

# Policy Analysis

No. 515

June 2, 2004

## ***Downsizing the Federal Government***

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### **Executive Summary**

The federal government is headed toward a financial crisis as a result of chronic overspending, large deficits, and huge future cost increases in Social Security and Medicare. Social Security and Medicare would be big fiscal challenges even if the rest of the government were lean and efficient, but the budget is littered with wasteful and unnecessary programs.

In recent years, mismanagement scandals have occurred in many federal agencies, including the Army Corps of Engineers, the Bureau of Indian Affairs, the Department of Energy, the Federal Bureau of Investigation, and the National Aeronautics and Space Administration. Even the National Zoo in Washington has recently been shaken by scandal. The \$2.3 trillion federal government has simply become too big for Congress to oversee.

The good news is that Americans do not need such a big government. Most federal programs are unconstitutional, unnecessary, actively damaging, or properly the responsibility of state governments or the private sector. This study analyzes programs that could be cut to create annual budget savings of \$300 billion. If these cuts were phased in over five years, the budget would be balanced by fiscal year 2009 with all of President Bush's tax cuts in place.

Some reform ideas should be applied throughout the government. Business subsidies should be terminated, and commercial activities should be privatized. Also, federal grants to the states should be scaled back. Currently, a complex array of 716 grant programs disgorges more than \$400 billion annually to state and local governments, which become strangled in federal regulations. That form of "trickle-down" economics is very inefficient.

Such reforms were on the agenda in the Reagan administration and in the Republican Congress of the mid-1990s. But the need for spending cuts is even more acute today because of the large fiscal imbalances that loom from projected growth in entitlement costs. Spending cuts would not just balance the budget; they would also increase individual freedom and expand the economy. All federal spending displaces private spending, but many federal programs actively damage the economy, cause social ills, despoil the environment, or restrict liberty as well.

Given the government's record of mismanaged and damaging programs reviewed in this report, policymakers should be far more skeptical about the government's ability to solve problems with higher spending.

**Chronic mismanagement is a signal that the \$2.3 trillion federal government is too big for Congress to oversee.**

## Introduction

Federal spending has grown rapidly in recent years, rising 35 percent between fiscal years 1999 and 2004.<sup>1</sup> Congress and the president have driven the budget deep into deficit just a few years before the costs of entitlements for the elderly soar when the baby-boom generation starts retiring in 2008.

Rising entitlement costs would be a huge fiscal challenge even if the rest of the federal government were lean and efficient. But unneeded programs are found throughout the federal budget, and mismanagement is widespread. Experts agree that entitlement programs should be overhauled, but the rest of the government also needs major reforms.

Some of the agencies recently making headlines for gross mismanagement include the Army Corps of Engineers, the Bureau of Indian Affairs, the Department of Energy, the Federal Bureau of Investigation, and the National Aeronautics and Space Administration.<sup>2</sup> Even the National Zoo in Washington has been grossly mismanaged in recent years.<sup>3</sup> The Office of Management and Budget's most recent "scorecard" of federal agency performance includes only 8 green grades for good performance out of 130 total grades given.<sup>4</sup> A major report on federal performance by the Senate Committee on Government Affairs in 2001 concluded that the government has "terrible" management and a "staggering" problem of waste, fraud, and abuse.<sup>5</sup>

Some efforts have been made to fix the worst abuses. The Bush administration has tried to improve federal management. Former vice president Albert Gore tried to reinvent government. Congress provides occasional oversight of federal agencies. But major failures continue to occur, and many programs cannot show any beneficial performance results. Chronic mismanagement is a signal that the \$2.3 trillion federal government is too big for Congress to oversee.

The good news is that Americans do not need such a big government. Many federal activities could be performed by the private sector. To pursue lasting reforms, Congress

should examine every agency and ask whether its activities need to be carried out by the government at all. This study focuses on cuts to the nondefense discretionary portion of the budget, which are not intended to be a comprehensive list of possible budget reforms. Indeed, major reforms are also needed in defense and entitlement programs, such as moving to a system of Social Security personal accounts. Such reforms are discussed in other Cato studies.<sup>6</sup>

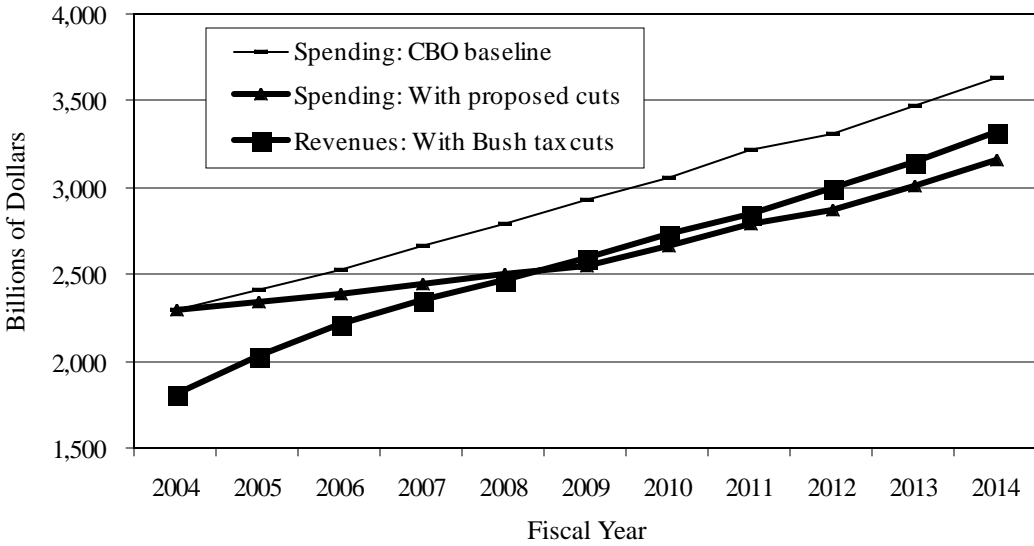
Along with a detailed list of cuts, this study proposes a framework to help policymakers determine which programs should be cut and which of three reform actions should be taken. The reform actions are

- termination,
- devolution to state or local governments, and
- privatization.

Many sources are available for use in determining the best targets for reform. The General Accounting Office provides a steady stream of analyses of wasteful and ineffective programs. The Reagan administration in the 1980s and congressional Republicans in the 1990s targeted many programs for termination.<sup>7</sup> For example, in 1995 the House passed a plan to eliminate more than 200 programs and agencies including the Departments of Education, Energy, and Commerce.<sup>8</sup> Those plans should be revived. Also, there is now extensive foreign experience in privatizing activities such as passenger rail, air traffic control, and postal services.

This study proposes detailed spending cuts of \$300 billion annually. Figure 1 shows that the cuts would balance the budget by FY09 with President Bush's tax cuts in place. The Brookings Institution released a detailed report in January with options for balancing the budget. The report noted that "although tax increases are unpopular with those who favor smaller government, no one has suggested how to achieve balance without them."<sup>9</sup> This study provides a detailed plan for smaller government that balances the

**Figure 1**  
**Proposed Spending Cuts Balance the Budget by 2009**



Sources: CBO March 2004 revenue and outlay projections and author’s budget cut calculations.

budget without tax increases.

Calculations for Figure 1 assume that spending cuts would be phased in over five years and that federal interest costs would fall as the deficit shrank.<sup>10</sup> Figure 1 uses the Congressional Budget Office’s projection for federal revenues assuming that all of President Bush’s tax cuts are in place and made permanent. The CBO’s spending baseline was used as the starting point for the spending projection that includes the proposed spending cuts.

The proposed spending cuts would substantially downsize the government compared to the CBO baseline, but total spending would increase during the next decade because of growth in entitlement programs. This report focuses on cuts to discretionary spending, but Figure 1 illustrates the need to cut both discretionary and entitlement spending if overall spending is to be reduced.

With the president’s tax cuts in place, federal revenues would rise to \$2.595 trillion by FY09.<sup>11</sup> With \$300 billion in spending cuts phased in over five years, overall federal outlays would rise to \$2.553 trillion in FY09, creating a \$42 billion surplus. By contrast, the CBO projects that the deficit in FY09 will be

\$281 billion under the baseline, or \$258 billion under the FY05 Bush budget.<sup>12</sup>

With the proposed budget cuts, spending would fall from 20 percent of gross domestic product in FY04 to 17.6 percent by FY09. Meanwhile, revenues would be 17.9 percent of GDP in FY09 with the Bush tax cuts in place.

By FY14, the proposed spending plan combined with revenues, assuming the Bush tax cuts, would generate a surplus of \$159 billion. By contrast, the deficit would be \$284 billion in FY14 under the Bush budget plan, according to the CBO.

It will be a big challenge for policymakers to make the proposed budget cuts in the next few years. Congress and the Bush administration still do not grasp the huge overspending problem that lies ahead as entitlement costs soar. The administration has called for “better management” of programs but has been loath to actually eliminate any. Pork-barrel programs and business subsidies do not need better management; they need to be terminated. Amtrak does not need better management; it needs to be cut free of the government yoke so it can innovate, cut routes, and maximize profits.

**Congress and the Bush administration still do not grasp the huge overspending problem that lies ahead as entitlement costs soar.**

**By using various tentacles, the federal government leverages its almost two million civilian employees to gain broad control over the economy and society.**

It is realistic and feasible to cut \$300 billion from the federal budget. American society would be better off, and individuals would enjoy greater economic freedom. If enacted, the proposals in this study would not only balance the budget in the near term; they would help defuse the fiscal time bomb of costs of entitlements for the elderly that is set to explode on young taxpayers. As entitlement costs rise, cuts that now seem radical will become a policy imperative.

This report first examines why federal downsizing is needed. The balance of the report discusses the five main failures of government programs that signal the need for termination, privatization, or devolution to state governments. The Appendix contains a department-by-department discussion of program weaknesses and proposed reforms.

## **Why Downsize?**

### **Less Is More**

The federal government will spend about \$2,300,000,000,000 this fiscal year. After taking out the government's core functions of national defense and justice, it will still spend about \$1,800,000,000,000. That amounts to about \$17,000 for every household in the United States. Clearly, the federal government has amassed a huge range of spending programs that go beyond its basic responsibilities.

Indeed, the government is so large that the activities of hundreds of federal agencies are beyond the knowledge of most citizens. The government has become too large for our representatives in Congress to oversee adequately, as scandal after scandal attests. Congress has shown itself incapable of running a \$2.3 trillion organization with an adequate degree of competence. For example, the General Accounting Office has not been able to certify the federal government's financial statements for seven years in a row because of weak accounting controls and mismeasurement of assets, liabilities, and costs.<sup>13</sup>

The government has become big not just in dollar terms; its influence has infiltrated a

vast range of activities that were previously private. Like an octopus, the federal government has eight tentacles that reach out to manipulate society, as illustrated in Figure 2.<sup>14</sup> Those include direct activities of the federal bureaucracy, government purchases, loans, grants to state and local governments, transfer payments and subsidies, regulations, taxes, and stand-alone federal businesses such as the U.S. Postal Service.<sup>15</sup>

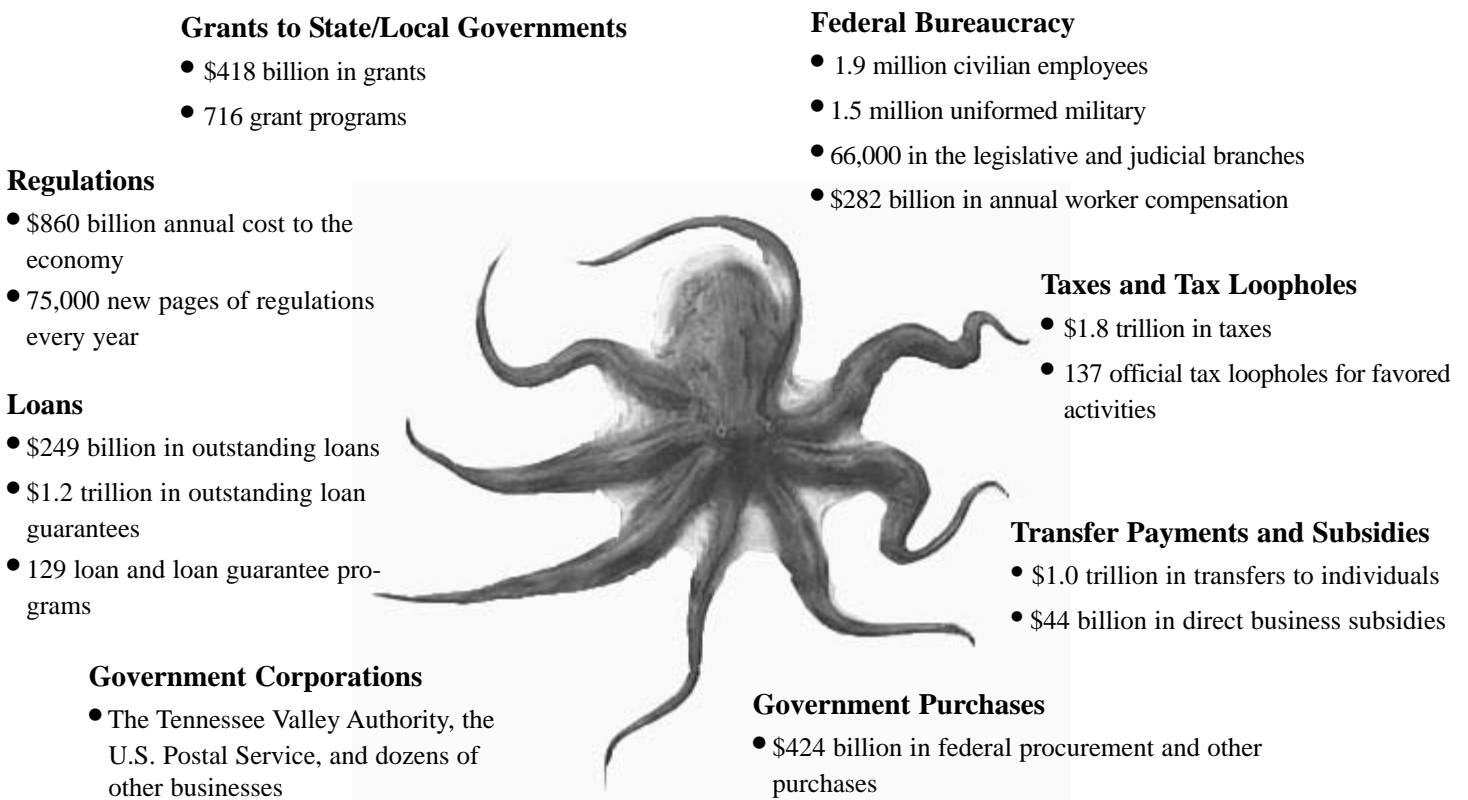
Figure 2 shows that federal spending in FY04 includes \$1.0 trillion in transfer payments to individuals, \$0.4 trillion in government purchases, \$0.4 trillion in grants to state and local governments, and \$0.3 trillion in compensation for federal workers. This report focuses on the spending tentacles: it does not discuss taxation and regulation in detail.

From the perspective of individuals and businesses, dealing with the ever-changing actions of the tentacles is a complex task. For example, businesses play defense as they struggle under the burden of taxes and regulations, but they go on the offense by taking advantage of subsidies, such as grants and loans.

From the perspective of the government, multiple tentacles expand its power over society to the greatest degree within the political and legal constraints it faces. For example, loans and loan guarantees grew rapidly in the 1970s as members of Congress discovered that they could reward favored interests while sidestepping the political constraints on higher direct spending.<sup>16</sup> Similarly, grants (or "grants-in-aid") to the states allowed the federal government to circumvent traditional concerns about expansion of its power over state activities. Grants allow federal politicians to become do-gooder activists in areas such as education while shoveling cash into state coffers to muffle concerns about federal encroachment.

By using the various tentacles, the federal government leverages its almost two million civilian employees to gain broad control over the economy and society. For example, federal procurement turns private-sector workers into government-directed agents. Federal grants turn state and local government workers into tools of the federal government. The Brookings

**Figure 2**  
**Tentacles of the Federal Government: The Reach of Government in 2004**



Sources: Author’s compilation based primarily on the *Budget of the U.S. Government, FY 2005*, and U.S. Bureau of Economic Analysis, *Survey of Current Business*, March 2004, p. 23. All data are for FY04.

Institution’s Paul Light set out to determine how many people were in the federal government’s “shadow workforce,” which includes those who are not in the civil service but perform government-directed work.<sup>17</sup> For 2002, Light found that the total federal workforce was 16.8 million, including 1.76 million in the civil service, 5.17 million contractors, 2.86 million employed through grants to private organizations, 4.65 million employed through grants to state and local governments, 0.88 million in the U.S. Postal Service, and 1.46 million in the uniformed military, as shown in Table 1. (By FY04, the number of workers in the civil service had risen to 1.86 million.)<sup>18</sup>

Americans would be better off if the size, scope, and complexity of the federal government were reduced and they received a more

limited range of better quality federal services. The federal government has become like a bloated conglomerate corporation that is involved in so many activities that corporate executives are distracted from core mission areas. For example, the Bush White House at the highest levels was spending substantial time and effort in 2001 helping out Enron Corporation on an investment in India that had gone bad.<sup>19</sup> When the *Washington Post* reported that in 2002, the administration argued that it was just performing routine business to help guard taxpayer interests in the \$640 million in federal loans that had been given to Enron for the project.<sup>20</sup> However, the fundamental problem was with involving taxpayer money in such a risky foreign scheme to begin with.

**Policymakers are usually too busy dishing out special-interest spending and intruding on state functions to focus on national security problems.**

**Table 1  
Federal Workforce Including Shadow Workforce, 2002**

Federal civilian workforce	1.76 million
Federal contractors	5.17 million
Federal grant-created jobs	2.86 million
State and local workers doing federal business	4.65 million
U.S. Postal Service	0.88 million
Uniformed military personnel	1.46 million
Total workers doing federal activities	16.8 million

Source: Paul C. Light, "Fact Sheet on the New True Size of Government," September 5, 2003, [www.brook.edu/gs/cps/light20030905.pdf](http://www.brook.edu/gs/cps/light20030905.pdf).

Consider that, a year and a half after the 9/11 tragedy, the GAO reported that nine different government agencies still had a dozen different terrorist "watch lists" that were not easily comparable.<sup>21</sup> The GAO concluded that the watch list system was "overly complex, unnecessarily inefficient, and potentially ineffective."<sup>22</sup> The problem had still not been fixed by early 2004.<sup>23</sup> Americans deserve better than that. Unfortunately, policymakers are usually too busy dishing out special-interest spending and intruding on state functions to focus on national security problems. Indeed, the *Washington Post* recently reported that most members of the House and Senate intelligence committees have been too busy with other political and policy activities to read crucial terrorism reports or hold oversight hearings to rectify problems in the intelligence agencies.<sup>24</sup>

Modernist architects argued that "less is more" in building design. The same is true in government design. Many poorly performing corporations have shed extraneous activities in recent years to refocus on "core competencies." The federal government should do the same. Reforms should focus on shedding the noncore functions of the government so that Congress and the administration can concentrate on delivering high-quality basic services such as national security.

**Making Room for the Elderly Spending Explosion**

Modest spending constraint, a falling defense budget, and a strong economy pro-

duced the first federal budget surplus in 29 years in FY98. But fiscal responsibility did not last long, and a gaping deficit appeared just four years later in FY02. The budget deficit for FY04 will be a record \$477 billion, with large deficits expected for years to come.<sup>25</sup>

Most of the recent run-up in spending has been in the discretionary budget—those funds that are annually appropriated by Congress. This study focuses mainly on cuts to that part of the budget, which represents 7.8 percent of GDP. The proposed cuts would reduce that by 2.6 percent of GDP, enough to eliminate the deficit with the Bush tax cuts in place for at least the next 10 years.<sup>26</sup>

The proposed cuts would also begin tackling the bigger fiscal problem of making way for the coming cost explosions in Social Security and Medicare. The number of retired Americans will grow rapidly in the next few decades—by 2030 the number of Americans aged 65 and older will rise by 96 percent, while the number of workers to support them will rise only 18 percent.<sup>27</sup> That will create a severe budget strain because Congress has made generous promises to future retirees without any plan to pay the cost. In addition to programs for the elderly, growth in Medicaid will add to the budget squeeze with an expected annual growth rate of more than 8 percent after 2008.<sup>28</sup>

The nation is on a financial collision course, and Congress will be forced to make radical changes sooner or later. If the overall

size of the federal government is limited to 20 percent of GDP as it is today, then unreformed Social Security, Medicare, and Medicaid will consume nearly 80 percent of the budget by 2040.<sup>29</sup> The fiscal collision course is also evident in the size of unfunded promises that Congress has made. In addition to today's federal public debt of \$3.9 trillion, taxpayers may be on the hook for \$2.9 trillion in federal employee retirement benefits, \$1 trillion in veterans' benefits, \$3.6 trillion in Social Security benefits, \$15.6 trillion in Medicare benefits, and \$7 trillion in the new Medicare drug benefits.<sup>30</sup>

The only realistic way out of the coming budget squeeze is to reform entitlements and cut discretionary programs. The \$300 billion in cuts proposed in this study would be an unprecedented reform, but it will make sense to more policymakers as gushers of red ink continue to flow in coming years. Besides, \$300 billion in budget cuts is hardly radical when one considers recent growth in the federal budget. Total outlays increased from \$1.9 trillion in FY01 to \$2.3 trillion in FY04. Thus, the cuts proposed here would not even be as large as three years of spending increases under President Bush.

### **Government Spending Displaces Private Spending**

To support its huge array of programs, the federal government extracts about \$2 trillion in taxes from families and businesses each year. That extraction comes at an enormous cost. Most obviously, every dollar the government spends is one dollar less for the private sector to spend. The more tax money is extracted from individuals, the less they have to spend on food, clothing, housing, and other needs. The more tax money is extracted from businesses, the less they can spend on research, investment, and expansion, to the detriment of the nation's economic growth.

The costs of a large government do not end there. Every added dollar of federal spending costs the private sector more than just a dollar. Taxes cause economic distortions by changing relative prices and divert-

ing resources into less productive uses. The costs created by those distortions are called "deadweight losses."<sup>31</sup> Economic research indicates that deadweight losses cost the economy 25 cents or more of each added dollar of federal revenue.<sup>32</sup> Thus, government programs that do not create benefits at least 25 percent greater than their tax costs make no economic sense.

Many academic studies have found that deadweight losses of additional taxes are much larger than 25 percent. Harvard's Martin Feldstein concluded that "the deadweight burden caused by incremental taxation . . . may exceed one dollar per dollar of revenue raised, making the cost of incremental governmental spending more than two dollars for each dollar of government spending."<sup>33</sup> Thus, a new \$1 billion NASA spacecraft could cost the private sector more than \$2 billion.

As the government grows larger, higher taxes reduce the rewards to work, savings, entrepreneurial activity, and business investment. Consider a working person who is considering launching a side business to earn extra income. If the government raises tax rates and dissuades her from those plans, the nation loses the added production and the innovative ideas that she could bring to the economy. As federal spending rises, taxes are pressed upward, and many such private opportunities are suppressed.

