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The Economics of Bad Ideas

Our politics are awash in economic illiteracy, with no shortage of bad ideas streaming out of the US Capitol and filling the airwaves. While the left's innumeracy is well documented, the right has also fallen for technocratic naivete in various areas, such as the recent support for tariffs and other trade barriers that benefit a concentrated group at the expense of everyone else.

These well-intentioned proposals frequently create a maelstrom of unintended consequences that are counterproductive for the free and prosperous society our institutions are meant to nurture. Cato scholars take on five such proposals here, correcting the record on unrestrained government spending, the refusal to reform entitlements, the harm caused by trade wars, the foolhardy push for a green electric grid, and the pitfalls of a wealth tax.

ILLUSTRATIONS BY LUCY JONES

"We are a sovereign currency, we can print all the money we want to serve the people whom we serve."

—Former House Budget Committee chair John Yarmuth (D-KY), testifying to Congress on October 19, 2023

By Romina Boccia

The US national debt is nearing record levels not seen since World War II, driven by politicians on both sides of the aisle abdicating their responsibility to control spending across multiple presidential administrations and Congresses.

Ignoring the threats posed by our ever-increasing debt will only exacerbate problems for future generations, burdening them with slower economic growth, runaway inflation, and higher interest rates.

Despite calls by some independent-minded politicians to balance the budget, most lawmakers and pundits either overlook or downplay these dangers. Others, including former House Budget Committee chair John Yarmuth (D-KY), dismiss concerns about the debt altogether.

"We are a sovereign currency, we can print all the money we want to serve the people whom we serve," Yarmuth testified to the House Budget Committee last October, several months after he retired from Congress. "Why are we paying interest on the money we borrow? And why do we

borrow money anyway? We can print it and put it in the Treasury."

The belief that federal deficits and government spending don't matter because the government can print more money underlies modern monetary theory. This unworkable economic doctrine has gained considerable traction in some circles on the left while downplaying the risks of inflation resulting from fiat money issuance.

But history is replete with examples of runaway inflation caused by out-of-control money printing and government spending. Between 2015 and 2019, average inflation levels in Argentina more than doubled, from 27 to 54 percent, and then hit triple digits last year. This reduction in Argentines' buying power occurred alongside reckless government spending and rapid growth in the country's money supply. Argentine president Javier Milei was elected last year on the promise of taming inflation and slashing spending. The early results have been promising, with inflation falling for the fifth straight month in May.

When the government prints more money without the market first creating more resources, the additional money devalues existing money by driving up prices. More money chasing the same number of resources creates inflation. Inflation hits the most vulnerable hardest, eating away at the buying power of wages and savings.

Printing more money is not the answer to growing the economy. Instead, the government should reduce regulation and spending to unleash innovation and improve living standards.

There's a Milton Friedman quote I keep top of mind when crafting solutions to the federal budget problem: "The important thing is to establish a political climate of opinion which will make it politically profitable for the wrong people to do the right thing." Few politicians are willing to sign off on the necessary budget cuts to put us back on a path to fiscal sanity; after all, reducing spending at the scale required to balance the budget would mean cutting back on old-age entitlement programs such as Medicare and Social Security—a move so politically unpopular it threatens politicians' prospects for reelection.

To make entitlement reform politically feasible, Congress needs political cover to make the tough choices necessary. At the very least, Congress could establish an independent, nonpartisan commission of experts tasked with stabilizing the nation's debt at a size not exceeding the gross domestic product (also referred to as the economy). An initiative modeled after the Base Realignment and Closure (BRAC) commission would offer a promising path forward. Establishing such a commission would enable members of Congress to set reform discussions in motion while advocating for their constituents' interests.

Following the BRAC model, an independent commission's recommendations would become law within 45 days unless the House and Senate pass a joint resolution to disapprove of the reform package. As such, the reform package would be enacted by default after presidential approval and without members of Congress being required to vote on it. George Will promoted this idea in a *Washington Post* column last August, pointing out that the BRAC-like commission would address "fatalism about the political system's inability" to tackle the debt.

With inflation at an all-time high, there's been a growing appetite in Congress for fresh ideas on heading off an impending fiscal crisis. I've already had dozens of meetings with key members of Congress and their staffers about my proposal for a BRAC-like commission to limit spending and control the national debt.

