DECODING the DEBATES

Fugitive Notes on Federal Economic Policy

A collection of articles from E21

CHARLES BLAHOUS

Decoding the Debates

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Author's Note

The pieces in this collection span the period from 2010, when the Affordable Care Act became law, to 2018, when my estimates of the cost of Medicare for All were published. Many of these articles portray an intensifying need for federal fiscal corrections—especially corrections that involve federal health programs, which are not only straining the federal budget but also exacerbating national health cost growth. The fact that the debate has since shifted toward even more lavish federal benefit promises indicates that I have been swimming against the political current.

Yet rereading these pieces a few years after their initial publication has not been as demoralizing as one might expect. Several of the analyses and predictions have held up well, though they represented minority opinions when they were first published. I've written prefatory notes to place each piece in its particular moment in ongoing public policy debates.

I was aided in the process of culling these pieces by the generous help of several professional colleagues and regular readers of my E21 articles, who were kind enough to send me lists of their favorites. I also benefited from E21's data about which pieces had received the most attention from the largest number of readers. I cross-referenced these various lists with my own subjective list of personal favorites to produce the final selections for this compilation.

Many thanks are due to Garrett Brown for seeing this project through the publication process, to Corrie Schwab for her always excellent editing, and to Andrew Blackburn for keeping this project alive amid many competing organizational priorities. Unfortunately, there are more individuals at E21 than I can properly thank for their support in editing and publishing these pieces over the years, but I would like to single out Chris Papagianis for first bringing me on board with E21. Finally, I want to thank Angela Kuck, who had the initial idea to compile these disparate utterances and create a one-stop guide to the most important economic policy debates of the turbulent 2010–2019 decade.

PART 1

The Healthcare Debate

The Fiscal Consequences of the Affordable Care Act

This article was originally published at E21 on April 10, 2012.

I had never sought to enter the fierce national debate over healthcare policy. When I first began serving as a public trustee for Medicare and Social Security in 2010, I had an established track record writing about Social Security policy, and chose to follow the tradition of previous trustees in making such analyses available to lawmakers, press, and public. I had no similar record of publicly opining on differing visions for the future of Medicare. Amid the intense, ongoing political debate over healthcare policy, I felt that my honest-broker role as a trustee would be best served by avoiding such engagement, except for providing information about the program's financial challenges—as trustees are routinely asked to do.

After the Affordable Care Act (ACA) was enacted, the Mercatus Center asked me if I would perform a similar analysis of the ACA's public finance implications, a project that struck me as interesting and appropriately within the contours of my self-imposed restrictions. Almost immediately upon beginning that research, I was struck by a lack of public and press awareness of the discrepancies between Congress's prescribed scorekeeping methodologies and the laws—particularly those affecting Medicare—that the scorekeeping is ostensibly there to evaluate. Even if one accepted (as I did) the entirety of the Congressional Budget Office's assumptions about the effects of the ACA, the law's passage had unambiguously worsened the federal fiscal outlook when accounting for these discrepancies.

The publication of this information, both in the original Mercatus research paper and in the E21 article reproduced here, unleashed a firestorm. The *Washington Post* published an article about it on page 3 of its print edition, provoking thousands of comments, criticisms from prominent supporters of the ACA, television appearances in which I explained my findings, and even a White House press conference exchange involving President Obama's press secretary, Jay Carney. I had expected some of this and am generally not naive about the passion that suffuses high-stakes policy controversies. It was nevertheless sobering to witness the tenor of much of this discussion. The study hadn't opined on the larger merits or demerits of the ACA, but had focused narrowly on a factual explanation of a congressional scorekeeping quirk that caused a deficit-increasing law to appear to be a deficit-reducing one. Many complaints about my study, even some arising from within academia, had incorrectly assumed that it had written off some of the ACA's key savings provisions (it hadn't) or that it was motivated by a predisposed hostility to all the ACA's policy goals (it wasn't).

After the smoke cleared, the correctness of the study's central point was acknowledged by more and more sources. Several of the Congressional Budget Office's subsequent publications contained updated language acknowledging the existence of the scorekeeping quirk central to the study's findings. The Committee for a Responsible Federal Budget subsequently recommended that the loophole be closed to inhibit similar deficit-increasing legislation in the future. Tom Price, then the chairman of the House Budget Committee, introduced legislation to do so. By the time Congress began debating repeal-and-replace legislation in 2017, the claim that the ACA was reducing federal deficits had been largely abandoned. The arguments against repeal-and-replace were premised almost entirely on projected coverage declines under repeal, and most reporting acknowledged that repeal legislation would reduce future deficits even if the legislation included substantially expensive replacement provisions.

Life being unpredictable, and scholars being fallible, it's rare for articles venturing projections to look very prescient years after their initial publication. But whatever this article's flaws, the cautions it offered have held up surprisingly well over time. The piece notes a "substantial risk" that the ACA's Independent Payment Advisory Board (IPAB) might never produce its projected savings. In fact, IPAB was never constituted. The piece suggests that the ACA's Cadillac plan tax might produce "far less revenue than currently projected." The tax has since been postponed, weakened, and finally repealed. The piece also warns that the law's health insurance exchanges are "susceptible to future expansion"—and indeed, in the wake of the failure of repeal-and-replace legislation, there have been calls for Congress to further increase federal spending to shore up troubled ACA exchange plans.

Of course, appearing prescient after the fact wasn't the purpose of this piece. It would have been far better if this article had had sufficient influence at the time it was first published and the warnings it contains had been heeded.

THIS MORNING [APRIL 10, 2012] THE MERCATUS CENTER IS PUBLISHING my study, "The Fiscal Consequences of the Affordable Care Act," which evaluates the comprehensive healthcare reform law (the ACA) enacted in 2010.[1] In this study, I project that the ACA will add over $1.15 trillion to net federal spending and more than $340 billion to federal deficits over the next 10 years, and far more thereafter.

1. Charles Blahous, "The Fiscal Consequences of the Affordable Care Act" (Mercatus Center at George Mason University, Arlington, VA, 2012).

That this law on which so many high hopes were placed will significantly worsen federal finances is an unfortunate but unambiguous result. The finding is based on analyses published by the Congressional Budget Office (CBO) and Centers for Medicare & Medicaid Services (CMS) Medicare Actuary, and it reflects an optimistic fiscal scenario in which all the law's cost-saving provisions work as currently envisioned.

Quantifying the Fiscal Consequences of Healthcare Reform

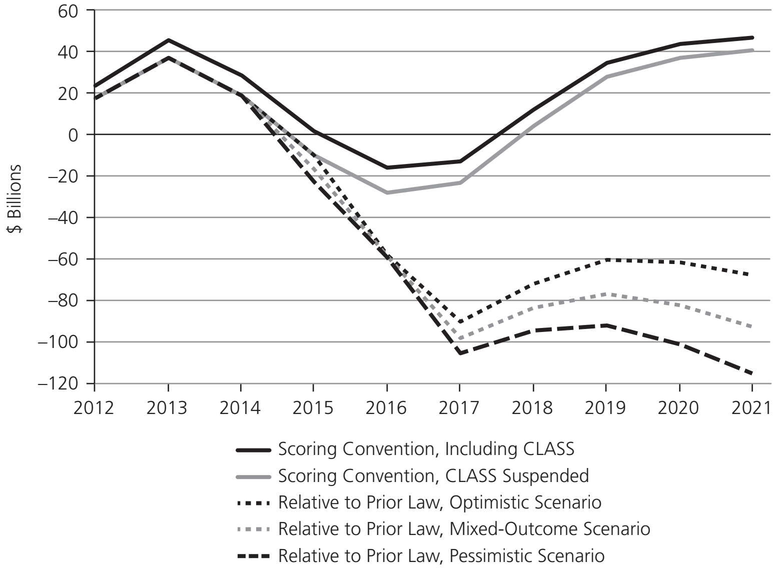
The fiscal stakes of healthcare reform are high. Prior to the law's passage its proponents and opponents disagreed on many things but they agreed on one: rising healthcare cost commitments were a key driver of an unsustainable federal fiscal outlook. Motivations and goals for the 2010 legislation were various, but among the most prominent was the view that such action was necessary to correct the course of federal finances. For this landmark legislation to actually worsen the fiscal situation would represent a substantial failure of governance, and it threatens disastrous consequences if the law is not corrected before its provisions become fully effective.

The ACA unambiguously worsens federal finances. As figure 1 shows, under a variety of possible assumptions (all based on the analyses of CBO and CMS), our annual deficits will be much larger because of the ACA than they would have been under prior law. As visually represented in this picture, up is good and down is bad from a budgetary perspective.

The top two lines on the graph show that the law appears to have a helpful effect on the federal budget under a particular government scorekeeping convention. This is true both as the law was originally scored by CBO and as it was adjusted for last year's suspension of one of its provisions, the CLASS program. The bottom three lines, however, show that the ACA greatly worsens the situation relative to actual previous law.

Under each of the optimistic, mixed-outcome, and pessimistic assumptions concerning the future implementation of the ACA's various provisions, the law would add between $340 billion and $530 billion to federal deficits over the next decade. Under the pessimistic scenario—by no means a worst-case scenario, but one assuming that Congress acts in the future according to historical precedent—the law would add over $100 billion annually to federal deficits by 2021. This suggests that it would add more than $1 trillion to deficits in its second decade.

Figure 1. Net Annual Budgetary Effect of the Affordable Care Act



Note: The figures above are positive if they improve the budget outlook and negative if they worsen deficits.

Source: Figure 7 in Charles Blahous, "The Fiscal Consequences of the Affordable Care Act" (Mercatus Center at George Mason University, Arlington, VA, 2012). Author's calculations based on data and projections from the Congressional Budget Office and the Centers for Medicare & Medicaid Services.

There are two important yardsticks for measuring the fiscal effects of healthcare reform. Measuring its effects on federal deficits is one. The other—measuring its effect on total federal healthcare spending—is equally important. This is because under current law, federal healthcare spending commitments are widely acknowledged to be unsustainable. A "solution" that appears to reduce federal deficits while adding to total federal healthcare spending is no solution at all, as it would subject future generations to tax burdens far higher than the American public has ever tolerated. This is why health experts across the ideological spectrum have stressed the necessity not only of reducing federal deficits, but also of "bending the healthcare cost curve" downward.

Unfortunately, the ACA fails this second test by an even wider margin. Under any realistic scenario it would add to federal outlays by more than $1.15 trillion over the next 10 years.

The Use of Medicare Savings to Finance a New Health Entitlement

Why are these dire fiscal consequences not more widely understood? A great source of confusion lies in government scorekeeping methods, which compare the effects of legislation to a hypothetical baseline scenario rather than to enacted law. To understand the difference, it is necessary to go briefly into the weeds of Medicare trust fund accounting.

The ACA contains many provisions designed to slow the growth of Medicare spending. This matters because the federal Medicare program is financed in a particular way—from special, separate trust funds. The Medicare Hospital Insurance (HI) Trust Fund in particular is governed under law by certain rules. Medicare HI is only permitted to spend money on benefits as long as there is a positive balance in its trust fund. If that trust fund is depleted, then—under law—benefit payments must automatically be cut to the level that can be financed from incoming tax revenues.

This is relevant to an evaluation of the ACA because the CMS Medicare actuary has projected that, had the ACA not been passed, the Medicare HI Trust Fund would have been depleted in 2016. If that were allowed to happen, Medicare HI payments would have been sharply cut in that year.

Due to the ACA's Medicare cost-saving provisions, however, these automatic spending cuts are no longer projected to begin in 2016. Medicare HI is now projected to remain solvent until 2024, postponing forced outlay reductions until then. In other words, the ACA's Medicare provisions decrease the level of Medicare HI spending prior to 2016, but then increase it from 2016 to 2024 relative to previous law. Considered separately and apart that would be a good thing, but it has inescapable fiscal ramifications in the context of the ACA's other spending expansions.

Here's a simple way to think of it: under law, Medicare is permitted to spend any proceeds of savings in the Medicare HI program. If we cut $1 from Medicare HI spending in the near term, then an additional $1 is credited to the HI Trust Fund as a result. The Trust Fund thus lasts longer and its spending authority is expanded, permitting it to spend another $1 in a later year.

A core fiscal problem with the ACA is that the same $1 in Medicare savings that expands Medicare's future spending authority by $1 is also assumed to finance the creation of a large new federal health program. Taken together, these two expansions of spending authorities—the new health program and Medicare's solvency extension—far exceed the cost savings in the legislation.

Many people understood this instinctively when the law was originally debated. They wondered how a law could simultaneously extend the solvency of Medicare, provide subsidized health coverage to 30 million new people, and also reduce the deficit. The answer is that it can't. The cost savings of the ACA are insufficient to both extend Medicare solvency and finance a new health program without adding enormously to the federal debt.

The government scorekeeping conventions now in widespread use are useful and appropriate for many policy purposes, but unfortunately they do not account for this phenomenon. CBO is diligent in carefully noting that these scoring conventions, dating back to the 1985 Deficit Control Act, do not represent actual law.[2] As CBO states, "CBO's baseline incorporates the assumption that payments will continue to be made after the trust fund has been exhausted, although there is no legal authority to make such payments." The scorekeeping convention thus ignores the additional spending authority created when the HI trust fund is extended, as occurs under the ACA. Unfortunately, few people read or understand these critical disclosures.

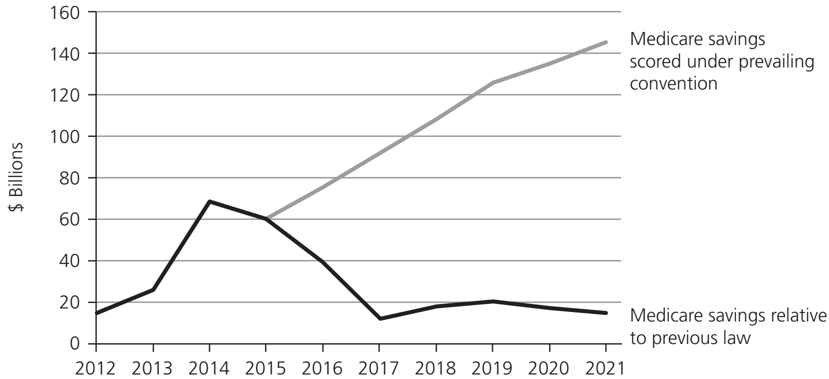
As a result, much of the cost savings attributed to the ACA is actually not net new savings, but rather substitutions for those required under previous law. Under previous law, either Medicare payments would have been suddenly cut in 2016 or lawmakers would have had to enact other Medicare cost savings (indeed, perhaps much like those in the ACA). The difference is that under previous law this all would have happened without also creating an expensive new spending program.

Figure 2 shows the vast difference between the Medicare cost savings attributed to the ACA under the prevailing scoring convention and the much lower amount of actual net new savings.

It is critical to understand that this is not merely a presentational matter. It is reflective of something far more important than the dueling press releases of healthcare reform's proponents and opponents. It means that under law, substantial real additional spending and real additional debt will accrue as a result of the legislation having been passed.

2. Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2012 to 2022," January 2012.

Figure 2. Medicare Savings under the Affordable Care Act



Source: Author's calculations based on projections of the Congressional Budget Office (2011) and Centers for Medicare & Medicaid Services Medicare Actuary (2010).

Alternative Scenarios

The results presented thus far assume that all the ACA's cost-savings provisions work as currently envisioned—even those that would require future Congresses to behave in ways considerably different from historical precedent. Unfortunately, the projected fiscal results of the ACA grow still worse when various plausible legislative scenarios are taken into account.

The ACA contains various provisions that aim to constrain the growing costs of federal healthcare spending, as well as various provisions that would expand its spending commitments. There is a substantial risk that its cost-increasing provisions will cost more than currently projected, and that its cost-containing measures will accomplish less than currently projected.

The law's new health insurance exchanges are particularly susceptible to future expansion. This is generally the case with major federal entitlement programs. The original design of Social Security, for example, did not include cost-of-living adjustments, early retirement options, disability benefits, or today's more generous benefit formula. All of those features were added later as individuals grew more dependent on the program.