It is doubtful that most federal programs create benefits as large as those of the private-sector activities they displace. Consider the effects of federal crop subsidies of \$17 billion that will go directly to farmers this year.<sup>34</sup> First, the subsidies add \$17 billion to the farm economy but destroy \$17 billion of activity elsewhere as resources are shifted into farming. Second, extracting higher taxes to pay for the program creates deadweight losses costing at least another \$4.25 billion (or as much as \$17 billion if Feldstein is correct). Third, the subsidy program itself may cause further damage. For example, farm subsidies are thought to harm the environment by causing excessive use of fertilizers

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and overuse of marginal farmland that would otherwise be forests or wetlands.

To conclude, higher taxes and government spending crowd out the private agendas of families and businesses, causing resources to flow to activities chosen by the political elite rather than by Americans themselves. There is a high hurdle that needs to be cleared for government programs to make any sense, given the private-sector damage that is caused by funding them.

## **Are Programs Constitutional?**

This study focuses on the economic and practical failures of federal programs, but in sorting out which programs should be cut, policymakers should first consider whether programs are authorized by the U.S. Constitution. The Constitution established a federal government of limited powers. Those powers are enumerated in Article I, section 8, which allows for spending mainly on security-related functions, such as establishing courts, punishing crime, and maintaining an army and a navy.<sup>35</sup>

Despite the straightforward limitations created by the Constitution, the Supreme Court has accepted ever-looser readings of the limits to federal power. Since the 1930s spending has flowed into any area that has happened to suit the immediate whims of federal politicians. Today, the government funds a vast range of activities that violate both the letter and the spirit of the Constitution, even if the Court fails to enforce the original legal controls on federal authority.

The Constitution’s Commerce Clause has been expanded far beyond what the Framers envisioned. Written to ensure the free flow of “commerce among the states,” it was meant to limit state governments, which had begun erecting protectionist barriers to trade.<sup>36</sup> Since the New Deal, that interpretation has been turned on its head by the Supreme Court. The clause has served as an excuse to expand federal regulatory power over any-

thing that has a vague relationship to interstate commerce. Instead of acting as a brake on government power as originally intended, the clause has been used to expand government power over the economy.

Recently, however, the Supreme Court has begun to rediscover the limits on the Commerce Clause. In *United States v. Lopez*, the Supreme Court ruled that Congress exceeded its constitutional authority by outlawing the possession of guns near schools.<sup>37</sup> That was the first time in more than 60 years that the Court acknowledged that there are limits to the commerce power.<sup>38</sup>

The General Welfare Clause of Article I, section 8, is also said to provide a justification for much of today’s \$2.3 trillion federal budget. But the clause, as understood by James Madison and other Founders, was meant to ensure that spending on enumerated ends was for the broad benefit of Americans, not for narrow groups of citizens.<sup>39</sup> Unfortunately, expansive interpretations of the clause by the Supreme Court in recent decades have allowed Congress to establish many programs that are not to the general benefit of Americans at all. Today, much federal spending targets certain businesses and individuals and is not for the “general welfare.”

To provide one small example, two federal agencies provided loans of more than \$1 billion to Enron Corporation during the 1990s for risky overseas projects.<sup>40</sup> That spending was clearly aimed at a narrow interest and not the general interest. Aside from being constitutionally dubious, such narrowly targeted spending schemes usually do not make practical sense—in this case, large firms have easy access to private financing and do not need government loans.<sup>41</sup> This report focuses on practical problems with such spending, but the deeper problem is that such programs do not pass constitutional muster either.

Members of Congress take an oath to uphold the Constitution, and they should start taking that oath seriously. Too often Congress either ignores the Constitution or casually inserts boilerplate language into legislation to claim authority—under the



Commerce Clause, for example. Instead, when a questionable program comes before them, members of Congress should ask whether there is constitutional authority for it and vote against it if it violates the fundamental law of the land.

## Federal Programs: Five Reasons for Reform

Regard for the Constitution has not been a sufficient reason for members of Congress to control federal spending. Therefore, this study provides policymakers with a framework to use in addressing the practical problems that confront many programs. A federal program may have any of five types of problems that would justify its elimination:

1. A program is wasteful. As defined here, that means it has high levels of fraud and abuse or is duplicative, obsolete, mismanaged, or ineffective.
2. A program is an unjustified redistribution of wealth.
3. A program actively damages society, for example by distorting the economy or reducing individual freedom.
4. A program's function would be better performed by state and local governments.
5. A program's function would be better performed by private businesses or charities.

This study identifies more than 100 feder-

al programs and two major departments that possess one or more of those deficiencies. Depending on the problems with each program, one of four reform solutions may be appropriate: restructuring, termination, devolution to state governments, or privatization. Table 2 illustrates the relationship between problems and solutions.

Row 1 in the table includes such programs and agencies as NASA, which is both obsolete and mismanaged. NASA's activities should be privatized to the extent possible, then the rest of the agency should be terminated. This study focuses on programs that can be ended entirely and does not address program restructuring, which may be appropriate in some cases for proper federal functions such as defense.

Row 2 includes federal subsidies to individuals and businesses that make no economic or moral sense, such as farm subsidies. Whether or not such subsidy programs are well managed or efficiently delivered is beside the point. Congress should cut programs that have no purpose other than to transfer money to narrow special-interest groups.

Row 3 includes programs that restrict individual freedom, damage the economy, harm the environment, or hurt society in other ways. One example is antitrust enforcement by the Department of Justice and the Federal Trade Commission, which restricts commercial freedom. While the federal antitrust bureaucracy will cost \$215 million in FY04, the negative economic impact could be much larger if the agency blocks mergers

**A federal program may have any of five types of problems that would justify its elimination.**

**Table 2  
Program Problems and Reform Solutions**

Program Problems	Reform Solutions
1. Wasteful (fraud and abuse, duplicative, obsolete, mismanaged, or ineffective)	Restructure, terminate, devolve, or privatize
2. Unjustified redistribution	Terminate
3. Actively damaging	Terminate
4. State and local function	Terminate or devolve
5. Private function	Terminate or privatize

**“Wasteful”  
spending refers to  
five types of  
program failure:  
high levels of  
fraud and abuse,  
duplication,  
obsolescence,  
mismanagement,  
and ineffective  
performance.**

and other business activities that increase market efficiency.<sup>42</sup> Another type of harmful federal activity is subsidies for agriculture, logging, electricity, and water, which waste resources and can damage the environment.

Row 4 includes the large array of federal programs that are properly state and local government functions. Federal spending in those areas should be ended. For example, federal primary and secondary education programs should be ended as a counterproductive intrusion into a local activity. If federal involvement in state and local activities were ended, policymakers and taxpayers in each state could decide which programs were appropriate in each state’s particular situation.

Row 5 includes federal activities that should be left to the private sector and carried out by individuals, businesses, or charitable institutions. This study makes a best guess as to whether programs should be simply terminated or actively privatized. For example, Amtrak could be privatized as a whole entity. On the other hand, federal foreign aid programs should simply be terminated and aid work left to private charities.

Table 3 provides a list of \$300 billion in budget cuts.<sup>43</sup> The proposed cuts are primarily in the nondefense discretionary portion of the federal budget. Defense spending is not tackled in this study, but it should also be cut.<sup>44</sup> Indeed, by most accounts, the Pentagon is one of the most wasteful federal agencies, and large savings could be gained by restructuring its operations.<sup>45</sup> For example, much traditional government-owned military housing is in poor shape and needs to be upgraded. A good solution that is being pursued by the Bush administration is to privatize military housing; that would create higher quality housing and cut costs.<sup>46</sup>

The failures of each program or agency are marked in Table 3, and one or more reform options are recommended. To simplify the analysis, the study focuses on those programs that should be zeroed out entirely. Most federal programs could be trimmed to save money, but the best option for programs listed here is full termination, devolution, or privatization.

Multiple reform options are marked in some cases because different reforms are suitable for different parts of some agencies. For example, the first row in the table proposes termination or privatization of the \$124 million Agriculture Statistics Service. Many of this agency’s activities are probably wasteful, but some statistics might be in high demand. Useful activities could be transferred to private farm organizations, which could assemble and distribute statistics themselves. Ultimately, it should be up to entrepreneurs and consumers to determine whether such activities are worthwhile.

The following sections provide a discussion of each of the five justifications for ending federal programs. The Appendix provides further discussion of many of the programs listed in Table 3.

## **Wasteful Programs**

Budget analysts and policymakers often mean different things when they describe a federal program as wasteful. In this study, “wasteful” spending refers to five types of program failure: high levels of fraud and abuse, duplication, obsolescence, mismanagement, and ineffective performance. Those five types of waste are discussed in turn here. In Table 3, programs are marked as wasteful if they fail on one or more of these counts.

### **Fraud and Abuse**

Government and private watchdog groups regularly uncover waste, fraud, and abuse in the federal budget. To focus on those government failings, the GAO began tracking a “high-risk” group of poorly managed agencies in 1990.<sup>47</sup> The 1990 list of 14 high-risk agencies has expanded to 25 today. Some activities, such as student loans, have been on the list for 14 years despite repeated GAO calls for reform.

The federal government pays out hundreds of billions of dollars a year to businesses for purchases, reimbursements, and subsidies. Large handouts attract large-scale abuses. For example, about \$13 billion of annual pay-

**Table 3**  
**Proposed Federal Budget Cuts**

	FY04 Outlays (\$millions)	Program Problems					Reform Solutions		
		Wasteful	Unjustified Redistribution	Actively Damaging	State/Local Function	Private Function	Terminate	Devolve to States	Privatize
<b>Department of Agriculture</b>									
Agricultural Statistics Svc.	\$124					X	X		X
Economic Research Svc.	\$71					X	X		
Agricultural Research Svc.	\$1,154					X	X		X
Coop. State Research and Ext. Svc.	\$1,082	X	X		X	X		X	
Agricultural Marketing Svc.	\$1,021	X	X			X	X		
Risk Management Agency	\$4,034		X			X	X		X
Farm Service Agency	\$16,877	X	X	X			X		
Rural Development	\$1,043	X	X			X	X		
Rural Housing Svc.	\$1,549	X	X			X	X		
Rural Business Cooperative Svc.	\$107	X	X			X	X		
Rural Utilities Svc.	\$108	X	X			X	X		
Foreign Agricultural Svc.	\$1,917	X	X			X	X		
Forest Service: Land Acquisition	\$154	X				X	X		
Forest Service: State and Private	\$455		X		X	X		X	
Total proposed cuts	\$29,696								
Total department outlays	\$77,739								
<b>Department of Commerce</b>									
Economic Development Administration	\$417	X	X			X	X		
International Trade Administration	\$364	X	X			X	X		
Minority Business Development Agency	\$22	X	X				X		
Fisheries Loans and Marketing	\$32	X	X			X	X		
Pacific Salmon state grants	\$330				X		X		
Technology Administration	\$9	X					X		
Advanced Technology Program	\$195	X	X			X	X		
Manufacturing Extension Partnership	\$40	X	X			X	X		X
Other NIST programs	\$421					X	X		X
National Telecom. and Info. Admin.	\$104		X			X	X		X
Total proposed cuts	\$1,934								
Total department outlays	\$6,194								
<b>Department of Education</b>									
Elementary and Secondary Education	\$24,968	X		X	X	X	X	X	
Innovation and Improvement	\$55				X		X	X	
Safe and Drug-Free Schools	\$43	X			X		X		
English Language Acquisition	\$819				X	X	X		
Special Education and Rehab.	\$12,482				X			X	
Vocational and Adult Education	\$1,932		X			X			X
Postsecondary Education	\$2,379		X			X	X	X	
Student Aid	\$19,067	X	X			X	X		
Education Sciences	\$598		X		X		X	X	
Department management	\$522	X					X		
Total proposed cuts	\$62,815								
Total department outlays	\$62,815								
<b>Department of Energy</b>									
General Science	\$3,405					X	X		
Energy Supply	\$714	X	X			X	X		
Fossil Energy, Research and Dev.	\$590	X	X			X	X		
Energy Conservation	\$882	X	X			X	X		
Strategic Petroleum Reserve	\$171	X				X			X
Energy Information Administration	\$78	X				X	X		
Clean Coal Technology	\$19	X	X			X	X		
Power Marketing Administrations	\$155	X	X	X		X			X
Total proposed cuts	\$6,014								
Total department outlays	\$20,623								

*Continued*

**Table 3 Continued**

	FY04 Outlays (\$millions)	Program Problems					Reform Solutions		
		Wasteful	Unjustified Redistribution	Actively Damaging	State/Local Function	Private Function	Terminate	Devolve to States	Privatize
Department of Health and Human Services									
Substance Abuse and Mental Health Svc.	\$3,133	X				X	X		
Health Care Research and Quality	\$327					X	X		
Temporary Assistance for Needy Families	\$18,866				X			X	
State payments for family support	\$4,098				X			X	
Low-Income Home Energy Assistance	\$1,892	X	X			X	X		
Promoting safe and stable families	\$414				X		X		
NIH: Applied R&D	\$12,500		X			X	X		
Health professions education	\$409	X	X			X	X		
Child care entitlements to states	\$2,866				X			X	
Child Care and Development block grant	\$2,237				X			X	
Social Services block grant	\$1,767				X			X	
Head Start	\$6,775	X			X			X	
Foster Care and Adoption grants	\$6,442				X			X	
Administration on Aging	\$1,313	X					X		
Total proposed cuts	<u>\$63,039</u>								
Total department outlays	\$547,898								
Department of Homeland Security									
State and local programs	\$3,768				X			X	
Firefighter assistance grants	\$399				X			X	
Transportation Security Administration	\$2,810			X		X			
Coast Guard - Boat Safety grants	\$65					X	X		
Total proposed cuts	<u>\$7,042</u>								
Total department outlays	\$30,663								
Department of Housing and Urban Development									
Low-Income Housing Assistance	\$22,250	X	X	X		X	X		
Public Housing Operating Subsidies	\$3,551	X	X	X		X		X	
Drug Elimination Grants	\$75	X					X		
Revitalization of Public Housing	\$626	X	X	X		X		X	
Public Housing Capital Fund	\$3,716	X	X	X		X		X	
Native American Housing block grant	\$734		X			X	X		
Community Development Block Grants	\$5,990	X	X		X	X	X		
Home Investment Partnership Program	\$1,747	X				X	X		
Homeless Assistance grants	\$1,400				X	X	X		
Other Community Planning and Dev.	\$461	X			X	X	X		
Assisted Housing Programs	\$609				X	X	X		
Policy Development & Research	\$44	X					X		
Management and Administration	\$937	X					X		
Other activities	\$4,037				X	X	X		
Total proposed cuts	<u>\$46,177</u>								
Total department outlays	\$46,177								
Department of the Interior									
Bureau of Reclamation	\$1,234	X	X	X	X	X		X	
U.S. Geological Survey	\$840	X				X		X	
State and Tribal Wildlife grants	\$65				X		X		
Sport Fish Restoration Fund	\$336					X	X		
Bureau of Indian Affairs	\$2,180	X			X		X		
Land Acquisition Programs	\$63			X		X	X		
Total proposed cuts	<u>\$4,718</u>								
Total department outlays	\$9,965								
Department of Justice									
State and Local Law Enforcement Assist.	\$1,516				X			X	
Weed and Seed program	\$31	X					X		
Community Oriented Policing Services	\$1,271				X			X	
Juvenile Justice Programs	\$208				X			X	

	FY04 Outlays (\$Millions)	Program Problems					Reform Solutions		
		Wasteful	Unjustified Redistribution	Actively Damaging	State/Local Function	Private Function	Terminate	Devolve to States	Privatize
Department of Justice <i>continued</i>									
Antitrust investigations	\$133			X			X		
Total proposed cuts	\$3,159								
Total department outlays	\$23,488								
Department of Labor									
Employment and Training Admin.	\$5,600	X	X			X	X		
Welfare to Work	\$181				X	X	X		
Community Service for Seniors	\$445		X				X	X	
Trade Adjustment Assistance	\$770		X				X		
International labor affairs	\$110		X					X	
Total proposed cuts	\$7,106								
Total department outlays	\$59,949								
Department of State									
Education and cultural exchanges	\$325	X	X			X	X		
United Nations	\$317	X					X		
Inter-American Organizations	\$129	X					X		
OECD	\$82	X					X		
International Narcotics Control	\$520	X		X			X		
Andean Counterdrug Initiative	\$966	X		X			X		
Total proposed cuts	\$2,339								
Total department outlays	\$11,301								
Department of Transportation									
Amtrak and related	\$1,457	X				X		X	
FAA-Essential air service	\$20	X	X			X	X		
FAA-Air Traffic Control	\$2,798	X		X				X	
FAA-Grants to Airports	\$3,394					X	X	X	
FAA-Facilities and Equipment	\$3,271					X	X	X	
Federal Highway Administration	n/a	X			X	X		X	
Federal Transit Administration	n/a	X			X	X		X	
Maritime Administration	\$633	X	X			X	X		
Total proposed cuts	\$11,573								
Total department outlays	\$58,010								
Other Agencies and Activities									
Accounting Oversight Board	\$97					X	X		
Agency for International Development	\$4,613	X	X			X	X		
Appalachian, Delta, Denali Comm.	\$94	X	X				X		
Army Corps of Engineers	\$4,308	X	X	X		X		X	
Cargo Preference	\$443	X	X				X		
Corporation for National and Comm. Svc.	\$609	X				X	X		
Corporation for Public Broadcasting	\$437		X			X		X	
Davis Bacon Act	\$1,100		X	X			X		
Drug control advertising & related	\$500	X					X		
EPA-State and Tribal Assistance Grants	\$4,039				X			X	
Equal Employment Opportunity Comm.	\$325	X					X		
Export-Import Bank	\$0	X	X	X		X		X	
Foreign Military Financing	\$5,432		X			X	X		
Foreign Military Sales	\$3		X			X	X		
FTC-Antitrust enforcement	\$82			X			X		
Int. Assistance: Economic support	\$3,760	X	X			X	X		
Int. Assistance: Multilateral	\$2,632	X	X			X	X		
International Military Training	\$89		X				X		
International Trade Commission	\$60			X			X		
Legal Services Corporation	\$341					X	X		
Millenium Challenge Corporation	\$298		X			X	X		
Excess military bases	\$5,000	X					X		

Continued

**Table 3** *Continued*

	FY04 Outlays (\$millions)	Program Problems					Reform Solutions		
		Wasteful	Unjustified Redistribution	Actively Damaging	State/Local Function	Private Function	Terminate	Devolve to States	Privatize
NASA	\$14,604	X				X	X	X	
National Endowment for the Arts	\$118		X			X	X		
National Endowment for the Humanities	\$132		X			X	X		
National Labor Relations Board	\$242					X	X		
National Mediation Board	\$11					X	X		
Neighborhood Reinvestment Corp.	\$114	X			X	X	X		
Overseas Private Investment Corporation	\$0	X	X	X		X	X	X	
Peace Corps	\$302	X					X		
Presidio Trust	\$43				X			X	
Service Contract Act	\$610		X	X			X		
Small Business Administration	\$3,978	X	X			X	X		
Tennessee Valley Authority	\$0			X		X		X	
Trade and Development Agency	\$62	X					X		
U.S. Postal Service subsidies	\$60	X					X		
Total proposed cuts	<u>\$54,538</u>								
Grand total spending cuts	\$300,150								

Source: Author’s analysis. FY04 outlays are from the *Budget of the U.S. Government, FY2005*.

Note: “Wasteful” programs are those that are duplicative, obsolete, mismanaged, ineffective, or have high levels of fraud. Federal highway and transit are “n/a” because both spending and gasoline taxes should be cut, resulting in no net effect on the deficit.

ments to Medicare providers are erroneous or fraudulent, according to the GAO.<sup>48</sup> The program is bilked by numerous scams, such as billing the government for more expensive health services than are provided and making claims for bogus patients.<sup>49</sup>

Similar problems face Medicaid, which is subject to “waste and exploitation,” according to the GAO.<sup>50</sup> Recent investigations found \$1 billion of fraud just in California’s portion of Medicaid.<sup>51</sup> The program’s nursing home benefits have generated a large industry of financial planners who help higher-income seniors hide their assets in order to qualify. That costs about \$10 billion per year in excess charges.<sup>52</sup> Also, state governments have concocted a variety of abusive schemes to boost federal Medicaid payments to their coffers.<sup>53</sup>

Programs that provide handouts to individuals have similar problems. Scam artists bilk federal taxpayers out of billions of dollars in housing subsidies, earned income tax credits (EITC), student loans, food stamps, and unemployment insurance.<sup>54</sup> There is \$2 billion in annual overpayments for federal rental housing subsidies.<sup>55</sup> Almost one-third of EITC payments—about \$9 billion annual-

ly—are erroneous or fraudulent.<sup>56</sup> People have a clear incentive to underreport their income and overreport the number of their children to boost EITC payments. The food stamp program pays out \$1.4 billion annually in erroneous and fraudulent benefits.<sup>57</sup>

Substantial fraud seems to occur in just about every federal program that hands out transfer payments. An interesting case was the Department of Housing and Urban Development’s program for police officers to buy cut-price homes in troubled neighborhoods. The program was suspended after it was discovered that officers were buying the subsidized houses but then renting them out rather than moving in, thus making a profit at the taxpayers’ expense.<sup>58</sup>

Another common type of fraud is misuse of federal grant money. In one recent example, a Washington, DC, anti-poverty organization with a \$36 million annual budget was found using federal grant money to purchase luxury automobiles, a fishing boat, sports tickets, and other items for the personal use of its executives. A *Washington Post* editorial noted that “it’s an old but nauseating story: anti-poverty workers advancing their inter-

ests at the poor's expense."<sup>59</sup>

Congress occasionally looks into these problems and promises reforms, but the problems continue unabated because of the nature of government. Fraud generates a Catch-22 for those who support expansive government programs. On the one hand, fraud is clearly a waste of taxpayer money and should be stopped. On the other hand, minimizing fraud to acceptable levels requires a huge amount of bureaucratic rules and enforcement activities, which cost taxpayer money and reduce program efficiency. The EITC program is a good example. A high error and fraud rate has plagued the program for years despite new anti-fraud rules and more paperwork. The federal budget even contains a separate line item for "Earned Income Tax Compliance Initiative," which will cost \$202 million in FY04.<sup>60</sup> That is a big bureaucratic expense just to police one program.

Another type of abuse is old-fashioned misuse of the public purse by self-interested politicians and bureaucrats. For example, a *Los Angeles Times* investigation found that Senate Appropriations Committee chairman Ted Stevens (R-AK) has become a millionaire by using his legislative power to channel federal contracts to business partners in his home state.<sup>61</sup> In one deal, Stevens steered a \$450 million military housing contract to an Anchorage businessman. The businessman, in turn, helpfully turned a \$50,000 investment by Stevens into a \$750,000 windfall for the senator six years later.<sup>62</sup>

Another recent example of abuse was a \$23 billion Pentagon contract for new tanker airplanes. The deal involved Air Force procurement officials and members of Congress currying favor with Boeing and pushing through an inflated contract for the planes.<sup>63</sup> The Pentagon's inspector general concluded that the deal broke a variety of federal contracting rules and could waste anywhere from \$500 million to \$2.5 billion of taxpayer money if it goes through.<sup>64</sup>

The only lasting solution to these problems is to cut the government down to size. With a smaller federal empire, members of

Congress would have less money to steer toward dubious projects and could devote more time to overseeing the operation of remaining programs. At the same time, citizens, watchdog groups, and the media could pay closer attention to the problems in each program and spend more time questioning the politicians who are supposed to watch out for taxpayer interests.

