Most programs of the type funded by the NEH, the NEA, and the CPB should and would be financed entirely with private financing. The clientele for each of those programs tends to be the affluent, who can afford to pay for the programs if they are deemed to be of high quality. The highly controversial nature of much of the programming and many of the projects that receive funding, such as the Mapplethorpe exhibit financed by the NEA, is a further argument for withdrawing taxpayer money.

24. Terminate Impact Aid Part B. Impact Aid compensates local governments for the ostensible cost of educating school children of military employees. Impact Aid Part B is a payment to local districts for the 1.5 million children of parents who work on military bases but do not live there. Those families already contribute state and local taxes to finance schooling for their children. Impact Aid is based on the erroneous premise that military bases are a cost for local communities. Yet the current fierce resistance to closures of obsolete bases demonstrates the value of those bases to local communities. When Hurricane Andrew wiped out a military base in Florida that was supposed to be closed, the community lobbied successfully to have it rebuilt. Given the benefits of military bases to localities in the form of jobs and infusion of funds, there is no reason for additional dollars provided through Impact Aid.

25. Reduce National Institute of Health (NIH) subsidies for overhead expenses. Reports by both the GAO and the CBO have faulted the NIH for reimbursing universities, hospitals, and other outside institutions for excessive overhead expenditures. More than 30 percent of NIH grants pay for costs not directly associated with the research being funded. The recent Defense Department contract scandals at Stanford University have brought to public attention the problem of universities' overcharging for indirect expenses. Now over 250 schools are under investigation by the NIH. Cutting indirect cost reimbursement by 20 percent would not sacrifice valuable biomedical research, but it would give institutions a greater incentive to control costs.

26. Reform the Federal Housing Administration (FHA) mortgage guarantee program. Next to Social Security, the FHA, which insures mortgages on single-family and multiple-family homes, is perhaps the largest middle-income subsidy program in the federal budget. The FHA now controls roughly 55 percent of the mortgage insurance business, because of its attractive subsidies to homebuyers. In recent years, those subsidies have forced federal taxpayers to swallow billions of dollars in losses on defaulted mortgages. At one time, during the depression, the FHA was the only available mortgage insurer. Today, there are many private mortgage insurance alternatives to the FHA. To reduce its future losses and to pave the way toward a gradual exit from the market, the FHA should institute an income floor of $40,000 for all FHA borrowers, require a 6 percent down payment on all FHA loans, and discontinue FHA insurance

of refinanced loans, second homes, and investor properties.

27. Eliminate the Job Corps, the Job Training Partnership Act (JTPA), and Trade Adjustment Assistance (TAA). Federal job training programs for youth and retraining programs for adults have a long history of failure. For example, the Job Corps costs about $30,000 per client, or roughly what it would cost to sent those youngsters to Harvard. The JTPA has a very poor record of successfully training and placing its clients in good-paying jobs. Years of experience indicate that the best job training is on-the-job training. The Job Corps and JTPA often delay workers' entry or reentry into the labor force. The TAA gives workers displaced from their jobs because of foreign competition up to 78 weeks of paid benefits. Yet there is no reason workers who lose their jobs as a result of foreign competition should be entitled to a longer period of government assistance than workers displaced for other reasons. The TAA should be abolished and replaced by the normal unemployment insurance program.

28. Repeal the Davis-Bacon Act. The 1931 Davis-Bacon Act requires construction contractors to pay their workers at least the "prevailing wage" on all federal construction contracts. In practice the prevailing wage has become the unionized wage. It inflates the cost of all the tens of billions of dollars of federal construction contracts by an estimated 30 percent. Moreover, the original purpose of the act was to keep blacks and immigrants from competing with white unionized workers on federal construction contracts. Today, it continues to have that effect. Hence, the law is not only discriminatory in intent but in practice. The CBO, the GAO, the Grace Commission, and many other independent groups have called for the repeal of Davis-Bacon. Doing so would save at least $2 billion per year.