The attention my proposal is receiving renews hope that national spending can be reformed and that we can avoid the consequences of continuing to kick the budget can down the road: a doom loop of rising interest rates, higher inflation, and shrinking economic growth. The stakes are far higher now than when Congress first set up the original BRAC commission to close obsolete military bases. It's time for a fiscal BRAC.

An independent commission is the best chance we have of hitting the debt brakes and maybe, just maybe, reversing some of the damage that the government has done to our economy and our everyday lives.

"It is time to scrap the cap, expand benefits, and fully fund Social Security."

—Sen. Bernie Sanders (I-VT)

By Romina Boccia

The shaky financial footing of Social Security grows more apparent by the year, with automatic cuts due in 2033, when the program's reserves are set to be depleted. Without much-needed structural reforms, Social Security looks even more unsustainable from 2033 onward, as lower fertility rates and longer life expectancies will further disrupt the balance of the $1.2 trillion program.

Despite the dismal outlook, leaders on both the left and right have failed to offer realistic solutions, while some lawmakers, such as Sen. Bernie Sanders (I-VT), want to *expand* benefits by uncapping payroll taxes for high earners.

But expanding benefits while dismissing necessary structural reforms will not slow Social Security's spiral. Congress should instead increase the eligibility age to align benefits with increased life expectancies, expand legal immigration for young workers to alleviate US demographic challenges, reduce excessive benefits for wealthy retirees, and return more control over retirement savings to individuals.

Social Security is a pay-as-you-go scheme, with the current 12.4 percent payroll tax on earnings of up to $168,600 funding all benefit payments each year. The aforementioned demographic shift presents a problem for this financing structure, as Social Security has paid out more in benefits than it has received through the payroll tax every year since 2010. That cash deficit is projected to be $182 billion this year with associated interest costs and will increase to more than $600 billion annually by 2032, leading to a cumulative 10-year deficit of $4.1 trillion over the next decade.

The program does have $2.7 trillion in reserves from previous decades of surpluses to cover these growing deficits, but that cash has already been used to purchase special-issue Treasury bonds so that the government could spend the surplus elsewhere. Aside from mounting interest costs, redeeming those Treasury bonds to cover deficits requires the government

to borrow *more* money, raise taxes, or cut spending from other programs.

Sanders and other lawmakers have proposed uncapping taxable earnings so that income beyond $168,600 also contributes to Social Security. Along with reducing economic growth and investment, eliminating the cap would only address half the long-term funding shortfall.

Simply increasing the payroll tax rate for everyone is an equally unsavory option. To pay all benefits through 2097 and maintain one year's worth of reserves, the payroll tax would have to increase from 12.4 percent to 17.5 percent, with employees and employers still contributing half the total payroll tax burden each, according to the Congressional Budget Office. The median US worker, who has a salary of $60,070, would see their annual payroll tax burden jump 40 percent, from $7,449 to $10,512.

Wider changes to Social Security are clearly needed. Lawmakers could start by reducing excessive benefits for the same wealthy retirees that Sanders wants to pay more taxes. The current maximum benefit for a dual-earner, retired couple is $117,000—a far cry from the modest "measure of protection" that President Franklin D. Roosevelt originally envisioned in 1935. This would be possible by changing the earnings-related formulas currently used to determine benefits or by transitioning to a flat benefit system altogether, as many other countries have done.

We also must confront the demographic shift underway in the United States. Fertility rates are falling, and government policies aimed at reversing this trend have been largely ineffective in other countries. Expanding legal immigration, however, is the most straightforward way to alleviate the imbalance between workers paying into the system and retirees drawing from it.

These changes would help move the needle, but a larger overhaul is needed that allows individuals to make their own saving and investing decisions while reducing the government's role in retirement planning. The introduction of voluntary, tax-advantaged universal savings accounts, for instance, would allow Americans to build their own financial security for themselves and their families.

Simply raising taxes on Americans will not solve Social Security's problems. Lawmakers should instead work to reduce excessive benefits, increase the eligibility age, expand immigration, and allow individuals to plan their own retirements through universal savings accounts or similar tax-advantaged accounts.

"A wealth tax is popular among voters on both sides for good reason: because they understand the system is rigged to benefit the wealthy and large corporations."

