

## **Reducing Wasteful Federal Spending**

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**before the House Committee on Oversight and Government Reform**

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Mr. Chairman and members of the committee, thank you for inviting me to testify today. My comments will examine the need to cut spending, causes of government waste, and budget reforms that policymakers should consider.

### **The Need to Cut Spending**

Federal spending and debt have soared this century. As a share of gross domestic product (GDP), spending grew from 18 percent in 2000 to 22 percent today, while debt held by the public jumped from 35 percent to 75 percent. Some of the causes of these increases include the cost of wars, the effects of the recession, and the growth of entitlement programs.

Projections from the Congressional Budget Office (CBO) show that—without reforms—spending and debt will continue rising for decades to come. Under the CBO’s long-term baseline, spending is expected to grow to more than 26 percent of GDP by 2038 and debt will rise to 100 percent.<sup>1</sup>

However, the CBO baseline may be optimistic for at least six reasons:

1. Policymakers may break future spending caps under the Budget Control Act.
2. The United States may face unforeseen wars and military challenges.
3. The economy may have another deep recession.
4. Future presidents and congresses may launch expensive new spending programs.
5. Interest rates may be higher than projected, further pushing up federal interest costs.
6. Rising spending and debt will suppress economic growth in coming decades. That negative effect is not accounted for in CBO’s baseline after the first 10 years.

These factors could make our fiscal outlook even worse than the official baseline. The upshot is that policymakers should begin to identify low-priority programs to cut and terminate. They should scour every agency for waste.

Narrowly defined, government “waste” is usually thought as the sort of silly or embarrassing projects and failures that Senator Tom Coburn identifies in his annual wastebok.<sup>2</sup> Most people would agree that spending \$1 million on studying romance novels or the Pentagon spending \$300 million on unused blimps is a waste of money.

However, as an economist, I have a broader view of waste. Waste means the misallocation of resources to low-value activities. It means government spending on projects that cost

more than the benefits they create. It means subsidies and regulations that cause individuals and businesses to reduce their productive efforts or to engage in unproductive activities. Federal waste occurs when the government causes the inefficient use of capital, labor, time, and effort.

The federal government will spend \$3.6 trillion this year. The waste problem is not just that there are cost overruns and mismanagement in many federal agencies. The problem is that the federal government does many things that would be done better by state and local governments and the private sector, and that it does many things that should not be done at all.

### **Why Is the Federal Government So Wasteful?**

I have been reading the *Washington Post* for 24 years, and there has been a never-ending stream of articles on federal waste and agency failures. Programs do not work, officials are wasting taxpayer money, and many unscrupulous people are receiving improper payments.

However, federal waste is not just a modern phenomenon. I have researched some of the oldest federal agencies and found that cost overruns, pork-barrel spending, fraud, and scandals were common as far back as the 19th century. In that century, for example, the Bureau of Indian Affairs was rife with corruption and organized groups plundered the aid sent to Indian tribes.<sup>3</sup> The Army Corps of Engineers has also been known for mismanagement and pork-barrel spending for a very long time. The House Ways and Means Committee issued a report in 1836, for example, looking into chronic cost overruns in that agency's projects.<sup>4</sup>

So federal waste is not new, and it is not isolated to either political party. It is a structural problem with the way government works. Private businesses can also make bad decisions, have cost overruns, and misallocate investments. But private markets have built-in mechanisms to minimize those problems, whereas the government does not. The federal government has a hard time learning from its mistakes, and so wasteful spending has become chronic.

Here are 15 reasons for federal government wastefulness:

1. The government has become so huge that federal auditors, private watchdogs, and congressional oversight committees cannot even begin to review all the spending. The federal government funds more than 2,200 subsidy and benefit programs, and they are all susceptible to waste, fraud, and abuse.<sup>5</sup>
2. People tend not to spend other people's money as carefully as they spend their own. For federal decisionmakers, the source of funding for their favored programs can seem to be distant or abstract, but private-sector decisionmakers must weigh the costs and benefits of spending their own money.
3. Unlike in the private sector, poorly performing federal agencies are not subject to takeover bids, nor do they go bankrupt, and thus there is no built-in system to eliminate failed activities. In the private sector, roughly 10 percent of U.S. companies go out of

business each year, and corporate executives get ousted all the time. In the private sector, poor performance gets punished.