The ACA's new health exchange subsidies are currently designed so that their total cost will not grow faster than our gross domestic product (GDP). Because healthcare costs tend to grow faster than the underlying economy, low-income participants in the exchanges will over time shoulder an increasing share of their healthcare expenses. Will this be politically sustainable, or will lawmakers yield to pressure to expand the subsidies to spare poor participants from these cost increases? Even if participation continues as projected by the CMS Actuary, if it grows afterward by a mere 1% annually, and if the subsidies grow only with healthcare inflation, this will add $50 billion to their costs in the first 10 years and far more afterward.

On the other hand, the law's cost-saving measures could well produce considerably less savings than now assumed. The law establishes a controversial new Independent Payment Advisory Board, charged with facilitating measures to hold down the growth of Medicare costs over time. There is a substantial risk that its recommendations could be overridden or that the board will be eliminated altogether.

In addition, various new taxes under the law could unleash a dynamic much like the one that now exists with the federal Alternative Minimum Tax (AMT). Under current-law projections, the AMT would bring in dramatically rising federal revenues over time because its income thresholds are not indexed. Each year, Congress acts to raise these thresholds so that rapidly rising numbers of Americans are not newly subject to the AMT. The ACA's "Cadillac plan tax" and 3.8% Medicare surcharge are similarly designed such that they would subject rapidly rising numbers of Americans to these taxes every year. If Congress simply allows the thresholds triggering these taxes to rise with general economic growth, they will produce far less revenue than currently projected.

None of this is intended to suggest that the ACA's various cost-saving measures are necessarily bad policies. But their proceeds cannot safely be spent until they have verifiably accrued.

Under a plausible "pessimistic" scenario in which future Congresses handle such provisions roughly in keeping with historical precedent, the ACA will add nearly $530 billion to federal deficits over the next 10 years, and far more thereafter.

Fiscal Corrections

Properly understood, the ACA stands to precipitate dire fiscal consequences. To forestall these, sharp corrections are required before 2014, when millions of Americans would begin to depend on its various new benefits.

To meet the original promise that the legislation would bend the federal healthcare cost curve downward, fully $1.15 trillion in spending over the next 10 years would need to be stripped out of the law. This would gut the preponderance of its subsidized coverage expansions, both through the health exchanges and through Medicaid and the Children's Health Insurance Program (CHIP).

A more modest standard would be to require that the law simply not make the federal deficit situation worse under a more pessimistic (but plausible) scenario. This would still allow the law to add to overall federal healthcare obligations, but would at least provide protection against the possibility of accelerating severe federal fiscal problems. Aiming for this weaker standard could allow the law's Medicaid/CHIP expansion to remain in place but would require eliminating roughly two-thirds of the law's health exchange subsidies.

There are many important issues surrounding healthcare reform that my study does not speak to. Among them are the constitutionality of the law's health insurance purchase mandate, the appropriate role of the federal government in facilitating expanded coverage, the long-term viability of the ACA's Medicare cost restraints, how central employer-provided coverage should remain, and the merits of the IPAB concept. My paper instead focuses on a central fiscal question: Does this law improve or worsen the federal government's fiscal predicament?

The answer, unfortunately, is that it greatly worsens the fiscal outlook. Only by considerably scaling back the new spending commitments made under the law, or by finding new financing sources for these commitments, will it make the positive contribution to federal finances that experts across the ideological spectrum agree is required.

Expanding Medicaid: The Conflicting Incentives Facing States

This article was originally published at E21 on March 5, 2013.

As with the previous piece, this article was written to summarize the results of a comprehensive study conducted for the Mercatus Center. The study concerned the conflicting incentives facing states with respect to voluntarily expanding Medicaid per the terms of the ACA, because in 2012 the Supreme Court had affirmed states' prerogatives to accept or reject Medicaid expansion.

The study reached the (in my eyes unremarkable) conclusion that expansion was a very difficult call for states, and that the balance could be tipped by factors ranging from subjective value judgments to a state's unique budgetary circumstances and socioeconomic profile to the results of specific state–federal negotiations. Accordingly, it projected that states would likely make a wide variety of decisions—with some states expanding, others not, and still others attempting to negotiate and implement a middle-ground policy. This is essentially what has happened.

The study's analysis and conclusions might have appeared insignificant were it not for the peculiar political dynamic surrounding Medicaid expansion. After the Supreme Court rendered its decision, a great number of articles asserted that all states would nevertheless expand Medicaid per the ACA's terms, and that only a combination of irrationality and partisan obstructionism could possibly induce states to do otherwise. This was demonstrably untrue if one combed through the complex and conflicting considerations facing the states. Indeed, many of the states were already in difficult fiscal circumstances, making it less practicable for them to take on additional health spending even if the federal government picked up a bigger share of the tab. But the assumption that expansion was a no-brainer nevertheless worked its way into countless publications.

The dynamic of the Medicaid expansion issue is instructive in that it reveals the power of assumptions and value judgments. It is too easy for us to succumb to the illusion that, if other people reach a different conclusion than ours as to what public policies are desirable, they must be motivated by malice. The Medicaid expansion question is an issue where, if one looks openly at the considerations cutting both ways, it quickly becomes obvious why some states would make different decisions than others.

RECENT DECISIONS BY INDIVIDUAL STATES CONCERNING THE Affordable Care Act's now-optional Medicaid expansion have been much in the news of late.[1] Today [March 5, 2013] the Mercatus Center is publishing my comprehensive study of the conflicting incentives facing states as they make their choices about expansion.[2]

The decision facing individual states is complex. Setting aside the larger question of whether the ACA's ambitious coverage expansion is good national policy, several competing factors now bear upon the states' incentives. These include individual state budget circumstances, the 2012 Supreme Court decision,[3] federal Medicaid financing support levels, the federal government's own fiscal problems, and interactions between Medicaid and the ACA's new health exchanges, among many others. Some press coverage has portrayed the current dynamic as a divide between pragmatic governors (choosing to expand) and ideologues (choosing not to).[4] I strongly disagree with that characterization. There are powerful incentives operating against expansion just as there are incentives in favor of it; a diversity of state decisions is to be expected even assuming that all governors behave wholly pragmatically.

Some brief background is in order. Through the ACA, federal lawmakers sought to aggressively expand health insurance coverage, choosing the preexisting Medicaid program as the primary vehicle for covering the previously uninsured poor. The new law expanded the ranks of individuals that state Medicaid programs must cover to include childless adults with incomes up to 133% of the federal poverty level (FPL)—effectively 138% because of a 5% income exclusion. For 2014–2016, the federal government is to finance 100% of the cost of covering the newly eligible population, and this percentage will gradually decline to 90% in the years 2020 and beyond. Last year the Supreme Court ruled that the federal government could not compel the states to expand Medicaid by threatening the withdrawal of their current funding. This decision effectively rendered expansion optional for the states.

1. "An Offer They Can't Refuse," *The Economist*, March 2, 2013.

2. Charles Blahous, "The Affordable Care Act's Optional Medicaid Expansion: Considerations Facing State Governments" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2013).

3. National Federation of Independent Business v. Sebelius, 567 U.S. 519 (2012).

4. David Nather and Jason Millman, "The GOP Split on Obamacare," *Politico*, February 21, 2013.

Finding 1

For states generally, the expansion decision is a very close call. States now face a value judgment that is anything but trivial. They must weigh the gains of expanded health benefits for their citizens, financed primarily by taxpayers residing elsewhere, against the additional costs expansion would pose on their own state budgets that are already strained in many instances. The particulars render this decision a very close call for most states: we should therefore expect different states to make different decisions reflecting their unique budgetary circumstances, subjective value judgments, and the specific needs of their populations.

Beyond theoretical considerations, we know from states' historical behavior that they weight these competing considerations differently. Historically Medicaid eligibility has varied significantly from state to state; states have long made very different choices about whether to pursue waivers to expand Medicaid coverage, even with the federal government providing the majority of funding for states that have done so.

Finding 2

States face substantial Medicaid cost increases even before budgeting for the optional coverage expansion. Expanding Medicaid exposes states to additional costs at a time when they are already struggling to budget for projected Medicaid cost increases under pre-ACA law. Though by some estimates average state Medicaid costs would further increase by only 3%–4% if they expand, this would be layered on top of a huge previously projected increase. The latest CMS Medicaid report projects state Medicaid costs to grow by 158% cumulatively over the next decade, assuming all states opt for expansion. (See figure 1.)

Even relative to Medicaid's troubled history of rapid cost growth, these projections point to a coming cost explosion. They embody substantially higher future growth rates than states faced during the last decade. Yet Medicaid already absorbs 24% of state budgets and is described by the bipartisan State Budget Crisis Task Force as "crowding out other needs."[5]

One of the factors driving this rising pressure on state budgets is that states' Medicaid costs were kept artificially low in 2009–2011 through federal

5. State Budget Crisis Task Force, *Report of the State Budget Crisis Task Force*, January 2014.

assistance under the 2009 stimulus law. Thus, even with the generous federal assistance rates under the ACA, states that choose to expand would face not only higher costs but a higher percentage of total Medicaid costs going forward than they faced during the 2009–2011 period. (See figure 2.)

Finding 3

After the Supreme Court decision, states face a common incentive to decline to cover childless adults with incomes above the FPL under Medicaid. The

Figure 1. State Medicaid Expenditures (Projected Costs If All Participate in Expansion)

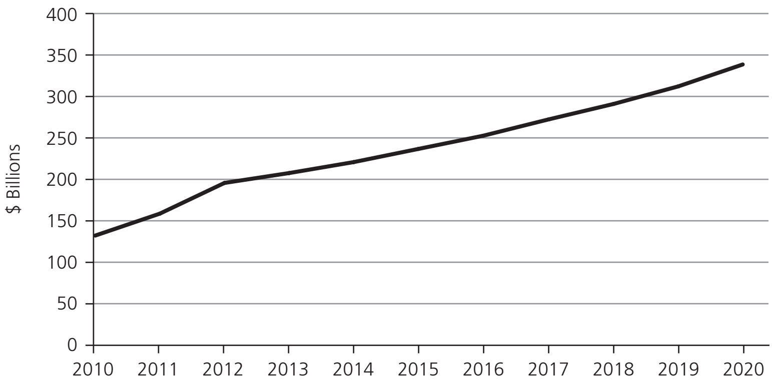
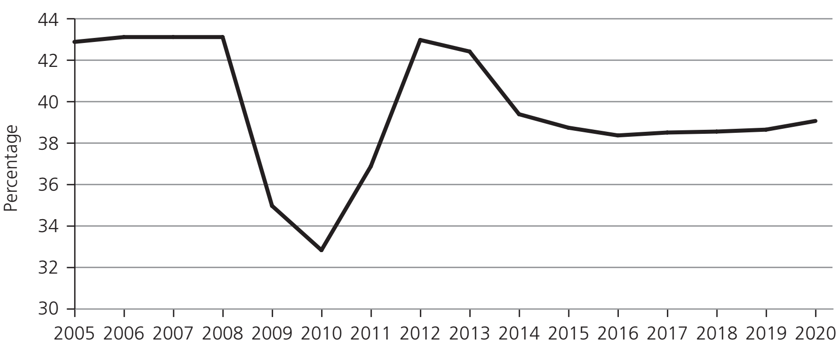


Figure 2. State Share of Total Medicaid Expenses



ACA establishes federal subsidies for individuals with incomes between 100% and 400% of the FPL if they buy health insurance through newly established exchanges. Individuals are only eligible for these subsidies if they are not eligible for Medicaid. Insuring these individuals under Medicaid would require states to bear some of the cost of coverage after 2016. By contrast, the federal government would provide the entirety of the subsidy through tax credits if these individuals' insurance is provided through the exchanges. The states can therefore save money by leaving these individuals uninsured by Medicaid to be insured through the exchanges instead.

Not only would leaving these individuals out of the Medicaid coverage expansion save the states money—it could potentially provide beneficiaries with access to better health services and more generous subsidies. Estimates of the average annual total insurance value under the exchanges are about $9,500 by 2022, as opposed to a total value for Medicaid coverage of less than $7,000. Leaving these individuals uncovered by Medicaid thus sets up a potential win-win for state taxpayers and ACA beneficiaries alike.

Finding 4

States' toughest decisions pertain to covering childless adults with incomes below the FPL. Some have suggested that states might come out ahead financially if they cover this population under Medicaid with the ACA's generous federal match rates. The data suggest otherwise. Expanding Medicaid would increase this population's health benefits but it would cost states substantial money relative to their current expenditures for financing healthcare for the uninsured.

Taking into account the historical allocation of the costs of the uninsured's health services, as well as differences in health service consumption between Medicaid recipients and the uninsured, federal match rates for the expansion population would probably need to be about 92% over the long term for states to come out ahead. Effective match rates under the ACA are substantially less: probably about 79% on average given the expected blend of those newly eligible and those already eligible but previously uncovered (who would bring the lower pre-ACA match rates) within the expansion population. Because this effective match rate for expansion is well below states' break-even point, expansion is expected to cost the states money.

Further adding to the disincentives here is the fact that HHS announced in December 2012 that states conducting only partial expansions will not receive the ACA's enhanced federal match rate.[6] This further reduces incentives for states to expand Medicaid at all.

Finding 5

Future federal cost-shifting to states is virtually certain, though the amount is unknown. Given the current state of federal finances, it is unrealistic to assume that the federal government will make all future Medicaid payments now scheduled under law. To return federal spending to historically sustainable norms would require across-the-board spending cuts of roughly 15% relative to current levels, and 25% relative to projected future levels, to avoid all cuts in the growth of Medicaid and in the ACA's new health exchanges. (See figures 3 and 4.)

Every serious bipartisan budget discussion in recent years has envisioned reductions in future federal Medicaid outlays. The bare minimum of required savings appears to be $100 billion over the next 10 years, with much evidence suggesting that the savings required will be closer to $200 billion. I do not agree with those who assert that every dollar cut from federal Medicaid expenditures is a dollar of costs necessarily shifted to states. Nevertheless, if states absorb even half of the effects of federal belt-tightening, they will face further additional costs on the same order of magnitude as the Medicaid expansion.

Finding 6

Given the difficulty of the decision, state negotiations with the federal government could tip the balance. It is clearly against many states' fiscal interests to expand Medicaid unless they are given the latitude to implement fundamental structural reforms to slow the growth of its costs. That said, states need as much relief from the rising cost baseline as they do from the cost of a possible Medicaid expansion. This gives the states ample incentive to use the prospect of expansion as a bargaining chip to get as much relief as

6. Kathleen Sebelius, "Progress Continues in Setting up Health Insurance Marketplaces," *HealthCare Blog* (HealthCare.gov), December 10, 2012.

Figure 3. Federal Noninterest Spending as a Percentage of GDP (CBO Current Policy Scenario)

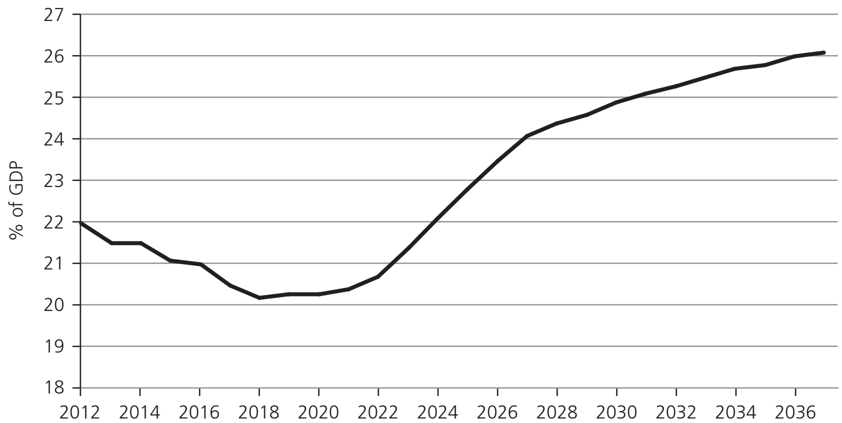
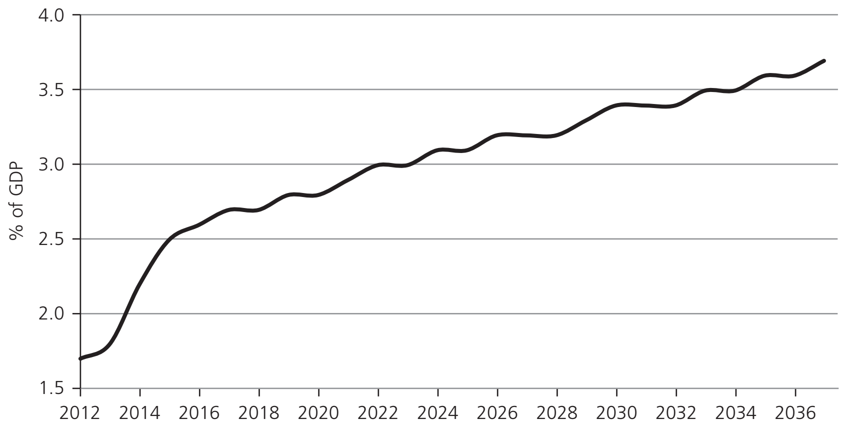


Figure 4. Projected Federal Spending on Medicaid/CHIP, Health Exchanges, as a Percentage of GDP (CBO Current Policy Scenario)



they can from currently projected financing requirements. Whether states are allowed to implement market-based reforms to improve Medicaid efficiencies could be a critical determinant of whether they are able to handle projected caseload increases with or without the expansion. Given this context, it's unsurprising to see a series of divergent, individually negotiated state–federal arrangements.

