THE ECONOMIC PERFORMANCE of the U.S. economy in the twentieth century was an incredible success story. In 1900, the average American earned $5,500 (in year 2010 dollars), and we ranked fourth among all countries in per capita income. By the year 2000, the average American earned about $29,500, and we stood at the summit of economic development. In contrast, the United Kingdom, which started the century in first place, dropped to twelfth by 2000. To paraphrase Frank Sinatra, for the United States, it was not merely a very good year but a very good century. The record could have been better still.

This book focuses not on the good economic policies that helped create the U.S. success story but rather on the policies that were major economic blunders. As former British Prime Minister Winston Churchill noted, those who fail to learn from history are doomed to repeat it. Reflecting on the painful lessons of history not only helps us to avoid repeating them, but constitutes an important first step toward finding solutions for lingering problems. Some of the worst economic policies of the past one hundred years are recent and will continue to create problems for us as we go further into the twenty-first century.

Criteria for Selecting the Worst Economic Policies

How were the ten worst economic policies selected? Two standard economic tools were used. One tool is benefit-cost analysis, which provides a framework for evaluating the social benefits and costs of public policies. The second tool is an equity or fairness assessment. How does the policy impact members of society? Are the distributional consequences fair?
For the most part, the policies chosen either have imposed significantly more costs than benefits on society or have distributional effects that most people would consider unfair. Some of the policies selected satisfy both criteria. It was difficult to winnow the list of bad policies down to the ten worst. Some economists may feel some great candidates were overlooked or the rankings were out of order. Most, however, would agree that the ten selected here were poorly designed and needlessly wasteful.

**Why So Many Bad Policies?**

Bad economic policies are not hard to find. Some of the worst are old, and some are new; some are Red and some are Blue. Bad economic policies are not the monopoly of any one political party. The blunders divide fairly equally among Democrats and Republicans. This was not the author's intention. Basic forces work to encourage the production of wasteful economic policies, regardless of the political party in power.

Government is plagued by the same governance problems corporations face, arguably more so. Voters elect representatives, and shareholders elect corporate decision-makers, and both groups of owners—voters and shareholders—share the problem of getting their representatives to act responsibly in their behalf. The bigger the corporation and the bigger the government, it would seem, the bigger the governance problem.

When Willie Sutton, one of the most notorious twentieth-century criminals, was asked why he robbed banks, he replied, “Because that’s where the money is.” The same rationale motivates many of those who seek to run large corporations or to hold government office. Government office seekers might honestly add, “because that’s also where the power is.” Another major problem facing both shareholders and voters is how to keep people like Willie Sutton—or imprisoned financier Bernie Madoff, for that matter—from becoming our corporate and government leaders and how to prevent good, honest corporate and government leaders from evolving into Willie Suttions. Interestingly, two of our wrecks are government Ponzi-type schemes similar to the one operated by Bernie Madoff, only bigger: the pay-as-you-go Social Security and Medicare programs.¹

¹. These are not “true” Ponzi schemes, as explained later.

Government governance is in many ways more problem-prone than running a corporation. Shareholders have a common interest, the bottom line, and the failure of executives to perform is eventually clear. Bankruptcy or hostile takeovers are possible consequences for nonperformance in the business world, but these remedies for mismanagement really don’t exist in our political market. First, it is often difficult to assign blame for bad economic policies. Most voters are disgusted with Congress, but they may feel their own representatives and senators are doing a good job. Second, replacing Republicans with Democrats or vice versa, which might seem to be a type of hostile takeover, seems to do little to improve governance. Regardless of party, government decision makers tend to favor short-run benefits for friends—especially major campaign contributors and special-interest groups—while imposing costs on the rest of us or imposing the costs on later generations.

When corporate governance fails, as demonstrated by the collapse of such firms as Enron and Lehman Brothers, jobs are lost. Paradoxically, when government governance fails, the role and scope of government is usually increased. For example, the recent failure of government regulation of the financial sector, one of the blunders discussed in this book, produced proposals for not one but two new financial regulatory agencies and a coordinating council to add to the numerous regulatory agencies already in place, agencies that had already demonstrated failure in their assigned tasks.

The Sarbanes-Oxley Act of 2002 was government’s attempt to improve corporate governance by reducing accounting abuses and making the bottom line more accurate and transparent. Whether or not Sarbanes-Oxley achieves its objectives, making corporations more accountable and transparent are moves in the right direction. The same reasoning could be applied to government as well. How are we to get the government to impose similar laws regarding its own behavior? This is like asking the fox to set the rules for watching the hen house. Can government governance be improved? This important question is addressed in the epilogue.

**Motivating Factors Producing Bad Economic Policies**

Governments produce wasteful or ineffective policies for several major reasons:
Special-Interest Groups

Many bad public policies stem from the pressure that special-interest groups place on the political system as they seek to redistribute income or wealth to themselves from others. They seek legislative profits, increased profits that come from government subsidies, changes in regulation, or special legislation. Economic profits arise from building a better mousetrap or producing more efficiently, but legislative profits are usually characterized by waste.

Special-interest economic policies that are adopted and survive for any significant period tend to have two characteristics. First, the members of the special-interest group stand to gain a substantial amount, so they will fight hard to get and keep it. Of course, they will be willing to share some of that gain with supportive politicians (for example, through campaign contributions). Second, the group paying for these special-interest benefits is large so that no individual feels a substantial burden. Indeed, many of those who pay the bill for special-interest group benefits are often completely unaware of what’s happening.

