Introduction

The federal government is a vast money transfer machine. It spends hundreds of billions of taxpayer dollars each year on subsidy programs—from the massive Medicare to hundreds of more obscure programs that most people have never heard of. There are more than 1,800 federal subsidy programs.\(^1\)

With such a huge array of handouts, the federal budget has become victim to large-scale fraud and abuse—that is, people taking government benefits to which they are not entitled. Just about every subsidy program suffers from fraud and abuse, and we illustrate the problems here with discussions of Medicare, Medicaid, housing programs, student aid, and farm subsidies. Losses to federal taxpayers from fraud, abuse, and other types of improper payments are in the ballpark of $100 billion a year or more.\(^2\)

There have been efforts to reduce improper payments, but the abuse of federal programs continues at high levels. We think that federal subsidy programs should be cut because they harm the economy and are unfair to taxpayers.\(^3\) But endemic fraud and abuse provides an additional reason to pursue cuts and terminations to many federal programs.

Medicare and Medicaid

Fraud in the two main federal health programs is huge, imposing costs on taxpayers at least in the tens of billions of dollars each year. As broad-based government programs, the massive size of Medicare and Medicaid makes them very difficult to police. Medicare, for example, processes 1.2 billion claims each year by computer, generally without human eyes checking them for accuracy.

Let's look first at the fraud and abuse problems in Medicare. The Government Accountability Office estimates that there are about $17 billion of improper Medicare payments each year, including fraudulent and erroneous overpayments to health care providers.\(^4\) That figure does not include the huge new prescription drug benefit, which is thought to be highly susceptible to abuse.

Other estimates of improper Medicare payments are higher. Malcolm Sparrow of Harvard University, a top specialist in health care fraud, argues that estimates by federal auditors do not measure all types of fraud. He believes that as much as 20 percent of federal health program budgets are consumed by fraud and abuse, which would be about $85 billion a year for Medicare.\(^5\)

Sparrow says that criminals can rip off federal health care programs simply by carefully filling out and submitting the proper forms, and then the "claims will be paid in full and on time, without a hiccup, by a computer, and with no human involvement at all."\(^6\) He argues that the abuses do not just stem from occasional overbillings by doctors, but involves organized looting of health care programs by criminals.

A perfect example of what Sparrow is talking about was reported by the \textit{Washington Post} in 2008. A high-school dropout with a laptop computer was able to single-handedly cheat Medicare out of $105 million by electronically submitting 140,000 fraudulent claims over four years for equipment and services.\(^7\)

There are many ways that Medicare gets ripped off: "Billing by health care providers for services not rendered, billing for products not delivered, misrepresenting services, unbundling services, billing for medically unnecessary services, duplicate billing, increasing units of service which are subject to a payment rate, falsifying cost reports resulting in increased payment to the health care provider, kickbacks, and on and on."\(^8\) You can read about the different types of fraud on Medicare’s website.\(^9\)

One area of rampant fraud is Medicare’s medical equipment subsidies.\(^10\) One scam is for doctors to steer patients into buying motorized wheelchairs that they don’t really need, but that Medicare pays for. Then the doctors receive kickbacks from wheelchair supply companies or other operatives. A 2008 report by Senate investigators found that 30 percent of medical equipment reimbursements that they examined appeared to be fraudulent.\(^11\)

Another area of fraud is Medicare’s home health care benefits. Medicare pays for home visits by health professionals under certain limited conditions, but patients find ways to illegally get around those limits. In addition, criminal gangs have simply looted this program by submitting false claims.\(^12\) The costs of Medicare home health care coverage soared 44 percent over the last five years, and fraud appears...
to be an important cause of the increase. Auditors have been concerned about fraud in home health care for years, but the problem never seems to get solved.

The bigger Medicare gets, the more fraud there is. The newest subsidy—the $60 billion a year prescription drug benefit—is thought to be particularly susceptible to abuse. A physicians’ publication noted that the benefit was “staggeringly complicated and largely incomprehensible to the very population it was intended to help. It’s also ripe with opportunities for the dishonest and fraught with traps for the unwary. … The drug program’s very complexity is a source of fraud.”

The Medicaid program also has a giant fraud and abuse problem. The GAO puts the cost of improper Medicaid payments at $33 billion, or about 10.5 percent of the program’s total spending. But if improper payments are 20 percent of the program’s cost, as Malcolm Sparrow thinks might be the case, that would be a $63 billion annual loss to taxpayers.