The bottom line is that Medicaid expansion brings additional federally financed health benefits to the states while exposing state budgets to higher costs. It is reasonable for state governors to reach differing conclusions as to which is the overriding factor. Perhaps the only common incentive clearly facing all states is to shift their childless adults above the FPL from Medicaid to the ACA's new health exchanges and to let the federal government absorb the full cost of their subsidies. Beyond that, much decision-making will depend on whether the states believe they can negotiate satisfactory terms to justify shouldering the costs of expansion, and on how states believe the troubled federal fiscal picture will ultimately be resolved.

No Grounds for Claim That the ACA Lowers Healthcare Costs

This article was originally published at E21 on November 25, 2013, as "No Grounds for Claim That Obamacare Lowers Healthcare Costs."

Policy experts ill serve their reputations when they compulsively wade into all aspects of an ongoing public policy debate. On occasion, however, an erroneous claim achieves such wide circulation that it essentially obligates those with some expertise to step up and push back before the claim is broadly internalized and becomes difficult to dislodge. Such a dynamic existed about claims that the ACA was successfully holding down growth in healthcare costs—claims first promoted even before the ACA's core provisions went into effect.

The following piece provides fuller details, but the root of the controversy was that national healthcare cost growth turned out to be slower in the first few years after 2010 than previously projected, and some sought to credit the ACA for this development. These claims didn't withstand scrutiny for several reasons, among them the fact that the cost slowdown had preceded the ACA's enactment, as well as the fact that the ACA's relative effect on national health expenditure projections was to increase them. This piece explained these various factors in greater detail.

PUBLIC SUPPORT FOR THE AFFORDABLE CARE ACT (ACA) HAS plummeted now that the oft-repeated claim that "if you like your health care plan, you can keep it" is widely understood to be untrue.[1] Despite previous assurances, millions of Americans are now grappling with ACA-triggered cancellations of their health insurance policies. Faced with public anger, ACA supporters are now turning to another argument to promote the law: that the ACA is already working to hold down healthcare cost growth. Unfortunately, some of these claims are just as groundless as the ones that misled so many Americans to believe they would be able to keep their previous coverage.

1. "How Low Can It Go? ObamaCare Poll Numbers Drop—Again," Fox News, November 20, 2013; Glenn Kessler, "Obama's Pledge That 'No One Will Take Away' Your Health Plan," *Washington Post*, October 30, 2013.

One particularly egregious example is White House adviser David Cutler's op-ed, published November 8, 2013, in the *Washington Post*, titled "The Health-Care Law's Success Story: Slowing Down Medical Costs."[2] This piece contains the following paragraph:

> Before he was criticized for his statements about insurance continuity, President Obama was lambasted for his forecasts of cost savings. In 2007, Obama asserted that his health-care reform plan would save $2,500 per family relative to the trends at the time.[3] The criticism was harsh; I know because I helped the then-senator make this forecast. Yet events have shown him to be right. Between early 2009 and now, the Office of the Actuaries at the Centers for Medicare & Medicaid Services has lowered its forecast of medical spending in 2016 by 1 percentage point of GDP. In dollar terms, this is $2,500 for a family of four.

To see why this is wrong, it is useful to break down this paragraph's thesis into its component parts. Specifically, it claims that

- the president's previous assertions that his "health-care reform plan" would "save $2,500 per family" have been "shown" "to be right," and
- this is proved by the fact that the CMS actuaries have lowered, between early 2009 and now, their forecast of medical spending in 2016 by $2,500 per family.

For this paragraph to be correct, the ACA must be the reason the CMS actuaries have lowered their 2016 health spending projections. That is flatly untrue.

To clear this up, let us take a look at those CMS projections for health spending and examine how and why they have changed since early 2009. Figure 1 shows CMS's February 2009 projections for national health spending, as a percentage of GDP, through 2016.

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2. David Cutler, "The Health-Care Law's Success Story: Slowing Down Medical Costs," *Washington Post*, November 8, 2013. See also Keith Koffler, "Former Obama Advisor: Premiums Could Get 'Very High,'" *White House Dossier*, November 12, 2013.

3. Barack Obama, "Remarks at a Labor Day Rally in Manchester, New Hampshire," American Presidency Project, September 3, 2007, http://www.presidency.ucsb.edu/ws/index.php?pid=77010#ixzz1zUgBTIKQ.

Shortly after these projections were made, in June 2009, CMS slightly modified the outlook to take into account subsequent legislation, including the 2009 stimulus law. These modified projections are added on figure 2. These June 2009 projections were the operative baseline projections when the ACA was signed into law in March 2010.

Figure 1. Projected National Health Expenditures, February 2009

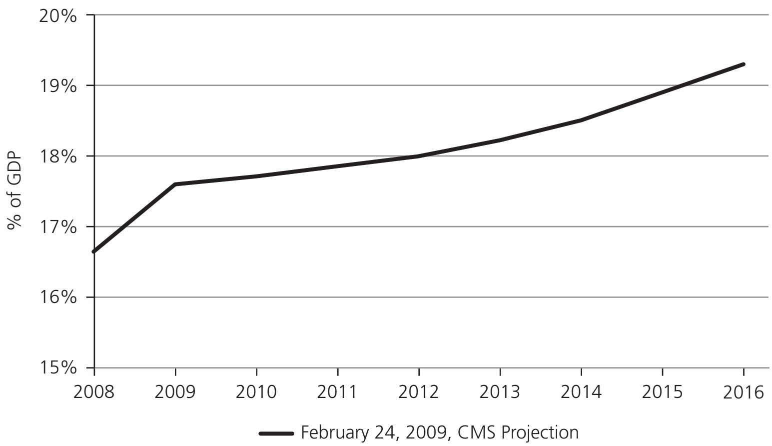


Figure 2. Projected National Health Expenditures, June 2009

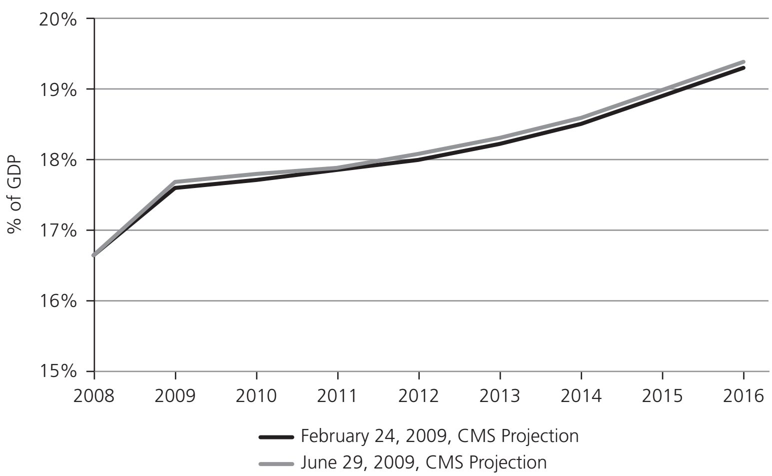
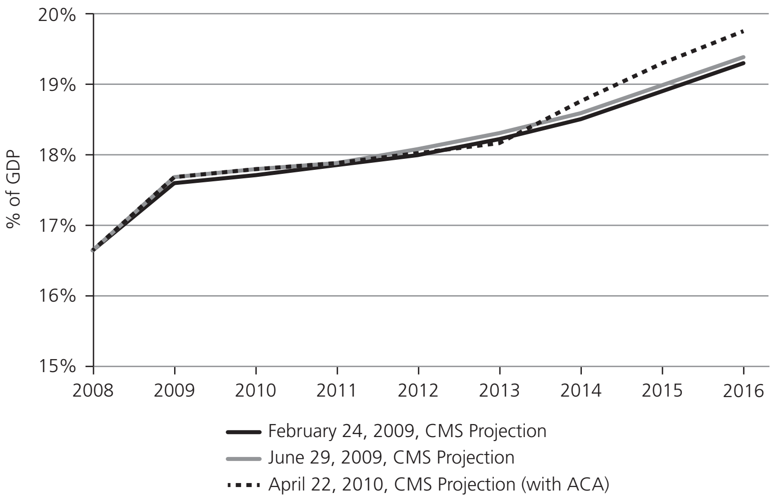


Figure 3. Projected National Health Expenditures, April 2010



Just after the ACA was enacted the following March, CMS released a memorandum in April 2010, explaining how the projections for national health spending would be affected by the new law.[4] Those projections are shown on in figure 3.

The obvious point that leaps out from this graph is that the chief CMS actuary found that the ACA would increase national health expenditures through 2016. Not content to let the tables speak for themselves on this point, CMS was explicit in the text of its memorandum that the ACA increased the near-term cost projections:

> The estimated effects of the PPACA on overall national health expenditures (NHE) are shown in table 5. In aggregate, we estimate that for calendar years 2010 through 2019, NHE would increase by $311 billion or 0.9 percent, over the updated baseline projection that was released on June 29, 2009. Year by year, the relative increases are largest in 2016, when the coverage expansions would be fully phased

4. Richard S. Foster, chief actuary of the Centers for Medicare & Medicaid Services, memorandum, "Estimated Financial Effects of the 'Patient Protection and Affordable Care Act,' as Amended," April 22, 2010.

> in. . . . The increase in total NHE is estimated to occur primarily as a net result of the substantial expansions in coverage under the PPACA.[5]

The CMS actuaries most recently updated their projections in September 2013. These are the latest projections to which Dr. Cutler refers in his op-ed.[6] These projections are shown in figure 4.

As Dr. Cutler notes, CMS is now projecting slower healthcare expenditure growth than it was in 2009 and 2010. CMS's current projection of 2016 health spending totaling 18.4% of GDP is 1 percentage point lower than its June 2009 estimate (19.4%) and 0.9 points lower than its February 2009 estimate (19.3%).

Why did CMS lower its estimates of future health spending? It wasn't because of the ACA. We know this for a fact because CMS has released a memorandum detailing the reasons for changes in its 10-year outlook since April 2010.[7] Here are the factors CMS cited, and the percentage of the improvement each was responsible for:

- Medicare, Medicaid, and other programs "unrelated to the ACA": 50.7% of improvement
- Other factors "unrelated to the ACA": 26.1%
- Updated data on historical spending growth: 21.8%
- Updated macroeconomic assumptions: 6.1%

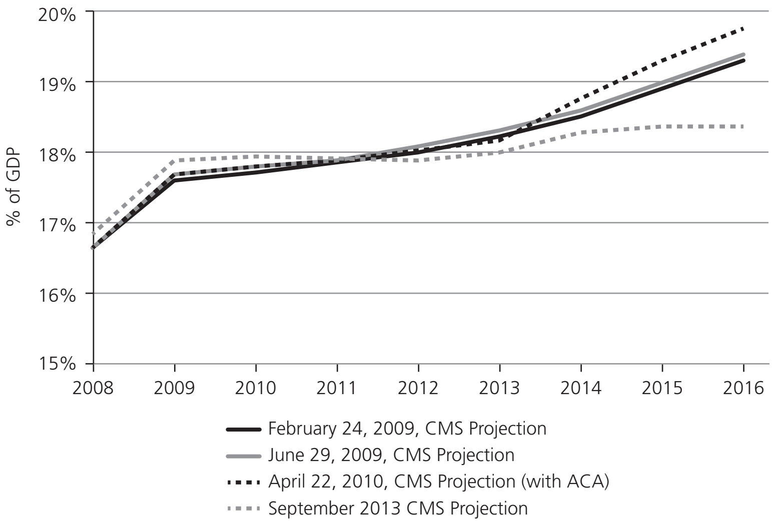
Now, that adds up to 104.7% of the total improvement. The reason these four factors add to more than 100% is that a fifth factor, the "impact of the ACA," worked against the improvement. Per CMS, adjusting the

5. Richard S. Foster, Chief Actuary of the Centers for Medicare & Medicaid Services, memorandum, "Estimated Financial Effects of the 'Patient Protection and Affordable Care Act,' as Passed by the Senate on December 24, 2009," January 8, 2010.

6. Centers for Medicare & Medicaid Services, "National Health Expenditure Projections 2012–2022."

7. Centers for Medicare & Medicaid Services, "Analysis of Factors Leading to Changes in Projected 2019 National Health Expenditure Estimates: A Comparison of April 2010 Projections and September 2013 Projections," 2013.

Figure 4. Projected National Health Expenditures, September 2013



April 2010 projections for the subsequent impact of the ACA shows it further increasing spending over 10 years (equal to and opposite from 4.7% of the total change). CMS analyzes these numbers through 2019, but we can safely say that, through Dr. Cutler's cited year of 2016, CMS sees the ACA doing even less to hold down cost growth (CMS elsewhere found that 2016 is when the ACA would cause the largest "relative increases" in health spending).

This of course does not prove that the ACA is doing nothing to lower health costs. The ACA contains some provisions (e.g., those expanding health coverage) that clearly increase healthcare costs, as well as other provisions aimed at reducing costs. Reasonable people can argue over which effect will be larger in the long run. Reasonable people can even debate what has transpired to date. But no one can rightly claim that CMS has revised its near-term cost projections downward because of the ACA. That is simply false.

A recent White House Council of Economic Advisers (CEA) report is much more careful in promoting the impression that the ACA is slowing health cost growth.[8] It fairly notes that health spending has slowed (true), that slower health spending growth carries budgetary and economic benefits (true), that the causes of the slowdown are "not fully understood" (true), and that the ACA contains provisions designed to slow cost growth (true). The report also argues (reasonably) that other recent changes in the healthcare sector, such as increased patient cost-sharing and expiration of drug patents, are by themselves insufficient to explain the cost slowdown. Neither is the Great Recession the full explanation, CEA argues, because the health cost slowdown has outlasted it. Largely by process of elimination, CEA encourages the belief that a root cause of cost-reduction is the ACA "really, really working," in the words of one especially credulous reader.[9]

But CEA's case for crediting the ACA is extremely weak. In the first place, the basis on which CEA argues that the Great Recession cannot be solely responsible for the cost slowdown applies with much greater force to the ACA. We are told that the Recession can't be the sole cause because the cost slowdown has outlasted it. But clearly the ACA cannot be a leading cause either, because the cost slowdown long preceded its 2010 enactment.[10] (See figure 5.)

It may be even more useful to look at these data as adjusted for general price inflation, as shown in figure 6. But whether measured in nominal or real terms, the health spending slowdown clearly predated the ACA. Still, we do not hear anyone arguing that the slowdown was brought about by implementing the Medicare prescription drug benefit in 2005.

The CEA report acknowledges that the ACA will cause healthcare spending "to grow at an elevated rate for a few years" because of the massive coverage expansion at the core of the law.[11] CEA argues that this burst of healthcare spending will eventually be followed by cost reductions. Given the countless problems that have arisen with ACA implementation so far, this is far from a reliable bet, much less a demonstration that the ACA is successfully bringing costs down already.

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8. Jason Furman, "New Report from the Council of Economic Advisers: The recent Slowdown in Health Care Cost Growth and the Role of the Affordable Care Act," White House, November 20, 2013.

