

THE COST OF GOVERNMENT

Revisited

BY FRED KILBOURNE



BACK IN THE SPRING OF 2000, *Contingencies* published my article on the cost of government, both direct and indirect, in these United States of ours. Eight years out, with another national election looming on the horizon, I figured it was time for an update.

First a refresher: Direct costs are cash expenditures by federal, state, and local governments. The huge national problem of promises without adequate provision isn't addressed in this article, since unfunded promises are not included until the money is spent. Indirect costs are your cash expenditures incurred in complying with government regulations and mandates, again at all levels of government. The pros and cons of all of these expenditures is also beyond the scope of the article, which is concerned solely with the actuarial exercise of projecting future costs based on an analysis of historical experience in the light of present and anticipated conditions.

The chart that accompanies this article traces the cost of government in this land of the free over two centuries. The top half of the chart shows the cost of government during quinquennial years in the recently ended 20th century. The numbers differ slightly from my original article, largely because of improved data available in the 2006 publication *Historical Statistics of the United States: Millennial Edition* (HSUS). This half of the chart traces the inexorable rise of government cost, expressed as a percentage of the gross domestic product (GDP), from about 5 percent at the beginning of the century to about 10 times that proportion at the end. There are two notable exceptions. First, the final 20 years were quite stable, at about half the GDP. Second, the high point wasn't reached at the end of the century but rather in 1945, when the tab for prosecuting World War II reached 40 percent of GDP, pushing government costs to a century-high total of about 54 percent.

The bottom half of the chart projects the cost of government


during the newly entered 21st century. Actually, the first two rows of the exhibit (2000 and 2005) are now history, and so those entries are either facts or supported estimates. The new century has had some surprises, of course, most of which have had the effect of increasing the cost of government—in some cases dramatically—and increasing, correspondingly, projections for the balance of the century. This will become clear as we examine the components of that cost.

Projections for GDP

Entries in the GDP column of the exhibit are in billions or trillions of dollars, as indicated, and all other entries in the exhibit are expressed as percentages of GDP. For reasons that are not entirely clear but that serve to illustrate the volatility of very long term forecasting, the projections for GDP are significantly different from those in the original article. The 2000 entry is from HSUS, Vol. #3 (Pages 25 and 26), and the 2005 entry is taken from Table 1.1.5 at www.bea.gov/bea/dn/nipaweb. Subsequent entries are based on Table VIF6 of the 2007 Annual Report of the Social Security Board of Trustees, with the final four entries based on 24 percent per quinquennium increases, the rate used in the report. The Social Security and Medicare projections are also based on trustee reports (see below), but the other projections are mine, supported by review of the historical statistics, analysis of turn-of-the-century data and events, and judgment reflective of trends in the data and news of the day. The chart's eight columns of component government cash expenditures combine to make up the direct cost of government (DIR), to which is added the indirect cost (IND) to yield the total cost of government (GVT).

National Defense

The national defense category (DEF) is from a single HSUS table (Ea63), which includes international relations as well as military expenditures. Alone among the various itemized categories, defense costs may best be characterized as volatile. Accounting for a mere



The original prediction in 2000 was that the soaring government costs that characterized much of the 20th century would continue increasing but at a much slower rate. It's been eight years. How do the numbers hold up?

The Cost of Government in the 20th and 21st Centuries

YEAR	GDP	DEF	ESS	INT	SSA	CMS	H&W	EDU	MSC	DIR	IND	GVT
1900	19	1	1				1	1	1	5		5
1905	26	1	1				1	2	3	8	1	9
1910	32	1	2				1	2	3	9	1	10
1915	36	1	3				1	2	4	11	1	12
1920	87	1	3	1			1	2	1	9	1	10
1925	91	1	3	2			1	2	2	11	2	13
1930	91	1	3	2			2	2	3	13	2	15
1935	73	1	4	2			4	3	7	21	2	23
1940	101	2	3	2			3	3	7	20	3	23
1945	223	40	3	1			2	2	3	51	3	54
1950	294	6	2	2			3	3	8	24	4	28
1955	415	10	3	2	1		2	3	6	27	4	31
1960	527	9	3	2	2		3	4	6	29	6	35
1965	720	8	3	2	3		3	4	6	29	8	37
1970	1040	8	3	2	3	1	4	5	6	32	9	41
1975	1635	6	3	2	4	1	5	6	7	34	12	46
1980	2796	5	3	3	4	1	5	5	8	34	15	49
1985	4213	7	2	4	5	2	4	5	9	38	13	51
1990	5803	6	3	4	4	2	4	6	9	38	12	50
1995	7401	4	4	4	5	2	5	6	8	38	12	50
2000	9825	3	4	3	4	2	5	6	11	38	12	50
2005	12487	4	4	4	4	3	5	6	11	41	15	56
2010	16T	6	4	4	4	3	5	7	11	44	17	61
2015	20T	7	4	4	5	4	5	7	12	48	18	66
2020	25T	7	4	5	5	5	5	7	12	50	19	69
2025	32T	7	4	5	6	5	6	7	12	52	19	71
2030	39T	7	4	5	6	6	7	7	12	54	20	74
2035	49T	7	4	5	6	8	7	7	12	56	20	76
2040	61T	7	4	5	6	8	7	7	13	57	20	77
2045	76T	7	4	5	6	9	7	7	13	58	20	78
2050	94T	7	4	5	6	9	8	7	13	59	20	79
2055	116T	7	4	6	6	9	8	7	13	60	20	80
2060	144T	7	4	6	6	10	8	7	13	61	20	81
2065	179T	7	4	6	6	11	8	7	13	62	20	82
2070	222T	7	4	6	6	11	8	7	13	62	20	82
2075	275T	7	4	6	6	11	9	7	13	63	20	83
2080	341T	7	4	6	6	12	9	7	13	64	20	84
2085	422T	7	4	6	6	12	9	7	13	64	20	84
2090	523T	7	4	6	6	12	9	7	14	65	20	85
2095	649T	7	4	6	6	12	9	7	14	65	20	85
2100	805T	7	4	6	6	12	9	7	14	65	20	85

