Competitive Enterprise Institute

One Nation, Ungovernable?

A Bipartisan Agenda for Economic Liberalization and Restraint on Political Power

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Rediscovering Political Accountability and Limited Government

As both political parties wrangle over economic stimulus packages and appoint czars with unprecedented powers, the federal budget deficit is ballooning above $1 trillion. The federal government's annual spending before the creation of the $700 billion Troubled Assets Relief Program (TARP) already topped $3 trillion. Since the bulk of that goes to "nondiscretionary" entitlement, health, and defense budget commitments, the budget was already largely uncontrollable—even before the economic crisis deepened.

Alongside direct spending, economist Mark Crain estimates regulatory compliance costs (health, safety, environmental, and economic rules) to exceed $1.1 trillion. That is more than one-third the level of annual federal spending. Combining regulatory costs and federal spending, Washington's share of the nation's $13-trillion annual economic output tops 29 percent. If government intervention were stimulative, the nation should be overflowing with wealth and job creation already. The answers lie elsewhere.

Stimulus bills and TARP-like measures obscure the reality that recessions, and the distortions created by prior decades of mixing politics with free enterprise, must be ridden out—if not now, then in the coming months or years, when the readjustments could be even more painful. Worse, panicky new political controls and resource misallocation today sow the seeds for future dislocations and recessions. But by then, the economic pain will be other politicians' problem.

From poorly understood (and rapidly shifting) financial market interventions, to the auto industry bailout, to transferring wealth to politically determined "infrastructure" projects, today's policy responses expand state authority, impose new controls on businesses and entrepreneurs, and neglect a vast alternative agenda of private, voluntary stimulus and economic liberalization.

To downplay the voluntary sector's own potential contributions and replace them with state mandates and wealth transfers is to court disaster. A genuine predicament faced by the market today is *not knowing what government will do next*; that uncertainty paralyzes private investment, which could otherwise bloom.

Today's sweeping government interventions appear tectonic, not incremental, and are a grave threat to our nation's future. We face not just the aforementioned bedrock of expanding federal entitlements, but the cost of two wars, grave economic distress, and a new open-ended culture of bailouts and "stimulus." The promise of a new administration is surely dampened

upon confronting the biggest government on Earth, already some 20 percent larger in a matter of months. The stimulus culture, engineered by lawmakers from both parties, has made much else on the Obama agenda a second tier issue—so those items are now being repackaged as stimulative in themselves.

A better economic recovery agenda is to create the conditions for the market to *actually* do what the government *claims* it can do. It would entail an ongoing program, not of "investing" or stimulating or intervening, but of liberalizing the wealth-creating energies of citizens and the private institutions.

Such an agenda would abolish agencies that have contributed to the mess we are in and downsize others, freeze spending, place a moratorium on new regulations, loosen existing rules, reduce capital gains taxes, and return the financial sector to the private market in such a way that the moral hazard created by regulatory guarantees never again occurs. (That's difficult; already, on a smaller scale in frontier industries like cybersecurity and nanotechnology, government funding and intervention threaten to remove much of the market discipline that would otherwise regulate risk and temper poor investments.) A true recovery agenda would also institute myriad other reforms, such as strengthening the Office of Management and Budget's central review of regulations with an eye toward reducing mandates, and exploring enterprise zone concepts like those established in New Orleans after Hurricane Katrina.

When times are hard, you share; but the fundamental notion that you do not *take* other people's stuff to get out of an economic crisis seems alien to the political class. Washington's primary function is no longer to lightly administer the "silken bands of mild government" envisioned by the Founders, but to transfer wealth to politically favored constituencies. As Competitive Enterprise Institute President Fred Smith has aptly put it: "The Constitution isn't perfect; but it's better than what we have now."

"New Steal"

To date, Washington's economic recovery strategy has been a mash-up of short-term stimulus measures, massive infrastructure projects, and promises about investment and "efficiency." In mere months, Keynesian demand management has re-conquered economics as surely as the political response to the Wall Street meltdown response furthered Alexander Hamilton's dreams of centrally managed government finance. In this "New Steal," government is stimulating like it is 1929. With the federal reindeer on the roof, the economy remains frozen, waiting to see what comes down the chimney next.

Stimulus packages and a stimulus culture foster political ends unrelated to actual economic recovery. Innumerable special interests benefit from an interventionist, mixed economy—and when circumstances deteriorate, as they always do, the liberalizing market reforms that could actually contribute to recovery become further marginalized from the policy discussion.

As George Mason University economist Richard Wagner points out, unconstrained democracy has a built-in bias toward deficit finance, so demand-side Keynesian policy responses to downturns enjoy perennial staying power. And, since modern legislatures are at root wealth-transfer institutions, they rarely publicly acknowledge the limitations of their *actual* contributions to the real economy, not to mention their culpability in downturns. So they "stimulate." And then they stimulate some more.

Indeed, the real problem—the one jeopardizing actual recovery—is the fact that the political price of pursuing non-governmental recovery measures is too high for election-bound politicians to entertain.