9. Paul Krugman, "Real Entitlement Reform," *New York Times*, November 21, 2013.

10. Centers for Medicare & Medicaid Services, National Health Expenditures tables.

11. Furman, "New Report from the Council of Economic Advisers."

Figure 5. Annual Percentage Growth in National Health Expenditures

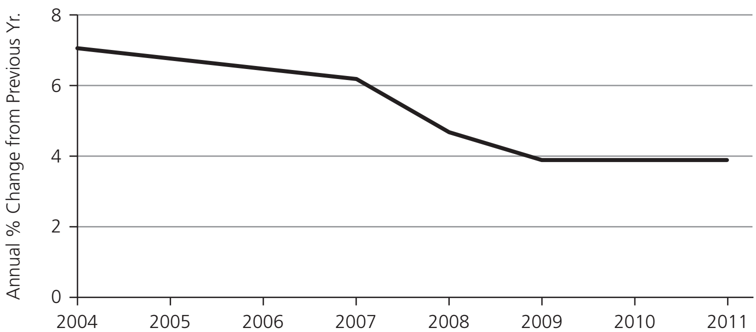
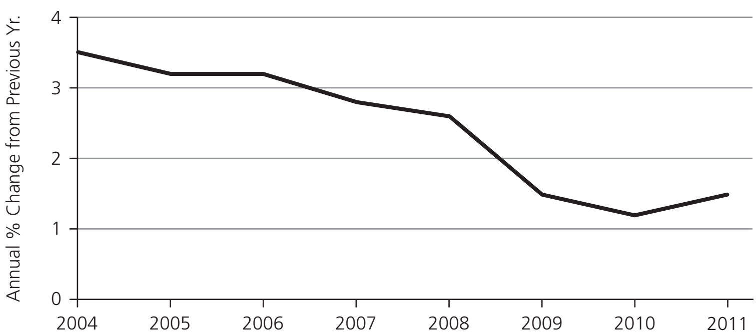


Figure 6. Annual Percentage Growth in Real National Health Expenditures



Public confidence in the ACA took a beating when it was revealed that millions would lose health coverage that they had been told they could keep. Now the public is being told that the ACA is responsible for government actuaries' improved health spending projections, when an examination of those projections clearly shows that not to be so. If the supporters of the ACA want to win back public support and confidence, they will need to find a stronger case for the virtues of the law.

The ACA Lowers Employment, and That's Terrible News

This article was originally published at E21 on March 3, 2014.

Soon after the ACA was passed, a particular effect of the law began to draw greater attention: the fact that it substantially reduces labor force participation. Economist Casey Mulligan was one of the first prominent voices to draw attention to this problem, and it was later recognized by CBO as well as substantiated in employer surveys.

Like all legislation, the ACA has upsides and downsides, depending on one's subjective value judgments. It significantly increased health insurance coverage, while at the same time greatly increasing government spending and tax burdens as well as reducing economic growth and workforce participation. It should be acceptable to argue that the law's health insurance coverage expansion justifies its problematic effects on government finance and on the labor force, or alternatively that it does not. But each side of that argument should acknowledge the real adverse effects that accompany the adoption of its policy position.

With particular respect to CBO's recognition that the ACA would depress labor force participation, there was a temptation for some to argue that this wasn't such a bad thing, either because it was a matter of workers voluntarily leaving work rather than being fired by employers or because individuals who left their jobs would be freed to make other lifestyle choices. This piece was intended to show why, irrespective of whether one favors or disfavors the ACA, its adverse effect on workforce participation is a real problem that must not remain uncorrected.

ON FEBRUARY 4, 2014, THE CBO RELEASED A REPORT THAT INSTANTLY became a focus of intense controversy.[1] The report found that the ACA would reduce US employment by the equivalent of 2 million full-time workers by 2017, 2.5 million by 2024. This news was received in the context of the polarizing politics surrounding the ACA, with commenters choosing sides over the report according to their attitudes toward the healthcare law itself.[2]

1. Congressional Budget Office, "The Budget and Economic Outlook: 2014 to 2024," February 2014.
2. Mike Flynn, "CBO: Obamacare Will Kill 2.5 Million Jobs," *Breitbart*, February 5, 2014.

When CBO's findings are instead viewed from the standpoint of our larger economic policy challenges, it becomes clear that this consequence of the ACA is unequivocally bad, irrespective of one's general attitude toward healthcare reform. To clarify this, let's step back from the debate over the ACA for a moment and examine the current state of our economy.

Our prosperity derives from two factors: the first is how much Americans work, the second is how productive we are while working. Perhaps America's biggest current economic problem is that workers are leaving the labor force by the millions. Part of the worker drain is due to population aging and was a widely anticipated problem. But other factors have also arisen to make the exodus much worse than foreseen.

In 2007, we knew we had a significant problem coming when the baby boomers would begin to leave the workforce. The growth of our labor force would slow and our economic growth would slow along with it. (The data in figures 1 and 2 come from annual Social Security trustees' reports.)

Unfortunately the labor force has shrunk much more than anticipated. The number of workers dropped through the floorboards, and economic growth fell alongside it. (See the 2009 plunge in figures 3 and 4.)

Part of the explanation is that the Great Recession arrived, causing unemployment to rise just as many boomers were starting to retire. But other phenomena also entered the picture.

Figure 1. Past/Future Labor Force Growth as Projected in 2007

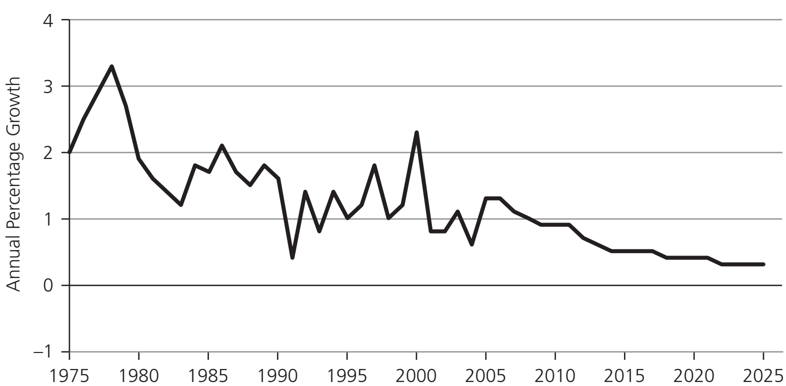


Figure 2. Past/Future Real GDP Growth as Projected in 2007

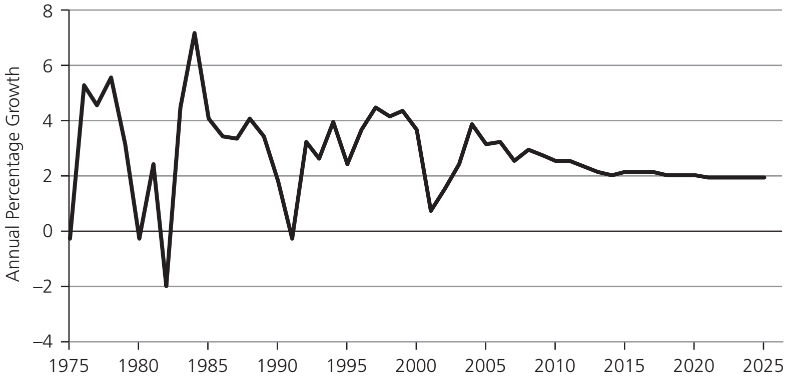
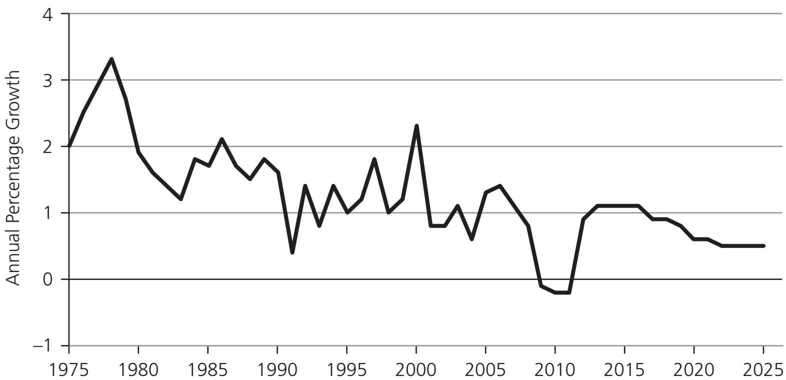


Figure 3. Past/Future Labor Force Growth as Projected in 2013



One is that Social Security disability benefit awards skyrocketed, as often happens (albeit usually to a lesser extent) during a recession. This means that many who otherwise would have continued to look for work are now extremely unlikely to ever return to the labor force. (See figure 5.)

Our sagging economy also caused net immigration to plummet, further depressing the ranks of workers. People are much less likely to join—whether legally or illegally—an economy in which it is tough to find work. Recently

Figure 4. Past/Future Real GDP Growth as Projected in 2013

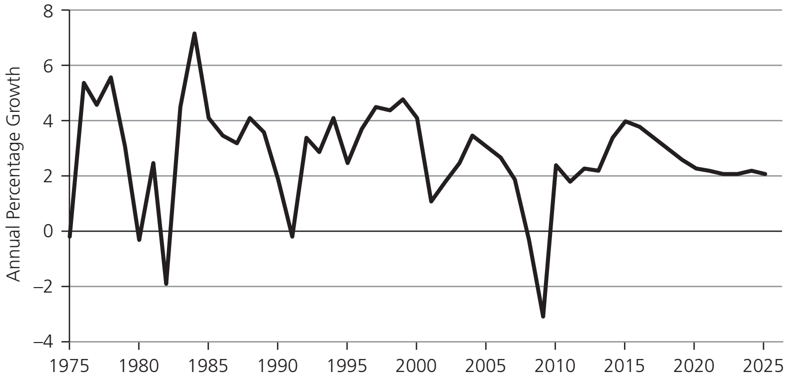
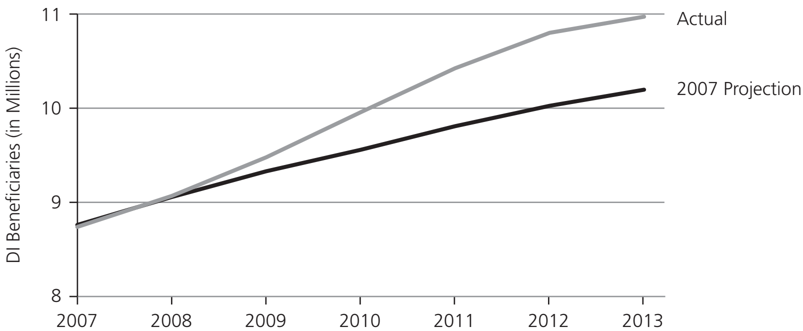


Figure 5. Social Security Disability Beneficiaries: Projected vs. Actual

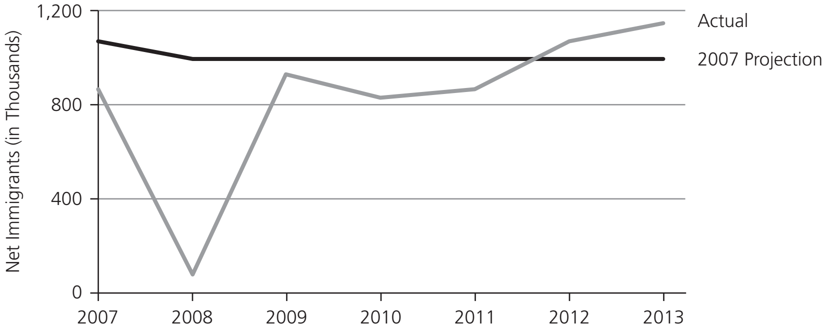


immigration has recovered, but not enough to replace the immigrants lost from 2007–2011. (See figure 6.)

On top of all that, there is a deeply concerning phenomenon of "discouraged workers"—those who have simply given up finding work. Put all these factors together, and we now have an economy with far too few workers.[3]

3. Floyd Norris, "A Dire Economic Forecast Based on New Assumptions," *New York Times*, February 27, 2014.

Figure 6. Net Immigration: Projected vs. Actual



CBO's latest projections for labor force participation are sobering indeed. (See figure 7.)

Inadequate labor force participation has long been a central concern of economists on both sides of the political aisle. The problem of individuals heading into permanent retirement undesirably early has prompted efforts by myself, Peter Orszag, Jeff Liebman, Jason Fichtner, and many other esteemed economists to correct flawed work incentives facing middle-aged Americans.[4]

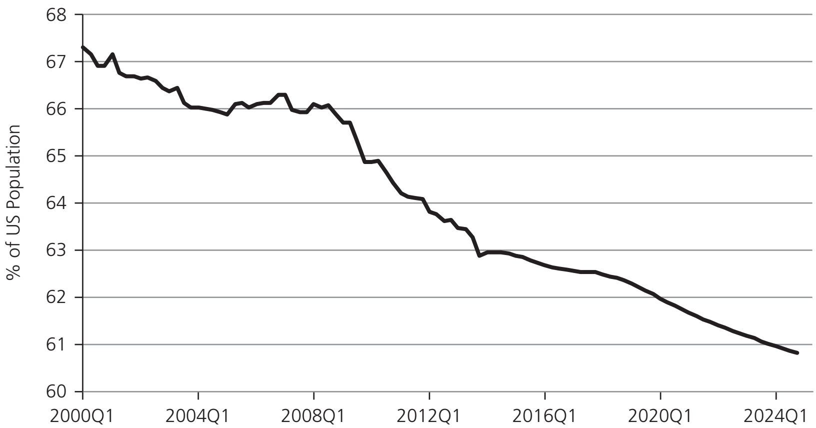
Those who leave the workforce at younger ages constitute an even more serious problem. The left-leaning Center for American Progress encapsulated these widely shared concerns:

> According to our analysis, a young person who experiences a six-month period of unemployment can expect to miss out on at least $45,000 in wages—about $23,000 for the period of unemployment and an additional $22,000 in lagging wages over the next decade due to their time spent unemployed.[5]

4. Charles Blahous, "Social Security and Work," *National Affairs*, 2009; Peter Orszag, "Should a Lump-Sum Payment Replace Social Security's Delayed Retirement Credit?," *An Issue in Brief*, no. 6 (April 2001); Jeffrey B. Liebman and Erzo F. P. Luttmer, "The Perception of Social Security Incentives for Labor Supply and Retirement: The Median Voter Knows More than You'd Think," *Tax Policy and the Economy* 26, no. 1 (2012); Jason J. Fichtner (acting deputy commissioner of Social Security), interview transcript, *Retirement Revolution*, February 19, 2009; Andrew G. Biggs, Aspen Gorry, and Sita Nataraj Slavov, "Improving Work Incentives and Fairness in Social Security and Medicare" (panel, American Enterprise Institute, March 28, 2013).

5. Sarah Ayres Steinberg, "America's 10 Million Unemployed Youth Spell Danger for Future Economic Growth," Center for American Process, June 5, 2013.

Figure 7. Historical/Projected US Labor Force Participation



Until the recent CBO report, the Obama White House had also been a part of the bipartisan consensus that employment is the key to economic advancement. National Economic Council Director Gene Sperling said this at a January 6, 2014, press conference:

> I think there's no question over the last 50 years things have been done wrong, but I think we've learned from lessons. I think that both Democrats and Republicans have learned you have to look at—to make sure about the incentives you're creating and that policies are better if they are designed to reward work. One of the reasons the earned income tax credit has been so important is that it's an incentive for work.[6]

The ACA did not by itself cause our declining labor force problem, though it is now understood to be making it worse. Importantly, this is not—as some have claimed—a desirable, necessary side effect of ending "job lock."[7] Alternative reform proposals would have enhanced health insurance

6. White House, Office of the Press Secretary, "Press Briefing by Press Secretary Jay Carney and Director of the National Economic Council Gene Sperling 01/06/14," January 6, 2014.

7. White House, Office of the Press Secretary, "Statement by the Press Secretary on Today's CBO Report and the Affordable Care Act," February 4, 2014.

portability without having anti-employment effects; examples include proposals by President George W. Bush and Senator John McCain.[8]

Given the central role of the ACA in our national political dialogue, it's inevitable that advocates would try to spin the recent CBO report according to how they want the ACA to be perceived. But when the spinning is put aside, there's no avoiding reality: we simply cannot afford to be implementing policies that drag our sagging labor force participation even further downward.

8. Edward Lazear, "Bushcare," *Politico Magazine*, February 18, 2014; Nina Owcharenko and Robert Moffit, "The McCain Health Care Plan: More Power to Families," *Backgrounder*, no. 2198, October 15, 2008.

I Was Right about the ACA

This article was originally published at E21 on June 30, 2014.