YEAR Calendar year—beyond 2005 are projections

GDP Gross domestic product in dollars—billions through 2005, trillions thereafter

DEF National defense as a percentage of GDP dollars—includes expenditures for international relations

ESS Other essential government costs as a percentage of GDP—public safety and transportation

INT Interest on the public debt as a percentage of GDP—includes federal, state, and local debt

SSA Social Security as a percentage of GDP—trustee projections from 2010 through 2180

CMS Medicare as a percentage of GDP—trustee projections from 2010 through 2180

H&W Health and welfare as a percentage of GDP—includes Medicaid and veterans' services

EDU Education as a percentage of GDP—includes federal, state, and local expenditures

MSC Miscellaneous as a percentage of GDP—public employee retirement costs, etc.

DIR Direct government spending as a percentage of GDP—sum of the prior columns

IND Indirect government spending as a percentage of GDP—includes the cost of compliance with regulations

GVT Cost of government as a percentage of GDP—direct and indirect costs combined

1 percent of GDP for the first third of the past century (World War I was no doubt an exception, but its years aren't shown in the table since they didn't hit a quinquennial year), defense (then called "war") expenditures reached an incredible 40 percent of GDP in 1945. After a brief respite, pursuing the Cold War cost an average 7 percent for the next 40 years. Following that, the country experienced a decade free of perceived enemies during which about 3 percent of GDP was diverted from guns to butter. The events of Sept. 11, 2001, showed that this was an illusion. By 2005, Table Ea63 was back up to 4 percent and well on its way to who knows where (much less, for how long). The fight against the Soviet Union lasted three generations, during the first of which that enemy was misperceived to be our ally. Will the fight against radical Islam last another several generations, as its adherents believe? Will it cost as much, or more (or less?), to fight the terrorists as it did to fight the Communists? (And is that latter fight over?) Or will it cost what it did to fight and defeat the Nazis? (And is that fight over?) For our purpose, the assumption is that national defense costs will quickly return to 7 percent of GDP and stay there for the foreseeable future.

Other Essential Government Services and Interest

Other essential government services (ESS) include public safety and transportation, which are projected to remain steady at 4 percent (2 percent for each element). The components represent HSUS tables Ea81 to 91, which include police, fire, corrections, highway, air travel (which doubled from 2000 to 2003), and other lesser elements.

The public debt interest category (INT) also comes from a single HSUS table (Ea109) that grew from a negligible amount (under \$100 million) at the beginning of the 20th century to 3 or 4 percent of GDP at the end. While projected to grow to 6 percent during the 21st century, this projection may prove to be inadequate for several reasons. For one, a footnote to the HSUS table notes that the numbers exclude "interest on federal securities held by federal agencies and funds." For another, the politicians of tomorrow may find that their efforts to incur debt as a means of financing their spending are overwhelmed by redemptions and maturities of the debt instruments used by yesterday's politicians to finance their spending (and by understandable reluctance on the part of prospective lenders). Finally, interest rates of the future will likely be higher than today because of inflation caused, in part, by those same politicians of tomorrow seeking to raise money by taxing savings. There seems little reason to expect that the 6 percent figure will prove to be excessive.

Social Insurance, Health, Welfare, and Education

The Social Security (SSA) and Medicare (CMS) numbers in the 21st-century portion of the chart are intermediate projections based on the 2007 trustees' reports of Social Security (Table VIF4) and of Medicare (Table IIIA2).

The health and welfare category (H&W) is broken out separately in this update because of its size and trend rate. Comprising HSUS

Tables Ea72 to 80, it includes federal, state, and local public welfare, health and hospitals, and veteran services. Having grown from 1 to 5 percent of GDP in the 20th century, the projection assumes that the category will grow to 9 percent by the end of the current century. This 100-year growth rate (80 percent) is more than the increase anticipated for Social Security (50 percent) but less than projected Medicare growth (300 percent), which has some related components.