—Sen. Elizabeth Warren (D-MA) on March 1, 2021

By Chris Edwards

In the grand theater of American politics, the proposal to tax the rich has become a perennial crowd-pleaser on the political left. Federal politicians are calling for higher taxes on millionaires and billionaires to solve every imaginable problem. The populist left wants large income tax hikes at the top end and even a new European-style wealth tax, arguing that the rich are not paying their fair share and that wealth concentration is out of control.

This outlook is seductive to some people but deeply flawed.

The idea that taxing the wealthy can single-handedly cover budget deficits and fund ambitious government spending initiatives is a fiscal fairy tale. For one thing, data from the Congressional Budget Office show that the top one-fifth of US households already pay about three-quarters of all federal taxes.

There simply isn't enough untaxed income at the top to foot the bill for our ever-expanding budget deficits, let alone a massive surge in federal spending over the next decade. Larger welfare states abroad fund their higher spending with high taxes on the middle class. Many European countries tried imposing annual taxes on wealth, but they raised little money, induced widespread avoidance and evasion, and were damaging to entrepreneurs and the economy. The number of European countries with a wealth tax has fallen from 12 in 1990 to just 3 today.

More importantly, raising taxes on high earners would damage investment, entrepreneurship, and all Americans through slower economic growth. Markets reward work, innovation, and successful risk-taking by gains in wealth. The wealth of successful entrepreneurs is savings, which supports workers by providing investment resources for businesses.

Jeff Bezos' wealth of nearly $200 billion is not comprised of gold bars under his mattress but mainly of capital in Amazon, which supports opportunities for more than a million workers. His wealth is not concentrated but is instead spread across the economy, providing opportunities and services to all. Without such wealth or capital, productivity and wages would decline. *Forbes* reports that 66 percent of the world's billionaires are self-made, not inheritors of wealth. These folks have invented new products, driven down costs for every family, and improved our daily lives.

Wealth is not a fixed pie. In open and competitive markets, entrepreneurs creating wealth do not diminish the wealth available to others. Business innovations in these markets benefit not only businesses themselves but also consumers and the general public by offering higher-quality products at lower costs. Imposing higher "fair share" taxes would reduce investment, hiring, and innovation.

Rather than imposing a misguided tax on wealth, Congress could minimize tax avoidance by high earners by greatly simplifying the tax code. Such a step would also reduce the massive complexity of our tax system, which imposes substantial costs on both individuals and businesses. Americans spend more than six billion hours annually filling out tax forms, keeping records, and learning tax rules. Frequent rule changes and tax complexity lead to costly errors; this complexity also hampers efficient economic decisionmaking while creating inequality in the treatment of taxpayers.

It's true that some rich individuals use loopholes to reduce their taxes, but Congress put most of the loopholes in the tax code in the first place. The solution is a major tax overhaul to lower overall tax rates while eliminating distortionary deductions, credits, and exemptions. In

recent years, Congress has gone in the wrong direction with billions of dollars of narrow tax breaks for the electric vehicle industry, housing developers, energy companies, ethanol producers, and many others.

Instead of implementing a wealth tax or raising tax rates on capital income, policymakers should make reforms in the direction of consumption-based taxation, which would tax labor and capital but in a simpler way that does not stifle growth. A promising reform could involve universal savings accounts, which would be like supercharged Roth IRAs but could be used for all savings purposes, not just the activities favored by the government. Both Canada and the United Kingdom have enacted such accounts, and they have been hugely popular with individuals at all income levels. Universal savings accounts would encourage people to build larger nest eggs and increase their personal financial security.

Such pro-growth tax reforms should be matched by reining in excess spending and balancing the federal budget. If policymakers are worried about the rich gaining unfairly, they should focus on cutting spending subsidies for wealthy farmers, auto and energy companies, and other groups who should not be on the federal dole.

"Trade wars are good, and easy to win."

—Donald Trump in 2018, after announcing his first round of tariffs on Chinese goods

By Scott Lincicome

During the four years of former president Donald Trump's administration, US trade policy took a beating. On his very first day in office, he signed an executive order removing the United States from the 12-nation Trans-Pacific Partnership trade agreement (one of the most boneheaded US policy moves of the past decade). Next, he imposed global tariffs on metals, solar panels, appliances, and around half of all imports from China, including many household necessities and manufacturing inputs. Then, he showered new subsidies upon farmers unsurprisingly harmed by foreign retaliation to those same tariffs (never considering the obvious solution of reforming or eliminating the tariffs that fomented said retaliation). He also tightened Buy American policies to require that federal projects use domestic materials,

raising costs and delaying the projects' completion.