4. There are more political rewards for federal policymakers to add new programs and expand existing ones than to weed out low-priority programs and waste. By contrast, private-sector decisionmakers are forced by bottom-line pressures to make tough decisions.
5. Federal managers face no profit incentive, giving them little reason to proactively reduce waste and cut costs. Indeed, without profits to worry about, federal managers often favor budget increases without any idea about whether expansion will add net value to society above the taxpayer costs.
6. Without the profit motive, there is little incentive for government workers and managers to innovate. There is less motivation than in the private sector to try and produce better services of higher quality.
7. To policymakers, costs are benefits, and that creates bad incentives. If a Pentagon project has a cost overrun, members with related jobs in their districts may not be worried because an overrun means more spending on their constituents. Academic research has shown that cost overruns are more frequent on government projects than on private-sector projects.<sup>6</sup>
8. Even if a federal agency wanted to adopt business-style efficiencies, the output of much government work is hard to measure, which would make it difficult to set performance goals for managers and workers.
9. Even if federal performance could be easily measured, federal worker pay is generally tied to longevity, not performance. Federal workers receive rising salaries even if they perform poorly.
10. Disciplining federal workers is difficult and they are rarely fired, which can result in agencies carrying heavy loads of poor performers.
11. The government needs complex regulations and extensive paperwork to carry out routine functions such as procurement. One reason is that in the public sector there are no clear goals such as maximizing profits. Another reason is the need to prevent public corruption. The plethora of rules adds to federal inefficiency and sluggishness.
12. Because of the frequent turnover of political appointees in federal agencies, many agencies experience continual changes in their missions driven by transitory and political factors.
13. Congress imposes extra costs on federal agencies in carrying out their duties, such as resisting closure of low-value facilities or cutting projects that affect the states or districts of important members.
14. Federal agencies can get influenced or “captured” by special interest groups that steer policies toward narrow goals, rather than broad public-interest goals.

15. The sheer size of the federal government makes coordination and decisionmaking for many activities very difficult. The multiplicity of congressional committees and executive branch agencies—each with an interest in expansion or mission creep—has led to a great deal of overlap and duplication in federal activities.

What is the solution to these problems? There is no straightforward, technocratic way to “reinvent” the federal government to make it work with a decent amount of efficiency. Some of these problems can be reduced to an extent, but as long as the federal government is as large as it is, it will sadly continue wasting hundreds of billions of dollars from misallocation, mismanagement, and other problems.

The only real solution to the ongoing waste in the federal government is to downsize it. To improve the performance of American government, we should begin decentralizing funding and decisionmaking for programs and activities out of Washington. We should revive federalism and hand more responsibilities back to state governments, while privatizing federal activities where we can.

### **Reviving Federalism**

The federal government spent about \$560 billion on aid to the states in 2013, making aid the third largest item in the federal budget after Social Security and defense. The aid system has grown to more than 1,100 separate programs as the federal government has become involved in a large array of state and local activities, such as education, housing, and community development.<sup>7</sup>

The theory behind grants-in-aid is that the federal government can fund programs in the national interest to efficiently solve local problems. The idea is that policymakers can dispassionately allocate large sums of money across hundreds of activities based on a rational plan designed in Washington.

However, the aid system does not work that way in practice. Federal policymakers are often more focused on securing benefits for their states than ensuring money is spent efficiently. At the same time, aid stimulates overspending by state governments and creates a web of top-down federal rules that stifle state autonomy.

The aid system is rife with waste and inefficiency.<sup>8</sup> I am not surprised that Senator Coburn’s wastebook provides many examples of dubious spending on aid-to-state programs.

Here are six reasons why the aid system is wasteful:

**1. Bad Incentives.** The incentive structure of aid programs encourages overspending by federal and state policymakers. Policymakers at both levels can claim credit for spending on a program, while relying on the other level of government to collect part of the tax bill. Aid programs often have a “matching” structure, which further stimulates overspending by the states. Coburn’s report, for example, profiles a gold-plated \$1 million bus stop in Arlington, Virginia, and huge cost overruns at a transit center in Maryland.<sup>9</sup> These are

classic cases of how local governments are not frugal on projects when the federal government is picking up a substantial share of the tab.

**2. Misallocation.** Supporters of federal aid assume that funding can be optimally distributed to those areas with the greatest needs. But the aid system often does not work that way. For example, fast-growing Texas and Florida usually get the short end of the stick on highway aid.<sup>10</sup> In private markets, the price mechanism allocates resources and investments efficiently based on market demands. By contrast, federal aid is often distributed based on guesswork, political pull, parochial concerns, and pressure from lobbyists.

**3. One Size Fits All.** Certain programs may make sense for some states, but not for others. Yet the federal aid system essentially requires all the states to pay for programs dreamed up in Washington, even though residents of the various states may have different needs and viewpoints on the spending. Furthermore, each of the 1,100 aid programs comes with federal rules and regulations that can put a straightjacket on state policy innovation.

The American states were supposed to be laboratories of democracy. State policy diversity is a good thing, as is fiscal competition between the states. If California wants to spend its own funds on high-speed rail, it can do so, and the rest of the states will be able to learn from California's experience. A decentralized approach where states are free to fund their own activities would lead to better public policy for the whole nation.