Rarely have I been more reluctant to submit a piece for publication than when I submitted this one, with its self-congratulating headline. But there had recently been a brief flurry of news developments documenting several instances of my previous research making correct predictions. The developments confirming these predictions hadn't received nearly the same level of press coverage as had contrary predictions made to promote the ACA. It seemed that the fulfillment of the predictions wouldn't be widely noted unless it was specifically written about, and it seemed inappropriate to ask someone else to do it.

During the editing process for this piece, my original title—"Who Was Right about the ACA?"—was changed to the more aggressive version reproduced here. I acquiesced to this change because the original was, I admit, disingenuously coy.

The piece simply listed a few realities that showed conventional wisdom to have been wrong. Among these were the fact that states were making a wide variety of decisions about Medicaid expansion, the fact that expansion was proving quite costly to states, and the fact that the fiscal effects of the ACA were proving problematic, in large part because several of its cost-saving provisions were not being successfully implemented.

AROUND AND AFTER THE TIME THAT THE AFFORDABLE CARE ACT WAS enacted, many analysts identified problems with claims being made about the law, and we offered explanations of its likely actual effects. Too often these were brushed aside amid efforts to promote the ACA in the face of growing public opposition.[1] But, four years into the ACA, it is remarkable how well our predictions have been borne out.

1. Frank Newport, "Americans Tilt against Democrats' Plan If Summit Fails," *Gallup*, February 25, 2010.

Below I will resurrect five of my own specific predictions about the ACA, contrast them with what many ACA advocates had said, and review what subsequent events have shown.

Prediction 1: States Will Make a Variety of Decisions with Respect to Expanding Medicaid

What I predicted: "In contrast with some statements made by both supporters and opponents of the ACA, the complexities of these decisions suggest that states should be expected to make a wide variety of policy choices."[2]

ACA advocates' claims: "All these states will opt in. Every one" (Jennifer Granholm).[3] "The deal the federal government is offering states on Medicaid is too good to refuse. And that's particularly true for the red states. If Mitt Romney loses the election and Republicans lose their chance to repeal the Affordable Care Act, they're going to end up participating in the law. They can't afford not to" (Ezra Klein).[4]

What has happened: As of June 2014, the Kaiser Family Foundation lists 27 states (including Washington, DC) as "implementing expansion," 21 as "not moving forward at this time," and 3 in "open debate."[5]

Prediction 2: Expanding Medicaid Will Cost the States Money, in Part Because of the "Woodwork Effect"

What I predicted: "Projections indicate that . . . covering newly eligible individuals as well as increased numbers of those previously eligible (but yet uncovered) would add substantially to state budget costs. Effective [federal support] rates associated with expansion will be lower than those expressly provided for in the ACA because of the 'woodwork effect' of previously eligible individuals being brought under Medicaid."[6]

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2. Charles Blahous, "The Affordable Care Act's Optional Medicaid Expansion: Considerations Facing State Governments" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, March 2013), 36.

3. Jennifer Granholm, "Why All Govs Will Opt into 'Obamacare,'" *Politico*, July 11, 2012.

4. Ezra Klein, "The Affordable Care Act's Big Giveaway to Stingy Red States," *Washington Post*, July 3, 2012.

5. "Status of State Action on the Medicaid Expansion Decision," Kaiser Family Foundation, accessed June 2014, https://www.kff.org/health-reform/state-indicator/state-activity-around-expanding-medicaid-under-the-affordable-care-act.

6. Charles Blahous, "The ACA's Optional Medicaid Expansion: Considerations Facing State Governments" (Research Summary, Mercatus Center at George Mason University, March 2013), 2.

ACA advocates' claim: "There has been some concern in state capitals surrounding this proposal given the possible increase in state Medicaid expenditures that could result. . . . The move to greater insurance coverage would likely result in substantial savings for state and local governments. Rather than harming the budget situation of the states, health insurance reform would improve it" (CEA, Obama White House).[7]

What has happened: "At least a couple of states have already cited higher-than-expected costs. . . . California officials on Tuesday said the woodwork population is expected to grow 60 percent more than what they had expected, costing the state [an] additional $1.2 billion. Rhode Island is now expecting to pay $52 million more than previously projected over two years after Medicaid sign-ups beat expectations by more than double. . . . This graph from a December 2012 NASBO report shows how Medicaid has been taking a greater portion of state general funds, while education spending has decreased."[8]

Prediction 3: The ACA Will Significantly Worsen the Federal Budget Deficit

What I predicted: "The Affordable Care Act (ACA) enacted in 2010 will significantly worsen the federal government's fiscal position relative to previous law. . . . These adverse fiscal effects are not everywhere understood because of widely circulated analyses referencing scoring conventions of the Congressional Budget Office (CBO) . . . which compare the health care reform legislation to a baseline scenario that differs from actual law."[9]

ACA advocates' claim: "According to the official Administration and Congressional scorekeepers, the Affordable Care Act will reduce the deficit: its costs are more than fully paid for" (White House blog).[10]

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7. Executive Office of the President, Council of Economic Advisers, "The Impact of Health Insurance Reform on State and Local Governments," September 15, 2009, https://obamawhitehouse.archives.gov/administration/eop/cea/Impactofhealthinsurancereform.

8. Jason Millman, "Medicaid Enrollment Is Growing Faster Than Expected in Some States. It's Going to Cost Them," *Washington Post*, May 14, 2014. The graph cited is from Michael A. Fletcher, "States Face Double Fiscal Whammy: Federal Aid Cuts and Spiraling Healthcare Costs," *Washington Post*, December 14, 2012.

9. Charles Blahous, "The Fiscal Consequences of the Affordable Care Act" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012).

10. Jeanne Lambrew, "Official Sources Agree: The Affordable Care Act Reduces the Deficit," White House, April 9, 2012.

What has happened: Two months after my study was published, CBO's next long-term budget outlook clarified explicitly that I was correct. CBO's baseline comparison that appeared to show the ACA reducing the deficit did not reflect how it changed actual law: "Projections in this report are consistent with a statutory requirement that CBO, in its baseline projections, assume that benefit payments will continue to be made after trust funds have been exhausted, even if there is no legal authority to make such payments."[11]

Prediction 4: Expanding Health Insurance Coverage Will Increase Health Service Consumption and Costs

What I predicted: "The same report found that the uninsured received only about 55 percent of the total medical care received by the insured population and that, if covered, per-person health spending for the uninsured would increase by 39 percent. . . . Thus, taking important relevant factors into account, including both the higher amount of health services received by the uninsured and the woodwork effect of newly covering those previously eligible, it appears likely that expanding Medicaid coverage would add substantially to state budget costs."[12]

ACA advocates' claim: "It is deficit-neutral; it bends the cost curve; it covers 30 million Americans who don't have health insurance . . . to make sure that people are getting the care they need and the checkups they need and the screenings they need before they get sick—which will save all of us money and reduce pressures on emergency rooms all across the country" (President Obama).[13]

What has happened: "As the health-care law expands Medicaid to cover millions more Americans, a new Harvard University study finds that enrollment . . . significantly increases enrollees' use of emergency departments."[14]

11. Congressional Budget Office, "The 2012 Long-Term Budget Outlook," June 2012.
12. Blahous, "Affordable Care Act's Optional Medicaid Expansion," 27.
13. White House, Office of the Press Secretary, "Remarks by the President after Meeting with Senate Democrats," December 15, 2009.
14. Sarah Kliff, "Study: Expanding Medicaid Doesn't Reduce ER Trips. It Increases Them," *Washington Post*, January 2, 2014.

Prediction 5: There Was a Substantial Risk That Cost Savings Projected for Several ACA Provisions Would Not Fully Materialize

What I predicted: "The legislation employs comparatively uncertain cost-saving measures as budgetary offsets for comparatively certain cost-increasing provisions. . . . The proceeds of such cost-savings cannot safely be spent until they have verifiably accrued."[15]

ACA advocates' claims: We can expect "$750 billion in reliable revenues and savings," "$145 billion saved . . . by phasing out overpayments to . . . Medicare Advantage," "$69 billion in penalties paid by employers and individuals who choose not to purchase insurance," "$32 billion raised by taxing very expensive ('Cadillac') health insurance policies. . . . The numbers on this list do not represent 'hoped-for' savings. . . . These are firm estimates that CBO was able to 'score' with some confidence, based on known facts and solid historical data."[16]

What has happened: The employer and individual mandates have not been enforced and there is mounting pressure for repeal.[17] Planned Medicare Advantage cuts have been scaled back.[18] The Cadillac plan tax has not yet taken effect and labor unions are mobilizing against its implementation.[19]

While I got this basic story right, I did miss some details. In 2012 I predicted that ACA provisions such as the Cadillac plan tax, Independent Payment Advisory Board, and Unearned Income Medicare Contribution would face obstacles to implementation, but did not anticipate similar blocking of the employer and individual mandates and the Medicare Advantage cuts.[20]

15. Blahous, "Fiscal Consequences," 11.

16. Maggie Mahar, "How the Affordable Care Act Pays for Itself and Cuts the Deficit" (report, Century Foundation, New York, 2011).

17. Sarah Kliff, "Obamacare's Employer Mandate Keeps Getting Delayed. What Happens If It Gets Killed?," *Washington Post*, February 11, 2014; Linda J. Blumberg, John Holahan, and Matthew Beuttgens, "Why Not Just Eliminate the Employer Mandate?," Urban Institute, May 2014.

18. Jay Hancock, "Obama Administration Retreats on Private Medicare Rate Cuts," *Kaiser Health News*, April 8, 2014.

19. Ned Resnikoff, "Why Unions Are Turning on Obamacare," *MSNBC*, August 5, 2013.

20. Blahous, "Fiscal Consequences."

Conclusion

In any event, the first years of ACA implementation have unfolded essentially as I anticipated in my 2012 and 2013 studies.[21] The point is not that I am omniscient or that I have a special gift for anticipating unknowable outcomes. Rather, these statements resulted from straightforward, commonsense analysis of easily predictable effects.

While we cannot erase past policy mistakes, going forward we should make better use of predictive information widely available to lawmakers, press, and the public than was done in the case of the ACA.

21. Blahous, "Fiscal Consequences"; Blahous, "Affordable Care Act's Optional Medicaid Expansion."

Five Lessons of the Cadillac Plan Tax Failure

This article was originally published at E21 on December 22, 2015.

Although I believed from the start that the ACA's Cadillac plan tax was of flawed design and uncertain political staying power, I supported a central aim of its designers: to limit the tax preference for employer-sponsored health insurance that is a prime driver of healthcare cost inflation. In that context, and looking back after the fact, it was a good choice to make this piece about the broader lessons to be learned from the Cadillac plan tax's unraveling, rather than focusing on critiquing the tax itself.

The piece lays out five lessons to be learned from the failure of the tax, but they all in some way relate to two of its sentences: "Legislators have a long history of enacting laws that require spending certain funds right away, purportedly to be financed by less-certain savings scheduled to take effect later. This rarely works as advertised."

THE OMNIBUS SPENDING BILL RECENTLY PASSED BY CONGRESS AND signed into law by President Obama delays the onset of the Affordable Care Act's so-called Cadillac plan tax for two years.[1] The new law also weakens the effect of the tax (assuming it's ever collected) by making it deductible, as noted by my Mercatus Center colleague Brian Blase.[2] I agree with former Office of Management and Budget director Peter Orszag's observation that the delay may simply be a first instance of a "rolling permanent deferral" of the Cadillac plan tax.[3]

The tax has long been on shaky political ground and the new law considerably reduces the chances of its ever taking effect. It is worth understanding what caused the unraveling of the tax, and what lessons can be drawn from this.

1. Lisa Mascaro, "President Obama Signs Massive Year-End Tax Cut and Spending Package," *Los Angeles Times*, December 18, 2016.

2. Brian Blase, "Delaying and Weakening Obamacare's Cadillac Tax Is a Move in the Wrong Direction," *Forbes*, December 16, 2015.

3. Amy Goldstein, "Congress to Delay ACA's Cadillac Tax on Pricey Health Plans until 2020," *Washington Post*, December 16, 2015.

The Cadillac plan tax is (was) a 40% excise tax on the amount by which health insurance plan costs exceeded annual thresholds of $10,200 (individuals) or $27,500 (families), starting in 2018.[4] These thresholds were indexed to grow more slowly than historical health cost growth, so that over time more and more plans would be subject to the tax, producing escalating federal revenues necessary to help fund the ACA's ambitious health entitlement expansion. A key policy intent of the tax was to offset the damaging effects of the longstanding federal tax preference for employer-sponsored insurance, one of which is to drive excess healthcare cost inflation.[5]

Lesson 1: Save Before You Spend

After the ACA was enacted, I expressed concern that "the legislation employs comparatively uncertain cost-saving measures as budgetary offsets for comparatively certain cost-increasing provisions."[6] My observation was hardly original, nor was the concern applicable only to the ACA.[7] Legislators have a long history of enacting laws that require spending certain funds right away, purportedly to be financed by less-certain savings scheduled to take effect later. This rarely works as advertised.

Regardless of one's view about whether the ACA's particular savings measures were ever likely to pan out, my other observation from the same paper remains a broadly applicable legislative principle: "The proceeds of such cost-savings cannot safely be spent until they have verifiably accrued."[8] This principle was not heeded with the ACA.

Lesson 2: Don't Assume a Favorable Future Political Alignment

The ACA was passed during a rare historical moment in which Democrats held the White House, the House, and a wide majority in the Senate. The long-term fate of the ACA's individual provisions was always likely to be a

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4. Gary Claxton and Larry Levitt, "How Many Employers Could Be Affected by the Cadillac Plan Tax?" (Issue Brief, Kaiser Family Foundation, August 25, 2015).

5. Charles Blahous, "Distinguishing Policy from Politics in the Cadillac Plan Tax," E21 (Manhattan Institute for Policy Research), October 5, 2015.

6. Charles Blahous, "The Fiscal Consequences of the Affordable Care Act" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012), 11.

7. Medicare and Social Security: The Facts, Hearing before the Committee on the Budget, 112th Congress. 112-13 (2011).

8. Blahous, "Fiscal Consequences," 43.

function of how a differently constituted future Congress might view them. As Orszag has noted, even congressional Democratic support for the tax collapsed after Congress switched hands.[9]

The writing was on the wall for the Cadillac plan tax as soon as it was enacted. I noted in 2012 that "it did not survive its initial clash with political pressures; the form of the tax enacted with the ACA was almost simultaneously amended in accompanying reconciliation legislation, changes that both postponed the effective date and increased the thresholds below which the tax would not apply."[10] Thus, "to assume that the tax will always be applied to the letter of current law is to assume that political actors in the future will be far more committed to this tax than even the original authors of ACA were."[11]

Lesson 2 is closely related to lesson 1's admonition about fiscal prudence because it's much easier for an incoming party majority to attack a previously enacted tax than it is to repeal benefits on which people have become dependent. In any case, no successful legislative strategy can be built on the assumption that a rare political majority will persist.

Lesson 3: Be Transparent

A key policy purpose of the Cadillac plan tax was to "offset some of the excessive spending that economists attribute to the longstanding tax preference for employer-provided insurance."[12] The most direct and transparent way to address that problem would have been to scale back that tax preference. But instead of straightforwardly attacking the distortion and its damaging effects, the Cadillac plan tax constituted an opaque attempt at devising a countervailing distortion.[13]

This opacity received negative attention when videos surfaced of ACA architect Jonathan Gruber asserting that he and other proponents engaged in "mislabeling" to invisibly achieve the Cadillac plan tax's policy goals.[14] But apart from ethical considerations, deliberate opacity is often a tactical mistake. A transparent debate over scaling back the employer-sponsored

9. Peter R. Orszag, "Democrats Attack a Pillar of Obamacare: Ending the Cadillac Tax Would Undermine Efforts to Contain Health-Care Costs," *Bloomberg Opinion*, December 10, 2015.