New York’s Medicaid is especially fraud-ridden. The former chief investigator of the state’s Medicaid fraud office believes that about 10 percent of the state’s Medicaid budget is consumed by pure fraud, while another 20 to 30 percent is consumed by dubious spending that might not cross the line of being outright criminal.

A 2005 investigation by the New York Times found remarkably brazen examples of fraud and abuse in New York’s Medicaid. The article noted that the program has “become so huge, so complex, and so lightly policed that it is easily exploited … the program has been misspending billions of dollars annually because of fraud, waste, and profiteering.” Here are some of the findings:

- A dentist stole more than $1 million from New York’s Medicaid by making claims for fictitious patients and procedures. She even had the chutzpah to make claims for 991 procedures supposedly performed in a single day.
- Medicaid’s subsidies for handicapped transportation are widely abused. The program pays $50 per trip for handicapped persons to go to doctor’s appointments, but investigators found that many people using the service were not handicapped and that many transportation companies were rigging the system to earn unjustified profits.
- Schools across the state charged Medicaid more than $1 billion for unneeded or unprovided special education activities as a way to bilk the state out of additional Medicaid grant money.
- Criminal gangs diverted Medicaid-covered muscle-building drugs that were intended for AIDS patients to bodybuilders.

Similar schemes to bilk federal health programs are routinely uncovered across the nation. Federal investigators say that they play “whack-a-mole” with organized criminals, because when they crack down on them in one area of the country, they move to a different area and continue bilking federal health programs.

A classic type of fraud in both Medicare and Medicaid is double-billing. In one recent case, the University of Medicine and Dentistry of New Jersey double-billed Medicaid repeatedly over the years by directly submitting claims for outpatient physician services, even as doctors working in the hospital’s outpatient centers were submitting their own claims for exactly the same procedures.

Another area of fraud is Medicaid’s long-term care benefits, which cover the costs of nursing homes and home care for the elderly poor. Medicaid pays about half of the costs of all long-term care in the nation. The program has complex rules for eligibility related to one’s income and financial assets. But nursing homes are expensive, and so the program creates incentives for middle- and higher-income families to try and qualify for it. Indeed, an industry of financial consultants helps seniors hide their income and assets so that they become eligible. This sort of abuse costs taxpayers about one-fifth of the program’s cost, or about $13 billion in 2009.

One reason why Medicaid has high levels of fraud is that it is an open-ended “matching” program. The states administer the program and decide how much to spend, but the federal government pays more than half of the costs. That creates a disincentive for state officials to worry too much about fraud and abuse. Indeed, state governments themselves have a history of abusing Medicaid by creating schemes to improperly boost their receipt of federal matching dollars. The Washington Post rightly called these state schemes a “swindle,” but noted the political resistance to doing anything about it. One solution to these problems is to turn Medicaid into a block grant and freeze the amount of aid to each state. That would immediately give states a big incentive to cut all types of waste, fraud, and abuse.

In sum, the magnitude and complexity of federal health programs results in a huge and ongoing waste of taxpayer funds. Sparrow argues that health care fraud and abuse “might be as low as one hundred billion. More likely two or three. Possibly four or five” hundred billion.

The Inspector General of the Department of Health and Human Service told Congress in 2009: “Although it is not possible to measure precisely the extent of fraud in Medicare and Medicaid, everywhere it looks the Office of Inspector General continues to find fraud against these programs.”

**Housing Subsidies**

Federal housing programs have long been a ripe target for fraud and abuse. In 1971, Time discussed a scandal at the Federal Housing Administration in which “real estate speculators used the program to make huge profits at the expense of the poor through what amounts to sheer fraud.” The article also discussed a scandal from the 1950s whereby “builders pocketed millions of dollars of unearned profit from mortgage loans that exceeded the cost of construction” under a federal program. The magazine concluded that “whenever the government writes a blank check to the housing industry, some sort of scandal is likely to result.”

In the 1980s, huge scandals broke out at the Department of Housing and Urban Development involving influence-peddling and gross mismanagement, costing taxpayers billions of dollars. Senior HUD staff were using their positions for personal gain, and when they left HUD they used their inside contacts to win subsidies and contracts. HUD Secretary Sam Pierce favored friends and political allies with contracts, and his mismanagement allowed HUD programs to become targets for abuse by financial and real estate interests.