### **Duplicative**

Federal programs often have overlapping objectives. The GAO reports that there are 50 different programs for the homeless in eight different federal agencies, 23 programs for housing aid in four agencies, 26 programs for food and nutrition aid in six agencies, and 44 programs for employment and training services in nine agencies.<sup>65</sup>

The Senate Committee on Government Affairs also examined federal duplication.<sup>66</sup> It found 27 different programs for teen pregnancy, 130 programs for at-risk youth, 19 programs for substance abuse prevention, 25 programs for rural development, 17 agencies that monitor international trade agreements, 10 agencies that are involved in export promotion, and 342 programs for economic development.

One reason why all this duplication occurs is that politicians and bureaucrats have their fingers in the wind to discern the sexy issues of the day, whether they involve "environment," "exports," "jobs," "children," or "homeland security." When a hot new issue arises, every department is quick to erect a new program to score a larger budget allocation. For example, the Small Business Administration has tried to cash in on the popularity of anti-drug programs with the creation of a "Drug-Free Workplace" grant program, which is supposed to help small businesses create drug-free work environments. At least nine other federal departments are on the anti-drug taxpayer gravy train.<sup>67</sup>

A classic case of unneeded bureaucracy is the Bush administration's new position for an assistant secretary of commerce for manufacturing in the Department of Commerce.

***A Los Angeles Times* investigation found that Sen. Ted Stevens has become a millionaire by using his legislative power to channel federal contracts to business partners in his home state.**

**Economic growth, technological advances, and entrepreneurial innovation often mitigate the social ills that programs have tried to solve.**

The position is a political sop in response to recent concerns about manufacturing job losses. No doubt the new “manufacturing czar” will write reports and jet off to conferences here and there to give speeches, but the czar will have no actual ability to create manufacturing jobs.

Program duplication often occurs when it becomes clear that a government program simply does not work. In that case, politicians create a new program to tackle the problem because they gain talking points for the campaign trail by proposing legislation to “solve” problems. However, to avoid getting into bureaucratic turf fights and offending special interests, policymakers often leave old programs in place to spin their wheels.

A good example is the Bush administration’s new Millennium Challenge Account program for foreign aid. Bush plans to boost U.S. foreign aid by 50 percent with the addition of MCAs, which would be run out of a new agency. Foreign aid is already dispensed by the U.S. Agency for International Development and half a dozen other agencies.<sup>68</sup> MCAs were created because it was widely recognized that the traditional delivery of foreign aid was a failure. Steven Radelet, a foreign aid expert and former top Treasury official, testified to Congress last year: “The U.S. foreign aid system, particularly USAID, is bogged down under heavy bureaucracy, overly restrictive legislative burdens, and conflicting objectives. The MCA is intended to be different.”<sup>69</sup> Unfortunately, that difference will cost taxpayers an additional \$5 billion annually by 2006.<sup>70</sup>

### **Obsolete**

Federal programs have an unfortunate tendency to linger decades after the problems they were designed to solve have disappeared. Economic growth, technological advances, and entrepreneurial innovation often mitigate the social ills that programs have tried to solve. For example, cable television undercuts the traditional justification for subsidies to the Corporation for Public Broadcasting. CPB was supported as an educational alternative to

the three main commercial TV networks. But today there are dozens of cable networks, including specialized educational channels, that fill every conceivable market niche.

Federal loan programs are another example of obsolescence. The government has loan and loan guarantee programs for farmers, small businesses, housing developers, students, and many other favored groups. But those programs make less sense all the time because of the increasing sophistication of financial markets. As noted in this year’s federal budget, greater availability of information, better managing of risks with derivatives, and financial deregulation have reduced the need for federal loan programs.<sup>71</sup> Consider, for example, that one of today’s key sources of risk capital for small growth companies—venture capital—barely existed 30 years ago. But today the venture capital industry pumps as much as \$100 billion annually into small companies.<sup>72</sup>

NASA is also obsolete. In the 1960s it played a role in winning the Cold War by ensuring that the United States was the leader in space. In recent decades, private businesses, such as communications satellite firms, have gained a foothold in space. Meanwhile, NASA has floundered with poor management, cost overruns, and unclear goals, particularly in its manned space program. Congress should begin closing down NASA and opening up space to private entrepreneurs. Even manned space flight could be supported by the private sector if space tourism becomes viable in coming years.<sup>73</sup>

NASA provides a good example of what can be called “policy by talking points,” by which obsolete programs are sustained because of simple retail politics. Casting about for an uplifting initiative for President Bush to discuss on the campaign trail, the White House recently announced an ambitious scheme to send a manned space mission to the moon and to Mars. With recent NASA failures, little demand for such a scheme from the public, and the government deep into red ink, that expensive initiative makes no practical sense.



Nonetheless, the White House marketing team keeps reviving old and unneeded programs because the president needs sound bites for his election year speeches. Recently, the Bush administration indicated that it was interested in expanding the Trade Adjustment Assistance program—a position that the administration opposed just two years ago—because Bush needs a media message on jobs.<sup>74</sup> A few months ago, the administration called for reviving the Manufacturing Extension Partnership—a program that used to be targeted for termination by Republicans—because the administration needed talking points on manufacturing. Thus, regardless of whether programs work, if they fit into the latest media themes from the White House, they get gold plated.

Defenders of federal programs often argue that there are no private alternatives to a particular service offered by the government. But in many cases it is the existence of government programs and government regulations that prevents entrepreneurs from offering services in the first place. For example, NASA has discouraged entrepreneurship and competition with itself in the space business, and government has thrown numerous regulatory roadblocks in front of private space launches.<sup>75</sup> Another well-known example is federal law that makes it illegal for entrepreneurs to compete against the USPS on first-class mail service, even if the competitor would offer consumers better service at lower cost.

When the government gets out of the way, there can be explosive private-sector growth. For example, growth in the U.S. venture capital industry was triggered by two policy changes.<sup>76</sup> First, the rules for pension plans under ERISA (the Employee Retirement Income Security Act) were loosened in 1978 to allow pension funds to invest in higher-risk investments including venture capital. Second, venture capital markets were stimulated by a cut in the capital gains tax rate from 49.5 percent to 28 percent in 1978, and to 20 percent in 1980.

As a result of those policy changes, venture capital investments soared from under

\$1 billion per year in the late 1970s to more than \$4 billion by 1983.<sup>77</sup> Early recipients of venture capital funding included high-tech dynamos Apple Computer, Intel, and Genentech. Who needs business subsidy programs when private markets fuel the growth of such great companies?

With further free-market reforms, entrepreneurs could demonstrate that there are more obsolete government programs than are usually recognized. For example, in many cities developers are dissuaded from constructing low-income housing because of rent controls, costly construction standards, and other regulations that reduce the return to investment. It is a myth that private housing markets cannot provide decent homes for the urban poor.<sup>78</sup> Rather than piling one housing program on top of another, policymakers should focus on removing barriers to entrepreneurs in the low-income housing industry. As policymakers look to downsize the government, they should also look to clear the way for America's entrepreneurs to fill the voids.

### **Mismanaged**

Federal mismanagement runs wide and deep, with serious shortcomings in government financial controls, human resources, technology implementation, and other activities. The federal government has failed seven years in a row to produce financial statements that could be certified by the GAO.<sup>79</sup>

There are common mismanagement problems that occur in agencies across the government. For example, major procurements and construction projects—from highways to weapon systems—routinely have large cost overruns. At many agencies, mismanagement problems occur year after year despite wrist slapping by the GAO and other watchdogs. The following are some recent examples of serious mismanagement problems:

- **Department of Defense.** The GAO concludes that the Pentagon's financial management problems are "pervasive, complex, long-standing, and deeply

**The White House marketing team keeps reviving old and unneeded programs because the president needs sound bites for his election year speeches.**

**The International Space Station's estimated cost has skyrocketed from \$17 billion in 1995 to \$30 billion today.**

rooted in virtually all business operations throughout the department.”<sup>80</sup>

The Pentagon loses track of assets, wastes billions of dollars on poor management of its excessive inventory, keeps unreliable budget data, low-balls project costs, and makes billions of dollars in overpayments to contractors.<sup>81</sup>

- **NASA.** The official report on the *Columbia* disaster in 2003 found that NASA suffers from ineffective leadership, flawed analyses, and a reactive and complacent approach to safety. It noted that the mistakes made on *Columbia* were “not isolated failures, but are indicative of systematic flaws” in the agency.<sup>82</sup> The 1986 *Challenger* disaster was also traced to flawed NASA management.<sup>83</sup> NASA’s poor management manifests itself in the large cost overruns of the International Space Station. The project’s estimated cost has skyrocketed from \$17 billion in 1995 to \$30 billion today, and the station is four years behind schedule.<sup>84</sup> A new GAO report in April called attention once again to NASA’s poor financial management.<sup>85</sup>
  - **FBI.** The FBI has come under criticism that poor management during the past decade prevented it from averting the 9/11 disaster. It seems that all the clues needed to prevent Al Qaeda’s destructive activities were available to the FBI in the aftermath of the 1993 World Trade Center bombing and that the agency could have prevented further attacks if it had pieced the clues together.<sup>86</sup> With a smaller federal government, members of Congress would have more time to scrutinize agencies charged with anti-terrorism functions to ensure good performance.
  - **Bureau of Indian Affairs.** In what has been called the “Indian Enron,” the BIA has mismanaged billions of dollars in Indian trust funds. Former special trustees of BIA have given scathing congressional testimony about the BIA’s inability to clean up the financial mess.
- Trustee Thomas Slonaker testified that the Department of the Interior and the BIA are incapable of reform, unwilling to follow the law, and do not “hold people accountable for their actions with consequences for poor performance.”<sup>87</sup> Trustee Paul Homan testified that the “vast majority of upper and middle management at the BIA were incompetent,” but in reform efforts stretching over the last 25 years no senior manager has been removed.<sup>88</sup> In April 2004 a court-appointed investigator resigned, charging the government with obstructing his probe of federal corruption related to the trust funds.<sup>89</sup>
- **Army Corps of Engineers.** This \$4 billion agency has been found to falsify data to justify large white-elephant construction projects.<sup>90</sup> The agency is frequently criticized for pouring billions of dollars into unneeded and environmentally damaging projects in the districts of important members of Congress. In 2000 it was discovered that the agency’s top managers manipulated economic studies to lend support to a wasteful \$1 billion Mississippi River project.<sup>91</sup> A similar scandal erupted over a \$311 million project to dredge the Delaware River.<sup>92</sup> In the latter case, local refineries were the main beneficiaries of the project. The Army Corps should be privatized with local governments and businesses, such as the refineries, purchasing its services without imposing costs on federal taxpayers.
  - **Department of Energy.** Laboratories overseen by DOE, including Los Alamos, Oak Ridge, Sandia, and Lawrence Livermore, were mismanaged for years with ongoing security lapses. The GAO began reporting on those problems at least 20 years ago, but few reforms were made. Then a major scandal erupted in the late 1990s when it was revealed that China was stealing design information on nuclear weapons from the labs.<sup>93</sup> A 1999 House of Representatives report

concluded, “Despite repeated PRC thefts of the most sophisticated U.S. nuclear weapons technology, security at our national nuclear weapons laboratories does not meet even minimal standards.”<sup>94</sup> A high-level administration panel investigating the scandals condemned the DOE as a “dysfunctional bureaucracy” where “organizational disarray, managerial neglect, and a culture of arrogance . . . conspired to create an espionage scandal waiting to happen.”<sup>95</sup>

- **Transportation Projects.** Large, sometimes massive, cost overruns are commonplace in federally funded transportation projects.<sup>96</sup> In 1985 government officials claimed that Boston’s “Big Dig” highway project would cost \$2.6 billion and be completed by 1998. The cost has ballooned to \$14.6 billion, and the project is still not finished.<sup>97</sup> In a 1989 referendum, Denver residents agreed to construction of a new \$1.7 billion international airport. By the time the airport was opened in 1995, the cost had mushroomed to \$4.8 billion.<sup>98</sup> In 1994 Virginia officials claimed that the Springfield interchange project would cost \$241 million. The cost has now soared to \$676 million.<sup>99</sup> The cost of New York’s Penn Station redevelopment has more than doubled, and the project is years behind schedule.<sup>100</sup>

Those are not isolated cases of bad management. Such problems are chronic and plague much of the federal government.<sup>101</sup> The GAO found that half of the federal highway projects it examined in recent years had cost overruns of more than 25 percent.<sup>102</sup> Large cost overruns are routine on multi-billion-dollar technology upgrade projects at federal agencies.<sup>103</sup> For example, the FBI’s \$600 million project to update its computer systems finally neared completion in 2004 but is \$123 million over budget and 21 months late.<sup>104</sup>

Or consider the Department of Energy’s performance on big contracting projects. The GAO tracked 80 major DOE projects begun

between the mid-1970s and the mid-1990s.<sup>105</sup> It found that 31 were terminated prior to completion, which caused billions of dollars in losses. Most of the rest were either over budget or behind schedule.

The costs of Pentagon weapons systems are often low-balled in order to feed as many projects into the procurement pipeline as possible. Similarly, the government usually low-balls its estimates of the long-term costs of entitlement programs to gain initial approval. Legislators may include benefit limitations in entitlement bills to hold costs down. But such limits either do not work, are evaded, or are later repealed. When costs soar and programs do not work, politicians hold hearings to cast blame elsewhere—on drug firms or hospitals, for example.

When Medicare Part A was enacted in 1965, costs were projected to rise to \$9 billion by 1990, but actual costs reached \$67 billion. When the Medicaid special hospitals subsidy was added in 1987, the annual costs were projected at \$100 million. By 1992 costs had risen to \$11 billion annually.<sup>106</sup>

Soon after the ink was dry on the 2003 Medicare prescription drug bill, the Bush administration informed the public that the cost would be \$534 billion, one-third more than the \$400 billion that had been promised. Subsequent investigations revealed that Medicare’s chief cost analyst knew about the higher costs months before the legislation was enacted, but he was threatened with termination if he made that knowledge public.<sup>107</sup>

Of course, it is true that cost overruns and mismanagement are not unique to the federal government. There have been many high-profile scandals at major corporations and nonprofit groups such as the United Way.<sup>108</sup> Poor management can plague any organization, but recent corporate scandals show that private markets have mechanisms to correct excesses and to punish reckless and incompetent executives. In the private sector, poor performers are weeded out, executives and managers are fired, and resources are shifted to better-run competitors. By contrast, the federal government has few built-in mecha-

**Large, sometimes massive, cost overruns are commonplace in federally funded transportation projects.**

**The federal firing rate for poor performance is just 1 in 4,000 workers per year.**

nisms to correct mistakes and to create the renewal that all organizations need in our fast-changing society.

Nonetheless, Congress can take steps to avert the worst federal management failures. For one thing, more “carrots” and “sticks” are needed in the government to ensure good employee performance. For example, pay raises for federal managers should be contingent on good agency performance. Good performance could be defined as receipt of a passing grade on the Bush administration’s “management scorecard,” passing GAO financial audits, or keeping programs under budget. Managers in agencies that fail performance tests should have their salaries frozen. The Bush administration is pursuing reforms in the Departments of Defense and Homeland Security that would eliminate automatic pay raises based on longevity; raises would be tied instead to individual performance evaluations.<sup>109</sup>

One stick needed to improve federal performance is a substantial increase in the employee firing rate. In the private sector, everyone from CEOs to mailroom clerks gets fired if performance falls short. One survey found that 37 percent of departing CEOs at the largest U.S. companies were fired instead of leaving voluntarily.<sup>110</sup> By contrast, data from the Office of Personnel Management show that the federal firing rate for poor performance is just 1 in 4,000 workers per year.<sup>111</sup> The State Department has fired only six employees for poor performance during the past 18 years. Unfortunately, no private-sector firing data exist to compare directly with federal data. But for the broader category of “involuntary separations,” the federal rate is just one-fourth as high as the private-sector rate.<sup>112</sup>

The Bush administration has complained that it can take 18 months or longer to fire a federal employee. Firing a bad worker involves a major time commitment on the part of a conscientious federal manager. Indeed, the OPM notes that managers need to exert a “heroic” effort to overcome obstacles to removal of an employee.<sup>113</sup> According to an OPM survey, federal managers think that

“procedures dealing with poor performance are too complicated, time consuming, or onerous; they do not get higher management support; and they perceive their decisions will be reversed or that they will be falsely accused of discrimination in their actions.”<sup>114</sup>

As a result of those problems, bad workers are frequently reassigned within the government rather than fired. A Brookings Institution survey of federal workers found that, on average, 23 percent thought that their coworkers were “not up to par,” and only 30 percent thought that their organization did a good job of disciplining poor performers.<sup>115</sup> Note that that survey was after eight years of the Clinton administration’s “reinventing government” initiative.

One factor that sustains poor performance is that bad workers often receive good reviews from negligent managers who do not want to rock the boat. There is an ingrained federal culture to score virtually all workers highly: the federal Merit Systems Protection Board has found that just 1 percent of federal workers are rated below “fully successful” in annual reviews.<sup>116</sup> Such false high scores create a hurdle for new managers trying to prove that a worker’s actual performance is poor.<sup>117</sup>

The dearth of firing is consistent with the general lack of incentives for good performance in the bureaucracy. Surveys find that most federal workers do not believe that the best-qualified people are the ones receiving promotions.<sup>118</sup> A study by the OPM concluded that “the federal white-collar pay system sends and reinforces the message that performance does not matter.”<sup>119</sup> A 2003 OPM survey of 100,000 federal workers found that just 36 percent of employees thought that promotions were based on merit and just 27 percent thought that steps were taken to deal with poor employees.<sup>120</sup> All in all, federal workers put in their time, automatically move up the pay scales, and are nearly immune from dismissal.

**Ineffective**

Many federal programs do not solve the problems that they were set up to solve.

Sometimes that is due to mismanagement, but it is often due to the fact that many problems in society are simply not susceptible to government “solutions.”

One reform idea pursued by the Bush administration is to quantify the performance of federal programs. A “management scorecard” grades each department on various parameters. In its most recent scorecard, which had 130 total items, the administration’s Office of Management and Budget awarded just eight “green” grades for good performance.

At a more detailed level, the OMB has rated 400 individual programs on their effectiveness, revealing federal performance that is mixed at best. More than 40 percent of programs have been rated “ineffective” or “results not demonstrated,” meaning that even managers have not been able to measure performance. The administration claims that it will move funding from poor programs to better programs, but it would be much better if money were simply returned to the taxpayers.

The Bush reforms build on procedures established under the Government Performance and Results Act of 1993. That act required nearly all agencies to prepare strategic and performance plans regularly. Agencies are required to put down on paper what they are doing, what outcomes they are seeking, and whether they have reached their goals. Those sound like routine procedures that agencies should have been following since the founding of the nation. In the past, however, many agencies made no attempt to account for their performance. Despite recent reforms, the GAO nonetheless concludes that “few agencies adequately show the results that they are getting with the taxpayer dollars they spend.”<sup>121</sup>

Federal programs are not effective for a variety of reasons. Some programs fall into bureaucratic traps such as excessive layers of management. For example, much of the foreign aid budget gets lost in layers of bureaucracy inside and outside the government. Funding gets consumed by federal aid workers, U.S. contractors, subcontractors, sub-

subcontractors, and all their salaries, meetings, reports, plane flights, meals, and other expenses. Foreign aid also gets swallowed up by corrupt foreign officials.

The many “economic development” programs in the federal budget are awash in wasteful bureaucracy. Consider this explanation of a program in the FY05 budget: “The Rural Strategic Investment Program will provide rural communities with flexible resources to develop comprehensive, collaborative, and locally-based strategic planning processes; and will implement innovative community and economic development strategies that optimize regional competitive advantages.”<sup>122</sup> That fancy language probably covers the fact that much of the money will be spent on meetings, memos, reports, grant applications, and other unproductive activities.

The main reason why government programs do not work well, however, is not wasteful bureaucracy but that government activity involves central planning. Federal programs and regulations try to reorganize the voluntary interactions of millions of people in our complex society. Policymakers are often surprised by the unexpected consequences of their initiatives. An example is the recent reintroduction of wolves to Yellowstone National Park. The program is reshaping the park’s entire ecosystem in dramatic ways unforeseen by federal scientists.<sup>123</sup> Federal spending and regulation are like wolves let loose in a free-market ecosystem. Individuals and businesses react to government actions and try to avoid rules that reduce their wealth or restrict their freedom.

The effects of HUD’s Section 8 housing program provide an example of the law of unintended consequences. Section 8 is the largest housing subsidy program, and its vouchers are supposed to spread poor families out across many neighborhoods. But the program has instead created incentives that promote concentration of low-income families.<sup>124</sup> Also, the program was supposed to subsidize poor tenants, but it ends up providing higher profits to landlords who spe-

**Many problems in society are simply not susceptible to government “solutions.”**

**While entrepreneurs can quickly respond to prices and other market signals, the government does not have an efficient feedback mechanism to use in fixing faulty programs.**

cialize in the bureaucratic complexities of owning Section 8 apartments.<sup>125</sup>

The federal government simply does not have the local and tacit knowledge base that would be needed to implement most of its “solutions” with competence. By contrast, private entrepreneurs gain detailed information by dealing with customers, suppliers, and others in the market. While entrepreneurs can quickly respond to prices and other market signals, the government does not have an efficient feedback mechanism to use in fixing faulty programs.

Although economists have noted the systemic shortcomings of government action for more than two centuries, Washington policymakers continue to believe that they can centrally plan the economy. A minor scandal erupted last December when a high-level Department of Commerce official stated that the Bush administration had no “vision” or central plan for the U.S. manufacturing industry.<sup>126</sup> Although that official was pointing out a reality of government, many people perceived his statement to mean that the administration was not trying hard enough.