10. Blahous, "Fiscal Consequences," 35.

11. Blahous, 36.

12. Orszag, "Democrats Attack a Pillar."

13. Blahous, "Distinguishing Policy from Politics."

14. Jake Tapper, "Obamacare Architect in 6th Video: 'Mislabeling' Helped Us Get Rid of Tax Breaks," *CNN*, November 14, 2014.

insurance tax preference would undoubtedly have been contentious, but those who supported such a provision would thereafter have been publicly invested in the objective. But instead of reflecting a growing bipartisan consensus on the necessity of attacking tax preferences, what we wound up with was a new tax that had few friends.[15] The opacity created a situation in which support was largely confined to a small community of experts who had bought into the tax's purpose,[16] while powerful constituencies on both sides of the aisle rose in opposition.[17]

Lesson 4: Partisan Victories Can Be Short-Lived

Politically difficult measures like the Cadillac plan tax are much easier to defend if enacted with bipartisan support. If, on the other hand, legislation is passed over the strong and unified objections of one of the two major parties, it's often only a matter of time before that party has an opportunity to repeal strongly disliked parts of that legislation. Had the Cadillac plan tax (and other parts of the ACA) been bipartisan, its political staying power would likely have been greater.

Contrast the ACA dynamic with, for example, bipartisan legislation such as the 1983 Social Security reforms. Those controversial reforms were extremely difficult to enact,[18] but once they were enacted, negotiators on opposite sides were heavily invested and thus disinclined to revisit the legislation—even when tough measures like taxing Social Security benefits and raising the retirement age were taking effect.

Lesson 5: Don't Campaign against Necessary Policy Steps

The ACA was enacted after presidential candidate John McCain had been successfully attacked for his proposal to scale back the employer-sponsored

15. Donald B. Marron, "Cutting Tax Preferences Is Key to Tax Reform and Deficit Reduction" (Testimony before the Senate Committee on the Budget, Urban-Brookings Tax Policy Center, Washington, DC, February 2, 2011).

16. Letter to Orrin G. Hatch, Paul D. Ryan, Ron Wyden, and Sander M. Levin, October 1, 2015, https://www.cbpp.org/sites/default/files/atoms/files/cadillac_tax_letter.pdf.

17. Bob Herman, "New Lobbying Group to Grease Wheels for 'Cadillac' Tax Repeal," *Modern Healthcare*, July 15, 2015.

18. Charles Blahous, "Is It Becoming Too Late to Fix Social Security's Finances?," E21 (Manhattan Institute for Policy Research), August 31, 2012 (republished in this collection).

insurance tax preference[19]—even though experts on both sides understood his basic idea to be a necessary policy step.[20] When this happens, those elected to office find themselves with a bad choice between breaking their word and furthering large policy problems. A core reason we now lack an effective mechanism to constrain the drivers of excess health cost inflation is that, prior to the ACA, it was not adequately presented to voters what that might involve. While it's inevitable that candidates for office will want to present their platforms in the most salable light, they would do well to campaign in a manner consistent with how they need to govern. And voters, for their part, should be scrutinizing candidates to determine whether their promises can realistically be upheld if they are elected to office.

Conclusion

The apparent demise of the Cadillac plan tax contains many object lessons for legislative strategists. Crafting a more effective brake on health cost inflation will require that we learn from them.

19. Ben Smith, "Obama Attacks 'Radical' McCain Health Plan," *Ben Smith Blog (Politico)*, October 4, 2008.

20. Ryan Hill, "Reforming the Employer-Sponsored Insurance Tax Exclusion," American Action Forum, August 2, 2012; Paul N. Van de Water, "Limiting the Tax Exclusion for Employer-Sponsored Insurance Can Help Pay for Health Reform: Universal Coverage May Be Out of Reach Otherwise," Center on Budget and Policy Priorities, June 4, 2009.

Why the ACA's Medicaid Expansion Needs to Be Fixed

This article was originally published at E21 on March 13, 2017, as "Why Obamacare's Medicaid Expansion Needs to Be Fixed."

This and the remainder of the articles included in part 1 were written and published in the heat of intense national debate over congressional efforts to repeal and replace the ACA. Many aspects of this debate involved subjective value judgments that individuals will inevitably make differently even when they are looking at identical information, and these pieces do not address those issues. Instead they (and some other pieces I published around the same time) narrowly highlight one of the ACA's most clearly problematic features: its inflated federal match rate for covering the Medicaid expansion population.

Lawmakers were then in a bind: if repeal-and-replace legislation responsibly normalized Medicaid match rates to treat all beneficiaries equally (an action that would be consistent with longstanding historical practices), CBO would project states to have Medicaid cover millions fewer individuals than would be covered under the ACA. CBO's projection contributed to challenging political obstacles that the sponsors of such legislation proved unable to overcome.

Regardless of these political challenges, it is important for policymakers and the public to be aware of the significant and mounting problems—from inequities in the treatment of Medicaid's most vulnerable beneficiaries to enormous cost overruns—being caused by the ACA's inflated Medicaid match rate. These problems will persist until corrections are made.

CONGRESSIONAL REPUBLICANS, HAVING MOVED THEIR ACA repeal-and-replace bill through committee, are hearing the inevitable criticisms from both sides of the aisle as to what should be done differently. These disparate opinions are only useful insofar as they enable Senate and House leadership to finalize a bill that attracts the votes necessary to pass both chambers and get to the president's desk.

One of the issues in contention is what to do with the ACA's Medicaid expansion.[1] Medicaid provides health insurance for the poor and is jointly funded by the federal and state governments. The ACA departed from the historical distribution of government financing obligations, providing inflated federal matching payment rates specifically to cover those brought newly under Medicaid.[2] The federal government covered 100% of these costs from 2014 to 2016, scheduled to phase to 90% from 2020 onward.

The House bill would leave the ACA's match rates in place until 2020, thereafter reverting to Medicaid's historical matching formula, through which the federal government provided 57% of funding on average.[3] The expansion population enrolled before 2020 would be grandfathered in; the federal government would permanently fund these individuals at the ACA's elevated (90%) match rates. After 2020, federal payment growth per Medicaid enrollee would be limited to national health cost inflation.

The issue of how rapidly to reform the ACA's inflated Medicaid payment rates has divided congressional Republicans. Fiscal conservatives are concerned the bill does not do enough to scale back the ACA's expansion costs.[4] Other Republicans, as well as governors in expansion states, resist even the gradual cost-containment provisions in the House bill.[5]

The following explanation is not intended to provide guidance as to what schedule will produce the critical mass of votes necessary to pass legislation. Rather, it is an attempt to explain the substantive problems created by the ACA's inflated match rate. It's important that these problems be corrected. While the precise timetable must be determined by the vote-counting, the bill's sponsors are right to be taking this on.

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1. Jeremy Diamond, "In Major Shift, White House Privately Backing Earlier Rollback of Medicaid Expansion," *CNN*, March 10, 2017.

2. Charles Blahous, "The Affordable Care Act's Optional Medicaid Expansion: Considerations Facing State Governments" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2013).

3. See the section-by-section summary at House Committee on Energy and Commerce, "Energy and Commerce Republicans Release Legislation to Repeal and Replace Obamacare," press release, March 6, 2017.

4. John T. Bennett, "Trump Might Be Open to Earlier Freeze of Medicaid Expansion," *Roll Call*, March 10, 2017.

5. Jessie Hellmann, "Four GOP Senators Pledge to Vote against Rolling Back Medicaid Expansion," *The Hill*, March 6, 2017; Benjy Sarlin, "Why Medicaid Is So Hard for Republicans," *NBC News*, March 10, 2017.

Problem 1: The ACA Medicaid Expansion Payment Rate Is Inequitable

The only convincing way the ACA's inflated Medicaid payment rate can be justified is in terms of a political negotiation between the federal government and the states. Otherwise the ACA's match rate makes little policy sense. Consider the information about current federal Medicaid support payments in table 1.[6]

It is extremely difficult to explain or even understand this arrangement from a policy standpoint. The federal government has been covering 100% of costs for childless adults above the poverty line, but only 57% for children in poverty. A childless woman above the poverty line receives 100% support; her pregnant sister receives 57% support. An able-bodied adult above the poverty line receives 100% support; a disabled individual in poverty receives 57% support. This defies policy sense.

So why has this happened? It happened because the ACA was originally drafted to conscript states to expand Medicaid to cover childless adults up to 138% of the poverty line. The only way to overcome state objections to this was to have the federal government pick up virtually all the costs. After the Supreme Court rendered the ACA's Medicaid expansion optional for states, this elevated match rate thereafter became a lure for states to cover a population they would otherwise decline to spend significant resources to cover.[7]

Had states made a priority of covering childless adults above the poverty line, they would have previously sought federal waivers to do so at historical Medicaid match rates—but generally they did not.[8] The ACA's elevated Medicaid match rate for the expansion population, by design, distorted state coverage decisions relative to the results of their own prior policy deliberations.

Problem 2: The ACA's Medicaid Expansion Creates Access Challenges for Vulnerable Populations

There is an understandable tendency to treat the ACA's Medicaid expansion as an unalloyed gain for vulnerable populations. It is assumed that

6. Blahous, "Affordable Care Act's Optional Medicaid Expansion," 1–2, 8.

7. NFIB v. Sebelius, 567 U.S. 519 (2011).

8. John Holahan and Irene Headen, "Medicaid Coverage and Spending in Health Reform: National and State-by-State Results for Adults at or Below 133% FPL" (report, Kaiser Commission on Medicaid and the Uninsured, Washington, DC, May 2010).

Table 1. Federal Medical Assistance Percentages for Different Beneficiary Populations

Percentage of costs covered by the federal government for pregnant women and children under 6 below 133% of the poverty line, children ages 6–18 in poverty, and elderly or disabled individuals on SSI assistance (average among all states)	57%
Percentage of costs covered by the federal government for childless adults from 100% to 138% of the poverty line	100% from 2014–2016, phasing to 90% in 2020

compassion must be unambiguously on the side of Medicaid expansion. This is not necessarily so.

There would be winners and losers from repealing the ACA's inflated Medicaid match rates. The losers would be childless adults with incomes between 100% and 138% of the poverty line (assuming they do not move into superior coverage), as well as state governments. The winners would be federal taxpayers and, potentially, the most vulnerable populations—poor children, poor pregnant women, and poor aged and disabled individuals.

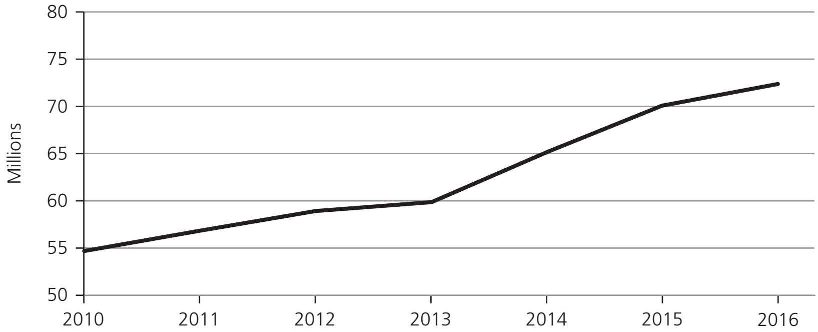
Recall that the ACA's principal effect on Medicaid was to expand financing support, enrollment, and thus the demand for services. From 2013 to 2016, competition for such services increased from fewer than 60 million individuals to more than 72 million—an enrollment increase of over 20%. (See figure 1.) As the National Academy of Science's Institute of Medicine has noted,

> As a result of the recent Medicaid expansion and the number of patients who are now insured through state exchanges, a shortage has developed in the supply of primary care physicians in some areas of the country relative to the demand.[9]

The ACA attempted to counteract this problem by increasing the supply of physicians willing to take Medicaid, via a fee increase for participating

9. Gary Kaplan, Marianne Hamilton Lopez, and J. Michael McGinnis, eds., *Transforming Health Care Scheduling and Access: Getting to Now* (Washington, DC: National Academies Press, 2015), 20.

Figure 1. Total Medicaid Enrollment



doctors.[10] There is an ongoing argument about whether access to care for Medicaid participants was made better or worse by the ACA, on balance.[11] That said, unless the supply of Medicaid services expanded proportionally with higher enrollment, it is virtually certain that part of the cost of expansion was paid by previously enrolled—and more vulnerable—individuals, in the form of increased competition for limited services.

Repeal of the ACA's inflated Medicaid match rate would not mean childless adults between 100% and 138% of the poverty line couldn't still be covered. It would simply end the federally imposed preference for covering this population over concentrating benefits on more vulnerable individuals. Applying the standard federal payment rate equally to the historic population and the expansion population would permit states to more accurately weigh the tradeoffs associated with expanded Medicaid coverage.

Problem 3: The ACA Medicaid Expansion Payment Rate Is Fueling a Cost Explosion

Medicaid has long struggled with financial stewardship issues due to its hybrid structure in which states do not bear the full costs of their own program

10. Michelle Ye Hee Lee, "Paul Ryan's Claim That 'More and More Doctors Just Won't Take Medicaid,'" *Washington Post*, February 1, 2017.

11. Molly Candon, "The Doctor Will See You Now: Appointment Availability for Medicaid Patients," Penn LDI blog, March 17, 2017; Deane Waldman, "ObamaCare's Dangerous Wait Lines," *The Hill*, December 5, 2016.

management decisions. The ACA worsened that problem by having the federal government pick up 100% of the bill for any cost-increasing decisions the states make. The predictable result has been a cost explosion in covering the newly eligible population.

Table 2 shows the CMS Medicaid actuary's evolving estimates for the per capita costs of covering newly eligible adults. Note, for example, that 2015 annual per capita costs, estimated at less than $4,000 in the 2013 report, came in at over $6,365, a full 60% higher.

It wasn't supposed to be this way. The Medicaid actuary initially expected that per capita costs for newly eligible adults would be much lower than for previous eligibles, based on the reasonable expectation that the expansion population would have better health and income while having fewer high-cost health conditions. The warped incentives of the ACA, however, have induced states to set payment rates for the expansion population far higher than for the needier historic Medicaid population.

The specific politics of Medicaid, as well as the general politics of ACA repeal, are inordinately complex. The Medicaid match rate issue, however, is substantively straightforward. While reasonable people can differ about whom Medicaid should cover, there is little in the way of a sensible policy rationale for the federal government providing greater support for the ACA's Medicaid expansion population than it does for everyone else in the program. Timetable aside, it's a problem warranting correction and the bill's sponsors deserve credit for addressing it.

Table 2. CMS Medicaid Actuary Estimates of Per Capita Costs of Newly Eligible Adults

Year	2014	2015	2016
2013 Report	$4,636	$3,976	$3,625
2014 Report	$5,517	$4,281	$3,606
2015 Report	$5,488	$6,366	$5,910
2016 Report	$5,511	$6,365	$5,926

Lawmakers Can’t Afford to Give Up on Fixing the ACA

This article was originally published at E21 on April 3, 2017, as “Lawmakers Can’t Afford to Give Up on Fixing Obamacare.”

Although the title of this piece was adapted to emphasize its relevance to the ongoing repeal-and-replace debate, it actually summarizes “The Fiscal Effects of Repealing the Affordable Care Act”—a comprehensive 2017 study performed for the Mercatus Center as a bookend to the 2012 study “The Fiscal Consequences of the Affordable Care Act.” The 2017 study found that, just as the passage of the ACA had worsened federal finances, its repeal would improve them.

This finding received considerably less press attention than the finding of the 2012 study, likely because the topic of debate had largely shifted from the ACA’s fiscal effects to its coverage effects. ACA supporters mostly conceded that repeal would lower the federal deficit, and were instead expressing concern about reduced coverage levels under potential repeal. Another factor was that repeal-and-replace sponsors had chosen not to touch the ACA’s major Medicare cost-containment provisions, thereby obviating potential controversies over any double-counting in the scorekeeping.

The 2017 study, and this accompanying article, pointed to numerous instances of the ACA’s cost-saving provisions failing to be implemented. This ongoing failure suggested that the savings realized from repealing the ACA might be substantially greater than the amount apparent under conventional scoring. At the same time, however, CBO made aggressive assumptions about how Medicaid enrollment would proceed if the ACA remained on the books—assumptions that, when considered separately, might suggest a possible overstatement of both the coverage reductions and the budget savings under potential repeal. I originally believed, owing to the failure of the ACA’s cost-saving provisions, that actual savings upon repeal would be greater than the central estimate. However, after further reviewing CBO’s baseline Medicaid participation assumptions, I have come to believe that the central estimate was probably the best one, because sources of projection error in both directions are likely to roughly cancel each other out.