**4. Intense Bureaucracy.** Federal aid is not a costless injection of funding to the states. Federal taxpayers pay the direct costs of the grants, but taxpayers at all levels of government are further burdened by the bureaucracy needed to support the system. The aid system engulfs government workers with unproductive activities such as proposal writing, program reporting, regulatory compliance, auditing, and litigation.

Many of the 16 million people employed by state and local governments must deal with complex federal regulations related to the plethora of aid programs. Each of the more than 1,100 aid programs have different rules, and the activities funded by the programs often overlap, which causes more confusion.

**5. Policymaking Overload.** One consequence of the large aid system is that the substantial time spent by federal policymakers on state and local issues takes away from their focus on truly national issues, such as defense. If members of Congress were to spend less time on local issues such as K-12 schools, for example, they would have more time to oversee the Pentagon and cut its waste. President Calvin Coolidge warned about the danger of "encumbering the national government beyond its wisdom to comprehend, or its ability to administer" interventions into local affairs.<sup>11</sup>

**6. Unclear Responsibilities.** The three layers of government in the United States no longer resemble a tidy layer cake, but instead are like a jumbled marble cake with responsibilities fragmented across multiple layers. Federal aid has made it difficult for citizens to figure out which level of government is responsible for particular activities. All three levels of government play big roles in such areas as education, which makes accountability difficult and encourages policymakers to point fingers of blame when problems arise. When every government is responsible for an activity, no government is responsible.

The federal aid system is a roundabout and inefficient funding method for state and local activities. Cutting federal aid programs would be a great way to reduce government waste.

## **Privatization**

I discussed how the private sector has built-in mechanisms to minimize waste that governments do not have. Many governments have figured that out, and since the 1980s there has been a revolution in privatizing government-owned businesses and assets around the world.<sup>12</sup> Over the last three decades, roughly \$2 trillion or more of airports, railroads, electric utilities, post offices, and many other items have been privatized.<sup>13</sup>

Governments have pursued privatization in order to cut waste, spur growth, create higher quality services, and reduce government deficits. Many international studies looking at this reform experience have generally confirmed the benefits of privatization.<sup>14</sup>

In the United States, there are many federal activities that could be privatized and have been privatized in other advanced economies. Germany, the Netherlands, and Britain privatized their post offices. Canada and Britain privatized their air traffic control systems. Britain privatized its passenger rail system. Most European countries have privatized their airport security screening. The United States has the Tennessee Valley Authority, but many other nations have privatized their electric utilities.

Let's look at our air traffic control (ATC) system, which is run by the Federal Aviation Administration (FAA). The FAA has been plagued by cost overruns and uninspiring performance for decades.<sup>15</sup> Currently, the FAA is struggling to move ahead with NextGen, a huge project to bring GPS and digital communications to ATC. Those changes would expand our airspace capacity and allow shorter flight paths, which would save time and reduce costs.

However, "NextGen remains mired by setbacks, cost overruns, and delays as a result of FAA mismanagement," noted one recent study.<sup>16</sup> *Bloomberg* reported that "more than one-third of the 30 contracts critical to building a new U.S. air-traffic system are over budget and half are delayed ... eleven of the 30 contracts underpinning the so-called NextGen system exceed projected costs by a total of \$4.2 billion."<sup>17</sup>

The solution is to privatize the ATC system and separate it from the government. Privatizing the FAA would give managers the flexibility they need to improve performance. It would allow for improved cost efficiency and better investment decisions. ATC is a high-tech industry, and so we should not be trying to run it as a bureaucracy.

Canada privatized its ATC in 1996, setting the system up as a nonprofit corporation, Nav Canada.<sup>18</sup> The company is self-supporting from charges on aviation users. It is one of the safest systems in the world, and has won international awards for its efficient and innovative management.<sup>19</sup> Britain has also privatized its ATC system in the form of a nonprofit corporation.

Another candidate for privatization is the U.S. Postal Service. The USPS has been losing money as it faces a long-term decline in mail volume. The USPS needs to reduce costs and

increase efficiencies. While USPS management is trying to make some reforms—such as ending Saturday delivery and closing post office locations—Congress often blocks such efforts. The way ahead is to privatize the USPS and repeal the company’s legal monopoly over first-class mail.

Britain recently privatized its Royal Mail, proceeding with an initial public offering of shares that raised about \$2.7 billion for the government.<sup>20</sup> The new private postal company will continue to provide universal service to all households. The government proceeded with this reform because the Royal Mail faces falling mail volumes and the need for greater efficiency to better compete—which are the same problems that the USPS faces.

In sum, governments around the world are tackling the problem of waste in government, and one of the solutions that many nations are pursuing is privatization.