29. Repeal the Service Contract Act, all minority set-aside programs, and Buy America provisions that raise the cost of federal contracts. The Service Contract Act is the counterpart to Davis-Bacon for all federal service contracts. Its prevailing wage requirements inflate the cost of federal contracts by roughly $1 billion per year, by limiting competition from low-cost contractors. Minority contract set asides are a form of affirmative action for federal contractors. They discriminate against nonminorities and add about 10 percent to the costs of federal contracts. Buy America provisions require contractors to use U.S.-made parts on selected contracts, even when lower cost, higher quality imports are available. That form of protectionism does not serve the interests of U.S. taxpayers, just as protectionism generally does not serve U.S. consumers.

30. Cut all agency overhead by 2 percent. The federal workforce grew by 100,000 workers between 1984 and 1992. The federal budget grew by 30 percent in real terms during the Bush years. A 2 percent across-the-board reduction in overhead costs should be easily achievable without sacrificing government services. Most businesses and households cut their budgets by at least that amount in the 1990-91 recession.

31. Cut federal pay by 10 percent. A 1988 Office of Personnel Management report found that the voluntary quit rate in the federal government is consistently lower than in the private sector, even during recessions. Moreover, there is a huge queue of qualified workers waiting to become federal employees. In recent years the wages of federal blue-collar employees have been rising faster than those of private-sector employees. The statistics suggest that the federal government could significantly reduce wages without sacrificing service quality or productivity.

32. Auction the electromagnetic spectrum. The Federal Communications Commission has the authority to license and regulate unassigned frequencies on the electromagnetic spectrum. Currently, those frequencies are assigned through a lottery system, which confers a huge windfall on the winning applicant, who often turns around and sells the frequency rights for a large profit. An auctioning system would be more economically efficient and would reduce the national debt by about $3.5 billion.

33. Lease the Arctic National Wildlife Refuge (ANWR). According to U.S. geologists, ANWR probably contains more oil than any remaining onshore area of the United States. In 1987 the U.S. Department of the Interior estimated that the net benefit to the U.S. economy of developing ANWR could approach $80 billion. Environmentalists have prevented its exploration, even though the area that would be developed would be only a tiny fraction of that vast uninhabited wilderness. If a portion of the revenues raised from ANWR's development were used to create a national wildlife trust fund, the environmental objections to drilling could be surmounted.

34. End all Power Marketing Administration subsidies. The federal government generates electric power at 127 federal dams under the authority of five Power Marketing Admin istrations (PMAs). The PMAs charge below-market rates for

electricity. The subsidies cost the federal government roughly $1.5 billion annually. Underpriced federal electricity powers many affluent neighborhoods and even gambling casinos in Las Vegas. Preferably, the PMAs should simply be privatized and operated as for-profit businesses. If Congress will not allow that, it should at least end the inefficient and costly subsidies to the PMAs.

35. Cut congressional and White House staff and expenses by 33 percent. Since the early 1960s the size of congressional staff has roughly tripled. Committee staffing has grown even faster. In real dollars, the cost of running Congress today ($2.8 billion) is two and a half times what it cost in the mid-1960s. Members of Congress make $120,000 salaries, and more than 350 staffers make at least $100,000. White House salaries often run even higher. Belt tightening in the legislative and executive branches would result in better and less intrusive government.

36. Reduce the U.S. Department of Commerce budget by 50 percent. Other than the functions of the Census Bureau and the Bureau of Economic Affairs, almost none of the activities of the Department of Commerce serve any overriding national interest. Many of its activities revolve around trade promotion, regulation of trade, and economic development. Not only are those inappropriate priorities of government, the Commerce Department has not proven effective in carrying them out. President Clinton should perform a comprehensive review of all the agencies of the Commerce Department and terminate those that are not inherently governmental in nature.

37. Eliminate the U.S. Department of Energy. The U.S. Department of Energy was created by Jimmy Carter in 1977 during the height of the oil crisis. Over the years, the price controls and subsidies of the DOE have cost U.S. taxpayers, consumers, and industry tens of billions of dollars. The length and severity of the oil crisis in the 1970s were directly attributable to the regulatory apparatus of DOE-- namely oil price controls. Other projects, such as the Synfuels Corporation, were multi-billion-dollar flops that never produced a kilowatt of electricity. The lesson of the 1970s and 1980s is that energy markets serve consumers and industry best when the free market is permitted to operate. Finally, about half of the DOE's budget is dedicated to nuclear weapons testing and experimentation. The end of the Cold War has reduced the urgency of such programs. Those that are still vital to national security should be shifted to the Defense Department.