Today, HUD provides a huge range of subsidies to state and local governments, real estate businesses, financial institutions, and nonprofit groups. The largest share of HUD’s budget goes toward rental subsidies for low-income tenants. There are about $1 billion in erroneous and fraudulent overpayments of these subsidies each year, according to the GAO. Tenants make false claims to gain eligibility for rental
subsidiary, and local public housing authorities (PHAs) have often abused these federal monies.

Public housing is another area of abuse. HUD provides about $8 billion a year to more than 2,000 PHAs. PHAs are infamous for their mismanagement, corruption, and wasteful spending.32

HUD is supposed to oversee the PHAs, but its efforts leave a lot to be desired. The Miami Herald won a Pulitzer Prize in 2006 for its series exposing fraud and corruption in Miami-Dade’s PHA—a PHA that had passed HUD audits.33 Here are some of the abuses uncovered by the Herald:34

- The PHA gave developers and nonprofit groups with political connections millions of dollars to build affordable housing, but they ended up building shoddy houses or no houses at all.
- HUD gave the PHA $35 million to tear down dilapidated public housing and replace it with new affordable housing. Six years later, half the money was gone, and only three houses had been built. The agency frittered away its money on staff salaries and consultants.
- Instead of selling new houses to low-income buyers, the PHA allowed developers to make sales to wealthy investors who then “flipped” them for a profit.

The Miami-Dade problems are far from unique. For decades, PHAs across the nation have been mishandling taxpayer money. Unfortunately, HUD rarely cuts off the mismanaged PHAs. A USA Today article counted 61 PHAs that received funding from the 2009 federal stimulus bill despite repeated financial mismanagement.35

Another area of ongoing abuse is the Federal Housing Administration’s mortgage loan insurance system. Buyers abuse the system by obtaining loans under false pretenses, and lenders abuse the system by issuing loans for more than properties are worth. These sorts of fraud increase the risks of default, which ultimately costs the taxpayers. As an example, a New Jersey underwriter routinely falsified employment verification documents to obtain FHA-insured mortgages for unqualified borrowers, which resulted in $10 million in losses after 66 mortgages defaulted in 2007.36

In sum, programs for public housing, rental assistance, and housing finance have been magnets for fraud and abuse for decades. The Department of Housing and Urban Development ought to be dismantled, and its poor record on controlling fraud and abuse is one good reason why.

Student Loans

Federal student-aid programs have long been subject to fraud and abuse. The three main culprits are students and their families, educational institutions, and lending companies. It is difficult to stop the cheating in student loan programs because they “are large, complex, and inherently risky,” according to the Inspector General of the Department of Education.37 Federal student loan programs involve more than 6,000 postsecondary institutions and more than 3,000 lenders.

Students and their families cheat aid programs by falsely reporting their income level and other items in order to garner larger benefits. With the Pell college grant program, for example, this type of fraud costs taxpayers hundreds of millions of dollars per year.38 Another abuse is that many students simply decide not to pay back their federal student loans. In 2001, the GAO found that there were more than $20 billion of student loans in default.39

Educational institutions often pilfer money meant for students. Under most student loan and grant programs, federal aid is sent to thousands of educational institutions, which are supposed to distribute it to eligible students. However, that distribution system has attracted swarms of shady schools and administrators over the decades that pocket the federal money at the expense of students and taxpayers.

A string of scandals in the early 1990s made clear the magnitude of the problem. One scandal regarded the trade school American Career Training Corporation in Florida. The school recruited new “students” at housing projects and helped them take out loans.40 The school owners received tens of millions of dollars in federally guaranteed student loans, and simply pocketed it. Another scheme involved 21 Jewish schools in New York State that used millions of dollars in Pell grants to line their pockets while spending little on education.41 Yet another scandal at the time involved owners of Advanced Business College in Puerto Rico, who used Pell grants to buy $3 million worth of sports cars and real estate for themselves.