A safer route for federal bureaucrats is to declare grand goals and claim exaggerated benefits for programs. Many federal websites include pie-in-the-sky mission statements, such as this one from the USDA’s Economic and Community Systems program:

Research, education and extension can be redesigned and targeted to further enrich diverse human capacity to build prosperity for sustainable communities. ECS encourages a whole systems approach. From inner city to farmland crossroads, locally geared, “people-focused” programs will result in families, farms, businesses, and community-based organizations linking to one another and will ensure that people share tools and strategies for community discovery of issues, needs and resources. It will also result in effective delivery of place-based, community-led solutions that are needed to balance

trends toward globalization of information and the economy.<sup>127</sup>

Other federal program descriptions reveal the wasteful bureaucracy of big government schemes. Consider this program summary from the FY05 federal budget:

The Hydrogen R&D Interagency Task Force, established by OSTP shortly after the President’s announcement of the Hydrogen Fuel Initiative, serves as the mechanism for collaboration among the nine Federal agencies that fund hydrogen-related R&D. In 2003, the task force gathered information and provided guidance for agency research directions. In 2004, the task force will complete an interagency 10-year plan that will improve coordination of agency efforts, accelerate progress toward the goals of the initiative, and foster collaboration between the Federal Government and the private sector, state agencies, and other stakeholders. The DOE-led International Partnership for the Hydrogen Economy coordinates hydrogen research between the U.S. and other participating governments.<sup>128</sup>

That paragraph exposes a number of classic bureaucratic crutches and failings. Funding for hydrogen research is being spread across nine separate agencies, guaranteeing that much time will be spent on meetings, writing memos, and similar tasks. The paragraph does not mention the inevitable turf wars that will arise between the multiple “stakeholders,” just the warm and fuzzy phrase “foster collaboration.” Phrases such as “task force” and “accelerate progress” also sound good, but how can work have accelerated when the government is giving itself 10 years to fiddle around with taxpayer money? Indeed, the government seems to be off to a slow start with 2003 spent “gathering information” and 2004 spent simply drafting a plan.

Past government failures with pushing

particular technologies are widely documented.<sup>129</sup> Billions of dollars have been wasted on federal projects for synthetic fuels, supersonic planes, and other schemes. That the current administration would try its hand at this game once again can be explained only by politics, not economics.

## Unjustified Redistribution

Which activities should the government pursue and which should be left to the private sector? Economists approach that question by asking which goods and services are “public goods.” Those are items that are broadly beneficial and have benefits that outweigh their costs but are inadequately provided by the private sector because of a market failure.<sup>130</sup> For example, national defense is a public good that contributes to the general welfare of all Americans and thus is an appropriate function of the government.

Most current federal programs are not public goods. Many programs provide services that could be more efficiently provided in private markets. Many other programs are not in the broad general interest but are targeted at narrow groups of recipients. Such programs do not gain funding because they have a sound economic justification or garner widespread support. Instead, they survive because special interests and a minority of self-interested policymakers can use logrolling and other features of the federal legislative apparatus to sustain them.

Some people support an expansive welfare state because they believe that a big government is crucial to helping those in need. However, much of government activity involves transferring resources from middle-income taxpayers to middle-income recipients. Some features of Social Security and Medicare, for example, are even biased against the poor. With regard to Social Security, low-income Americans tend to have shorter life spans than others and thus receive fewer years of benefits.

With regard to Medicare, higher-income recipients tend to incur higher annual expens-

es than poor recipients and may receive larger government benefits. Some analyses have found that Medicare is neutral or even regressive in its overall impact. A 1997 study by Mark McClellan and Jonathan Skinner concluded that “Medicare has led to net transfers from the poor to the wealthy.”<sup>131</sup>

Consider also federal student loan programs. Those are subsidies that go to people who will earn higher-than-average incomes during their lifetimes. Some people support student loan programs because they believe that college is a public good like national defense. The argument is that if workers are more educated, then the nation’s economic growth will be greater. Although that may be true, people with college educations will earn on average 75 percent more during their lifetimes than will those with just high-school degrees; that should provide a direct incentive for people to pay their own college costs.<sup>132</sup> With such a direct incentive for college investment, government loan programs are not needed to ensure that a sufficient number of students attend college.

Cash subsidies of \$17 billion will be paid out this year to a small group of farmers producing a handful of crops, including rice, wheat, and soybeans. Today’s farmers are not a particularly needy group. Government data show that farming families have higher incomes than other families, on average.<sup>133</sup> Also, farming does not seem to be a uniquely risky industry that especially needs government help. Industries ranging from high technology to restaurants have high failure rates but do not receive handouts from the government. Farm subsidies and similar giveaways send the message that Americans are not equal under the law and that it is OK to loot taxpayers if you have a vocal lobbying group in Washington.

There is about \$90 billion of business subsidies in the federal budget.<sup>134</sup> Such “corporate welfare” includes direct handouts and indirect commercial support. As one example of a direct handout, the Community Adjustment and Investment Program handed \$500,000 to a manufacturer of metal storage lockers so

**There is about \$90 billion of business subsidies in the federal budget.**

**Business subsidy programs are often given the warm and fuzzy label “public-private partnership.” But mixing government with private business usually leads to corruption.**

that it could relocate its Pennsylvania and Mississippi plants to North Carolina.<sup>135</sup> That is unfair to the two states that lost out, and unfair to taxpayers.

Indirect federal support of business includes subsidies for insurance, research, loans, marketing, and other services. Such subsidies make no economic sense—if a federal program is providing a useful service to businesses, then there should be demand in the private market to sustain the service without taxpayer subsidies. For example, the Department of Agriculture’s Risk Management Agency describes its mission as helping farmers “manage their business risks through effective, market-based risk management solutions.”<sup>136</sup> But if the RMA’s services are “market based,” the agency may as well be privatized.

The federal government also creates unjustified redistributions of wealth with the many domestic and international trading restrictions that it imposes. For example, import tariffs and quotas benefit some U.S. companies at the expense of both U.S. consumers and companies that use imported materials in their production processes. Sugar prices are three times higher in the United States than elsewhere because of federal controls; thus both U.S. consumers and U.S. candy companies are damaged.<sup>137</sup>

Subsidies and trade restrictions are often supported in order to prop up businesses that are failing in the marketplace. That makes no economic sense. Companies that are inefficient or producing second-rate goods should be allowed to fail because they weigh down the whole economy. On the other hand, subsidies sometimes go to companies that are highly profitable. But that makes no sense either because such companies do not need help from taxpayers.

Business subsidies would be a good first target for policymakers trying to downsize the federal budget. When the Republicans took control of Congress in 1994, they attempted to cut business subsidies.<sup>138</sup> Unfortunately, that attempt failed, and little has been done since to curtail subsidies.<sup>139</sup>

The Bush administration’s record on

business subsidies has been mixed at best. On the one hand, the president’s budgets have sought modest reductions in a few subsidy programs, such as the Advanced Technology Program, the Export-Import Bank, the Overseas Private Investment Corporation, and the Small Business Administration. Bush’s first budget director, Mitch Daniels, was critical of corporate welfare. He noted that it was not the government’s role to “subsidize, sometimes deeply subsidize, private interests.”<sup>140</sup> And he noted that some programs “have nothing to show for years and years and years of essentially subsidizing corporate research budgets.”<sup>141</sup>

On the other hand, the Bush administration has sought increases in some subsidy programs, including fossil energy research, the Manufacturing Extension Partnership, and alternate fuel subsidies. One Bush program that will cost \$1.7 billion over five years is supposed to develop a hydrogen-powered car. But a recent National Academy of Sciences report drove home what a waste of money that project is. The NAS predicts that hydrogen vehicles may not arrive on America’s roads until 2050.<sup>142</sup>

One would have thought that the current administration would have learned a lesson from the Clinton administration’s failed Partnership for a New Generation of Vehicles subsidy program. That program dished out \$1.5 billion during the 1990s to U.S. automakers for hybrid engine research. It turned out that U.S. companies did not come to market with any hybrid cars. Meanwhile, unsubsidized Honda and Toyota have introduced successful hybrid models to U.S. consumers.

Federal business subsidy programs are often given the warm and fuzzy label “public-private partnership.” But mixing government with private business usually leads to corruption. For example, one scandal that came to light in 2002 involved the Maritime Administration’s Title XI loan guarantee program for U.S. shipbuilders. A company called American Classic Voyages received a \$1.1 billion loan guarantee from the program to build two cruise ships in Sen. Trent Lott’s (R-



MS) hometown.<sup>143</sup> Before completion, the company went bankrupt and left federal taxpayers with a \$200 million tab. Clearly, the funneling of taxpayer money into risky schemes in important politicians' districts is not good government, but that is what happens when government gets involved in "helping" industry.

Instead of cozying up to industry, policymakers should keep their distance from lobbyists wanting subsidies at taxpayer expense. Concentrated and organized minorities are always asking for a free lunch at the expense of the silent majority that pays the costs. Unfortunately, too many members of Congress selfishly seek political success by giving benefits to the few at the expense of the many.

One problem is that policymakers are easily swayed by exaggerated claims of ruin should subsidies be withdrawn from particular groups. But could today's recipients of government largesse survive without federal help? New Zealand's experience with eliminating farm subsidies indicates that they could. That country's farmers adjusted to a repeal of subsidies and are thriving without Big Government.<sup>144</sup>

In 1984 New Zealand's Labour government ended all farm subsidies, which was a bold policy stroke because the New Zealand economy is roughly five times more dependent on farming than is the U.S. economy. Although the plan was initially met with large protests, the subsidies were ended and New Zealand farming has never been healthier. The value of farm output has soared since subsidies were repealed, and farm productivity has grown strongly. Forced to adjust to new economic realities, New Zealand farmers cut costs, diversified their land use, sought nonfarm income, and altered production as market signals advised. As a report by the Federated Farmers of New Zealand noted, the country's experience "thoroughly debunked the myth that the farming sector cannot prosper without government subsidies."<sup>145</sup> Reformers in Congress should work to debunk similar myths in this country.

## Actively Damaging Programs

Federal spending requires the extraction of resources from the private sector and the substitution of political preferences for the private preferences of individuals. Do government activities create higher value than the private activities that are forgone?

Many federal activities do not. Much spending is wasteful—either mismanaged, duplicative, or ineffective. Wasteful programs can be thought of as those the benefits of which are less than the added burden on taxpayers.

Some federal programs are worse than wasteful—they are actively damaging. Such programs can negatively affect Americans in a number of ways beyond the tax costs. First, programs can damage the economy and reduce income levels. Second, programs can restrict individual freedom. Third, programs can create negative social consequences. Fourth, federal programs can damage the environment. Those negative effects are discussed in turn.

### Economic Damage

Many federal programs damage the economy beyond the added cost of taxes needed to fund them. For example, the government operates a huge regulatory structure that pushes up production costs, stifles business innovation, and restricts consumer choice. Wayne Crews summarizes the scope of the federal regulatory state in his annual report "Ten Thousand Commandments."<sup>146</sup> His latest figures show that the budget cost of administering federal regulations is about \$25 billion annually, but the cost to the economy of federal regulations is about \$860 billion annually.<sup>147</sup>

Many regulations aim at particular social ends, while others are supposed to help the economy. Yet even the regulations that are supposed to help the economy can end up damaging it. Consider federal antitrust policy. The antitrust bureaucracies in the Depart-

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ment of Justice and the Federal Trade Commission will cost \$215 million this year.<sup>148</sup> But the economic harm created by antitrust laws might be much higher than that. Antitrust laws restrict commercial freedom on the assumption that the government knows best how markets should be organized. But the government does not have sufficient knowledge to make such determinations, and its interventions are hit-or-miss at best.

Antitrust laws are more than a century old, and experts still have no clear rules to determine when intervention might be a good idea. Two top Brookings Institution scholars recently surveyed a century of antitrust policy and found “little empirical evidence that past interventions have provided much direct benefit to consumers or significantly deterred anticompetitive behavior.”<sup>149</sup> Indeed, the authors discuss numerous large cases in which the government got it wrong and pursued actions that damaged the economy.

Antitrust is driven by special interests and by cloistered bureaucrats who view the economy from a static and legalistic perspective. But the economy is highly dynamic, which often makes government “solutions” obsolete by the time they are imposed. Consider the antitrust case against Xerox Corporation in the 1970s.<sup>150</sup> After inventing the modern photocopier in 1960, Xerox led the industry that it created. By the early 1970s, it still held a commanding market share, prompting the Federal Trade Commission to charge the company with monopoly. Xerox’s two-year struggle with the FTC cost millions of dollars and ended in a settlement. As it turned out, the government intervention was wholly unneeded as IBM, Eastman-Kodak, Canon, Minolta, and Ricoh surged into the market in the mid-1970s with copiers that were often superior to Xerox’s. Federal litigation drained the energy of Xerox’s management, and its market share eroded rapidly as the competition heated up.

Government intervention was also a big waste of time and energy in the infamous IBM antitrust case that lasted from 1969 to 1982.

IBM was charged with monopolizing the mainframe computer business. During the long legal battle, the industry evolved rapidly. In 1982 the government finally dropped its case as obsolete and conceded that it was without merit. The case cost hundreds of millions of dollars in legal expenses, generated 66 million pages of evidence, and diverted IBM’s time and energy from more productive business endeavors.<sup>151</sup> Today, business efforts to fend off the government antitrust wolves cost the economy billions of dollars a year.<sup>152</sup>

It is remarkable that the government persists in launching such dubious interventions after its many failures. Federal policymakers need to be far more humble about their ability to intervene successfully in the economy. The federal antitrust agencies should be terminated, and policymakers should start downsizing other agencies that add to the \$860 billion regulatory burden imposed on the U.S. economy.

### **Loss of Freedom**

Thousands of federal rules and regulations—ranging from limits on free speech in broadcasting to limits on the flush volume of American toilets—restrict personal freedom. About 75,000 pages of new federal regulations are published in the *Federal Register* each year.<sup>153</sup> Some rules are enacted with the public interest in mind, while others are pushed by special interests. Either way, the private and voluntary sphere of society continues to shrink as government control expands.

Examining the impact of the federal regulatory structure is beyond the scope of this report. But a general problem seems to be the lack of a presumption of individual freedom in the regulatory process. Currently, bureaucrats act as central planners in attempting to balance the costs and benefits of new regulations. But many costs and benefits are simply not knowable to the government, and federal planners cannot realistically put values on the diverse ends of 300 million citizens.

Add to that the government’s poor management record, and there should be a bigger onus on government to prove that programs,

laws, and regulations are absolutely necessary. Too often the knee-jerk reaction of policymakers is to add new government controls when a problem arises in society, even when there is substantial disagreement among experts about the costs and benefits. Instead, when there are large unknowns, the default position should be freedom, and a high hurdle placed on intervention. Congress should cut funding to agencies that are overzealous regulators.

Prescription drug approval is an area where individual freedom is undervalued and the costs of restrictions can be large. Many experts contend that the Food and Drug Administration's drug approval process, although improved in recent years, is still too burdensome and risk averse. The result is that life-improving and life-saving drugs are kept off the market. Henry Miller, a senior fellow at the Hoover Institution, argues that "Americans are literally dying for reform" of FDA regulations.<sup>154</sup> For example, a new anti-cancer drug, Erbitux, was withheld from cancer patients for two years while the FDA procrastinated on approval.<sup>155</sup> Some analysts figure that the slowness of FDA drug approvals during the past few decades, compared with approvals in other industrial countries, may have cost the lives of hundreds of thousands of Americans.<sup>156</sup> The FDA's overzealous regulation of medical devices has also been criticized for unnecessarily increasing the costs of medical innovation, increasing patient suffering and deaths, and driving medical technology companies overseas or out of business.<sup>157</sup>

Federal restrictions on drug use also undervalue individual freedom. Patrick Michaels recently took to the pages of the *Washington Post* to describe the damage that could result from the Bush administration's efforts to reduce the availability of prescription painkillers.<sup>158</sup> He believes that such actions would result in large economic costs, more Americans living in pain, and more deaths from heart attacks and strokes. *USA Today* also editorialized on the issue.<sup>159</sup> The paper argued that the administration's

tighter surveillance of doctors who prescribe painkillers is damaging to the tens of millions of Americans who suffer from chronic pain. In such cases, where there is substantial doubt about the justice and efficacy of government restrictions, freedom and nonintervention are the best policy.

### **Social Damage**

Despite what are often the best intentions, seven decades of growth in the federal welfare state have created many damaging side effects. For example, traditional unrestricted welfare payments to poor Americans created numerous social pathologies, such as trapping people in dependence and reducing upward mobility.

Seven decades of activist federal housing policy have also been socially destructive. The construction of massive high-rise public housing projects in the mid-20th century was perhaps the most infamous government failure in social policy. Those projects became warrens of drugs, crime, and despair for millions of families. In related efforts, the government's large-scale "slum clearing" and "redevelopment" schemes left many American cities with hideous and unwelcome zones of concrete and lifelessness.

Congress has begun to fix some of the worst welfare state policies. For example, in 1996 it enacted landmark welfare reforms, which have cut the welfare rolls and put greater emphasis on work and advancement by low-income Americans. Meanwhile, high-rise public housing was such a colossal failure that the government has been actively demolishing its apartment projects across the country in recent years.

However, much of the welfare state remains unreformed. In housing, the federal government has replaced some failed programs with newer schemes that are also damaging. In the 1970s Congress began replacing public housing with Section 8 housing vouchers, which are used by two million beneficiaries today. Vouchers, which allow recipients to rent private apartments, were supposed to solve the problem of concentrated

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**Enron Corporation received \$200 million in U.S. government financing to build a 390-mile pipeline from Bolivia to Brazil through a tropical forest in 2001.**

poverty that was the bane of public housing projects. But, in practice, Section 8 vouchers have created similar problems of poverty concentration.<sup>160</sup> Also, like old-fashioned welfare benefits, housing vouchers encourage long-term dependence by recipients and single-parent households. The program's income caps create disincentives to seek work, higher earnings, or advancement. President Bush has proposed a number of changes to Section 8 that move in a reform direction, but the best reform would be to terminate federal housing programs altogether.<sup>161</sup>

Howard Husock, a housing policy expert at the Manhattan Institute, argues that federal housing programs have been "profoundly destructive."<sup>162</sup> HUD programs have not only created concentrated poverty and dependence in subsidized communities; they have created negative effects radiating outward to surrounding neighborhoods in cities.<sup>163</sup>

Husock notes that prior to the federal government's large-scale intrusion into housing in the 1930s, private markets provided decent low-cost housing relative to standards of the day. When low-cost housing is private and unsubsidized, it transforms and improves over time. Tenants in private housing tend to be temporary, not permanent, as they have every incentive to strive to better themselves, earn more, and move up the ladder to better housing.

### **Environmental Damage**

Numerous federal spending programs actively damage the environment. Department of Agriculture subsidies can cause overproduction of crops, overuse of marginal farming land that would otherwise be forests or wetlands, and excessive use of fertilizers. The Forest Service has subsidized the cutting of large stretches of forest by constructing 380,000 miles of logging roads and undercharging timber companies in its timber harvest program.<sup>164</sup> The federal Power Marketing Administrations sell electricity at far below-market rates, which has encouraged overconsumption of energy by homes and the large industrial users of PMA power.<sup>165</sup>

The federal government's large engineering and construction programs have often damaged the environment. The Army Corps of Engineers has pushed ahead with huge projects that make little economic or environmental sense. Federal export loans have supported environmentally damaging projects in less-developed countries. For example, Enron Corporation received \$200 million in U.S. government financing to build a 390-mile pipeline from Bolivia to Brazil through a tropical forest in 2001.<sup>166</sup> The *Washington Post* reported that the Chiquitano Forest pipeline, financed by the federal Overseas Private Investment Corporation, was put through one of the most valuable and unscathed regions of forest in South America.<sup>167</sup> Recent scandals have brought down Enron, but scandals such as this never seem to bring down government agencies like OPIC.

Federal water subsidies are also damaging. The Bureau of Reclamation runs a vast water empire in the western United States that sells water to farmers and homes at a fraction of the market cost. The resulting overuse will eventually lead to a water crisis as the West's population keeps rising. The solution is to move water into the free market and allow prices to rise to efficient and environmentally sound levels.<sup>168</sup>

The bureau's water megaprojects have a history of cost overruns and running afoul of good environmental policy. For example, the giant Animas-La Plata dam project in southwestern Colorado has environmental groups up in arms, and it looks ugly from a taxpayer perspective as well. The official project cost estimate jumped from \$338 million in 1999 to \$500 million in 2003.<sup>169</sup> Taxpayers and environmental groups share a lot of common ground when it comes to federal policy, and pro-green budget cuts would be a good away to downsize the federal government.<sup>170</sup>

## **State and Local Functions**

The federal government was designed to have specific limited powers with most basic

government functions left to the states. The Tenth Amendment to the Constitution states this clearly: “The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.” But during recent decades, the federal government has undertaken a large number of activities that were traditionally and constitutionally reserved to the states.

The primary mechanism that the federal government has used to extend its power into state affairs is grants to state and local governments (“grants-in-aid”). In FY04 federal grants totaling \$418 billion will be paid out to lower levels of government for a huge range of activities, including health care, transportation, housing, and education.<sup>171</sup> Grants to state and local governments increased from 7.6 percent of total federal spending in FY60 to 18 percent in FY04.<sup>172</sup>

The federal grant structure is massive and complex, as detailed in the 1,800-page Catalog of Federal Domestic Assistance available at [www.cfda.gov](http://www.cfda.gov). That publication is a comprehensive summary of federal grant programs to lower levels of government, private organizations, and individuals. The CFDA lists 716 different grant programs aimed at state and local governments.<sup>173</sup> Grant programs range from the giant \$177 billion Medicaid to hundreds of more obscure programs that most taxpayers have never heard of. The CFDA lists a \$10 million grant program for Nursing Workforce Diversity and a \$59 million program for Boating Safety Financial Assistance. One Environmental Protection Agency program hands out \$25,000 grants to local governments for projects that “raise awareness” about environmental issues.<sup>174</sup>

Such huge federal granting activity has created an industry of consulting firms, specialized software, and trade publications all geared to help state and local governments grab more federal cash. Excessive complexity and duplication in the federal grant industry have been evident since the 1960s, and occasional reforms have not fixed the prob-

lems.<sup>175</sup> Indeed, duplicative programs are proliferating: The GAO recently reported that there are 16 overlapping grant programs for local “first responders” such as firefighters.<sup>176</sup> Grants have proven to be a terribly wasteful way of providing government services to Americans. It is time to begin large-scale cuts to the federal grant empire.

Ronald Reagan tried to do just that. In his 1983 budget message, Reagan argued that “during the past 20 years, what had been a classic division of functions between the federal government and the states and localities has become a confused mess.”<sup>177</sup> To sort out the mess, Reagan pushed for cuts to federal grants. He was modestly successful, as shown in Figure 3, which illustrates trends in health and nonhealth grants to the states in constant 2004 dollars. Between 1980 and 1985, Reagan cut overall grant spending by 15 percent in constant dollars and nonhealth grants by 21 percent. However, the cuts were short-lived and grant spending increased rapidly during the 1990s.

Figure 4 shows the total number of federal grant programs aimed at state and local governments. The effects of Reagan’s cuts in the early 1980s are evident. But since the mid-1980s the number of grant programs has soared with only a brief retrenchment in the mid-1990s after the Republicans gained power in Congress. There are more than twice as many grant programs today as there were in the mid-1980s. The number of grant programs increased from 463 in 1990 to 716 in 2003.