38. End Veterans' Administration health care benefits for non-service-related injuries and illnesses. The original purpose of veterans' medical benefits was to compensate servicemen for combat-related injuries and other illnesses sustained during the time of service. That is an appropriate government compact with the men and women who served in the military. But those health benefits have been expanded to cover impoverished and sick veterans, whose afflictions have no connection with their military service. The CBO reports that in 1987 almost 80 percent of Veterans' Administration health care, including 1.3 million hospital stays and 19 million doctor visits, were for non-service-related medical problems. Those veterans can and should obtain private health insurance coverage.

39. Cut regulatory agency budgets by 25 percent. Federal regulations grew at a rapid pace in the period 1989-93, reversing the anit-regulation policies of Ronald Reagan. At the same time, the budgets of all regulatory agencies grew at twice the inflation rate. That period proved that more money and more regulators lead to more stifling regulation. A 25 percent reduction in the total budgets of regulatory agencies would help eliminate unnecessary and capricious regulation, while forcing agency personnel to concentrte their resources on their highest priority responsibilities. That would unshackle business from frivolous regulatory burdens that have reduced economic growth.

Reducing Federal Entitlement Spending

It is virtually impossible to balance the budget without significantly curtailing spending on what have become known as entitlement programs. Entitlement are programs that automatically provide cash or benefits to individuals who meet the eligibility criteria. The major categories of entitlement are retirement benefits, health care, and welfare. From 1989 to 1992 real entitlement spending increased by $115 billion to $600 billion--a 23 percent increase over inflation. In addition to the health care and Social Security reforms mentioned above, we propose the following spending reductions.

40. Require the states to pay a minimum of 50 percent of the costs of Food Stamps, Aid to Families with Dependent Children, and Medicaid. States are beginning to aggressively experiment with cost reduction reforms in welfare and

health care. The most ambitious of those experiments, designed to get people off welfare in a hurry, have been adopted in Wisconsin under Gov. Tommy Thompson. Unfortunately, cost cutting is often discouraged under the current federal reimbursement scheme, because any welfare or Medicaid expense reductions mean smaller checks from the federal government. One method of spurring innovation in welfare and government health care insurance is to force all states to pay at least half the cost of the Food Stamps, AFDC, and Medicaid programs. That measure should be combined with a substantial reduction in federal mandates to allow state governments increased flexibility to structure the supply of welfare services. Eventually, all government low-income programs should be financed by the states and localities.

41. End military cost-of-living adjustments for personnel retiring before age 62. Neither Social Security nor most private pension programs offer retirement benefits before the age of 62. Yet it is not unusual for military personnel to retire in their 50s. Simply ending cost-of- living adjustments of the pensions of veterans who retire before the age of 62 would save at least $2.5 billion per year.

42. End the lump-sum Civil Service Retirement System (SCRS) option and require federal workers to cover a larger share of the cost of the CSRS system. The unfunded liability of the CSRS has already exceeded $1 trillion, and that debt is growing larger each year. Because many civil servants are also eligible for Social Security, it is not uncommon for a federal retiree to be receiving pension benefits of $75,000 per year. The excessive benefits offered under the CSRS program should be curtailed by eliminating the lump-sum retirement option that allows retirees to withdraw lump-sum payments from CSRS equal to the total of their own contributions to the system, increasing the federal retirement age from 55 to 65, and applying a means test to those retirees who are eligible for both CSRS and Social Security.

43. Replace AFDC, Food Stamps, public housing assistance, the earned income tax credit (EITC), and other welfare programs with a cash assistance program requiring work. The federal government along with the states and cities spends an estimated $180 billion per year on anti-poverty programs. That is roughly three times the amount that would be needed to lift every family now below the poverty level to above the poverty level. Still, the poverty rate in the United States is extremely high. One reason is that a portion of anti-poverty spending finances the welfare bureaucracies and service providers. Milwaukee, Wisconsin, for example, has more than 70 separate welfare assistance programs. America's current fragmented system of welfare delivery serves no one well other than a large and growing welfare industry. AFDC, public housing, Food Stamps, the EITC, and other welfare programs should be merged into a single welfare cash assistance program. The program should have a spending ceiling of 70 percent of the current welfare programs folded into it. All recipients without young children should be required to work in exchange for their monthly checks.