IN MARCH 2017 CONGRESSIONAL EFFORTS TO REPEAL AND REPLACE THE Affordable Care Act came to a screeching halt when the House leadership couldn't muster the votes to pass the American Health Care Act (AHCA).[1] While it's unclear how long lawmakers will put the effort aside, they cannot afford to simply abandon the objective.[2] As my latest study (published this morning by the Mercatus Center) analyzes in detail, the fiscal damage being caused by the ACA is simply too great to leave uncorrected.[3]

Healthcare policy involves difficult tradeoffs with implications affecting the health and income security of millions of people; its effect on federal finances is only one factor lawmakers must consider. But fiscal implications cannot be ignored, as we are reminded by the Congressional Budget Office's latest projections of unsustainable federal debt accumulation.[4]

The fiscal damage caused by the ACA is of such a magnitude that many members of the press and policy commentariat continue to have difficulty wrapping their minds around it.[5] Before President Obama took office, federal debt held by the public stood at less than 50% of GDP and there was a solid expert consensus that federal health spending growth constituted a dire threat to long-term fiscal stability.[6] And yet the ACA added further to this fastest-growing part of federal spending, even under the most optimistic projections for the law.[7] Today federal debt held by the public is 77% of GDP and growing, while federal health spending obligations are greater than ever before.[8]

Many of the provisions initially designed to pay for the ACA's dramatic expansion of federally subsidized health insurance coverage have been repealed, suspended, postponed, weakened, or otherwise not implemented. In my 2012 study, "The Fiscal Consequences of the Affordable Care Act," I

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1. "Live Coverage: House Pulls ObamaCare Repeal Bill," *The Hill*, March 24, 2017.

2. Peter Sullivan and Jessie Hellmann, "House GOP Insists: We're Not Giving Up on ObamaCare Repeal," *The Hill*, March 28, 2017.

3. Charles Blahous, "The Fiscal Effects of Repealing the Affordable Care Act" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, April 2017).

4. Congressional Budget Office, "The Budget and Economic Outlook: 2017 to 2027," January 2017.

5. Catherine Rampell, "Reports of Obamacare's Demise Are Greatly Exaggerated," *Washington Post*, October 13, 2016.

6. Congressional Budget Office, "Budget and Economic Data," https://www.cbo.gov/about/products/budget-economic-data; Henry Aaron et al., "Busting the Budget: Healthcare Costs of Entitlement Programs?" (panel, Committee for a Responsible Federal Budget, September 15, 2008).

7. Douglas W. Elmendorf, Letter to Speaker of the House Nancy Pelosi, March 20, 2010.

8. Congressional Budget Office, "Budget and Economic Outlook," 5.

anticipated some, but not nearly all, of this fiscal slippage.[9] The 2012 study correctly anticipated that the ACA's Cadillac plan tax might not produce the full amount of revenues projected, and that its cost-containing Independent Payment Advisory Board might prove too controversial to ever become operational.[10] But the subsequent deterioration of the ACA's financing proved more severe than even these pessimistic predictions, due to the suspensions of the ACA's health insurance fees and medical device tax, the postponement and weakening of its individual and employer mandate penalties, and the repeal of the CLASS long-term care program (which had been projected to produce a surplus over Congress's 10-year budget window).[11]

Table 1 shows how key ACA financing mechanisms have deteriorated relative to initial projections. CBO initially scored the ACA as reducing federal deficits by $124 billion from 2010 to 2019 relative to Congress's budget baseline. That scorekeeping method effectively mandated that the ACA's Medicare Hospital Insurance (HI) cost savings be doubly counted—once to extend the solvency of the HI trust fund, and a second time to finance the ACA's coverage expansion (further details on this technical, but critical, point are available in my study).[12] Adjusting for this scoring quirk, I projected in 2012 that the ACA would add $346 billion to federal deficits from 2012 to 2021.[13] At the bottom line, the ACA's finances have turned out worse than projected, relative to either baseline.

Regardless of what has happened to date, what matters now are the choices going forward. My latest study explores the fiscal ramifications of repealing and replacing the ACA, while detailing various factors that could cause the savings to be either more or less than currently projected.[14]

The most encouraging news from the study is that the fiscal benefits of repeal may well be substantially larger than can be gleaned from any CBO report.[15] This result has nothing to do with any fault of CBO's, and indeed lawmakers should resist the temptation to attack CBO if they disagree with

9. Charles Blahous, "The Fiscal Consequences of the Affordable Care Act" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012).

10. Blahous, "Fiscal Consequences."

11. Charles Blahous, "How to Repair ObamaCare's Fiscal Damage," *Wall Street Journal*, March 16, 2017.

12. Blahous, "Fiscal Effects."

13. Blahous, "Fiscal Consequences."

14. Blahous, "Fiscal Effects."

15. Blahous, "Fiscal Effects."

Table 1. Deterioration of Key ACA Financing Provisions

Provision	Estimated financing contribution, 2010–2019 ($B)	Current status
Fees on medical manufacturers and insurers	$107	Medical device and health insurance fees suspended until 2018
CLASS program	$70	Repealed
Employer mandate penalties	$52	Suspended for smaller employers and relaxed for larger employers until 2016
Cadillac plan tax	$32	Delayed until 2020
Individual mandate penalties	$17	Hardship exemptions expanded

its estimates. CBO has certain charges it must meet: it must make a single best-guess estimate even when there is a wide range of projection uncertainty. And CBO must also project the effects of the ACA as currently written—not as it has been, or is likely to be, implemented.

For example, CBO must assume that, going forward, the ACA's Cadillac plan tax, health insurance fees, and medical device tax will together produce escalating streams of federal revenue—even though to date legislators' tendency has been to suspend or postpone these taxes, while adding the resulting revenue loss to the deficit. The ACA, whose finances depend greatly on these taxes, thus threatens to add far more to federal deficits than a hypothetical replacement plan that does not depend on these taxes.

A number of factors—ranging from the policy choices made in repeal legislation to assumptions for economic variables and counterfactual legislative behavior—could plausibly push the 10-year savings from repealing the ACA's full array of spending and taxes up above $1 trillion over 10 years.[16] The fiscal improvement could approach this magnitude if one recognizes

16. Blahous, "Fiscal Effects."

that many of the ACA's various taxes might never be collected anyway, if lawmakers include repeal of the ACA's various insurance market rules, and if government forecasters are continuing to underestimate the per capita costs of the ACA's Medicaid expansion (see table 2).

On the other hand, the savings could be less than currently projected if CBO is continuing to overestimate future participation in the ACA's exchanges or if, as some have argued, CBO is overestimating the decline in Medicaid coverage under repeal-and-replace legislation (see table 3 and figure 1).[17]

Another factor lawmakers should be aware of is that repeal of the ACA's Medicare provisions would accelerate Medicare HI trust fund depletion. The acceleration would be most sudden if the ACA's Medicare HI cost-containment provisions are repealed (which the AHCA would not have done). But there would still be some acceleration of HI insolvency from repealing the ACA's Medicare payroll tax increase or its restraints on disproportionate share hospital payments (which the AHCA would have done).

Stepping back from recent efforts to repeal and replace the ACA is a setback from some perspectives, but also affords lawmakers more time to get the policy right. A key decision in this respect is how best to replace the ACA's Cadillac plan tax, ideally with an alternative policy that scales back the damaging effects of the longstanding tax distortion favoring employer-sponsored health benefits over take-home pay.[18] In addition, care should be applied to the contours of any replacement provisions aimed at maintaining health insurance coverage, lest they perpetuate the fiscal problems the ACA created.

Regardless of how these and other policy dilemmas are resolved, lawmakers cannot afford to give up on enacting fiscal corrections to the ACA. A comprehensive analysis of the situation shows that the fiscal stakes are far too high.[19]

17. Avik Roy, "Four Critical Problems with the CBO's Latest Obamacare Repeal Estimates," *Forbes*, January 17, 2017.

18. Charles Blahous, "Distinguishing Policy from Politics in the Cadillac Plan Tax," E21 (Manhattan Institute for Policy Research), October 5, 2015.

19. Blahous, "Fiscal Effects."

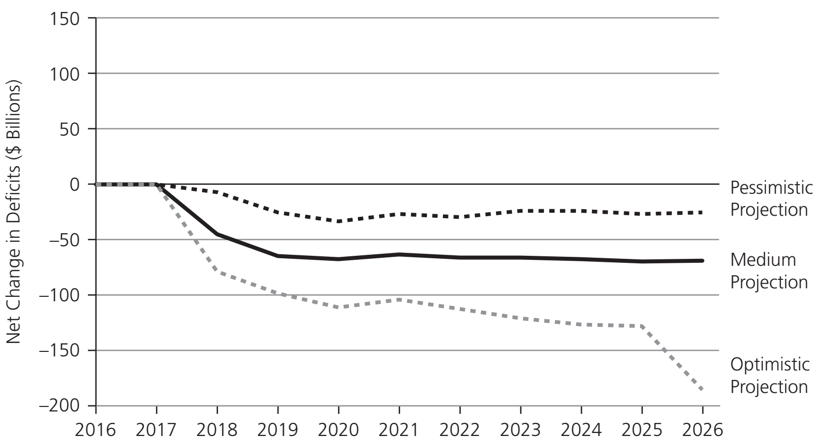
Table 2. Successive CMS Medicaid Actuarial Report Estimates of Per Capita ACA Expansion Costs

Year	2014	2015	2016
2013 Report	$4,636	$3,976	$3,625
2014 Report	$5,517	$4,281	$3,606
2015 Report	$5,488	$6,366	$5,910
2016 Report	$5,511	$6,365	$5,926

Table 3. Range of Projected Deficit Reduction If ACA Spending and Taxes Are Repealed, Effective 2018

	Pessimistic projection	Medium projection	Optimistic projection
Federal deficit reduction, 2017–2026	$228 billion	$586 billion	$1,070 billion

Figure 1. Net Projected Change in Federal Deficits If ACA Spending and Taxes Are Repealed, Effective 2018



Who Should Pay to Cover Pre-existing Conditions?

This article was originally published at E21 on April 30, 2017.

This article falls into the "you never can tell" category. I had expected it to appeal to only a very limited audience, because it describes a complex policy problem, outlines multiple approaches to dealing with the problem, and shies away from opining on the best solution. Yet I probably received more compliments upon the publication of this piece, from sources covering a wider range of the political spectrum, than for any other piece published over the previous couple of years.

When things turn out differently than we expect, we have an opportunity to learn. I've tried to learn something from the relative success of this piece. One possible lesson is that there is a greater audience than previously realized for writing that merely tries to explain the basic directional choices facing policy-makers without attempting to focus the reader on any particular conclusion.

If there is one takeaway point from this piece readers should internalize, it's that paying for the care of those with pre-existing health conditions isn't an insurance issue per se, even though we tend to treat it as such in our national policy discussion. Insuring people against a problem they might someday have, as opposed to helping them to pay for a problem they already do have, are two very different things, and need to be clearly distinguished if we are to make informed policy choices.

AMONG THE MOST VEXING OF OUR NATIONAL HEALTHCARE POLICY challenges is the question of who should pay (and how) for the medical care of those with pre-existing health conditions. Advocates propose a broad array of answers to this question, explanations of which rapidly grow complicated. The purpose of this column is to simplify as much as to explain—to provide a cursory, thumbnail guide to the basic value judgments underlying these complex proposals.

Disagreement over how to handle pre-existing conditions is a big part of how we came to our current impasse over national healthcare policy. The promise that the Affordable Care Act would guarantee coverage for those with pre-existing conditions was one of the most popular provisions of an otherwise unpopular law, and a central motivation for its passage.[1] Donald Trump, while a candidate for president, expressed support for maintaining a pre-existing condition coverage guarantee even as he opposed the ACA as a whole.[2] More recently, congressional Republicans have been working to bridge internal differences over how to handle pre-existing conditions in a repeal-and-replace bill, resulting in the draft MacArthur amendment to the AHCA.[3]

We have a tendency to use "pre-existing conditions" as a euphemism for "expensive healthcare needs," but the two aren't quite the same. If you and I are both healthy today, and both participating in the same insurance plan, the pricing of our insurance should already factor in the probability that one of us will someday face a health problem requiring expensive treatment—and the plan should be able to handle it when we do. But sick people without insurance (or looking to change plans) are in a different situation; their need for health treatment is a certain problem rather than a merely possible one, and hence the average expected cost is much higher. Technically, what they need is not insurance against a possible, unknown problem, but rather help paying for a certain, known problem.

There's no way around a simple truth: treating an expensive health condition costs (someone) lots of money. There are four basic approaches that can be taken to this problem.

1. Leave sick people to face the costs of their own treatment, whether out of pocket or through high-cost insurance, no matter how ruinous those costs become.
2. Mandate that other, healthier people overpay for the value of their own health insurance so that sick people can underpay for the value of theirs.
3. Spread the costs of paying expensive health bills throughout society, for example by having taxpayers pick up the tab.
4. Require a targeted group to shoulder the costs.

Let's summarize these approaches in turn.

1. Patricia Zengerle, "Most Americans Oppose Health Law but Like Provisions," *Reuters*, June 24, 2012.

2. "Donald Trump on Health Care," *On the Issues*, March 10, 2017.

3. The American Health Care Act of 2017, H.R. 1628, amendment.

Approach 1

Leave sick people to face the costs of their own treatment, no matter how high they get. Theoretically (albeit callously) we could leave people with expensive health conditions to their fates, forcing many to first bankrupt themselves and later be denied essential care. The cost of insuring against such expenses would be enormously high, so the sick would face a choice between paying their bills out of pocket without insurance or carrying far more expensive insurance than everyone else. American society appears to wholeheartedly reject this approach, which suggests we must find an alternative.[4]

Approach 2

Force other, healthier people to carry insurance and overpay for its value, so that sick people can underpay for the value of theirs. This is, in effect, the approach taken under the ACA. The ACA sought to mandate that everyone carry insurance and to impose "modified community rating"—i.e., an individual's health history could not be the basis for charging him or her a different premium amount.

This approach requires that healthy people pay far more than the value of the health services they expect, while sick people pay far less than the value of the services they expect. The key word here is "expect." Under all insurance, people who make more claims receive more value for their premiums than those who make fewer. But more typically, the individual only chooses to carry the insurance in the first place if he believes that the likelihood of his making a claim is such that it justifies paying the assessed premium amount. Community rating and mandatory coverage by contrast create a very different dynamic—forcing many people to pay premiums well in excess of the expected value of their claims, so that others can pay premiums that are far less than the expected value of theirs.

The value judgment made in the ACA is a defensible one. Simplified, it is like saying, "We want to ensure that those in our society facing ruinous healthcare costs are shielded from those costs. We are choosing to have this done through our health insurance system. Paying for their treatments will cost money. So, all the rest of you will pay extra for your own health insurance,

4. Ashley Kirzinger, Bryan Wu, and Mollyann Brodie, "Kaiser Health Tracking Poll: Health Care Priorities for 2017" (report, Kaiser Family Foundation, Washington, DC, January 6, 2017).

to cover not only your own average expected healthcare costs but theirs as well. We believe this is the right thing for a compassionate society to do."

Had this fundamental value judgment of the ACA been forthrightly explained to voters, it might have sustained more popular support. Instead, however, Americans were repeatedly told that the ACA would simultaneously provide for the sick while lowering everyone else's insurance costs, reducing the federal deficit, and extending Medicare solvency at the same time.[5] When people realized they were being forced to bear additional costs through their own insurance—and when some of these people were hit much harder than others due to patterns in their particular markets—they felt misled and grew angry in a way they perhaps might not have if they had agreed to this tradeoff from the beginning.[6]

Approach 3

Spread the costs throughout society, for example by having taxpayers pick up the tab. An alternative approach is to straightforwardly say, "We want to help sick people meet their health expenses. There's no particular policy rationale for hiding these expected costs in insurance premiums, since this isn't really an insurance problem so much as one of straightforward financial support. Therefore, we'll just have taxpayers pay for it directly."

There are a lot of ways this could be done. One option is through "high-risk pools"—coverage programs funded by states specifically to finance such costs, and a model Republicans are considering as a successor to the ACA.[7] And while the ACA generally reflected approach 2 above, it also featured taxpayer-provided subsidies per approach 3, in the form of tax credits for low-income individuals to offset their insurance premiums. Other examples of approach 3 include the support taxpayers provide for both the ACA and non-ACA portions of Medicaid, and for much of Medicare as well (though none of those programs specifically targets people with pre-existing conditions).