"Stimulating" demand for the burgeoning supply of government programs, services, and wealth transfers is never difficult—and becomes ever easier as successive interventions fail but escape blame and Newer Deals gain sway among a fearful public. So efforts to promote wealth creation by reducing regulatory and fiscal interventions in the economy—and establishing institutions to keep future such interventions minimal—go nowhere.

As the Nobel Prize-winning economist Friedrich Hayek noted, the politicians blamed for problems during a bumpy but real recovery are often those who *stop* state interventions—interest-group benefits, artificially fluid credit, labor union privileges, inflationary monetary policy, and malinvestment from earlier government interventions—not the ones who started those costly processes and even erected entire institutions to enshrine them decades earlier. As one example, few in official Washington seriously discuss phasing out and liquidating Freddie Mac and Fannie Mae, even though those institutions bear responsibility for some of the distortions behind the credit crisis.

"Stimulate" Supply, Not Demand

A truly effective economic stimulus program would reduce the "tariffs" on wealth creation. It would free the world's largest economy from excessive regulation and spending—by freezing both, for starters—and from the undisciplined political money and credit creation at the core of the financial crisis. It would never foist the uncertainty of the TARP on a limping economy in the first place (and if it did make that mistake it would rapidly eliminate it once it recognized the damage it can create and prolong). For immediate stimulus, rapid and retroactive marginal tax rate cuts could facilitate economic activity via increased supply.

Such real stimulus requires politically difficult changes in what people expect from government—and in government officials' authority—so political reality prevents halting the compounded economic damage from artificial stimulation and financial "bailouts to nowhere." That makes America largely ungovernable now, since, along with entitlements on autopilot, wealth transfers managed by unelected czars dominate the federal agenda.

That is depressing, not stimulating. As soon as President Obama gets down to work in the White House, he should announce a regulatory freeze and set about liberalizing wealth creation, not spending yet more wealth that has not even been created, worsening the nation's prospects.

Too Big to Fail? Not under True Capitalism

Members of both parties opportunistically blame markets for recession while downplaying the regulatory leviathan that government has become. There is plenty of blame for the private sector to shoulder—make no mistake—but it is the mixed economy that fosters the distortions and ensuing corruption which have led us to the current crisis.

When government interventions artificially collectivize risk beyond what a free market permits, and generate entities considered "too big to fail," one cannot fairly deem them products of capitalism. One of the gravest threats we now face is that the U.S. government seems determined to impose vague yet vastly powerful programs—led by unaccountable czars—*with more scale and scope than that of any imagin-*

able private entity. What happens when *those* entities fail?

When market capitalism, rather than a mixed economy, prevails, no firm is ever "bigger" than the disciplinarians arrayed against it if it misbehaves—clients, suppliers, partners, advertisers, competitors, media, employees, investors, and upstart rivals. Only government guarantees—like those fostered by Fannie Mae and Freddie Mac, and even in the federal deposit insurance program—can remove those disciplinary forces.

We have had a century of government control of money with the too-big-to-fail Federal Reserve—and, more recently, of the credit supply with Fannie and Freddie. The risk now is that today's "rescuers" are further centralizing risk, kicking decision making upstairs to the federal government itself—a coercive, wealth-transferring institution where few of the disciplinary forces that exist in markets have any sway at all.

A better approach to address errant market behavior is to reestablish the market discipline that governments routinely undermine. Capitalism, by dispersing wealth, is one of the most democratizing institutions ever devised, and thus properly prevents the "too big to fail" phenomenon from occurring in the first place. To allow properly functioning capital markets to flourish, policy makers should remove all barriers to the private, brutal market for corporate control—including allowing hostile corporate takeovers and even more modern equivalents—rather than waste time on side-show distractions like coercive limits on firm size or CEO pay.

Markets and capitalism disperse risk; our failure has been to have too little free enterprise, not too much. Unfortunately, that lesson is not being learned, and the ability to reinvigorate the disciplinary institutions of capitalism diminish by the day as government assumes even more powers—which will be difficult, if not impossible, to wrest away in the future.

Now About this "Infrastructure Investment" Business…

President-elect Obama has said that he wants the federal government to fund "shovel ready" projects as an infrastructure stimulus to the economy. A December 2008 Drudge Report headline blared: "JOBS, ROADS, BRIDGES, SCHOOLS, BROADBAND, ELECTRONIC MEDICAL RECORDS, ENERGY"—but this high profile campaign may only be shoveling from the right hand to the left. This is an age-old political ploy—not to actually produce, but to transfer yet more of the nation's dwindling wealth to those with political pull. Each wave of the spending wand toward some high-profile project diverts media and public attention away from what free individuals would have done instead with those resources, and from the many ways to spark private, rather than government, investment in these very ventures.

Genuine leadership does not consist of promising to take yet more of other people's resources and giving it to federal agencies and favored government contractors. Yet that is what we observe: proposals for government to enact "renewable" energy plans, repair drafty school buildings, provide broadband for everyone, upgrade the electric power grid, computerize medical records, and so forth.