44. Eliminate Food Stamps, public housing, and other welfare benefits for all able-bodied adults. Many states, including Michigan and Massachusetts, have begun to eliminate public assistance for employable adults--a category they have tended to define as those without disabilities or young children at home. Yet many federal programs, including, most prominently, the Food Stamp program, offer benefits to low-income Americans even if they are fully capable of working. Today, for example, roughly 24 million people-- or 1 of every 10 Americans--receive food stamps. The vast majority of those recipients are able to work.

45. Sharply reduce unemployment insurance benefits and delay benefits for one month. Studies have shown that roughly one-third of all unemployment in the United States is a result of the federal government's perverse unemployment insurance system. It rewards those who become unemployed to stay unemployed. Yet in the past two years Congress has made the unemployment insurance system far more rewarding by extending benefits from 26 weeks to 52 weeks or more. Almost all unemployment insurance claimants are able-bodied employable adults. Benefits should be delayed for one month upon layoff or firing, and benefits should be reduced by 5 percent per week for 20 weeks.

46. End all federal child-care subsidies. Only in the past few years has anyone thought of child care, which was once called baby sitting, as a federal responsibility. Yet today the federal government spends roughly $3 billion annually on payments to government child-care centers and subsidies to parents who place their children in private childcare facilities. That means that families with two parents working and a child in day care receive a federal subsidy paid for by parents who make the financial sacrifice of having only one parent working and a mother or father taking care of

the child at home. Financing child care, regardless of what type families choose, is the proper responsibility of parents, not taxpayers.

47. Reduce Head Start funding by 50 percent. The budget for Head Start has climbed by two-thirds since 1989-- after adjusting for inflation. Although Head Start is one of Washington's most popular programs, the evidence for its success is mixed at best.[8] Several studies document that Head Start does offer children a head start, but that this lead over non-Head Start children dissipates after several years in school. The most negative impact of Head Start is that it has created a huge and expanding pre-school bureaucracy.

48. End all new construction of public housing. Even many advocates of public housing now concede that the huge public housing projects built in the 1960s and 1970s were an expensive mistake. Public housing projects became unlivable centers of crime, drugs, teen pregnancy, juvenile delinquency--a vicious cycle of poverty. Yet under George Bush from 1989 to 1992, new public housing starts accelerated. In almost all areas of the country today, the low-income housing problem is one of lack of affordability, not lack of availability. If low-income housing is in short supply in some cities, it is a result of counterproductive government housing policies, such as rent control, building code regulations, and exclusionary zoning. Rather than build more public housing units, the federal government should combat policies that hurt the housing opportunities of the poor.

49. Target all children's nutrition subsidies to families with incomes below the poverty level. The federal government spends $800 million each year on school lunches, breakfasts, and other nutrition subsidies for children of families that are middle class, not poor. In 1988 subsidized meals to home day-care centers cost $250 million--and 70 percent of the children came from families with incomes over $30,000. A strong case could be made for abolishing those feeding subsidies entirely; if they continue, they should provide assistance only to children from families under the poverty line.

50. End low-income home energy assistance. The low- income home energy assistance program was created in the 1970s during the energy crisis to provide subsidies for home heating to low-income families. The energy crisis ended a decade ago. Home heating costs are now at about their pre- OPEC levels. Since the crisis has ended, so should the subsidies.

The table in the appendix to this analysis summarizes the proposed program changes and the estimated savings specific to each measure. The sum of the proposed spending cuts would reduce total spending by about $118 billion relative to the level now projected for FY98.

A final note: we do not necessarily endorse any federal program by its omission from this list. The current federal budget share of GDP is about nine times what it was in 1929, and many of the new programs added since that time merit reconsideration. We invite readers to identify their own least favorite programs to add to our list.

Total Savings and the Budget

The sum of the measures described above would be sufficient to balance the budget by the end of the decade with no increase in taxes. Table 2 summarizes those savings by major category. The defense budget would bear the largest proportionate cuts. The many domestic programs other than Social Security and medical insurance would bear the largest absolute cuts.