An example will help illustrate the point. Suppose dairy farmers successfully lobby a government for a law that sets milk prices one-cent per quart higher than the market price. A large dairy farmer supplying one million gallons of milk per year would stand to rake in an extra $40,000 annually. By contrast, the typical milk-drinking family will pay just a few pennies more a week for milk, an amount so small that it will generally go unnoticed. This story and numbers have a basis in reality. In 1972, the government raised the price it was guaranteeing dairy farmers for their output. The price of a quart of milk increased by an estimated one cent as a result. The overall gain in revenues to the dairy industry was placed at $500 million per year. When this type of asymmetry in benefits and costs occurs, the situation is ripe for abuse, and bad policies are the result. Some examples discussed in this book include the Hawley-Smoot Act of 1930, which involved tariff legislation supporting domestic producers, and U.S. government regulatory policies in the financial sector that contributed heavily to the Great Recession.

Maternalism/Paternalism/Parentalism

Parents know quite well the need to occasionally restrain the behavior of their children. Paternalism, maternalism, or parentalism applies the power of the state to enact policies that restrain individuals from engaging in activities that lawmakers or their constituents find offensive. Some politically influential pressure group may support the policy, or it even may receive broad support from the electorate. Often the support for such policies is based on ideology or religion and the supporters usually receive only psychological benefits from knowing that their fellow citizens are doing the “right” things. Prohibition, one of the blunders in this book, probably is best described as a paternalistic policy. The government’s policies to greatly expand home ownership, fostering the real estate bubble prior to the Great Recession, also could be characterized as paternalistic, although special-interest groups benefited as well.

Majority Takes Advantage

Another reason for bad policies is that the political system, responding to the wishes of the majority, takes advantage of a minority, sometimes imposing substantial costs on them. Overall costs of a policy may exceed the benefits by a wide margin. But as long as the benefits to the majority exceed their costs, such a policy can survive. A highly progressive income tax system that attempts to soak the rich is a good example. A period of incredibly high marginal tax rates on the wealthy is included in the chapter, “Tax Follies.” The exemptions and deductions within the tax codes, also dealt with in that chapter, might best be classified as special-interest favors, but paternalism plays a role as well.

Short-run Obsession (Immediosis)

Immediacs are individuals obsessed with immediate gratification with little or no regard for the future consequences of their actions. Politics seems to breed or attract immediacs. Politicians naturally are concerned about getting reelected, and to assist in their reelection, they need to produce tangible benefits for constituents prior to the next election. Policies that offer clear short-run benefits may be adopted, even though the policy’s costs outweigh its benefits over the long run.

2. This concept is original to the author. Don’t expect to find it in Wikipedia—at least, not yet. Immediasis is my name for the psychological disorder.
Social Security provides a good example. Between 1968 and 1974, our elected federal officials raised Social Security benefits five separate times, four of them falling during an election year. Overall, benefits were increased 90 percent in this six-year period. Clearly, the large and growing elderly population must have felt very warmly toward the incumbents who showered them with this largesse. Yet, at the time, it was clear that this largesse would create serious problems decades later, as the retiree population grew ever larger. The politicians increasing benefits chose not to worry about the long run, which would be some other elected officials’ problem many years down the road. “Short-run gain, long-term pain” is the politician’s golden rule for reelection. Four of the ten blunders fall into this category. In addition to Social Security, excessive deficit spending in the first decades of this century receives a chapter. A third is the business cycle engineered by President Richard Nixon that window-dressed the economy before his reelection bid and produced a decade of inflation that required three recessions to correct. Fourth and last is the government’s establishment of massive amounts of unfunded obligations, mostly in our Medicare program.

**Policymaker Ignorance**

Bad economic policies also may arise out of just plain ignorance. Policymakers may think that an idea is superficially sound, unaware of or unable to understand its deeper ramifications. One of the most costly of the wrecks in this book is probably best explained by policymaker ignorance about how the economy functions: the Federal Reserve Bank’s mishandling of monetary policy that produced the Great Depression.

**Plausible Acceptability**

Regardless of the underlying reason for their existence, most bad economic policies have a ring of “plausible acceptability,” which helps to diffuse objections from injured parties. Borrowing from Richard Nixon, we might dub this requirement the “Will it play in Peoria?” principle. Consider just a few examples. Tariffs on imports “protect hard-working American workers from cheap foreign labor and unfair competition,” their proponents might say—overlooking the damage done to consumers. Prospective homeowners “need subsidies to achieve the American dream,” others may argue. These policies would be much less palatable to the American public if the lawmakers said, for example, that tariff protections and mortgage subsidies were supported by special-interest groups that made huge campaign contributions to key politicians. The Hawley-Smoot Act, one of our wrecks, pandered to special interests and started a worldwide trade war. Subsidies given to homeowners to buy houses they couldn’t afford are included in the chapter on Tax Follies and in the chapter on the Great Recession.

Let’s now turn to identifying and explaining the ten worst policies. Arranging the worst policies in chronological order made sense as it helps to maintain an historical context. I took some liberty in deviating from a strict chronological order. One of the great economic wrecks, for example, owes its origin to legislation passed in 1913, but I plunked it down in the 1950s, when its effects really began to become wasteful. First up is a policy that many readers may not consider an economic policy. It was an attempt to destroy a particular market in the United States, a declaration of war on alcohol. It was the 18th Amendment.