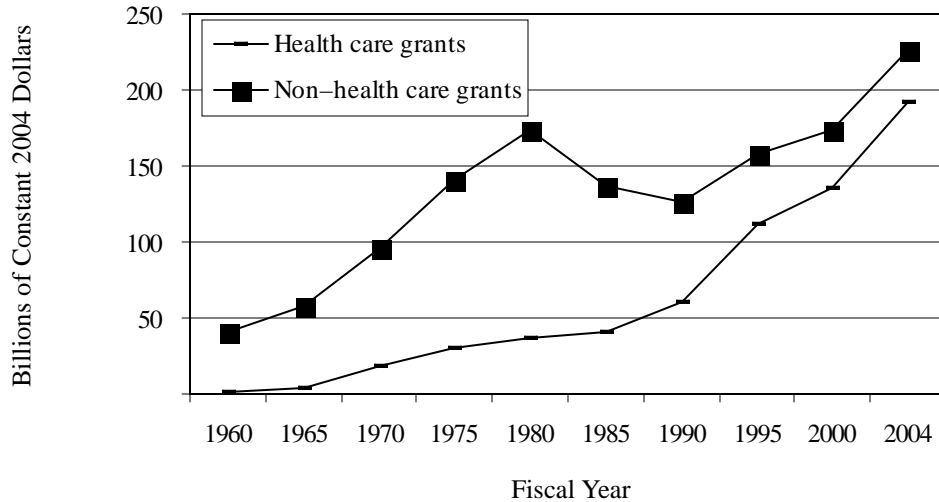
The increase in federal grants has occurred because of political logic, not economic logic. Federal grants allow Washington to sidestep concerns about expansion of its powers over traditionally state activities. By using grants, federal politicians can become activists in areas such as education, while overcoming states’ concerns about encroachment on their power by shoveling cash into state coffers.

Much of the support for grants—and support for centralization of government power in general—comes from policymakers who think that the federal government should redistribute income from prosperous to poor

**There are more than twice as many grant programs today as there were in the mid-1980s.**

**Every member  
of Congress  
ultimately wants  
a piece of the  
action.**

**Figure 3**  
**Real Federal Grants to State and Local Governments**

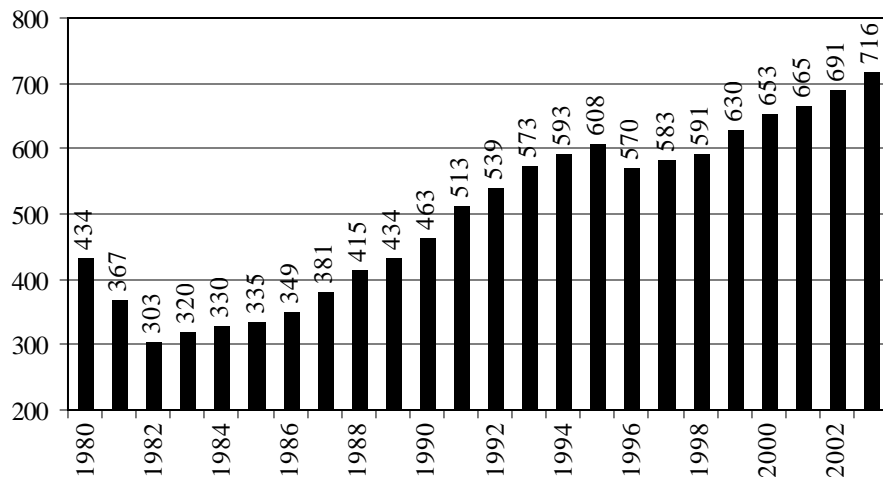


Source: Author's calculations based on *Budget of the U.S. Government, FY05, Analytical Perspectives*, p. 120.

regions of the country.<sup>178</sup> But political realities have tended to undermine such egalitarian plans. As a study by the Urban Institute noted a number of years ago, “political pressures in the design of grant funding formulas considerably limit the design of grants to even out economic disparities among regions, thus undermining one of the major rationales for

their use.”<sup>179</sup> Although the initial goal of a grant program might be to aid poor regions, every member of Congress ultimately wants a piece of the action. Grant programs “must sprinkle funds among all jurisdictions to gain acceptance” as each member aims to win votes back home.<sup>180</sup> Much grant money is “earmarked” today and thus goes to the districts

**Figure 4**  
**Number of Federal Grant Programs for State/Local Governments**



Source: Office of Management and Budget based on Catalog of Federal Domestic Assistance. The figure for 2002 is estimated.

of powerful members of Congress, not to the truly needy regions.

A good example is the \$6 billion Community Development Block Grant program. That HUD program was created in 1974 to channel federal money to low-income urban areas for key services such as fire and police. But today the program spreads taxpayer largesse widely to some of the wealthiest areas of the country for often-dubious projects. Today, all urban areas with 50,000 or more people are eligible for the program, not just the needy ones.<sup>181</sup> The FY03 federal budget noted that the program has funded such projects as the installation of a traffic light in wealthy Newton, Massachusetts.<sup>182</sup> Such grant programs often become little more than slush funds that federal politicians use to buy votes back home.

The Department of Education's \$10 billion Title I program provides another example of the difficulty of targeting grants to aid poor Americans. A recent statistical analysis by Nora Gordon of the University of California, San Diego, found that, although Title I is supposed to steer money to poor school districts, the actual effect is different.<sup>183</sup> She found that within a few years of a grant being given, state and local governments used the federal funds to displace their own funding of poor schools. Thus, poor schools may be no further ahead despite the federal grant money directed at them.

A high-minded purpose may underlie many federal grant programs, but grants are an inefficient method of governing America. The money to fund federal grants comes from people living in the 50 states. They send their tax dollars to Washington where they get reallocated by Capitol Hill horse-trading and routed through layers of departmental bureaucracy. The depleted funds are sent back down to state and local agencies, coupled with long lists of complex federal regulations with which those agencies must comply.

Federal grants can set off a gold-rush response at state and local levels, producing irresponsible overspending decisions. With federal matching grants, state politicians can spend an added dollar on their constituents

while charging them only a fraction of a dollar in state taxes, depending on the matching rate.<sup>184</sup> In such cases, program expansion is very attractive. With Medicaid, for example, state governments have expanded benefits and the number of eligible beneficiaries beyond reasonable levels because of the generous federal match.

Medicaid illustrates how states can abuse the handouts they receive from Washington. In recent years, numerous states have bilked the federal government out of billions of dollars with complex schemes to maximize Medicaid payments.<sup>185</sup> For example, some states imposed taxes on health care providers that were at the same time rebated to the providers. The effect was to increase reported state Medicaid spending and boost federal matching funds. Amazingly, states have continued to operate such schemes despite a decade of scrutiny by the federal government.<sup>186</sup> Indeed, state gamesmanship to maximize federal grants goes back to at least the 1960s.<sup>187</sup>

Given all those problems, it is not surprising that the OMB finds that grant programs have poorer performance, on average, than other federal programs.<sup>188</sup> States have little incentive to spend grant money efficiently because it comes to them "free." In Maryland recently the head of the state's Office of Crime Control and Prevention was indicted for diverting federal grant money into a political campaign.<sup>189</sup> Talk about inefficient!

To reduce the wasteful state spending of grant money, reformers have sought to convert matching grants to block grants. Block grants provide a fixed sum to states and give them flexibility in program design. For example, the 1996 welfare reform law turned Aid to Families with Dependent Children, a traditional open-ended matching grant, into Temporary Assistance for Needy Families, a lump-sum block grant.

Although state governors complain when the federal government cuts grants, taxpayers throughout the 50 states would benefit from cuts. First, state residents are, of course, federal taxpayers who will pay for the \$418 billion in grants this year. Second, centralization of

**Federal grants can set off a gold-rush response at state and local levels, producing irresponsible overspending decisions.**

**Federal grants for local “first responder” activities are popular in the wake of 9/11, but they too are bogged down in bureaucracy.**

government spending power creates unfair redistributions of taxpayer money between states. For example, states receive varying amounts of highway grants for each dollar of gasoline taxes sent to Washington.<sup>190</sup> While some states lose out, other states get unneeded “highways to nowhere,” often named after champion pork barrelers such as Sen. Robert Byrd (D-WV) and former representative Bud Shuster (R-PA).

Third, federal grants reduce state government flexibility and innovation. The classic one-size-fits-all federal regulation was the 55 mph national speed limit, which was enforced between 1974 and 1995 by federal threats to withdraw state highway grant money. Today, Medicaid has perhaps the most inefficient top-down rules of any grant program. The FY05 Bush budget notes that the “complex array of Medicaid laws, regulations, and administrative guidance is confusing, overly burdensome, and serves to stifle state innovation and flexibility.”<sup>191</sup> But while the Bush administration complains about Medicaid, its own No Child Left Behind education law of 2002 is the source of much state and local anger at top-down federal control.

Fourth, grants impose on taxpayers the costs of the bureaucracies that are needed to administer the intergovernmental flows of money. Indeed, the federal grant superstructure is intensely bureaucratic and wasteful. To take one example, the \$59 million Weed and Seed anti-drug program for schools has a 74-page application kit that references 1,300 pages of regulations that grant recipients must follow. The Bush administration is right that the federal grant process is “overwhelming,” “off-putting,” and “intimidating.”<sup>192</sup>

Many grant programs involve three levels of bureaucracy—federal, state, and local—before funds are disbursed for a project. That is “trickle-down” economics at its worst. For example, the \$441 million Safe and Drug Free Schools program sends money to state education bureaucracies, which in turn use complex procedures to send funds down to local school boards.<sup>193</sup> School boards need expert bureaucrats to complete lengthy

application forms to get the funds. The Bush administration has concluded that this program is not effective, as schools tend to spend the money wastefully.<sup>194</sup>

Federal grants for local “first responder” activities are popular in the wake of 9/11, but they too are bogged down in bureaucracy. In some cases, grant money flows through four levels of government—federal, state, county, and city—before items such as emergency radios are purchased.<sup>195</sup> A House committee reported in April 2004 that \$5.2 billion of \$6.3 billion in first responder grants made since 9/11 “remains stuck in the administrative pipeline at the state, country, and city levels.”<sup>196</sup>

Much of the first responder money has gone to dubious projects of little value that are unrelated to terrorism risk. A large share of the funding was distributed to states on the basis of factors, such as population, that are unrelated to risk. At the state level, the House report found that almost one-third was allocated to projects without regard to terrorism risk. One rural county of 11,500 people in Wyoming received \$546,000. One rural county in the state of Washington used a federal grant to buy a \$63,000 HAZMAT unit, but it does not have a HAZMAT team to use it.<sup>197</sup>

Like other grant programs, first responder grants have spurred much wasteful lobbying activity. On March 4, 3,000 local officials flew into Washington to lobby Congress for larger first responder grants.<sup>198</sup> They were followed on March 16 by firefighters from across the country coming to lobby Congress.<sup>199</sup>

Community Development Block Grants share those sorts of inefficiencies. Some CDBG money is handed out to state governments, which in turn hand it out to local governments. The program has terribly complex formulas for determining which areas get funding.<sup>200</sup> The OMB concludes that the CDBG program has “an unclear mission, loose targeting requirements, and a lack of focus on results.”<sup>201</sup>

Perhaps the most serious problem caused by grants is that federal politicians are spending their time dealing with local issues rather than devoting full attention to crucial national issues. Members of Congress busily steering



pork projects to their districts have had little time to seriously oversee government, for example by dealing with mismanagement at the FBI.

Federal grants create problems for the voting public as well. The overlapping programs of federal, state, and local governments make it very difficult for citizens to figure out which agency or politician is responsible for problems. All three levels of government play big roles in such areas as transportation and education, which makes accountability difficult. Politicians themselves have become skilled at pointing fingers at other levels of government when policies go sour.

The solution to those problems is to move traditional state and local functions back to the states. In the 1980s the Reagan administration pursued “New Federalism” to re-sort federal and state priorities such that each level of government would have full responsibility for financing its own programs. For example, Reagan proposed that the federal government fully run Medicaid but that welfare and food stamps be fully operated and financed by the states.<sup>202</sup>

Reagan sought to cut grants and terminate spending in areas that were properly state activities. For example, he tried unsuccessfully to abolish the Department of Education, calling it “President Carter’s new bureaucratic boondoggle.”<sup>203</sup> Another dimension of Reagan’s plan was for the federal government to cut direct funding of local governments and just deal with state governments.

Reagan’s New Federalism was only partly successful. He did manage to cut grant spending and turn some grant programs into block grants.<sup>204</sup> In the Omnibus Budget Reconciliation Act of 1981, 59 grant programs were eliminated, and 80 narrowly focused grants were consolidated into 9 block grants.<sup>205</sup> That consolidation into block grants substantially reduced the regulatory burden for those programs.<sup>206</sup> As noted, federal grants to the states, measured in constant dollars, were cut between FY80 and FY85.<sup>207</sup>

The Republican Congress in the mid-1990s tried to revive Reagan federalism. They sought

to abolish the Department of Education but were again unsuccessful. The Republicans did have some success in turning grant programs into block grants, most notably with welfare reform in 1996. However, President Clinton’s veto pen was a barrier to many reforms, including the Republican budget plan in 1995 that would have turned Medicaid into a block grant and cut the program by \$187 billion over seven years.<sup>208</sup>

Grant spending has soared in recent years. Total grant outlays have increased from \$225 billion in FY95 to \$418 billion in FY04. While Republicans used to seek abolition of the Department of Education, outlays on that department have soared from \$36 billion in FY01 to \$63 billion in FY04 under the current Republican president. In addition, under the Republican Congress the number of “earmarked” local spending projects has soared.<sup>209</sup>

With today’s large deficit and coming cost increases in entitlement programs, there is little budget room for federal spending on state and local activities. Policymakers need to revive federalism and transfer programs back to the states. State and local governments are in a better position to determine whether residents need more roads, schools, and other items. By federalizing such spending we are asking Congress to do the impossible—to efficiently plan for the competing needs of a diverse country of almost 300 million people.

## Private Functions

Many federal activities are commercial in nature and could be carried out by private firms in competitive markets. In some areas, companies are prevented from offering services to the public because of government restrictions. For example, the U.S. Postal Service has a legal monopoly on first-class mail. In other areas, the government duplicates services that are already available in the private sector. USPS’s parcel delivery competes with private parcel services, for example. Another example is the federal government’s National Zoo in Washington, which

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**Governments on every continent have been busy selling off assets, such as electric utilities, airlines, oil companies, railroads, and other businesses. Even postal services are being privatized.**

has recently been rocked by scandals regarding its poor treatment of animals.<sup>210</sup> There is no need for the government to be in the zoo business. Indeed, some of the best zoos in the country, such as the San Diego and Bronx zoos, are private.<sup>211</sup>

In a government-wide analysis, the Bush administration has determined that about half of all federal employees perform tasks that are also performed by private businesses in the marketplace and thus are not “inherently governmental.”<sup>212</sup> The administration has begun opening up some of those activities to allow private firms to bid for work that has been performed in-house. The administration estimates that the cost saving from such competitive sourcing averages about 20 percent.<sup>213</sup>

However, competitive sourcing is not privatization. The administration goes astray when it supports competitive sourcing of programs when privatization or termination would be superior. Privatization gets spending off the government’s budget entirely and provides for much greater dynamism, efficiency, and innovation than is possible through government contracting.

In addition, privatization avoids a serious pitfall of contracting—opening up the government to greater corruption. A recent scandal at the Pentagon was classic. Two senior procurement officials were convicted of receiving sexual favors and \$1 million in cash for awarding minority set-aside defense contracts to particular firms.<sup>214</sup> One of the men headed the Pentagon’s Office of Small and Disadvantaged Business Utilization, which helps minority firms win contracts. In this case, the best reform is not competitive sourcing but termination of this unneeded Pentagon office.

Privatization used to be considered a radical reform, but dozens of countries have pursued major privatizations during the past two decades. Governments on every continent have been busy selling off assets, such as electric utilities, airlines, oil companies, railroads, and other businesses. Even postal services are being privatized. Britain, Finland, Germany, the Netherlands, New Zealand, and Sweden have either opened up postal services to pri-

vate competition or privatized their national mail companies.<sup>215</sup> Unfortunately, Americans continue to be saddled with the 774,000-employee USPS and other inefficient government businesses.<sup>216</sup>

There has been the occasional reform effort in this country. Ronald Reagan established a President’s Commission on Privatization that proposed modest reforms in a 1988 report, but Congress generally did not act on them. A few federal entities have been sold off in recent decades. Conrail, a freight railroad in the Northeast, was privatized in 1987. The Alaska Power Administration was privatized in 1996. The U.S. Enrichment Corporation, which provides enriched uranium to the nuclear industry, was privatized in 1998.

Today, privatization of federal assets makes even more sense than in the past for a number of reasons. First, sales of federal assets would cut the budget deficit. Second, by reducing the responsibilities of the government, members of Congress could focus on their core responsibilities, such as national security. Third, other countries have had experience with privatization that could be drawn on in pursuing reforms in the United States. Fourth, privatization would spur economic growth by opening new markets to entrepreneurs. For example, privatization of USPS and the repeal of its legal monopoly would bring major innovation to the mail business, just as the breakup of AT&T’s monopoly in the 1980s brought innovation to the telecommunications business.

Some policymakers think that certain activities, such as air traffic control, are “too important” to leave to the private sector. But the reality is just the opposite. The government has shown itself to be a failure at providing efficient and high-quality air traffic control, passenger rail, and other services. Those industries are too important to miss out on the innovations and likely greater safety that private entrepreneurs could bring to them in open markets.<sup>217</sup>

### **Stand-Alone Businesses**

The federal government operates numer-

ous business enterprises, including the USPS, Amtrak, and a number of electric utilities, that could be converted into publicly traded corporations. The United States has lagged behind other countries that now provide in-depth experience that Congress can learn from when it moves ahead with reforms.

- **Postal Services.** A report by a presidential commission in 2003 and other studies have concluded that the outlook for USPS is bleak, with declining mail volume and rising costs.<sup>218</sup> The way ahead is to privatize the USPS and repeal the mail monopoly that it currently holds.<sup>219</sup> New Zealand and Germany have implemented bold reforms that Congress should examine. Since 1998 New Zealand's postal market has been open to private competition, with the result that postage rates have fallen and labor productivity at New Zealand Post has risen markedly.<sup>220</sup> Germany's Deutsche Post was privatized in 2000, with the result that the company has greatly improved productivity and has expanded into new lines of business.<sup>221</sup>
- **Electric Utilities.** Unlike the industry in other countries, the U.S. electricity industry has always been dominated by publicly traded corporations. However, the federal government owns the huge Tennessee Valley Authority and four Power Marketing Administrations, which sell power in 33 states. Those government power companies have become an anachronism as utility privatization has been pursued across the globe from Britain to Brazil and Argentina to Australia. TVA and PMA privatization would reduce the federal deficit, eliminate the artificially low TVA and PMA power rates that encourage overconsumption, and increase efficiency in utility operations and capital investment.<sup>222</sup> President Clinton proposed to sell off the four PMAs in his FY96 budget. It is time to dust off those plans and move ahead with reform.

- **Passenger Rail.** Subsidies to Amtrak were supposed to be temporary after the passenger rail agency was created in 1970. That has not occurred, and Amtrak has provided second-rate passenger rail service for 30 years while consuming more than \$25 billion in federal subsidies.<sup>223</sup> Reforms elsewhere show that private passenger rail can work. Full or partial rail privatization has occurred in Argentina, Australia, Britain, Germany, Japan, New Zealand, and other countries.

### Infrastructure

Before the 20th century, transportation infrastructure was often financed and built by the private sector. For example, there were more than 2,000 private companies that built and operated private roads in America in the 19th century.<sup>224</sup> But during much of the 20th century, transportation infrastructure was thought of as a government function. By the 1980s that started to change, and governments around the world began selling off, or letting private firms build, billions of dollars worth of airports, highways, bridges, and other infrastructure.<sup>225</sup>

Just about any service that can be supported by fees paid by consumers can be privatized. A big advantage of privatized airports, air traffic control, highways, bridges, and other infrastructure is that private companies can freely tap debt and equity markets for capital expansion to meet rising consumer demand and reduce congestion. Today, infrastructure upgrades and modernization are constrained by reliance on available government funding and lack of long-term government budget planning.

- **Air Traffic Control.** Numerous countries have partly or fully privatized their ATC services. Canada's reforms provide a good model for the United States. In 1996 Canada set up a fully private, non-profit ATC corporation, Nav Canada, which is self-supporting from charges paid by aviation users. The new Canadian system has received rave

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reviews for investing in the latest technology and reducing air congestion.<sup>226</sup> Meanwhile, the Federal Aviation Administration has been struggling to modernize U.S. air traffic control for two decades. The FAA's upgrade efforts have frequently fallen behind schedule and gone over budget. The GAO found that one FAA upgrade begun in 1983 was to be completed by 1996 for \$2.5 billion.<sup>227</sup> But the completion date was pushed back to 2003, and the project ended up costing \$7.6 billion, with \$1.5 billion wasted on activities that were ultimately scrapped. ATC is far too important for such government mismanagement. Privatization is long overdue.

- **Highways.** A number of states and foreign countries have started experimenting with privately financed and operated highways. The Dulles Greenway in northern Virginia is a 14-mile private highway opened in 1995. It was financed through private bond and equity issues and uses an electronic toll system to maximize efficiency for drivers. In Richmond, the 895 Connector project is being financed by private capital and will be operated by a nonprofit firm. Fluor Daniel, a leading engineering company, has proposed building private highways in Virginia, including widening the Capital Beltway with four new electronic toll lanes.<sup>228</sup> The company also has a \$1 billion plan to build toll lanes running 56 miles south from Washington along an existing interstate.<sup>229</sup> Similar private road projects are being pursued in California, Texas, North Carolina, and South Carolina.<sup>230</sup> There is clearly a strong private-sector interest in funding and building highways. Policymakers should pave the way for such entrepreneurs to help reduce congestion and save taxpayer money.
- **Airports.** Most major airports in the United States are owned by municipal governments, but the federal government helps fund airport renovation and expansion.

Once again, the United States lags behind other countries on reforms. Airports have been fully or partially privatized in Auckland, Copenhagen, Frankfurt, London, Melbourne, Naples, Rome, Sydney, Vienna, and other cities. The British led the way with the 1987 privatization of British Airports Authority, which owns London's Heathrow and other airports. In the United States, Congress needs to take the lead on airport privatization because there are numerous federal roadblocks that make U.S. cities hesitant to proceed with reforms.<sup>231</sup> For example, under current laws government-owned airports can issue tax-exempt debt, which gives them a financial advantage over private airports.

### **Loan Programs**

The federal government runs a large array of loan and loan guarantee programs for farmers, students, small businesses, utilities, shipbuilders, weapons purchasers, exporters, fishermen, and other groups. There are at least 59 federal loan programs and 70 loan guarantee programs.<sup>232</sup> Loan guarantees are promises to private creditors, such as banks, that the government will cover borrower defaults. At the end of 2003, there was \$249 billion in outstanding federal loans and \$1.2 trillion in loan guarantees.<sup>233</sup>

In the 1970s federal loans and loan guarantees grew rapidly as members of Congress discovered that they could pay off special interests with loan programs, while not paying any political cost for directly supporting higher spending.<sup>234</sup> Like other federal programs, loan programs that make no economic sense can survive by creating an "iron triangle" of interests that resist reform. Supporters of loan programs include loan beneficiaries, financial institutions, federal loan administrators, and congressional committees that authorize loan programs.<sup>235</sup>

In the 1980s the Reagan administration tried to cut federal loan programs but did not have much success.<sup>236</sup> Policymakers should revive Reagan's initiatives and begin

terminating or privatizing federal loan programs. The provision of credit is a centuries-old institution that does not need government help, especially given the sophistication and liquidity of financial markets today.