Now the former president and current GOP nominee has expressed plans for a "universal baseline tariff": a 10 percent "ring around the US economy" that would automatically apply to all imports, regardless of source. And he wants to increase tariffs on Chinese imports to 60 percent or more (a tacit admission, by the way, that his 25 percent tariffs haven't worked).

The Biden White House has criticized the Trump tariff proposal because it would "hurt hardworking families with higher prices and higher inflation" and "stifle economic growth." It's nice to see President Biden's words acknowledge these realities; his actions over the past three years, however, have been disappointingly similar to his predecessor's.

President Biden has barely touched Trump's tariffs, even though he could remove almost all of them with the stroke of a pen. Not only that, he's also actively worked to give himself—and any future president—even more power under these same protectionist laws, which our dysfunctional Congress is either unable or unwilling to reform. The Biden White House has also doubled down on those Buy American rules, embraced the Jones Act (which mandates that American ships carry goods between US ports), and lauded new domestic content mandates and subsidies for US renewable energy, semiconductor, and infrastructure projects.

Bipartisan support for such harmful policies has been motivated by fear over the rise of China, lingering concern from the pandemic era's supply-chain problems, and the belief that decades of trade liberalization harmed many lower- and middle-income Americans, especially in the industrial Midwest.

But recent events and reams of scholarship reveal that these concerns are more about politics, not policy. And the proposed solutions are doing far more harm than good.

There is no doubt that competition, whether foreign or domestic, and market changes can be disruptive, but such disruptions are rarely if ever more costly than protectionism. As the Trump tariffs showed, higher prices arising from government import restrictions are borne almost entirely by American companies and consumers (especially poorer ones), leaving the US manufacturing sector and economy worse off on net. Protected companies and jobs don't suddenly start thriving; instead, they end up seeking more government support, while US firms hurt by the tariffs lobby for special exceptions or their own protection. By the end of 2021, American companies had filed more than 200,000 requests for tariff exclusions.

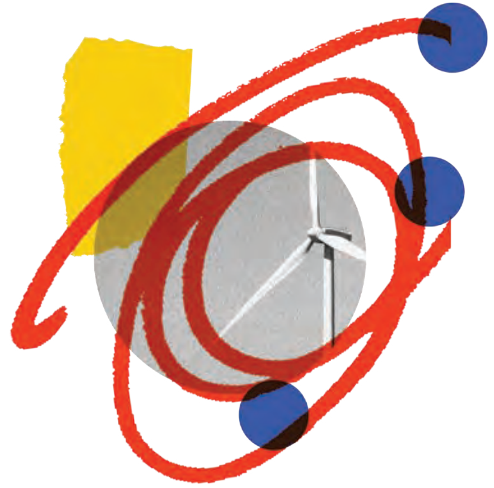
Pandemics and other global shocks inevitably do crazy things to supply chains, but protectionism is rarely a good solution. As we unfortunately saw with baby formula (almost all of which was made here), in fact, globally sourced products usually prove more resilient than those sourced domestically. China represents real and unique challenges for the United States, but current import taxes are indiscriminate—supposedly "strategic" tariffs cover garage door openers, vacuum cleaners, bicycles, tiki torches, baby blankets and clothing, and many other nonstrategic things. They mostly raise costs for American families and companies while doing nothing to convince Beijing to change course. Meanwhile, China's own policy missteps, demographic challenges, and myriad economic headwinds have imploded Washington policymakers' once-trendy view of China as

an unstoppable global power that demands the abandonment of Western democratic capitalism. All those tariffs, however, remain—and Biden just added more.

Fortunately, markets and people have shrugged off much of this protectionism, as well as post-pandemic predictions of wide-scale "deglobalization." Supply chains remain global, though different from what they were pre-pandemic; imports and exports of US goods in 2023 remained near the record highs they set in 2022; services trade and digital trade are booming; and energy and food crises have never materialized (thanks in large part to globalization).