Table 2
Proposed Savings Relative to the Clinton Budget (Billions of Dollars)

	Fiscal Year					
	93	94	95	96	97	98
Program						
Defense	0	13	34	50	55	78
Social Security	0	0	1	2	3	4

Medical	0	3	12	23	36	55
Other	18	35	47	53	67	82
Net interest	1	2	5	10	17	27
Total outlays	19	53	99	139	183	246
Revenues	-3	33	34	51	68	65
Deficit	22	21	65	87	115	181
Debt	22	43	108	195	310	491

Many beneficiaries of current federal programs, of course, would regard these proposed cuts as draconian. So be it. After the proposed cuts were made, however, the federal budget would still finance the largest defense budget in the world, maintain the real pension benefits of Social Security recipients, finance a continued substantial increase in expenditures for medical care, and maintain most other domestic programs. Total outlays in FY98 would be 19.5 percent of GDP, a higher share of national output than in any peacetime year prior to the 1970s. And total outlays for domestic programs would be 14.7 percent of GDP, a higher share of national output than in any year prior to the 1980s.

Table 3
The Path to a Balanced Budget (Billions of Dollars)

	Fiscal Year					
	93	94	95	96	97	98
Outlays						
Defense	293	264	238	215	194	175
Social Security	305	321	336	349	364	379
Medical	238	262	284	306	326	344
Other	449	434	431	428	428	67
Deposit Insurance	7	8	-4	-13	-11	-7
Offsetting receipts	-37	-39	-41	-43	-46	-46
Net interest	201	210	222	233	240	246
Total outlays	1,456	1,460	1,466	1,474	1,495	1,521
Revenues	1,146	1,218	1,289	1,357	1,403	1,461
Deficit	310	242	177	118	92	60
Debt	3,012	3,254	3,431	3,549	3,641	3,701

Finally, Table 3 summarizes the path to a balanced budget. The combination of measures described above would yield a deficit of only $60 billion in FY88 and a balanced budget by the end of the decade. Further changes in federal medical programs would still be necessary to put them on a sustainable basis. For the first time in 30 years, however, we would be financing total federal outlays without increasing the tax burden on either current workers or their children. It is not very important to achieve a balanced federal budget every year, but it is very important to try. That is the only way to force a sorting out of our fiscal priorities and to constrain total federal spending to a level that is broadly supported.

Notes

This Policy Analysis is a revision of a chapter prepared in September 1992 and published in the 1993 Cato book Market Liberalism: A Paradigm for the 21st Century, edited by David Boaz and Edward H. Crane. The major revisions reflect the February 1993 estimates of the baseline budget and comparisons with the budget proposed by President Clinton.

[1] The specific force structure and budget described here are from Earl Ravenal, Designing Defense for the New World Order (Washington: Cato Institute, 1991). Other groups that have proposed defense budgets of a similar magnitude incude William W. Kaufmann and John D. Steinbruner, Decisions for Defense: Prospects for a New World Order (Washington: Brook ings Institution, 1991); and the Center for Defense Information "Defending America: A Force Structure for 1995," Center for Defense Information, Washington, February 21, 1992.

[2] This includes a small amount of defense-related spending by other federal agencies.

[3] For the case for medical IRAs, see John C. Goodman and Gerald L. Musgrave, Patient Power: Solving America's Health Care Crisis (Washington: Cato Institute, 1992).

[4] A. Haeworth Robertson, "Social Security's Uncertain Future," in Market Liberalism, pp. 149-57.

[5] Peter J. Ferrara, ed., Social Security: Prospects for Real Reform (Washington: Cato Institute, 1985).

[6] Alice M. Rivlin, a former director of the Congressional Budget Office and now the deputy director of the Office of Management and Budget, has recently recommended devolving almost all federal domestic programs other than Medicaid to the states and local governments. See Rivlin, Reviving the American Dream: The Economy, the States, and the Federal Government (Washington, Brookings Institution, 1992).

[7] See James Bovard, The Farm Fiasco (San Francisco: ICS Press, 1989), for a general indictment of federal farm pro grams.

[8] John Hood, "Caveat Emptor: The Head Start Scam," Cato Institute Policy Analysis no. 187, December 18, 1992.