Some federal loan programs target borrowers who could have gotten private financing. In such cases, there is no need for government loans because they simply displace private loans. Other loan programs target borrowers who cannot secure private financing. In that case, federal loans support borrowers who are poor credit risks, and taxpayer money is likely to be wasted when loans are defaulted on.

The *Washington Post* recently provided an example of the first type of loan program.<sup>237</sup> It profiled the chief executive of a construction consulting firm that is successfully winning projects. The company has good prospects and is owned by an experienced entrepreneur and accountant who apparently would have little trouble obtaining regular business loans from a bank. But the company received a Small Business Administration 7(a) loan guarantee from the government. In addition, because the owner is a minority, the company is applying to the SBA 8(a) program for “disadvantaged” businesses in order to obtain subsidies and favored access to federal contracts. Taxpayers should not have to foot the bill for handouts to such prosperous members of society.

Some federal loans are targeted at high-risk borrowers who perhaps should not receive loans at all. For example, Farm Service Agency loans are aimed at farmers who are unable to obtain private credit at market interest rates. But such farmers might be bad credit risks with poor business prospects. Sure enough, default rates on FSA loans are higher than on comparable private-sector loans.<sup>238</sup> Taxpayers lose about half a billion dollars each year because of defaults on farm loans.<sup>239</sup> The delinquency rate for FSA direct loans was 21 percent in 2000 (down from 41 percent in 1995).<sup>240</sup> By comparison, delinquency rates on private farm loans, and other commercial loans, is only about 3 percent.<sup>241</sup>

The FY05 federal budget says that govern-

ment loan programs are needed because private markets suffer from “imperfections,” such as lenders not having perfect information about borrowers.<sup>242</sup> For example, banks might be more hesitant to lend to start-up businesses because they do not have lengthy credit histories. However, that analysis is flawed. It is appropriate that start-up firms face more scrutiny and pay higher interest rates when they access capital because of their higher risk of failure. Failure creates economic waste; thus it is good that creditors are more hesitant to lend to riskier businesses. Government loan subsidies result in too many loans going to borrowers with excessively risky and low-value projects.

Certainly, market allocation of credit is far from perfect. But markets have developed sophisticated mechanisms for funding risky endeavors. For example, venture capital and “angel” investment pump tens of billions of dollars of investment into new businesses every year. There is no need for the government to compete with such private financial mechanisms. Yet the government runs a Small Business Investment Company venture capital program at taxpayer expense. Taxpayers will be out \$2 billion this year because of recent investment losses of the SBIC, according to the federal budget.<sup>243</sup>

Instead of fixing loan market imperfections, government intervention introduces new distortions. For example, the EPA spends about \$2.6 billion annually for wastewater treatment facilities.<sup>244</sup> EPA funding flows to state governments, which make loans to local governments for new facilities. But the loans are set at artificially low interest rates, thus encouraging overinvestment by local officials.

Federal loan guarantees also distort markets. When financial institutions receive federal loan guarantees, they become overeager to lend to those with shaky credit because the government will cover losses in case of default. For example, the SBA 7(a) loan guarantee program targets businesses that cannot obtain private financing and have high default rates. The default rate on 7(a) preferred lender loans has

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averaged 14 percent in the last three years.<sup>245</sup> Loans under this program are supposed to be used for small business expansion. But in the past the GAO found that some SBA loans were going to pay off businesses' prior debts, rather than being used for new investment.<sup>246</sup>

Federal loan programs are generally poorly managed. The Department of Education has about \$100 billion in outstanding student loans under a variety of programs.<sup>247</sup> Student loans have been on GAO's high-risk list for waste, fraud, and abuse every year since 1990.<sup>248</sup> Individuals, financial institutions, and administrators at educational institutions all face incentives to make false claims to gain unjustified aid.<sup>249</sup> Lax enforcement of student loan repayments has led to large losses from defaults, which cost taxpayers \$28 billion during the 1990s.<sup>250</sup>

The federal government exposes taxpayers to losses on other types of financial commitments as well. The Pension Benefit Guaranty Corporation is a federal entity that bails out workers in failed private pension plans. Currently, the PBGC is in financial distress, having recently reported the largest loss in its history.<sup>251</sup> The PBGC could be terminated if distortions in the tax code that favor employer-based pensions were eliminated. Instead, taxes should be reduced on all savings, and retirement income should be the product of individual savings vehicles so that seniors are not dependent on employer plans. If personal savings were separated from employment, the PBGC could be phased out.<sup>252</sup>

Federal taxpayers also face financial exposure from the mortgage giants Fannie Mae and Freddie Mac. Those government-sponsored enterprises (GSEs) are private firms, but experts believe that taxpayers may become responsible for their debts because of their close ties to the government. The value of those ties created an implicit federal subsidy to the companies of \$23 billion in 2003, according to the CBO.<sup>253</sup> The large size of the GSEs creates the threat of a major financial crisis should they run into trouble. Balance sheet liabilities of the GSEs grew from \$374 billion in 1992 to \$2.3 trillion in 2002.<sup>254</sup>

Reforms should completely sever the ties between the government and the GSEs.

**Federal Assets**

At the end of FY03, the federal government held about \$1 trillion in buildings and equipment, \$200 billion in inventory, \$550 billion in land, and \$650 billion in mineral rights.<sup>255</sup> Many federal assets are neglected or abused and would be better cared for in the private sector. It is common to see government property that is in poor shape, with public housing being perhaps the most infamous federal eyesore. The GAO finds that "many assets are in an alarming state of deterioration" and has put federal property holdings on its high-risk waste list.<sup>256</sup> The solution is to sell federal assets that are in excess of public needs and to better manage the smaller set of remaining holdings.

The federal government owns about one-fourth of the land acreage in the United States and continues to accumulate more holdings.<sup>257</sup> Only a portion of that land is of environmental significance, and the government has proven itself to be a poor land custodian. There are widely reported maintenance backlogs on lands controlled by the Forest Service, Park Service, and Fish and Wildlife Service. The solution is, not a larger maintenance budget, but to trim down holdings to fit limited taxpayer resources.

The ongoing process of federalizing the nation's land should be reversed and low-priority holdings sold back to citizens. However, federal agencies do not like to give up their holdings. For example, the *Washington Post* recently reported that the Bureau of Land Management owns 23 acres of land in southern Maryland that have sat idle since 1994 when a radio telescope installation was closed down.<sup>258</sup> BLM is currently trying to find other government uses for the land, rather than transfer it back to the private sector.

The government also owns billions of dollars worth of excess buildings. The GAO finds that the government has "many assets it does not need," including 30 vacant Veterans Affairs buildings and 1,200 excess Department of Energy facilities.<sup>259</sup> The Pentagon estimates

that it spends up to \$4 billion each year maintaining its excess facilities.<sup>260</sup> The department owns excess supply depots, training facilities, medical facilities, research labs, and other installations. Federal asset sales would help reduce the deficit, allow improved maintenance of remaining assets, and improve economic efficiency by putting assets into more productive private employment.

## Conclusion

Congress and the Bush administration need to pursue bold fiscal reforms. The administration should propose cuts in defense, education, Medicare, and other programs rather than always push for increases. Leaders in Congress need to restrain the appropriators and oppose spending increases sought by the administration. All policymakers need to end their selfish jostling to fund favored programs because the looming entitlement crisis will require that the entire budget be scoured for cuts.

Cutting the federal budget will not be easy. It will take a sustained effort to rein in the big spenders in both parties. When campaigning in 1980, Ronald Reagan said clearly that his election would be “a mandate to reduce the size of government and the amount of federal spending.”<sup>261</sup> So far, that clarity of purpose has been absent in the Bush administration. Bush’s modest efforts at improving government efficiency will have little long-term impact. Indeed, Jimmy Carter believed in similar efficiency reforms, but he made no headway in cutting the budget.<sup>262</sup>

Instead, it took Reagan’s more fundamental challenge to achieve even modest reforms in the welfare state. The 1982 *Economic Report of the President* argued that “income redistribution is not a compelling justification in the 1980s for federal taxing and spending programs.”<sup>263</sup> It also stated that “this administration rejects paternalism as a basis for policy.”<sup>264</sup> That type of principled approach to policy is needed to make headway against today’s overgrown federal government.

Strong political leadership can restrain what Thomas Jefferson called “the natural progress of things . . . for liberty to yield and government to gain ground.”<sup>265</sup> Consider this 1982 assessment of Reagan’s federalism by the Urban Institute: “His proposal to turn back \$90 billion of domestic programs to the states was [originally] treated as an extremist gaffe. It is a tribute to the president’s ability to frame national policy debate that . . . his prescription for the future of federalism now commands authority, if not general assent.”<sup>266</sup>

Fiscal conservatives can make progress against out-of-control federal spending, but they need to articulate a clear and consistent vision. The cuts proposed in this study provide consistent Reagan-style solutions. Now the nation needs Reagan-style political leadership to make it happen.

## Appendix: Description of Selected Budget Cuts

This section provides descriptions, organized by department, of selected budget cuts proposed in Table 3. All spending data given are outlays from the *Budget of the U.S. Government, FY2005*. The proposed cuts in this study are not a comprehensive list of possible budget reforms. Indeed, major reforms are also needed in defense and entitlement programs, as discussed in other Cato studies.<sup>267</sup>

### Department of Agriculture

This department provides both cash subsidies to farm businesses and indirect subsidies such as marketing and loan services. It also imposes an array of legal restrictions and tariffs on agricultural goods that raise prices and impede markets. The USDA has 110,000 employees and 7,400 offices scattered throughout the country.<sup>268</sup> No other industry is as coddled as agriculture.

Farm programs damage the economy and unfairly redistribute wealth from taxpayers and consumers to farm businesses. For example, sugar prices are three times higher in the United States than elsewhere because of feder-

**Fiscal conservatives can make progress against out-of-control federal spending, but they need to articulate a clear and consistent vision.**

**Farm programs damage the economy and unfairly redistribute wealth from taxpayers and consumers to farm businesses.**

al controls. The effect is to damage U.S. consumers and U.S. candy companies that rely on sugar.<sup>269</sup> Agriculture subsidies and controls are also an impediment to world trade negotiations, which are designed to bring greater prosperity to every country.<sup>270</sup> All farm subsidy programs should be abolished.

**Crop Subsidies.** Direct crop subsidies by the Farm Service Agency will cost taxpayers \$17 billion in FY04. More than 90 percent of those subsidies go to farmers who raise just five crops—wheat, corn, soybeans, rice, and cotton.<sup>271</sup> Commodities that are eligible for federal payments account for 36 percent of U.S. farm production, while commodities that survive without federal subsidies, such as fruits and vegetables, account for 64 percent of production.

It is widely recognized that agriculture controls and subsidies cause overproduction and inflate land prices. Such inefficiencies had prompted Congress to reform and cut farm programs in 1996 under the “Freedom to Farm” law. However, the administration and Congress reversed course with the 2002 farm bill, which reintroduced price supports and retained high subsidy levels.

In addition to damaging the economy, farm subsidies unfairly redistribute wealth. While politicians love to discuss the plight of the “small farmer,” the bulk of farm subsidies go to the largest farms. For example, the largest 7 percent of farms received 45 percent of farm subsidy payments in 1999.<sup>272</sup> USDA figures show that the average farm household income was \$61,307 in 2000, or 7.5 percent higher than the national average household income of \$57,045.<sup>273</sup>

**Commercial Services for Farmers.** The USDA provides an array of commercial services to farmers, including loans, marketing services, and research. Those programs should be ended, and farmers should purchase such services in the marketplace, as do businesses in other industries. USDA commercial services are generally poorly run. For example, the GAO has found that more than \$2 billion in Farm Service Agency loans is delinquent.<sup>274</sup>

One egregious business subsidy is the USDA Market Access Program. It hands out more than \$100 million annually to farm-related businesses to pay for their foreign marketing expenses such as advertising.<sup>275</sup> This program received a doubling of funds under the Republican farm subsidy law of 2002.<sup>276</sup> Table 4 lists the subsidy recipients in 2003.<sup>277</sup> One would think that wealthy wine producers could market their own products instead of asking taxpayers to pay \$3.7 million to the Wine Institute. Instead of bilking taxpayers, perhaps the Wine Institute could cut its president’s \$595,000 salary to free funds for wine marketing.<sup>278</sup>

**Rural Subsidy Programs.** The USDA operates a range of general rural subsidy programs. For example, the Rural Community Advancement program funds everything from fire protection to waste disposal projects under a complex grant process.<sup>279</sup> The Rural Business-Cooperative Service provides grants and loans for projects such as the National Sheep Industry Improvement Center.<sup>280</sup> The Rural Utilities Service provides subsidized loans to electric, telephone, and water utilities in rural areas. The Rural Housing and Community Development Service provides loans to apartment developers and families through 1,700 offices across the country.<sup>281</sup>

Many studies have found that USDA rural subsidy programs are inefficient and mismanaged.<sup>282</sup> More important, those subsidies are unjust redistributions of wealth, especially given that rural dwellers are better off than other Americans in many ways. For example, home ownership in rural areas is 10 percent higher than the national average, yet the USDA subsidizes rural home loans.<sup>283</sup> Americans who live in rural areas should not be a privileged class deemed more important than other Americans. USDA rural subsidies should be ended.

**Department of Commerce**

This department operates numerous “corporate welfare” programs that reformers have long targeted for termination. Republicans in



**Table 4**  
**Your Tax Dollars at Work: USDA Market Access Program, FY03 Subsidies**

Subsidy Recipient	Amount	Subsidy Recipient	Amount
Alaska Seafood Marketing Institute	\$2,721,428	National Dry Bean Council	\$549,192
American Forest & Paper Association	\$5,979,825	National Honey Board	\$130,533
American Peanut Council	\$1,185,877	National Potato Promotion Board	\$2,331,169
American Seafood Institute	\$750,515	National Renderers Association	\$337,183
American Seed Trade Association/ Oregon Seed Council	\$354,451	National Sunflower Association	\$868,864
American Sheep Industry Association	\$276,916	National Watermelon Promotion Board	\$134,665
American Soybean Association	\$3,431,438	New York Wine and Grape Foundation	\$170,759
Blue Diamond Growers/Almond Board of California	\$1,214,877	North American Export Grain Association	\$75,226
California Agricultural Export Council	\$618,066	Northwest Wine Promotion Coalition	\$438,114
California Asparagus Commission	\$244,922	Organic Trade Association	\$73,573
California Cling Peach Growers Advisory Board	\$316,958	Pear Bureau Northwest	\$1,398,786
California Kiwifruit Commission	\$132,747	Pet Food Institute	\$864,327
California Pistachio Commission	\$771,698	Raisin Administrative Committee	\$1,835,893
California Prune Board	\$2,184,878	Southern United States Trade Association	\$4,644,176
California Strawberry Commission	\$552,809	Sunkist Growers, Inc	\$1,775,869
California Table Grape Commission	\$2,253,608	Texas Produce Export Association	\$72,053
California Tomato Commission/Florida Tomato Committee	\$614,285	The Catfish Institute	\$303,268
California Tree Fruit Agreement	\$1,150,782	The Popcorn Board	\$250,835
California Walnut Commission	\$2,812,106	U.S. Apple Association	\$497,763
Cherry Marketing Institute	\$122,265	U.S. Dairy Export Council	\$2,161,513
Chocolate Manufacturers Association	\$989,423	U.S. Grains Council	\$3,536,255
Cotton Council International	\$8,406,098	U.S. Highbush Blueberry Council	\$106,331
Cranberry Marketing Committee	\$736,959	U.S. Livestock Genetics Export, Inc.	\$754,338
Florida Department of Citrus	\$3,998,895	U.S. Meat Export Federation	\$10,138,190
Food Export USA Northeast	\$4,366,864	U.S. Wheat Associates	\$2,458,897
Ginseng Board of Wisconsin	\$28,559	USA Dry Pea and Lentil Council	\$478,213
Hawaii Papaya Industry Association	\$61,105	USA Poultry and Egg Export Council	\$2,709,601
Hop Growers of America	\$87,081	USA Rice Federation/U.S. Rice Producers Association	\$2,620,887
Intertribal Agriculture Council	\$444,794	WA State Fruit Commission/CA Cherry Advisory Board	\$801,734
Mid-America International Agri-Trade Council	\$6,056,818	Washington Apple Commission	\$1,814,050
Mohair Council of America	\$36,859	Welch's Food	\$535,458
National Association of State Departments of Agriculture	\$1,576,035	Western United States Agricultural Trade Association	\$6,643,513
		Wine Institute	\$3,758,831
		Reserve	\$250,000
		Total	\$110,000,000

Source: USDA, press release, June 6, 2003, [www.usda.gov/news/releases](http://www.usda.gov/news/releases).

the mid-1990s targeted the entire department for closure, with some of its functions moved to other departments. Given the large federal deficit, today is a good time for policymakers to reconsider downsizing Commerce.

**Economic Development Administration.** This agency provides grants and loans to state and local governments, nonprofit groups, and private businesses in regions

with high unemployment. The GAO finds that EDA grants do not significantly affect private-sector employment levels, despite EDA's claims of job creation.<sup>284</sup> Government handouts are not a solution for underperforming local economies. Instead, any U.S. region can become more prosperous by freeing the economy through tax cuts, regulatory reforms, tort reform, right-to-work laws,

**Experience in the United States, Japan, and Europe has shown that government aid and strategic advice to technology companies do not work.**

and other reductions in burdens on businesses and entrepreneurs.

**International Trade Administration.** This agency promotes exports and works with companies to develop strategies for selling abroad. But the GAO has reported that the ITA has been unable to show success in helping businesses enter foreign markets.<sup>285</sup> It makes little sense that career bureaucrats, who may never have worked in private industry, could provide essential help for exporters. Most U.S. exporters are successful without government help. Producers should foot the bill for their own trade activities.<sup>286</sup>

**Federal Technology Programs** A number of business subsidy programs try to create technological advances in U.S. industry. The Advanced Technology Program is supposed to give grants to companies that cannot get private funding. However, the GAO has found that most companies that applied for ATP grants never even looked for private capital.<sup>287</sup> The ATP and similar programs have never made sense and are even more obsolete today because of the large amounts of private financing available for technology firms, including “angel” investment and venture capital. For example, venture capitalists invested \$18 billion in U.S. growth companies in 2003.<sup>288</sup>

The government’s Small Business Innovative Research program is also supposed to “stimulate technological innovation” by handing out grants to businesses.<sup>289</sup> But the program simply displaces private research money that firms would have otherwise spent. One study found that for every dollar of SBIR money received, firms reduce their own research funding by a dollar.<sup>290</sup>

Experience in the United States, Japan, and Europe has shown that government aid and strategic advice to technology companies do not work.<sup>291</sup> The most famous government technology agency was Japan’s MITI, which was thought to be in the vanguard in the 1980s. MITI turned out to be a big failure. MITI advised Honda to stick to motorcycles and not get into cars; its Fifth Generation computing initiative was a flop; it famously gave bad advice to Sony.<sup>292</sup> What

then explained Japan’s industrial success up until the 1980s? Japan succeeded because of high levels of domestic competition, not because of industrial policy. The most successful Japanese industries, including automobiles, motorcycles, steel, robotics, and consumer electronics, had high numbers of firms competing intensely.

A number of U.S. states have tried to create technology agencies with similarly little success. For example, Virginia has spent more than \$100 million during the last decade on a Center for Innovative Technology, which has a fancy glass office tower near Dulles airport.<sup>293</sup> But the CIT is finally being closed down because it accomplished little and few people understood what it was trying to do. The federal government should do the same with its technology agencies.

**Manufacturing Extension Partnership.** This program provides grants to extension centers that assist small- and medium-sized firms in making use of new production technologies. However, the regular workings of the market help disseminate new production knowledge, and federal subsidies are not needed. For example, skilled engineers often move back and forth between firms, and between firms and universities, thus spreading knowledge of the latest techniques.

**Fisheries Subsidies.** The National Oceanic and Atmospheric Administration funds a variety of subsidies for the fishing industry. NOAA’s National Marine Fisheries Service provides industry statistics, promotes exports, and gives operating assistance. Those activities should be paid for by the industry itself.

### **Department of Education**

While campaigning for president in 1980, Ronald Reagan labeled the recently created Department of Education “President Carter’s new bureaucratic boondoggle.”<sup>294</sup> Following Reagan’s lead, the Republican House budget for FY96 proposed to eliminate the department. But it lives and continues to grow. By FY04 it had become President Bush’s \$63 billion boondoggle. The department is poorly managed and has not received a clean bill of

health for its finances from the GAO since 1997.<sup>295</sup> Congress should challenge the president's obsession with federalizing education and start shutting down the department.

**Elementary and Secondary Education.** Total spending on K-12 education rose from \$4,505 per pupil in 1970 to \$9,354 in 2002, measured in constant 2002 dollars.<sup>296</sup> Statistical studies have examined the relationship between public school spending and educational achievement and have found none: higher spending does not lead to higher test scores.<sup>297</sup>

The federal government has greatly expanded its role in K-12 education in recent decades, yet school performance has not improved. The average Scholastic Assessment Test score fell from 1049 in 1970 to 1026 in 2003.<sup>298</sup> National Assessment of Education Progress test scores are also unimpressive. In 2001 the share of 12th grade students scoring "below basic" on writing, history, and geography was 22 percent, 57 percent, and 29 percent, respectively.<sup>299</sup>

The experiment with federal control over the nation's schools has failed. Education should be left to the states and the private sector.<sup>300</sup> For their part, the states should innovate with voucher programs and other tools to inject competition and diversity into the public schools.

**Student Grants and Loans.** Loan programs for postsecondary education have been on the GAO list of high-risk programs for waste, fraud, and abuse since 1990.<sup>301</sup> About \$22 billion of student loans remains in default, more than when the GAO began calling for special scrutiny 14 years ago.<sup>302</sup> Individuals, financial institutions, and administrators at shady institutions have made billions of dollars of false claims for federal aid.<sup>303</sup> Those programs should be devolved to the states and the private sector. College students should rely on the private sector for financing of higher education. After all, students are the ones who gain from the higher salaries and better jobs that follow receipt of a college degree. Indeed, those with a college education will earn, on average, 75 percent more during their lifetimes than those with just high school degrees.<sup>304</sup>

**Grants for School Programs.** The Department of Education overflows with duplicative and wasteful grant programs for K-12 schools. The Safe and Drug-Free Schools and Communities program funds grants to reduce substance abuse by youth. That is a worthy cause, but studies have found that the grants are ineffective.<sup>305</sup> The OMB concludes that the program is "fundamentally flawed."<sup>306</sup> In this program, federal money is sent to the states, which in turn give grants to local school systems. It would be more efficient if school systems designed their own programs and funded them locally.