Our political class may be embracing autarky, but the millions of people actually engaged in the global economy still aren't buying it.

Hopefully the politicians will soon catch on too. Congress needs to recognize that protectionism creates a few short-term winners at everyone else's expense; that trade, immigration, and economic interdependence make US companies and workers wealthier, more competitive, and better able to withstand economic shocks; that US trade laws are far too susceptible to presidential abuse and politicking; and that meeting the China challenge requires not China-style industrial policy but the openness and dynamism that made America great in the first place (and still great today).



"There's no way around it: to realize the full benefit of the nation's goal of 100% clean electricity by 2035, we need to more than double our grid capacity."

—Secretary of Energy Jennifer Granholm

By Travis Fisher

During his administration's first week in office, President Biden issued an executive order on "tackling the climate crisis." The order detailed the administration's goal to achieve "net zero" greenhouse gas emissions by 2050, with an interim goal of attaining 100 percent clean electricity by 2035. These aims align with the Paris Agreement, which Biden took steps to rejoin on his first day in office.

According to many environmental activists, the goal of 100 percent clean electricity by 2035 is one of the easier pieces of the decarbonization puzzle. However, it requires remaking the power grid as we know it, and it is unlikely to happen under current policies (even after accounting for state-level mandates for renewable energy and trillions of dollars in federal subsidies).

According to Secretary of Energy Jennifer Granholm, the United States needs to "more than double our grid capacity" in order to "realize the full benefit of the nation's goal of

100% clean electricity by 2035," which would "deliver reliable, more affordable energy to every American community in turn driving down costs for American families."

What's the price tag for a government effort to double the capacity of the American electric grid? How could such a significant intervention drive down costs for American families, as Secretary Granholm has claimed? Let's review the economics of the idea of 100 percent clean electricity by 2035 by estimating the policy's costs to taxpayers and climate benefits.

The Cost of Doubling the Power Grid

Baked into Secretary Granholm's call to double our grid capacity is the fact that new renewable energy resources—namely wind and solar—tend to be in parts of the country that do not presently have robust electricity transmission infrastructure. In some cases, new transmission lines must be built before a new wind or solar facility can interconnect. In other cases, existing capacity must be increased.

Getting to a 100 percent clean electric grid thus means doubling our transmission capacity and building enough clean electricity generation to energize the grid and satisfy demand at all hours. In practice, that requires either a staggering amount of new renewables and new batteries for backup or an aggressive shift to new nuclear technologies.

In both cases, the cost to taxpayers of the new assets would reach multiple trillions of dollars (about $3 trillion by recent estimates), and the required transmission investment could be just as costly (some scholars estimate $2 trillion or more). For the sake of argument, let's place the cost of a 100 percent clean electric grid by 2035 at $5 trillion. Instead of reducing costs for American families, this plan jacks up prices and deepens the national debt.

What Climate Benefits Can We Expect?

If the United States achieves 100 percent clean electricity, does that mean other countries will follow suit? Game theory tells us that each country's government is likely to do what's in its own best interest, not what's in the interest of the global commons. Also, many of today's largest emitters are developing nations that have much lower per capita incomes than the developed West. Will they be capable of spending moon-shot money on an energy transition?

Let's check the data. According to a November 2023 UN report, the 195 parties to the Paris Agreement pledged to reduce emissions by 45 percent by 2030. Instead, the parties are on pace to increase emissions by 9 percent by 2030. Meanwhile, China continues to build new coal-fired power plants at a rate that overwhelms the West's efforts to close them. The Paris Agreement seems to be succumbing to the collective-action problem.

Although I wouldn't call the climate situation a crisis, tackling climate change is a lofty goal that many Americans support. However, the practical reality—often omitted from discussions of climate policy—is that the president of the United States cannot dictate global outcomes. If the United States ceased to emit greenhouse gases today, climate models used by the United Nations suggest the world would be 0.2 degrees Celsius cooler by the year 2100 than a world without such climate commands.

Keep in mind that the electricity sector is responsible for only 25 percent of US greenhouse gas emissions. Hence, spending $5 trillion on a 100 percent clean electric grid by 2035 would slow global warming by 0.05 degrees Celsius by the year 2100. Given everything else we can do with $5 trillion, greening the grid is not a wise use of taxpayer dollars. ✦