The education category (EDU) is from a single HSUS table (Ea67) and grew from 1 or 2 percent of GDP at the beginning of the past century to about 6 percent at the end. The projection assumes growth to

only 7 percent over the next 100 years. There will undoubtedly be powerful forces pushing for a larger share of the national pie, but these have also been around over the past generation, during which time the proportion has remained fairly steady at about 6 percent.

The 20th-century history of these seven categories of itemized costs, including social insurance programs, is thus growth from about 5 percent of GDP at the beginning, to about 16 percent at the midpoint, to about 27 percent at the end of the century. It's interesting to look at the trends in these itemized components of direct government spending. There are strong, long-term upward trends in Social Security, Medicare, and health and welfare, with flattening toward the end of the 20th century mainly for demographic reasons (relatively few people were born during the Depression and World War II). The education and debt interest categories also show

long-term upward trends, but they are less pronounced. Safety and transportation expenditures have been relatively flat as percentages of GNP, while defense costs have been volatile (for reasons that are readily apparent). As developed above, these seven itemized elements are projected to nearly double to 51 percent over the next 100 years.

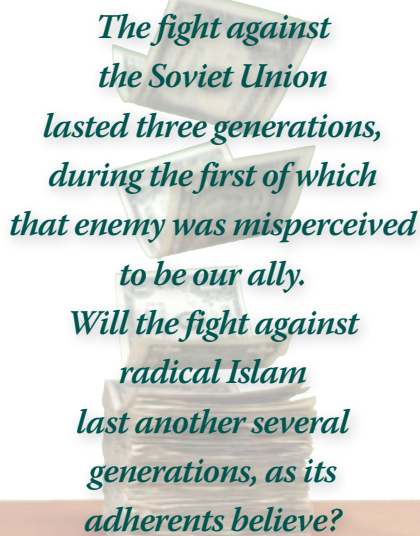
Everything Else

The other element of direct government spending is the "all other" category, which grew from about 1 percent at the beginning of the past century to about 11 percent at the end and which is projected to grow to 14 percent during this century. This category is the balancing item between total government spending (HSUS Table Ea61) and the itemized categories above. Its major components include public employee retirement (Ea120), natural resources (Ea92), utilities (Ea113), general administration (Ea104 to 108), postal services (Ea66), sanitation (Ea100), unemployment compensation (Ea121), and a host of lesser (under \$50 billion annually) expenditures.

The sum of all elements of direct government costs thus grew from 5 percent to 38 percent during the 20th century, as shown in the top half of the exhibit, and is projected to continue growing to 65 percent during the 21st century, as shown in the bottom half of the exhibit. This leaves the question of indirect government costs.

Indirect Costs of Government

The indirect cost of government (IND) column in the chart can only be estimated, consisting as it does of the unreported costs



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of compliance, by millions of businesses and families across the land, with thousands of regulations and other government mandates. Those who study these costs seem generally to take a dim view of regulation, while those who favor regulation seem to prefer to criticize those studies rather than look too deeply into the matter on their own. For the purpose of preparing the chart, my approach has been to develop estimates based on the studies but then to reduce them somewhat as an adjustment against potential bias.

The Americans for Tax Reform Foundation has studied the cost of compliance with government regulations extensively, if not entirely objectively, and concludes that cost currently to be about 17 percent of GDP and to have ranged from 15 percent to 18 percent over the past generation. The National Center for Public Policy Research comes to a similar conclusion, based on federal regulations. Perhaps most interesting is the thorough work done by the Mercatus Center at George Mason University, which places its focus on federal regulatory staffing and direct expenditures. While these costs are included within the direct government spending in the exhibit, they are probably related to compliance costs and are useful for the purpose of discerning and projecting trends. For example, inflation-adjusted federal regulatory costs increased during the 20 years ending in 1980 at an annual rate of 9 percent, during the next 20 years at a 3 percent rate, and during the first five years of this century at a 6 percent rate. The corresponding increases in federal regulatory staffing were 5 percent during the first 20-year period, 1 percent during the second, and 6 percent from 2000 to

2005. The recent increases are dramatic but not surprising in the light of regulation-breeding events such as the Enron debacle and the Sept. 11 attacks. Dramatic increases in regulation may also be expected in the future owing to perceived crises concerning health care financing and global warming, among others. Accordingly, the assumption used in the exhibit is that the cost of compliance with government regulations will increase from an estimated 12 percent of GDP in 2000 to 20 percent of GDP in 2030 and then remain proportionally flat for the remainder of the century.

Too High? Too Low? Who Cares?

Perhaps you think that some of my projections are too high or too low? If so, please let us know which ones, by how much, and why. This is a debate that must be joined if we the people are to chart our future rather than merely to succumb to the tyranny of trends beyond our control. Using my numbers, the future is bleak if you think that working for 15 cents of every dollar earned is 85 percent slavery. Or the future is bright if you consider government to be the most humane and efficient means of distributing and consuming those earnings. It must be remembered, however, that these projections assume that all of us will work just as hard for the government as we do for ourselves. Lacking that, the foundational GDP will slip and our standard of living along with it. I know that you and I will keep our noses to the grindstone, but I'm a little concerned about our kids. They seem so self-absorbed and selfish—but maybe they'll get over it. ●

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