## Conclusions

Federal spending is too high and government debt is piling up. Official projections show rivers of red ink for years to come unless policymakers enact reforms. Unless spending and deficits are reduced, the United States will face slower economic growth and possibly further financial crises down the road.

Policymakers should turn their attention to cutting unneeded and wasteful federal spending. Great places to start would be to cut aid programs for the states and to privatize activities where possible. When the federal government takes over activities best left to states, businesses, charities, and individuals, it usually generates a lot of bureaucratic waste and inefficiency, which ultimately harms the economy and reduces American incomes.

Some other nations have made substantial cuts to their government budgets and pursued reforms such as privatization with very beneficial results.<sup>21</sup> So U.S. policymakers should view spending reforms as an opportunity to create positive and lasting benefits to the economy and society.

Thank you for holding these important hearings.

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<sup>1</sup> Congressional Budget Office, “The 2013 Long-Term Budget Outlook,” September 2013.

<sup>2</sup> Office of Senator Tom Coburn, “Wastebook No. 4,” December 2013.

<sup>3</sup> [www.downsizinggovernment.org/interior/indian-lands-indian-subsidies](http://www.downsizinggovernment.org/interior/indian-lands-indian-subsidies).

<sup>4</sup> [www.downsizinggovernment.org/usace](http://www.downsizinggovernment.org/usace). And see Ryan Alexander, “The Army Corps of Engineers Excels at Wasting Money,” *usnews.com*, March 27, 2013.

<sup>5</sup> Program count from [www.cfd.gov](http://www.cfd.gov).

<sup>6</sup> Research summarized in [www.downsizinggovernment.org/government-cost-overruns](http://www.downsizinggovernment.org/government-cost-overruns).

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<sup>7</sup> [www.downsizinggovernment.org/fiscal-federalism](http://www.downsizinggovernment.org/fiscal-federalism).

<sup>8</sup> Chris Edwards, "Federal Aid to the States: Historical Cause of Government Growth and Bureaucracy," Cato Institute, May 2007.

<sup>9</sup> Office of Senator Tom Coburn, "Wastebook No. 4," December 2013, pp. 32, 45.

<sup>10</sup> Ronald Utt, "Turn Back Transportation to the States," Heritage Foundation, February 2012.

<sup>11</sup> [www.presidency.ucsb.edu/ws/index.php?pid=29566](http://www.presidency.ucsb.edu/ws/index.php?pid=29566).

<sup>12</sup> [www.downsizinggovernment.org/privatization](http://www.downsizinggovernment.org/privatization).

<sup>13</sup> Worldwide privatization proceeds between 1977 and 1999 is estimated at more than \$1 trillion. See Bernardo Bortolotti, Marcella Fantini, and Domenico Siniscalco, "Privatisation Around the World: Evidence From Panel Data," *Journal of Public Economics*, 2003. Worldwide privatization proceeds between 2000 and 2010 is also estimated at more than \$1 trillion. See John Nellis, "The International Experience With Privatization," School of Public Policy, University of Calgary, January 2012, p. 6.

<sup>14</sup> Some overview studies of the results of privatization include: Organization for Economic Cooperation and Development, "Privatising State-Owned Enterprises," 2003; Anthony Boardman and Aidan Vining, "A Review and Assessment of Privatization in Canada," School of Public Policy, University of Calgary, January 2012; and Stuart Holder, "Privatization and Competition: the Evidence from Utility and Infrastructure Privatisation in the UK," National Economic Research Associates, prepared for the Organization for Economic Cooperation and Development, September 1998.

<sup>15</sup> [www.downsizinggovernment.org/transportation/airports-atc](http://www.downsizinggovernment.org/transportation/airports-atc).

<sup>16</sup> U.S. Travel Association, "Thanksgiving in the Skies," November 2013, p. 5.

<sup>17</sup> Alan Levin, "NextGen FAA Contracts Are \$4.2 Billion Over Budget, GAO Says," *Bloomberg.com*, February 16, 2012.

<sup>18</sup> [www.navcanada.ca](http://www.navcanada.ca).

<sup>19</sup> Chris Edwards, "Privatize the FAA," *Daily Caller*, April 24, 2013. And see Glen McDougall and Alasdair S. Roberts, "Commercializing Air Traffic Control: Have the Reforms Worked?" Suffolk University Law School, February 17, 2009.

<sup>20</sup> The privatized Royal Mail delivers letters and packages. The government retained what is now called the "Post Office," which is a chain of retail outlets providing postal and other services. See [www.royalmailgroup.com/about-us/privatisation-our-journey](http://www.royalmailgroup.com/about-us/privatisation-our-journey).

<sup>21</sup> For example, see Joint Economic Committee, "Spend Less, Owe Less, Grow the Economy," Republican staff, March 15, 2011. And see Chris Edwards, "We Can Cut Government, Canada Did," *Cato Policy Report*, May-June 2012.

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