A common problem is that diversity in solutions is discouraged by the flow of federal money and regulations. For example, the Bilingual and Immigrant Education program gives funds to school districts for instruction of foreign language students. Some analysts think that the program does more harm than good by imposing top-down rules on local officials.<sup>307</sup> A similar squelching of flexibility occurs under the Education for the Disadvantaged program, which provides grants to help low-income students.<sup>308</sup>

**Other Ineffective Programs.** The TRIO program is supposed to increase the college enrollment rates of low-income students. However, the OMB concludes that the program "has not been effective in increasing college preparation and enrollment."<sup>309</sup> The Even Start program funds educational services for low-income, poorly educated families. However, the OMB rates the program as "ineffective" because it has no measurable impact on the children it is designed to help.<sup>310</sup>

### **Department of Energy**

This department is one of the largest sources of federal business subsidies. Like the agriculture industry, the energy industry has been coddled and regulated by the government for decades to the detriment of taxpayers and the economy. Many energy subsidy programs have been rated "ineffective" by the OMB.<sup>311</sup>

The department has also been poorly managed. The GAO has reported that many

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big energy projects have schedule delays and large cost overruns.”<sup>312</sup> Also, classified nuclear weapons information from the department’s laboratories has been acquired by the Chinese.<sup>313</sup> A 1999 House of Representatives report concluded, “Despite repeated PRC thefts of the most sophisticated U.S. nuclear weapons technology, security at our national nuclear weapons laboratories does not meet even minimal standards.”<sup>314</sup> A high-level administration panel investigating the scandals condemned the department as a “dysfunctional bureaucracy” where “organizational disarray, managerial neglect, and a culture of arrogance . . . conspired to create an espionage scandal waiting to happen.”<sup>315</sup>

***Energy Supply Research and Development.***

This program aims to develop new technologies by funding university research, the national laboratories, and public-private partnerships. Research topics range from solar power to nuclear energy. This program also funds the administration’s new hydrogen power initiative. That promises to throw billions of taxpayer dollars down a black hole, given that the National Academy of Sciences finds that hydrogen vehicles may not arrive on America’s roads until 2050.<sup>316</sup> The private sector is wholly capable of funding new energy technologies by itself when there is market potential.

***Fossil Energy Research and Development.***

This program also aims to develop energy technologies by funding university research, the national laboratories, and public-private partnerships. Research areas include clean fuels, oil technology, natural gas, and fuel cells. Federal fossil energy research has a poor record. The CBO has concluded: “Federal programs have had a long history of funding fossil-fuel technologies that . . . had little chance of commercial implementation. As a result, much of the federal spending has not been productive.”<sup>317</sup> That is a polite way of saying that those programs have been a big waste of taxpayer money.

***Energy Conservation.*** Numerous wasteful and unjustified handouts are funded under the rubric of energy conservation. For exam-

ple, solar, wind, and other renewable fuels have been receiving federal subsidies for decades. It is time for those energy sources to stand on their own and succeed or fail in the market. This budget category also includes such subsidies as a \$228 million grant program to help homeowners install weather stripping.

Energy conservation funding will also be spent on the FreedomCar corporate subsidy program.<sup>318</sup> The Bush administration replaced the Clinton administration’s Partnership for a New Generation of Vehicles subsidy with FreedomCAR. The PNGV handed out \$1.5 billion over eight years to U.S. automakers for development of hybrid cars.<sup>319</sup> Despite the subsidies, U.S. automakers did not deliver a hybrid car, while unsubsidized Honda and Toyota introduced the Insight and Prius hybrids, respectively. FreedomCAR subsidies are for fuel cell technologies. The FY03 budget said that while PNGV had a “misguided focus,” the new FreedomCAR would have “clear goals” and an “accountable manager.”<sup>320</sup> That seems doubtful: were any federal managers held accountable for wasting \$1.5 billion in taxpayer money on PNGV?

***Clean Coal Technology.*** This program funds public-private demonstration projects for technologies that burn coal in an environmentally friendly way. But even environmental groups do not like this subsidy for energy companies.<sup>321</sup> The GAO has found that many of the clean coal projects have “experienced delays, cost overruns, bankruptcies, and performance problems.”<sup>322</sup> In 2000 the GAO examined 13 projects and found that “8 had serious delays or financial problems, 6 were behind their original schedules by 2 to 7 years, and 2 projects were bankrupt.”<sup>323</sup>

***Energy Information Administration.*** The EIA collects data on energy sources, prices, supply and demand and related information. With a \$78 million budget, the EIA is a bloated jobs program for economists. The agency should be terminated. To the extent that the EIA data are valuable to users, private firms should be able to collect that information and charge fees for its distribution in private markets.

**Power Marketing Administrations.** The federal government generates electric power at more than 120 federal dams under the authority of four Power Marketing Administrations: Bonneville, Southeastern, Southwestern, and Western. Electricity is sold to utilities and cooperatives in 33 states, generally at far below market rates.<sup>324</sup> Those low rates distort the economy and encourage overconsumption by consumers and the large industrial users of PMA power.<sup>325</sup> President Clinton proposed selling off Southeastern, Southwestern, and Western in his FY96 budget.<sup>326</sup> Those plans should be revived. The CBO estimates that the sale of the Southeastern Power Administration alone would raise \$1.9 billion, which could be used to reduce federal debt.<sup>327</sup> Privatization would eliminate artificially low power rates and increase efficiency in utility operations and capital investment.<sup>328</sup> A fifth PMA, the Alaska Power Administration, was privatized in the 1990s.

### **Department of Health and Human Services**

HHS is the largest federal department, responsible for Medicare, Medicaid, and hundreds of smaller programs. As every policymaker should know, federal health care spending is headed for a major financial crisis in coming years. Growth in Medicare spending is the single biggest problem facing the federal budget. One recent estimate placed the program's long-term financial imbalance at \$37 trillion, and that was before Congress passed the big spending increase for prescription drugs in 2003.<sup>329</sup> That imbalance implies that tomorrow's young workers face a huge tax threat unless the program is reformed.

**Medicare.** Medicare and other HHS programs are rife with waste, fraud, and abuse. Medicare has been on GAO's high-risk waste list for more than a decade, and the program makes erroneous payments of at least \$13 billion every year.<sup>330</sup> The GAO noted that "the sheer size and complexity of the Medicare program makes it highly vulnerable to fraud, waste, and abuse."<sup>331</sup> Indeed, the

system pays about 900 million claims each year within a complex regulatory structure with price controls on 7,000 services and 110,000 pages of regulations.<sup>332</sup> Health care for the elderly should be moved away from top-down planning toward individual decisionmaking. In another study, I discuss options for major Medicare reforms.<sup>333</sup>

Even before major reforms, Congress can enact more modest taxpayer savings. One idea is to increase Part B premiums and reduce taxpayer contributions. Half of Part B expenses were originally supposed to be paid by the elderly through premiums, but premiums cover only about 25 percent of costs today.<sup>334</sup> The CBO estimates that raising the premiums for Part B to 30 percent of costs would save taxpayers about \$75 billion over 10 years.<sup>335</sup> Another idea is for Medicare to eliminate the 10 percent bonus given to doctors who provide services in areas designated as underserved. This program is ineffective for a number of reasons.<sup>336</sup> The CBO's "Budget Options" report provides other examples of modest cost savings for Medicare.<sup>337</sup>

**Medicaid.** Medicaid spending is out of control—outlays have increased more than 10 percent annually the past three years, on average.<sup>338</sup> Like Medicare's, Medicaid's basic structure encourages overspending and waste. The GAO has warned that "Medicaid is at risk for billions of dollars in improper payments."<sup>339</sup> Recent investigations have found that there is \$1 billion of fraud in California's portion of Medicaid alone.<sup>340</sup>

The federal-state structure of the program causes irresponsible overspending by the states. The federal government matches state Medicaid spending by between 50 and 83 percent.<sup>341</sup> That provides states an incentive to expand their programs beyond reasonable levels because only part of the cost falls on state taxpayers. State governments have concocted a variety of abusive schemes to inappropriately boost federal grants by billions of dollars a year.<sup>342</sup> For example, some states instituted taxes on health care providers that were rebated to the providers. The effect was to increase reported state Medicaid spending

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**Another problem common to all federal handout programs is that ineligible individuals find ways to gain unjustified benefits.**

and boost federal matching funds.<sup>343</sup> States have continued operating such schemes despite a decade of scrutiny by the federal government.<sup>344</sup>

Another problem common to all federal handout programs is that ineligible individuals find ways to gain unjustified benefits. For example, middle- and upper-income retirees use Medicaid to pay for their long-term health care, a benefit that is supposed to be for low-income seniors. A cottage industry of lawyers has sprung up to help seniors get around Medicaid income limits and receive benefits.<sup>345</sup>

A good first reform step is to turn Medicaid into a block grant and close off the open-ended growth in federal costs. Block grants were successfully implemented with welfare reforms in 1996. The idea is to give states lump-sum federal funding so that they are encouraged to implement cost-cutting controls.

Turning Medicaid into a block grant program was proposed in 1981 by the Reagan administration. That plan would have put 25 health care grants into one big block grant and capped growth at 5 percent annually.<sup>346</sup> Congressional Republicans proposed similar Medicaid reforms in the FY96 budget resolution. That proposal would have turned Medicaid into a block grant and reduced the annual growth rate from 10 percent to 4 percent to cut costs \$182 billion over seven years.<sup>347</sup> Unfortunately, President Clinton blocked the plan.

One option examined by the CBO is turning Medicaid acute care into a block grant. Acute care accounts for about two-thirds of Medicaid expenses and includes hospital care, doctor visits, and drugs. The CBO estimates that this option would save federal taxpayers \$318 billion over 10 years.<sup>348</sup>

Beyond turning Medicaid into a block grant, reforms should aim to create more consumer-driven health coverage. Medicaid's defined benefit structure could be replaced by a defined contribution structure.<sup>349</sup> Funding would flow to individuals in the form of tax credits or vouchers that would be used to pay for health insurance in private markets. Under such a structure, federal

costs could be controlled and much of Medicaid's huge regulatory apparatus could be eliminated.

**National Institutes for Health** NIH's budget doubled from \$12 billion in FY98 to \$24 billion in FY04.<sup>350</sup> NIH funds both basic and applied medical research. Private industry also performs basic and applied research, but it is the former that is considered to have the better argument for taxpayer support. Funding for NIH's applied research should be ended, generating taxpayer savings of more than \$12 billion annually.<sup>351</sup> Applied research creates direct benefits for private businesses such as pharmaceutical firms; thus it can be left to companies to fund without taxpayer help.

**Substance Abuse and Mental Health Services** Each year this agency costs taxpayers \$2 billion, which is mainly spent on grants to the states. Many of its functions are performed by other federal agencies and private organizations. The program has been rated "ineffective" by the OMB because its "formula for distributing funds does not correspond with the prevalence of substance abuse" and it has not shown progress toward its long-term goals.<sup>352</sup>

### **Department of Homeland Security**

**Transportation Security Administration.** After the terrorist attacks in 2001, legislation was passed that enabled the federal government to take over screening of passengers and baggage at all U.S. commercial airports. That policy, which created 45,000 new federal bureaucrats, was a big mistake.<sup>353</sup> Recent analyses by the GAO and the DHS inspector general (IG) found that TSA is excessively bureaucratic and unresponsive.<sup>354</sup> In April 2004 the IG found that U.S. airports with federal screeners and the few U.S. airports with private screeners do an equally poor job.<sup>355</sup> The difference is that if private security services do a poor job, they can be reformed quickly or terminated.

While the United States nationalized its airport screening, other countries moved in the opposite direction. Many large airports in

Europe have shifted from government workers for passenger and baggage screening to private security firms. In those airports, the government sets performance standards and provides contractor oversight. Prior to 9/11, U.S. airports generally used low-bid contractors for passenger screening instead of focusing on high-quality services. U.S. airports, air traffic control, and airport security should be privatized so that firms can compete to provide the safest and best quality services to air travelers.

### **Department of Housing and Urban Development**

The surest way to meet the housing needs of Americans is to deregulate housing markets and allow entrepreneurs to provide housing for people at all income levels. After all, private businesses provide food, clothing, and thousands of other products for people of all incomes and tastes. In housing markets, decades of government interference through rent controls, zoning regulations, import barriers on lumber, and other rules have distorted markets and pushed up prices, creating the housing problems that HUD tries to address.

A free and competitive market in housing would make HUD's programs redundant. Howard Husock, a housing expert at the Manhattan Institute, argues that it is a myth started by a Lyndon Johnson housing commission that private markets cannot provide decent housing for the urban poor.<sup>356</sup>

Federal housing policy is a history of big blunders, which have been "profoundly destructive," according to Husock.<sup>357</sup> The most infamous disaster was the mass construction of high-rise public housing in the mid-20th century and related "urban renewal" programs. Government housing has been poorly built and maintained, and it created, concentrated, and sustained pockets of poverty and hopelessness in America's cities.

HUD programs continue to create social problems. For example, means-tested housing programs discourage participants from improving their positions in life and graduat-

ing from dependence on government subsidies.<sup>358</sup> Other HUD programs simply duplicate services that are readily available in private markets, such as mortgage insurance.

In addition to pursuing dubious policies, HUD has been one of the most mismanaged departments in the government. In the 1980s HUD was rocked by scandals caused by influence peddling, payoffs, and fraud involving billions of dollars.<sup>359</sup> Some HUD programs have been on the GAO high-risk list for waste, fraud, and abuse since 1994.<sup>360</sup> As a result of error and fraud, the department overpays its rental assistance subsidies by \$2 billion every year.<sup>361</sup> HUD spending is also rife with wasteful pork. For all those reasons, the entire department should be terminated and the remaining public housing stock privatized.

#### ***Community Development Block Grants***

The CDBG program would be perhaps the single best cut to make in the budget. The activities it supports are of purely state, local, and private concern. Some grants go directly to local governments, while others trickle down through the states to local governments. Many CDBG projects are of dubious value, and others subsidize businesses. For example, CDBG money has been spent on revitalizing shopping malls in California and building parking lots in New York.<sup>362</sup>

The CDBG program was instituted to aid low-income regions, but a substantial share of the spending goes to wealthy jurisdictions. For example, Greenwich, Connecticut, receives five times more funding per low-income resident than Camden, New Jersey. Greenwich has a per capita income six times higher than Camden's.<sup>363</sup> Recent budgets have continued to shift funding from poorer to wealthier communities.<sup>364</sup> The program has been rated "ineffective" by the OMB because of its "lack of clarity" and "weak targeting of funds."<sup>365</sup>

#### ***Federal Housing Administration Subsidies***

The Federal Housing Administration provides mortgage insurance to moderate-income homebuyers. Those subsidies are unwarranted because there is a large private mortgage insurance industry that could fill the void in FHA's absence. FHA has been rocked by scandal in the

**Federal housing policy is a history of big blunders, which have been "profoundly destructive."**

**BIA is perhaps the worst-run agency in the government. In the ongoing “Indian Enron” scandal, the BIA has mismanaged billions of dollars in Indian trust funds.**

past and is vulnerable to political decisions to follow financially unsound lending practices.<sup>366</sup>

**Department of the Interior**

This department carries out a wide range of activities, from managing millions of acres of land, to overseeing programs for American Indians, to collecting earth science data. Many activities are poorly managed, and many could be privatized. The OMB has generally given the department poor grades on management performance.<sup>367</sup>

**Bureau of Reclamation.** This agency constructs and operates water projects to provide power, irrigation, and flood control in the western United States. The agency provides water at subsidized prices to cities and farmers and thus encourages overconsumption, and it constructs huge taxpayer-financed projects that make no economic sense. For example, the Animas-La Plata project in southwestern Colorado redirects the flow of the Animas River to irrigate low-value crops, and the project has angered environmentalists.<sup>368</sup> The project’s official cost estimate jumped from \$338 million in 1999 to \$500 million in 2003.<sup>369</sup> Many of the agency’s dams and pipelines and much of its other infrastructure can be privatized or transferred to state and local ownership. Like other commodities, water should be priced by supply and demand to ensure efficient usage.

**U.S. Geological Survey.** This agency disseminates scientific data on the nation’s water, land, and mineral resources. Those data are used by a wide variety of private groups such as mining and oil companies. With new technologies like inexpensive global positioning systems, the private sector can map and analyze the nation more cheaply and accurately than ever before. This agency should be privatized and research funded by the users of geological data.

**Bureau of Indian Affairs.** BIA is responsible for the management of land held for American Indians, which totals about 56 million acres. The BIA conducts a wide variety of activities including educating about 48,000 children. With regard to education, the GAO

has concluded that “the academic achievement of many BIA students as measured by their performance on standardized tests and other measures is far below the performance of students in public schools.”<sup>370</sup>

BIA is perhaps the worst-run agency in the government. In the ongoing “Indian Enron” scandal, the BIA has mismanaged billions of dollars in Indian trust funds. Former special trustee of BIA Thomas Slonaker testified to Congress that the BIA is incapable of reform, unwilling to follow the law, and does not hold managers accountable.<sup>371</sup> Special trustee Paul Homan testified that the “vast majority of upper and middle management at the BIA are incompetent.”<sup>372</sup> In a recent court case, BIA management was described by U.S. District Court Judge Royce Lamberth as “fiscal and governmental irresponsibility in its purest form.”<sup>373</sup> He also said that BIA “has served as a gold standard for mismanagement by the federal government for over a century.”<sup>374</sup>

**Forest Service.** This agency has subsidized the cutting of vast stretches of forests by paying for the construction of 380,000 miles of logging roads and spending more on its timber harvest program than it collects in charges paid by timber companies.<sup>375</sup> For example, an environmental group figures that the agency’s costs to aid timber companies in Alaska’s Tongass National Forest exceed federal charges paid by them by about \$30 million per year.<sup>376</sup>

**Department of Justice**

Like many federal agencies in recent decades, this department has expanded its power over traditional state and local activities. Budget savings can be found by ending activities that encroach on state law enforcement and ending the enforcement of unneeded laws.

**Community Oriented Policing Services.** This anti-crime program funds state grants to put police officers into community patrols. There is no solid evidence that this program has helped to reduce crime.<sup>377</sup> More important, policing is a classic responsibility of local government and should remain so. Top-down Washington solutions for policing make no sense because police priorities and tactics vary



from community to community. Besides, federal grants to local governments make no fiscal sense because local governments boosted by rising property taxes have been more flush with cash than the federal government in recent years.

**Antitrust Enforcement.** The DOJ and the Federal Trade Commission spend more than \$200 million per year on antitrust enforcement.<sup>378</sup> But antitrust laws, which are supposed to ensure competitive markets, are a solution in search of a problem. The government simply does not know how markets in many particular cases should best be organized to maximize consumer welfare. For example, it is usually not clear whether particular business mergers are good or bad, yet antitrust cops try to make such determinations. A recent study by Brookings Institution scholars found that antitrust laws have a mixed record at best and have often prevented mergers that could have increased consumer welfare.<sup>379</sup>

**Juvenile Justice Grants.** These grants are supposed to help states improve juvenile justice systems. But the programs funded by the grants have not led to any measurable impact on juvenile crime. The OMB has rated the program “ineffective” and asked that its funding be eliminated.<sup>380</sup>

### Department of Labor

Many programs in this department are either ineffective, actively damaging to labor markets, or designed to solve problems that the market economy solves by itself. Minimum wage laws raise unemployment. Government training programs are generally ineffective and duplicate activities that workers and companies undertake for themselves. The Davis-Bacon law sets wages on federal construction projects too high, which wastes taxpayer money and excludes less-skilled workers from employment on federal projects.

**Employment and Training Programs.** The department’s numerous training programs have generally proven to be ineffective. There are no fewer than 44 federal programs run by nine different agencies for employment and

training services.<sup>381</sup> Multiple programs designed to achieve similar outcomes create overlap and waste. Federal training programs are unnecessary because workers and companies have strong incentives to spend on training themselves. Indeed, one study found that U.S. businesses spent about \$373 billion annually on employee training, including payments for formal training courses, wages for training time, and other expenses.<sup>382</sup> Federal government attempts to train workers have been a failure and should be abandoned.

**Trade Adjustment Assistance.** This program hands out benefits, including extension of unemployment insurance, job search and relocation allowances, and subsidized education and training, to workers who have lost their jobs because of trade liberalization. However, it makes no sense that people who lose their jobs because of foreign competition should receive special benefits not received by those who lose their jobs because of domestic competition. Further, the program does not solve the more important problem of making American workers and businesses more competitive.<sup>383</sup> The OMB has labeled this program “ineffective” because it favors a small group of workers who are already eligible for other benefits.<sup>384</sup> Unfortunately, as the Bush administration has searched for some election year talking points, the president has recently been considering a costly expansion of the program.<sup>385</sup>

**Senior Community Service Employment.** This \$440 million grant program enrolls older Americans in community service activities. The program makes little sense because, if seniors are adding value in the jobs they are performing, then employers should be able to pay them market wages. Of course, millions of seniors continue working productively in private markets without help from this program, which has been rated “ineffective” by the OMB because of weaknesses in accountability, design, and delivery.<sup>386</sup>

**Davis-Bacon Act.** This law requires that companies pay “prevailing wages” for work on federally funded construction, such as

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highways and transit projects.<sup>387</sup> That means higher, union-level wages in many cases, creating an added burden on federal taxpayers. For individuals, the law unfairly excludes less-skilled workers from a fair chance at gaining employment on federal projects.

### **Department of Transportation**

The Department of Transportation employs 59,000 workers and has a budget of \$58 billion. The department's main function is to send federal taxpayer dollars to the states for highways, transit systems, airports, and other facilities. The department should be radically downsized and its activities either moved back to the states or privatized. Currently, the federal government acts as an unneeded middleman that misallocates transportation resources in accord with political pressures and imposes top-down planning on the states. Americans do not need more "highways to nowhere" in the districts of important members of Congress. Nor do Americans need the large cost overruns that come with federal transportation projects, such as Boston's Big Dig. Instead, Americans need a more efficient transportation system based on state control and state, local, and private financing.

**Air Traffic Control.** The Bush administration supports making the Federal Aviation Administration's ATC system more business oriented, but the ATC system should be fully privatized.<sup>388</sup> A privatized system would likely improve safety, cut costs, and allow access to private capital for infrastructure upgrading.<sup>389</sup> The sooner major reforms are implemented, the better because operational safety under the current government system has actually worsened in recent years.<sup>390</sup>

The United States lags behind other major nations on ATC reform. During the past 15 years, more than a dozen countries have partly or fully privatized ATC. Canada has created a private nonprofit corporation for its ATC services, which could be a good model for U.S. reforms. Nav Canada was set up in 1996 and is self-supporting from charges paid by aviation users. The Canadian system has received rave reviews for investing

in technology and reducing air congestion.<sup>391</sup> It is a world leader in new ATC technologies, has one of the best safety records in the world, and has cut Canadian airspace congestion in half.<sup>392</sup>

In Britain, air traffic control has been moved to the National Air Traffic Services company, NATS. NATS has a public-private corporate structure with shares owned by airlines, the government, and employees. Like Canada's system, NATS is self-supporting from fees and charges. Germany has created a self-supporting government corporation for ATC.