A Senate investigation in 1991 found that student loan programs were “plagued with fraud and abuse at every level,” which cost taxpayers billions of dollars.42 The investigation accused the Department of Education of “gross mismanagement, ineptitude, and neglect,” finding that it had a “disastrous record” of combating loan abuses.43 Losses from the student loan program totaled an enormous $13 billion between 1983 and 1990. In 1994, the department admitted that it was losing a staggering $3 billion or more annually to waste, fraud, and loan defaults. Education Secretary Richard Riley called the department’s oversight “worse than lax.”44

Today, fraud and abuse may have been reduced from the extraordinarily high levels of the 1980s and 1990s, but there are still large amounts of waste. In 2002, a GAO investigation revealed how easy it was to scam the student loan programs by simply sending in applications under fake student names.45 In 2005, an investigation found that owners of a company called the CSC Institute stole $4.3 million of the $13 million it received in Pell grants.46 The GAO currently estimates that taxpayers lose more than $1 billion a year to fraud and abuse in student aid programs.47

A new scandal involving financial institutions garnering excessively high profits from student loans has rocked the student-aid industry in recent years. Under the Federal Family Education Loan Program, dozens of loan originators figured out how to earn a 9.5 percent guaranteed return from the government, even though market interest rates have been much lower. Lenders have been able to earn billions of dollars at taxpayer expense. In response, some policymakers argue that private lenders should be cut out of the federal student loan process, and that all lending ought to flow directly from the Department of Education. But the department has been a terrible financial manager of its aid programs, including its direct-loan programs. Thus, the best reform would be to completely terminate the federal role in
Many other federal programs suffer from substantial fraud and abuse. The data cited in the following bullets are from a 2009 GAO report on Other Federal Programs.

The companies receive federal subsidies for providing farm insurance, but those subsidies are not passed through to farmers in the form of lower premiums. Instead, the companies operate like a cartel and are able to earn high profits from excessive premiums, all at taxpayer expense.

The biggest scandal with farm subsidies is that they exist at all, as discussed elsewhere. But fraud and abuse in farm programs add insult to injury for taxpayers. One GAO study found that improper or fraudulent farm-subsidy payments are as much as half a billion dollars a year. But other GAO studies make clear that the USDA doesn’t have a good handle on how much cheating is actually going on. For example, the USDA does not adequately police the income eligibility limits on subsidy programs.

Fraud and abuse in the farm programs takes many forms. Congress puts limits on subsidy payments to particular farmers, but farmers create complex business structures to get around those limits. Farmers are supposed to pay back loans, but farm loan programs have high delinquency rates.

Sloppy administration by the USDA makes cheating easier. A 2007 GAO report found that the USDA paid $1.1 billion in subsidies over six years to 170,000 deceased individuals. There is also the problem of “emergency” farm payments being handed out willy-nilly. After adverse events such as droughts, Congress often dishes out emergency payments to farmers who don’t need them or who have not even asked for them. In addition, some farmers will claim to have experienced crop damage even when they haven’t in order to receive subsidy payments.

The government response to a drought in 2003 illustrates how emergency subsidies get wasted. Ranchers needed feed for their cattle because of a drought, and the government responded by providing some of its large stockpile of powdered milk. However, much of the free milk ended up being illegally diverted to other uses, which allowed speculators to earn large profits at taxpayer expense.

Finally, the federal crop insurance system operates in a manner that enriches private insurance companies at the expense of taxpayers. The companies receive federal subsidies for providing farm insurance, but those subsidies are not passed through to farmers in the form of lower premiums. Instead, the companies operate like a cartel and are able to earn high profits from excessive premiums, all at taxpayer expense.

Other Federal Programs

Many other federal programs suffer from substantial fraud and abuse. The data cited in the following bullets are from a 2009 GAO report on improper payments, unless otherwise noted.

- **Food Stamps.** This welfare program is a target for fraud because it is so large and complex. The government must keep track of millions of individuals to accurately document their eligibility while keeping tabs on the 160,000 retailers who deal in food stamps to look for illegal trafficking. In the past, the program spawned a huge black market as recipients exchanged their food stamps for cash on the street. Today, food stamps are issued on electronic cards, and fraud levels have been reduced. Nonetheless, the program’s improper payment rate is still about 6 percent, costing taxpayers about $1.7 billion annually.

- **School Lunches.** A large share of subsidized school meals are taken by families with incomes above the legal cutoff points. Program audits and statistical data have found that about one-quarter of those receiving free and reduced-cost lunches are not eligible. Those unjustified benefits cost taxpayers about $1.4 billion annually.