Details are sketchy, but one thing is clear: Golden chains always accompany the receipt of government money. Take power grid investment: Utilities may get the cash, but they will end up diverting it toward politically favored and inferior "renewable" technologies, thereby

draining future wealth and resources from better, more effective uses. (For example, no fuel is "greener," in the proper sense of the term of using fewer overall resources, than petroleum-based gasoline.) Meanwhile, government power over the nation's energy supply grows.

Labor unions are not merely being placated with the various spending packages; they helped spearhead them, insisting that they will create "millions" of jobs. Yet it was such a make-work mentality that helped lead to the current disaster in the auto industry: Productivity may still improve if struggling industries are forced to deal with compulsory unionization, but those firms will also become saddled with legacy costs negotiated under monopoly labor conditions—from pensions to health insurance to even paying workers who are no longer needed.

Fostering Infrastructure Wealth the Right Way

It is undeniably true that America needs to create "infrastructure wealth"—we need it just as we need financial wealth, real estate wealth, manufacturing and service wealth, and health-care wealth, and more. But like all wealth creation, the roots are in *property rights, private ownership, free enterprise and entrepreneurship—voluntary institutions evolved over centuries, which were neither created by fiat nor paid for by* tax dollars.

The proper way to maximize infrastructure wealth—and the jobs and consumer benefits that go with it—is to clear the path for free enterprise to build it. Yanking funds from unseen, voiceless, and dispersed taxpayers and their less-glamorous projects and applying it to high-profile, vocal recipients is a destructive enterprise, not a wealth-building one.

Following are some better steps to lay the groundwork for a wealthier nation. *These are the sort of programs Washington should be implementing in a crisis like that of today.*

- End exclusive franchises that prohibit firms from competing with incumbent electric companies. Today, it is basically illegal to run an extension cord across the street.
- Liberalize all network and infrastructure industries, which are now artificially segregated into regulatory silos—telephone, electricity, water, sewer, cable, railroad, airline, and air traffic control. This would create opportunities for firms in these industries to work together and *jointly* invest in new infrastructure—power lines, fiber optic lines, roads, bridges, airports, toll roads, wireless ventures and more.
- Relax antitrust rules to allow firms within and across industry sectors to combine and create business plans to bring capitalism and infrastructure wealth creation to the next level. This would also aid nascent industries like nanotechnology, for which political regulation amounts to a pointless dispersion of taxpayer money across dozens of universities.
- To encourage broadband deployment, declare "net neutrality" permanently off the table, and make it clear that proprietary networks and investments will never be expropriated in any fashion, that there will be no forced sharing, only voluntary agreements and alliances.
- Liberalize spectrum and secondary markets in spectrum frequencies such that wireless wealth is freely created apart from regulatory decree.

These proposals are only a start. Other initiatives, like privatization of politically provided services like the mails, the mortgage giants, and retirement and health programs, also should be explored. As noted, the nation has

been rendered largely ungovernable because of the expansion of government beyond any constitutional limitations; moving enterprise back to the private sector will help return government to its proper boundaries.

Throwing money at infrastructure "stimulus" but leaving pre-21st century regulations intact, while adding new command-and-control and spending schemes, is not governing; it is not courageous, and it is not commendable. We have to do better.

Deregulate to Stimulate

The call for new regulations alongside new spending points up a need to reconsider *regulation* comprehensively in the context of stimulating economic growth and wealth creation. Reducing the accumulated impact of 70,000 annual pages of new regulations—in a Washington increasingly incapable of cutting spending—offers real stimulus opportunities but goes largely ignored. Pruning the regulatory enterprise would increase returns to investors and offer struggling entrepreneurs greater prospects that risky new ventures would succeed.

A recent Small Business Administration (SBA) initiative called Regulatory Review and Reform exemplifies, on a small scale, the kind of re-thinking needed. Recent regulatory proposals highlighted for reform by SBA cover everything from trans-fat labeling to the airline passenger screening system; from myriad auto and labor safety standards to energy efficiency mandates for anything with an exhaust pipe.

An economic liberalization package would create a more favorable environment for business development and wealth creation by, among other steps:

- Freezing enactment of new non-essential rules;
- Undertaking a sweeping review of the regulatory state as a whole and implementing a bipartisan package of regulatory cuts; and
- Instituting a permanent automatic sunsetting of rules, and ongoing rule reviews and purges.

As it stands, voters lack any real control over agency rule making, just as they will lack control over "car czars" and powerful Treasury secretaries. Only congressmen are elected, not bureaucrats. Congress has delegated power to agencies that lack real incentives to police themselves and that rarely acknowledge when their regulations create more costs than benefits. Along with halting the bailout culture and implementing growth-oriented liberalizing reforms, sound public policy requires that elected representatives affirm new major rules, after considering their costs, before they become effective.

Today, leadership requires unleashing America's creative, competitive, wealth-creating spirit, not dampening it and creating further dependency through compulsory wealth transfers. Those represent the low road and a lack of imagination and leadership.

You don't need to tell the grass to grow; just take the rock off of it. And lay off the federal "fertilizer" next time.