The United States should be a leader rather than a laggard in air traffic control, especially given this country's history of aviation innovation. Privatized ATC can help reduce congestion, save taxpayer money, and provide Americans with greater safety by speeding the adoption of new technologies.

**Essential Air Service.** EAS was created in 1978 as a "temporary" program to ensure that air service was continued in rural communities during airline deregulation. The program provides subsidies to air carriers that serve certain rural markets. Today, the air travel market is more advanced than it was in the 1970s, with airlines providing service to more markets. Regarding EAS, the GAO finds that "program costs have tripled since 1995, and fewer passengers use the subsidized local service. Most choose to drive to their destination or to fly to and from another nearby airport with more service or lower fares."<sup>393</sup>

**Grants-in-Aid for Airports.** This program provides grants to airports to fund expansion, terminal improvements, and noise mitigation. This program should be ended, and the nation's airports, which are generally owned by local governments, should be privatized. Once again, the United States lags behind other countries on reforms. Airports have been fully or partially privatized in Auckland, Copenhagen, Frankfurt, London, Melbourne, Naples, Rome, Sydney, Vienna, and other cities. Privatized airports can raise revenues from charges on airlines and airport users and can access financing in private debt and equity markets for expansions and

improvements. Putting the burden of airport costs on federal taxpayers is both inefficient and unnecessary.

**Federal Highway Administration.** The federal government should move full responsibility for highways to state governments and the private sector. State governments can balance the costs and benefits of highway building better than can appropriators and bureaucrats in Washington. When gasoline tax dollars for highways go through Congress, powerful politicians steer the money to their own states rather than the states most in need. For example, Senate Appropriations Committee chairman Ted Stevens has ensured that his state of Alaska receives five times more highway money than Alaska residents pay in gas taxes.<sup>394</sup>

In addition to politics, formulas used in allocating highway dollars make winners and losers of different states. The GAO notes that the FHA “allocates funds among the states based on their historic share of funding. This approach reflects antiquated indicators of highway needs, such as postal road miles and the land area of the state.”<sup>395</sup> While some states are shortchanged, others get overbuilt highways that are little used.

Highway spending is one of the biggest pork-barrel machines in Washington. Spending is earmarked for favored congressional districts with “demonstration” or “high-priority” projects.<sup>396</sup> The number of earmarked projects soared from 152 in the 1987 highway bill to 1,850 in the TEA-21 highway bill in 1998.<sup>397</sup>

The *Washington Post* ran a series of stories in 1998 and 1999 about the corrupt manner in which former House Transportation Committee chairman Bud Shuster (R-PA) dished out highway pork in exchange for millions of dollars in campaign donations.<sup>398</sup> Instead of ensuring that taxpayer money was spent efficiently, Shuster lived a high-spending lifestyle jetting around the country to raise campaign cash and hand out highway projects based on political calculations.

When such scandals hit the newspapers, there are usually calls for some limited reforms. But the best reform is to repeal the

federal gasoline tax and terminate federal highway spending. That would stem the flow of money to corrupt federal politicians. States could fund highways according to local demands, and they would be free to experiment with new alternatives such as privately financed highways.

**Maritime Administration.** MARAD funds a number of subsidy programs designed to prop up the shipping industry. Like other corporate welfare programs, MARAD’s programs create unsavory ties between the government and industry. For example, the Title XI loan guarantee program for U.S. shipbuilders has been involved in scandal in recent years. American Classic Voyages received a \$1.1 billion loan guarantee to build two cruise ships in Sen. Trent Lott’s (R-MS) hometown.<sup>399</sup> But before completion, the company went bankrupt and left taxpayers with a \$200 million tab. The GAO has found that MARAD’s loan programs are not operated in a businesslike fashion and are vulnerable to fraud, abuse, and mismanagement.<sup>400</sup>

Another subsidy program is MARAD’s operating differential program, which was established to sustain a private U.S. merchant fleet. The problem is that, by shielding U.S. shippers from foreign competition, the subsidies allow them to run higher-cost, less-efficient operations. Taxpayers should not have to pick up the tab for this industry’s inefficiency; maritime subsidies should be ended.

**Amtrak.** Amtrak was created in 1971 to be a self-supporting business with initial taxpayer subsidies to be phased out over time. That has not occurred. Amtrak has consumed more than \$25 billion in subsidies over the years and provided second-rate passenger rail service to Americans.<sup>401</sup> In recent years, Amtrak’s debt has been rising and its on-time performance falling.<sup>402</sup>

As other countries proceeded to privatize their rail systems, Congress created the Amtrak Reform Council in 1997 to study major reforms. ARC proposed a plan that would end Amtrak’s monopoly on passenger service, spin off its Northeast Corridor infrastructure, and permit states and private enti-

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ties to bid for Amtrak routes. Congress has not yet moved forward on those proposals, and it continues to resist the Bush administration's reform efforts.

Privatization is the way ahead for U.S. passenger rail, as it has been in other countries. Australia and its states sold off much of the government's freight and passenger rail infrastructure. Japan National Railways was broken up into seven companies in a 1997 privatization, with the government holding a minority and declining block of ownership shares. The German government is preparing to privatize Deutsche Bahn in 2005 or 2006. The head of Deutsche Bahn says he is eager to get rid of the "civil service mentality" in the German rail company.<sup>403</sup> Britain, New Zealand, and other countries have also privatized their rail systems.

Congress should study those foreign experiences and move ahead with Amtrak privatization. A key advantage of privatization is the flexibility a corporation has in raising debt and equity for capital investment. By contrast, government ownership often creates a financial bottleneck as a result of short-term political horizons and federal budget uncertainty. Amtrak should probably be sold as a single unit including operations, stations, rails, and trains. Congress should give Amtrak the needed flexibility to drop unneeded routes, cut costs, and maximize profits. Currently, a small handful of routes with few riders create large losses for the system.<sup>404</sup> How extensive a service Amtrak, or future competitors, might provide should be up to transportation consumers, not Congress.

#### **Other Agencies and Programs**

**Agency for International Development.** USAID is the main U.S. foreign aid agency. In recent years, there has been a growing realization that traditional foreign aid does not work very well. Much aid from Western countries has simply propped up corrupt regimes and acted to delay serious economic reforms that are the basis of sustained growth. Aid that is poured into countries that do not have secure property rights, market economies, or political

stability goes into a black hole and does little to help the needy.

Another problem with government aid is the inefficiency of delivery. While funding is supposed to help the poor, much money gets swallowed up by high-paid consultants and their expenses including plane flights, hotels, and restaurant costs. The GAO notes that, like many federal agencies, USAID has "long-standing financial management weaknesses."<sup>405</sup>

The heavy USAID bureaucracy and the failed approach of giving money to socialist and corrupt countries led to the creation of the Bush administration's Millennium Challenge Account agency.<sup>406</sup> That agency is supposed to avoid USAID's heavy bureaucracy, restrictive legislative burdens, and conflicting objectives.<sup>407</sup> Unfortunately, the MCA program will be costing taxpayers an additional \$5 billion annually by 2006.<sup>408</sup>

Instead, U.S. foreign aid should be left to private charitable groups, which have a much better track record of maximizing their impact with limited resources. Also, private investment capital is vast compared to aid money and is more likely to go into productive activities in developing countries. Countries with sensible economic policies can attract private investment flows to spur growth and reduce poverty without aid.

**Appalachian Regional Commission.** This agency was established in 1965 to encourage economic development in rural areas in 13 Appalachian states. Congress has recently added the similar Denali Commission and Delta Regional Authority to hand out subsidies to Alaska and areas along the Mississippi River, respectively.<sup>409</sup> Those programs make unjust transfers of wealth from some Americans to others in politically favored regions. Even accepting the dubious claim that such programs create jobs in the targeted regions, jobs are certainly destroyed in the rest of the country from which the tax money is extracted.

**Army Corps of Engineers.** The Army Corps of Engineers builds and operates infrastructure such as dams and harbors. For example, the agency spends about \$1 billion annually on construction and maintenance of com-

mercial harbors.<sup>410</sup> Such activities have clear beneficiaries, such as harbor users, and thus could be easily privatized. The Army Corps hydroelectric power projects could also be privatized. Other Army Corps activities are of dubious value and should be left to state and local governments, such as beach replacement, which costs \$100 million annually.<sup>411</sup>

The Army Corps has been rocked with scandal in recent years. It was found to be falsifying data to justify large and unneeded construction projects.<sup>412</sup> In 2000 it was discovered that the agency's top managers manipulated economic studies to provide support for a wasteful \$1 billion Mississippi River project.<sup>413</sup> A similar scandal erupted over a \$311 million project to dredge the Delaware River.<sup>414</sup> The agency is frequently criticized for pouring billions of dollars into the districts of powerful members of Congress and supporting environmentally damaging projects.

The Army Corps has a strong pro-spending bias because it does the economic analyses of proposed projects it later constructs if approved. To make matters worse, the *Washington Post* notes that "powerful members of Congress dictate the selection, pace, and price tag for major projects" of the Army Corps.<sup>415</sup> Indeed, even after the scandal broke regarding the Mississippi River project, Mississippi Sen. Christopher Bond "vowed to make sure the projects are funded no matter what the economics studies ultimately conclude."<sup>416</sup> To end the corruption and inefficiency, the Army Corps should be privatized.

**Cargo Preference Program.** The Cargo Preference Act of 1904 requires that certain government-owned or government-financed cargo be shipped only by vessels registered in the United States. The law pushes up costs because it is more expensive to register a ship in the United States than in most foreign countries. The CBO estimates that about \$443 million would be saved annually if Congress repealed this wasteful law and the government shipped cargo at market rates.<sup>417</sup>

**Corporation for Public Broadcasting** The CPB gives grants to public television and

radio stations across the country. Taxpayer support is just a small portion of support for public broadcasting; most funds come from private contributions. That suggests that CPB could probably survive the end of federal subsidies. After all, a number of public TV programs, such as *Sesame Street*, generate millions of dollars in merchandise sales and foreign broadcasting revenue. CPB is a business, and it should be set free from its government ties to function as one.

**Export Subsidies.** A variety of federal programs provide subsidies for exporting companies. The Export-Import Bank makes loans to foreigners, guarantees the loans of financial institutions, and provides export credit insurance. The amount of trade activity underwritten by Ex-Im Bank is very small—only about 1 percent of exports—so it is unlikely that the agency affects overall sales of U.S. goods.<sup>418</sup> Ex-Im activities mainly duplicate services that private markets already perform for exporters. Ex-Im subsidies go to some of the biggest Fortune 500 companies, such as Boeing, which can surely find private financing instead of imposing costs on taxpayers.<sup>419</sup>

The federal Overseas Private Investment Corporation provides direct loans, guaranteed loans, and insurance to U.S. firms that invest in developing countries. During the 1990s, Ex-Im Bank loaned Enron \$650 million and OPIC loaned it \$750 million for risky and sometimes environmentally damaging projects.<sup>420</sup> For example, the Chiquitano Forest pipeline, financed by OPIC, was run through one of the most valuable and unscathed regions of forest in South America.<sup>421</sup> That is a glaring example of corporate welfare waste.

The Trade and Development Agency performs a variety of subsidy activities for businesses such as funding export feasibility studies. TDA subsidies go to large companies, such as General Electric, and to foreign governments and private investors who engage in commerce with American businesses. The TDA, Ex-Im Bank, OPIC, and other similar agencies should be terminated.

**Foreign Military Financing and Sales** The

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**A big problem with NASA, which is common to many federal agencies, is that large projects go far over budget and lag far behind schedule.**

Foreign Military Financing program funds weapon purchases by foreign governments. This policy seems contrary to weapons non-proliferation policy and poses a risk if weapon buyers are not U.S. allies in the future. The program supports grants and loans to more than two dozen countries, with the bulk going to Egypt and Israel. The Foreign Military Sales program facilitates government-to-government sales of arms with the Pentagon acting as a broker, negotiating deals, and collecting payments for arms contractors. As a result of these two programs, more than half of U.S. arms sales are financed by U.S. taxpayers.<sup>422</sup> Private lenders and defense producers should handle foreign military sales on their own. The U.S. government should get out of the arms export business.

**National Aeronautics and Space Administration.** NASA is one of the most mismanaged agencies in the government. The official report on the *Columbia* disaster in 2003 found that NASA management had ineffective leadership, flawed analysis, and a safety culture that was reactive and complacent.<sup>423</sup> It noted that the mistakes on *Columbia* were “not isolated failures, but are indicative of systematic flaws” in the agency.<sup>424</sup> The 1986 *Challenger* disaster was also traced to failed NASA management.<sup>425</sup> The Mars Polar Lander failure was caused by one NASA project team using metric and another NASA team using English measurements.<sup>426</sup>

A big problem with NASA, which is common to many federal agencies, is that large projects go far over budget and lag far behind schedule. The GAO concludes that the agency has “debilitating weaknesses” in its management of large projects.<sup>427</sup> For example, the International Space Station’s construction costs have skyrocketed from \$17 billion in 1995 to \$30 billion today, and it is four years behind schedule.<sup>428</sup> Scrapping that project alone would save taxpayers \$70 billion over the next 12 years.<sup>429</sup>

Congress shares the blame for NASA’s waste, since it funds white-elephant projects, such as the space station, that have no clear policy goals. Americans do not need NASA in

order to further advance the space age. Space should be opened up to private entrepreneurs eager to move forward with space tourism and other space businesses of the future.<sup>430</sup>

**Small Business Administration.** The SBA provides a variety of loan programs and other services to small businesses. Yet most of the nation’s 25 million small businesses are founded and grown without government subsidies.

Government loan programs for small businesses make no economic sense. If a small business has a sound business plan with solid prospects, it should be able to raise debt and equity capital in private markets. If a small business has shaky finances and poor prospects, it will be denied private capital, which is a good thing because such loans would be economically wasteful. SBA’s history of high loan delinquency rates suggests that companies with poor prospects are the ones lining up for aid. The default rate on 7(a) preferred lender loans has averaged 14 percent the last three years.<sup>431</sup>

In addition to the dubious economics of SBA programs, the agency is poorly managed. The GAO notes that in the SBA “ineffective lines of communication; confusion over the mission of district offices; complicated, overlapping organizational relationships; and a field structure not consistently matched with mission requirements combine to impede the effective delivery of services.”<sup>432</sup> The SBA should be terminated.

**Tennessee Valley Authority.** TVA is the largest electricity producer in the United States. It has been mismanaged, has overinvested in nuclear plants, and has sunk deep into debt.<sup>433</sup> It is also subject to many of the same inefficiencies as the four Power Marketing Administrations discussed above. Those businesses, along with federal subsidies for cooperative and municipal utilities, are out of step with the new environment of electricity competition.<sup>434</sup>

Government-owned electric utilities originally had two justifications. First, it was thought that private companies would not find enough profit in electrifying rural America,

thus requiring government to step in. Second, it was thought that government could provide power to consumers at lower prices than private companies because it could set prices “at cost” without worrying about profits.

The first justification is now irrelevant because rural America has been thoroughly electrified. Indeed, 60 percent of rural America is serviced by investor-owned utilities. The second justification—that government power would be cheap—was socialist pie-in-the-sky thinking. Government electricity generation has proven to be costly and inefficient.

The United States lags behind other countries in freeing itself from government power generation. Australia, Britain, Canada, Germany, and other countries have privatized their electric utilities. The goals of privatization are to improve utility efficiency, allow prices to be set by supply and demand, and reduce government debt with privatization proceeds. All those goals are applicable to the United States. The sale of all federal power enterprises could raise \$20 billion or more that could be used to reduce the federal debt.<sup>435</sup>

**U.S. Postal Service.** There is no good reason for Americans to continue to be stuck with the stagnant \$69 billion and 774,000-worker USPS and its legally enforced monopoly.<sup>436</sup> Other countries, including Finland, Germany, the Netherlands, New Zealand, and Sweden, have either opened their postal services to competition or privatized their mail companies.<sup>437</sup> There is no reason why America should not be a leader in postal reform rather than a laggard.<sup>438</sup>

Fast, reliable, and cost-efficient communication is vital to today’s lifestyles and business world. The government postal service does not provide such communications, nor is it ever likely to. In fact, USPS’s performance is deteriorating. The average delivery time today for a first-class letter is 1.9 days, up from 1.6 days in 1981, despite all the new technology that is available to USPS.<sup>439</sup> The GAO concludes that the USPS “has an outdated and inflexible business model amid a rapidly changing postal landscape.”<sup>440</sup> It has put USPS on its

high-risk list because of its growing financial and operational difficulties.

Americans have turned to e-mail and private package carriers for many of their important communications today, but the USPS still holds a legal monopoly on first-class letters and other items. The monopoly needs to be ended. At the same time, the USPS should be privatized in order to compete with an expected rush of new mail companies.

## Notes

Jason LaFond contributed to this report.

1. Congressional Budget Office (CBO), “The Budget and Economic Outlook: Fiscal Years 2005 to 2014,” January 2004, [www.cbo.org](http://www.cbo.org). Cited hereafter as CBO, January 2004.
2. The Army Corps of Engineers, the Bureau of Indian Affairs, the Department of Energy, and NASA are discussed in the body of this report. FBI mismanagement during the past decade led to a failure to avert the 9/11 disaster. See Peter Lance, *1000 Years for Revenge: International Terrorism and the FBI—The Untold Story* (New York: Harper Collins-Regan Books, 2003).
3. The National Academy of Sciences released a report in February finding failures “at all levels” in zoo management leading to animal deaths, crumbling facilities, and other problems. See Karlyn Barker and James V. Grimaldi, “National Zoo Director Quits over Lapses,” *Washington Post*, February 26, 2004, p. A1. This was one in a series of reports on the zoo’s failures by the *Washington Post* in recent months.
4. *Budget of the United States Government, Fiscal Year 2005* (Washington: Government Printing Office, 2004), p. 51.
5. Senate Committee on Government Affairs, “Government at the Brink,” vol. 1, June 2001, p. 1, [www.senate.gov/~gov\\_affairs/vol1.pdf](http://www.senate.gov/~gov_affairs/vol1.pdf).
6. For entitlements, see Chris Edwards and Tad DeHaven, “War between the Generations: Federal Spending on the Elderly Set to Explode,” Cato Institute Policy Analysis no. 488, September 16, 2003. For detailed resources on Social Security reform, see Cato’s project at [www.socialsecurity.org](http://www.socialsecurity.org). For defense downsizing ideas, see Ted Galen Carpenter, “Clearing the Decks for War,” *Cato Handbook for the 108th Congress* (Washington: Cato Institute, 2003), chap. 4.

7. George E. Peterson, "The State and Local Sector," in *The Reagan Experiment*, ed. John L. Palmer and Isabel V. Sawhill (Washington: Urban Institute, 1982), p. 157.
8. *Congressional Quarterly Almanac 1995* 51 (1996): 2-22. See also Stephen Moore and Stephen Slivinski, "The Return of the Living Dead: Federal Programs That Survived the Republican Revolution," Cato Institute Policy Analysis no. 375, July 24, 2000. Table 1 in the study provides a list of proposed terminations.
9. Alice Rivlin and Isabel Sawhill, eds., *Restoring Fiscal Sanity: How to Balance the Budget* (Washington: Brookings Institution, 2004), p. 7. Note that the Heritage Foundation also produces a budget reform plan at the beginning of each Congress. See Angela Antonelli and Peter Sperry, eds., *A Budget for America* (Washington: Heritage Foundation, 2001).
10. Table 3 shows cuts totaling \$300 billion based on budget figures for FY04. Those cuts would be equal to cuts of \$340 billion in FY09, assuming that those programs would have grown at the CBO baseline discretionary growth rate. Cuts are phased in at \$68 billion per year to hit \$340 billion by FY09 and thereafter grown at CBO's discretionary spending growth rate. Also, federal outlays are reduced by the author's estimated reduction in federal interest costs as the deficit falls.
11. CBO, "An Analysis of the President's Budgetary Proposals for Fiscal Year 2005," March 2004, p. 3. Cited hereafter as CBO, March 2004.
12. *Ibid.*, pp. 3, 20.
13. General Accounting Office (GAO), "FY2003 U.S. Government Financial Statements," GAO-04-477T, March 3, 2004, www.gao.gov. Second and subsequent references to GAO publications are to GAO publication number.
14. In Figure 2 the data for "Transfer Payments and Subsidies" and "Government Purchases" are FY04 figures reported as part of the National Income and Product Accounts. See Bureau of Economic Analysis, *Survey of Current Business*, March 2004, p. 14, www.bea.gov/beatpubs.htm. See also NIPA Table 3.2 online at www.bea.gov/beatpubs/nipaweb. The data for "Regulations" are from Clyde Wayne Crews Jr., "Ten Thousand Commandments: An Annual Snapshot of the Federal Regulatory State," Cato Institute, 2003. All other data in Figure 2 are from *Budget of the U.S. Government, Fiscal Year 2005*. Note that data for "The Federal Bureaucracy" do not include the 774,000 U.S. Postal Service workers.
15. The Urban Institute had an interesting 1989 book that described the government's "tools," which I have called tentacles. See *Beyond Privatization: The Tools of Government Action*, ed. Lester M. Salamon (Washington: Urban Institute Press, 1989). Other "tools" not discussed here include vouchers, franchises, licenses, control of real estate, publicity and threats of action, and the Federal Reserve Board. Each tool can have sub-tools. For example, regulation can include price controls, trade restrictions, and other restraints.
16. Lester M. Salamon, "The Changing Tools of Government Action: An Overview," in *Beyond Privatization*, p. 17.
17. Paul C. Light, "Fact Sheet on the New True Size of Government," September 5, 2003, www.brook.edu/gs/cps/light20030905.pdf. See also Paul C. Light, *The True Size of Government* (Washington: Brookings Institution Press, 1999).
18. *Budget of the U.S. Government, Fiscal Year 2005, Analytical Perspectives*, p. 350.
19. Dana Milbank and Paul Blustein, "White House Aided Enron in Dispute," *Washington Post*, January 19, 2002, p. A1.
20. *Ibid.* The two federal agencies providing loans were the Export-Import Bank and the Overseas Private Investment Corporation.
21. Dan Eggen, "GAO Criticizes System for Tracking Terrorists," *Washington Post*, April 30, 2003, p. A21.
22. *Ibid.*
23. "Post-9/11 Reforms Haven't Fixed Intelligence Failings," editorial, *USA Today*, April 16, 2004.
24. Dana Priest, "Congressional Oversight of Intelligence Criticized," *Washington Post*, April 27, 2004, p. A1.
25. CBO, March 2004, p. 3.
26. With Bush's tax cuts in place, the deficit falls to 1.6 percent of GDP by 2014. See *ibid.*
27. *The 2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and the Federal Disability Insurance Trust Funds* (Washington: Government Printing Office, March 17, 2003), p. 82.
28. CBO, January 2004, p. 50.
29. Edwards and DeHaven, "War between the Generations," p. 5.
30. GAO-04-477T, p. 14.



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41. Aaron Lukas and Ian Vásquez, "Rethinking the Export-Import Bank," *Cato Institute Trade Briefing Paper* no. 15, March 12, 2002, p. 14.
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47. GAO-03-119.
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