- **Supplemental Security Income.** This program pays out $4.6 billion in improper and fraudulent benefits annually.

- **Children’s Health Insurance Program.** About 15 percent, or more than $800 million annually, of CHIP benefits are improper or fraudulent.

- **Child Care programs.** The federal child care, foster care, and Head Start programs pay out about $900 million in improper and fraudulent benefits annually.

- **Temporary Assistance for Needy Families.** This program pays out $1.7 billion annually in improper and fraudulent benefits.

- **Unemployment Insurance.** Almost $4 billion of annual UI benefits are improper or fraudulent.

- **Universal Service Fund.** This Federal Communications Commission program pays out almost $1.3 billion annually in improper and fraudulent subsidies.

- **Earned Income Tax Credit.** Almost one-third of EITC payments—$12 billion annually—are improper or fraudulent.

- **Veterans Affairs.** This department loses at least $800 million annually on improper and fraudulent payments, but the total is likely higher because losses are not reported for all of the department’s programs.

- **Emergency Response.** Subsidies provided in the wake of emergencies are highly susceptible to fraud and abuse because funds are usually pushed out the door quickly with little planning or oversight. Federal recovery aid after Hurricanes Katrina and Rita in 2005 were subject to high levels of waste. The GAO estimated that about $1 billion of payments by the Federal Emergency Management Agency made in just the first six months after the storms were “improper and potentially fraudulent.”

- **Procurement.** We have focused on fraud and abuse in federal subsidy programs. But another area of fraud and abuse is federal contracting. Most people have heard of this problem in defense procurement—weapons contractors that rip off federal taxpayers with inflated billings. But fraud and abuse in contracting are government-wide problems, which hamper the ability of government programs.
to operate efficiently.

Conclusions

All kinds of people are using the federal budget as a cookie jar to garner benefits to which they are not entitled. Families seek improper benefits through subsidies such as the school lunch program. Hospitals rip off taxpayers by double billing Medicare and Medicaid. Criminals loot subsidy programs such as food stamps. Owners of nonprofit groups that are supposed to aid the needy line their own pockets with taxpayer funds.

There have been many efforts to end such abuses, but federal programs are hugely complex and they deliver benefits to thousands or millions of recipients. Federal agencies are often sloppy in their administration of programs, and Congress provides little serious oversight. Fraud and abuse generate a catch-22 for policymakers who support spending programs. On the one hand, fraud is clearly a waste of money and should be stopped. On the other hand, minimizing fraud requires extensive bureaucratic rules and heavy enforcement, which reduces program efficiency. In a recent article on defense procurement, the Washington Post noted that reforms a decade ago intended to make the system more efficient and entrepreneurial have created the serious side-effect of increasing various forms of abuse.

A further problem is that Congress has little political incentive to cut down on waste and abuse. That’s because costs are benefits to politicians. If investigators find abuse by, say, a defense contractor in a member’s congressional district, that member will usually be inclined to take the contractor’s view of things. After all, if the contractor overbilled federal taxpayers, it just means that more money was spent in the member’s district. Of course, members of Congress must look as if they are on the side of the taxpayer, and so they will hold occasional oversight hearings to investigate abuses. But sustained congressional efforts to really combat waste, fraud, and abuse in the federal budget are rare.

In sum, fraud and abuse is a serious shortcoming of many federal programs. It is appalling that $100 billion a year—or perhaps much more—of benefits are misappropriated by people not entitled to them. Federal subsidies for industries such as health care and education ought to be cut because private markets can usually perform these activities better than governments. But the endemic fraud and abuse experienced by many government programs provides an additional reason to pursue major cuts in the federal budget.


3. See www.downsizinggovernment.org and www.cato.org for discussions about the problems with particular subsidy programs.


34. The Miami Herald series can be found at www.miamiherald.com/multimedia/news/houseoflies.


47. Government Accountability Office, "Improper Payments: Progress Made but Challenges Remain in Estimating and Reducing Improper

49. *Budget of the United States Government: FY2010, Historical Tables*, Table 3.2. This is spending on budget function 351.


51. Environmental Working Group, Farm Subsidy Database, www.ewg.org/farm. This is a nine-year average, from 1995 to 2003.


53. www.downsizinggovernment.org/agriculture/subsidies.