5. J. B. Wogan, "No Cut in Premiums for Typical Family," *PolitiFact*, August 31, 2012; Charles Blahous, "Repealing Obamacare Would Lower Federal Deficits," *CNSNews.com*, June 22, 2015; James C. Capretta, "Blahous and Capretta: Exposing the Medicare Double Count," *Wall Street Journal*, May 1, 2012.

6. Reuters, "Obamacare Premiums for 2017 Jumped 25% on Healthcare.gov," *Fortune*, October 25, 2016.

7. Karen Pollitz, "High-Risk Pools for Uninsurable Individuals," Kaiser Family Foundation, February 22, 2017.

Some advocates are concerned about taking approach 3 because they believe government funding will be inadequate to cover the costs of treating pre-existing conditions.[8] Another potential objection is the argument that all participants in the healthcare system should share in these costs, not just those who pay income taxes.

Approach 4

Require a targeted group to shoulder the costs. This is just another way of saying "find someone else to pay, other than the sick individual, the taxpayer, or other mandated participants in the insurance pool." Possibilities are theoretically endless, though few of them would have a compelling policy rationale.

One of the few potentially interesting versions of this approach would be to require insurance companies to shoulder the costs by grandfathering in guaranteed issue and modified community rating for those with pre-existing conditions who gained coverage under the ACA, while relieving other participants of the coverage mandate and associated penalties. For those with pre-existing conditions, this approach would implement President Obama's promise that "if you like your healthcare plan, you can keep it."

This would destabilize these plans and force insurance companies (and, by extension, investors in them) to accept substantial losses. To the extent that insurers withstand these losses and continue to operate, voters might regard this outcome as preferable to, or a useful amelioration of, shifting these costs to taxpayers and healthy participants. The ACA permitted insurers to pursue the upside of a potentially lucrative bet—participating in the ACA's insurance marketplaces so long as the new coverage mandate led to additional profits, but pulling out if the marketplace plans proved unprofitable. Approach 4 would effectively force insurers (and their investors) to accept the realization of downside risk from having made that bet.

Regardless of who shoulders the costs of caring for the uninsured, someone will bear those costs unless that care is denied. The complexities of the various policy options facing lawmakers should not obscure a more fundamental societal value judgment that must be made: specifically, who should bear those costs.

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8. Harris Meyer, "Why High-Risk Pools Won't Crack the Pre-existing Condition Dilemma," *Modern Healthcare*, February 13, 2017.

Medicaid Scare Tactics Are Irresponsible

This article was originally published at E21 on June 22, 2017.

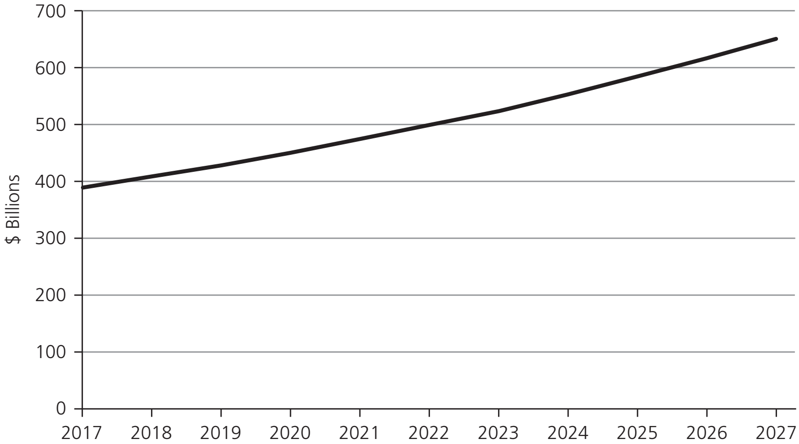
This piece caught the eye of contacts at the *Washington Post*, leading to the publication of a similar piece in the *Post* a few days later that made many of the same points in abbreviated form. The inspiration for it was a flurry of publications suggesting that the most vulnerable Medicaid beneficiaries—for example, children with pre-existing conditions and seniors needing nursing home care—were threatened by pending legislation to repeal and replace the ACA. Not only was this perspective adopted in the writings of many advocates, but it underlay a large chunk of news reporting. The widespread circulation of these charges subjected lawmakers to visceral and often vitriolic expressions of opposition.

There was no basis for the scare pieces, as the following piece explains. Without taking a position for or against the repeal-and-replace legislation, nearly all the budget savings attributed to it pertained to CBO's projections for what would happen to Medicaid expansion under the legislation. None of those effects would have adversely affected the vulnerable populations who depended on Medicaid before the ACA, and indeed might well have benefited them. However, this piece was unable to dislodge the misconception that those vulnerable Americans' benefits would be at significant risk, which persisted throughout the 2017 legislative debate.

IF WE WANT TO MAKE HEADWAY ON IMPROVING PUBLIC POLICY discourse, a good place to start might be with how we're debating Medicaid policy, in particular how it might be affected by pending legislation to repeal and replace the Affordable Care Act, including legislation presented on June 22, 2017, by Senate Republicans.

Medicaid has long been on an unsustainable cost growth trajectory. This was true long before the ACA was passed in 2010, though the ACA exacerbated the problem. Annual federal Medicaid spending is currently projected (see figure 1) to grow from $389 billion in 2017 to $650 billion in 2027. The biggest problem with that growth rate is that it's faster than what's projected

Figure 1. Projected Annual Federal Medicaid Spending



Source: Congressional Budget Office, January 2017 baseline.

for our economy as a whole. As with Social Security and Medicare, Medicaid costs are growing faster than our ability to finance them.

Medicaid serves a sympathetic low-income population. This purpose, however, does not lessen the necessity of placing the program on a financially sustainable course. Nor does it eliminate lawmakers' obligation to prioritize how Medicaid dollars are spent; to the contrary, it magnifies it. Lawmakers face the conflicting pressures of targeting Medicaid resources at where they are most needed while also limiting aggregate spending growth to a sustainable level.

This situation creates irresistible political opportunities for those inclined to exploit them. Whenever lawmakers take on the unenviable job of moderating cost growth to sustainable rates, these can be and are described as heartless "cuts" relative to existing law—even though existing Medicaid law cannot be maintained indefinitely. This creates a catch-22: the existence of an untenable Medicaid cost growth baseline both mandates responsible action to repair it and establishes a warped basis for comparison that amplifies the political hazards of doing so.

We have seen this dynamic operate with full force in the recent public debate over efforts to repeal and replace the ACA, including its Medicaid provisions. Countless editorials and news articles have portrayed an intent by

Congress to "gut" Medicaid to pay for "tax cuts for the rich."[1] This intensifying drumbeat has led to disturbing vitriol and threats against legislators, based on gross mischaracterizations of the implications of pending legislation.[2] Consider for example an op-ed recently published in the *New York Times:*

> Imagine your mother needs to move into a nursing home. It's going to cost her almost $100,000 a year. Very few people have private insurance to cover this. Your mother will most likely run out her savings until she qualifies for Medicaid. . . . Many American voters think Medicaid is only for low-income adults and their children—for people who aren't "like them." But Medicaid is not "somebody else's" insurance. It is insurance for all of our mothers and fathers and, eventually, for ourselves. The American Health Care Act that passed the House and is now being debated by the Senate would reduce spending on Medicaid by over $800 billion, the largest single reduction in a social insurance program in our nation's history. . . . Many nursing homes would stop admitting Medicaid recipients and those who don't have enough assets to ensure that they won't eventually end up on Medicaid. Older and disabled Medicaid beneficiaries can't pay out of pocket for services and they do not typically have family members able to care for them. The nursing home is a last resort. Where will they go instead? . . . Draconian cuts to Medicaid affect all of our families. They are a direct attack on our elderly, our disabled and our dignity.[3]

Most anyone reading such an editorial would come away with the fear that pending legislation would threaten the access of the elderly and disabled to Medicaid services. It wouldn't. The elderly and the disabled who were eligible for Medicaid before the ACA would remain eligible after its proposed repeal. The ACA's Medicaid expansion population involved childless adults under the age of 65, a different category of beneficiaries altogether.

The large projected expenditure reduction under the AHCA (the House's repeal-and-replace bill) actually has nothing to do with disabled or elderly Medicaid beneficiaries, but rather with changes in projected enrollment for

1. E. J. Dionne Jr., "Dionne: Senate's McConnell Is Gutting Health Care in Darkness," *Mercury News*, June 15, 2017; Mark Trahant, "The Secret Republican Health Care Plan: Cutting Taxes & Destroying Medicaid," *Native News Online*, June 21, 2017.

2. Sergio Bichao, "'Hunt' Republicans, Says Union County Democrat in Response to Shooting," New Jersey 101.5, June 15, 2017.

3. David Grabowski, Jonathan Gruber, and Vincent Mor, "You're Probably Going to Need Medicaid," *New York Times*, June 13, 2017.

the ACA's expansion population. Doug Badger estimated in a recent paper that 82% of the Medicaid savings projected for the AHCA by CBO arose from changes to projected enrollment patterns—not from anything that would undermine care for the person profiled in the *New York Times* op-ed.[4] The story is likely to be quite similar under the recently unveiled Senate bill.

The Chief CMS Actuary recently weighed in with its own estimate of 10-year cost savings of $383 billion over 10 years from the House bill's Medicaid provisions—less than half the savings projected by CBO.[5] A primary difference between the two estimates has to do with what CMS and CBO respectively believe would happen if the ACA remains on the books. CMS projects that under a continuation of the ACA, the proportion of the potentially newly-Medicaid-eligible population living in Medicaid-expansion states would remain at its current 55%. CBO, by contrast, assumes that additional states would expand Medicaid if the ACA remained law.[6] CBO further assumes that many fewer people will participate in Medicaid if the ACA is repealed, even if they remain fully eligible to participate. The bottom line is that the essential difference between these two assumptions has nothing to do with people now on Medicaid losing their access to coverage.

It is fair to be concerned that fewer people would receive Medicaid coverage in the future under pending legislation than under the ACA. However, current projections bear no resemblance to a picture in which people historically dependent on Medicaid would lose their benefits. To the contrary, CMS estimates (see figure 2) that Medicaid enrollment would stay roughly constant at current levels under the AHCA, while still being substantially higher than projected before the ACA was passed. Indeed, CMS finds that many states would still cover some of the ACA expansion population even if lawmakers do away with the ACA's inflated federal matching payment rates. This would mean expanded coverage relative to pre-ACA levels, and also more equity than under the ACA.[7]

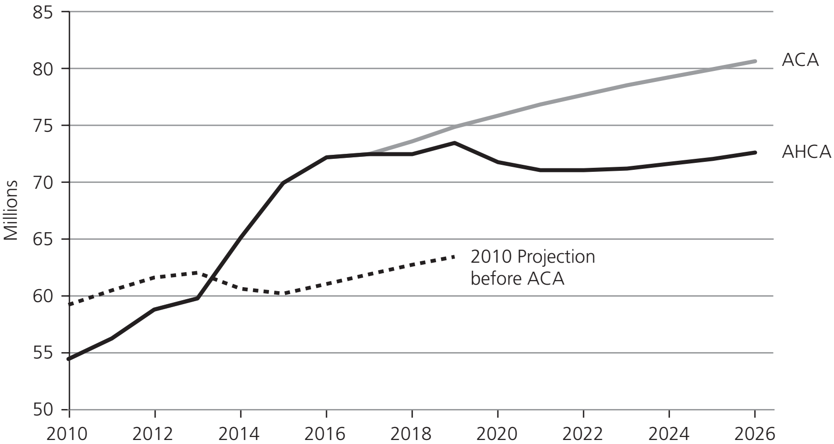
4. Doug Badger, "Dire Predictions about the Effects of AHCA's Per Capita Allocations Find No Support in the CMS Data," *Galen Institute*, June 15, 2017.

5. Paul Spitalnic, "Estimated Financial Effect of the 'American Healthcare Act of 2017,'" Department of Health & Human Services Centers for Medicare & Medicaid Services, June 13, 2017.

6. Congressional Budget Office, "American Healthcare Act," Congressional Budget Office Cost Estimate, March 13, 2017.

7. Charles Blahous, "Why Obamacare's Medicaid Expansion Needs to be Fixed," E21 (Manhattan Institute for Policy Research), March 13, 2017 (republished in this collection as "Why the ACA's Medicaid Expansion Needs to Be Fixed").

Figure 2. Medicaid Enrollment Projections



Source: Centers for Medicare and Medicaid Services Chief Actuary.

It is also fair to wonder about the long-term effects of per capita growth caps proposed under both the AHCA and the Senate bill—though not relative to unsustainable promises under current law, but rather to an alternative method of attaining financial sustainability. But no one should associate figures such as $800 billion in cuts with these proposed caps. As previously described, most of CBO's projected cost reduction is unrelated to the concept, while CMS's estimate of the caps' budgetary effects is well under 10% of that amount.

It is perfectly appropriate for there to be a vigorous, even impassioned debate about whose proposals would provide the best way forward for the Medicaid program. But we ill serve the public with misleading, incendiary rhetoric about vulnerable elderly people being ejected from nursing homes so that cruel politicians can provide tax cuts to the rich, when nothing under consideration can be fairly described as doing any such thing. If advocates want their health policy arguments to be taken seriously, and to usefully inform the American public, groundless hyperbole should be shelved in favor of a focus on what existing proposals would actually do.

The Spurious "People Will Die" Claim

This article was originally published at E21 on June 29, 2017.

Like the previous article, this piece was more about the poor quality of the public debate than about the substance of healthcare reform. As I wrote recently in another context, "intolerance arises when we become so persuaded of our own analytical and moral infallibility that we cannot interpret disagreement other than as evidence of another person's sinister motivations." Our national political dialogue suffers from a surfeit of this regrettable tendency.

With sufficiently tenuous reasoning, any of us could portray the adoption of our preferred economic policy views as literally a matter of life and death. After all, more prosperous people tend to live longer, so a stand we believe will lead to greater economic well-being could theoretically be equated with a stand for life itself, with opponents being little better than murderers. Most mature adults recognize that it is absurd to frame policy arguments in this way, as it runs far afoul of any reasonable assessment of our own capacity for error, to say nothing of the countless factors bearing upon whether each of us lives or dies. Yet, sadly, we seem to be seeing this style of argument more and more, with the recent debate over repealing and replacing the ACA displaying the tendency at its worst.

The attached piece walks through in some detail how the "people will die" charges leveled during the recent debate were spurious, overzealous, and lacked a rigorous basis.

PASSIONS ARE HIGH IN THE NATIONAL HEALTHCARE DEBATE. SOME supporters of the Affordable Care Act have taken to asserting that hundreds of thousands of "people will die" if it is repealed or significantly altered.[1] These claims do not withstand scrutiny, and those who wish their policy arguments to be taken seriously would be well advised to avoid them.

These sensational claims rest on fallacious reasoning, which I'll describe later in this piece. But first let's acknowledge that not I, you, or anyone else has any idea how many Americans will live or die under alternative federal

1. Richard Eskow, "How Many People Will Die for Each Rich American's Trumpcare Tax Cut?," *Huffpost*, May 5, 2017.

healthcare policies. It's an inherently fruitless exercise to attempt to quantify these effects. However, if one seriously wished to attempt it, one would not do so via the methods now being employed to promulgate the "people will die" claim.

The claims are based on extolling a single effect of the ACA: increasing health insurance coverage, which is said to reduce mortality.[2] Of course, the ACA didn't magically produce its coverage increase out of thin air. To finance it, the law included several features that likely have countervailing effects on mortality. Below is a partial list of such effects, provided with the caveat that it would be just as silly to charge the ACA with killing people as it is to attribute deaths to its possible repeal:

- CBO found the ACA to reduce economic growth, meaning that as a nation we are collectively poorer because the ACA is on the books.[3] Longevity correlates with income, as lower-income people have shorter lives.[4] Repeal would increase national wealth, which correlates with greater longevity.[5]
- CBO also found the ACA to reduce workforce participation.[6] Although there is a fierce national debate over the effects and causes of unemployment, there is broad understanding that unemployment correlates with worsened health.[7]
- The ACA imposed substantial taxes on medical devices and drugs, inhibiting their development and use.[8] We do not know how many lives these products would otherwise have saved.

2. Ann Crawford-Roberts et al., "Coverage Losses under the Senate Health Care Bill Could Result in 18,100 to 27,700 Additional Deaths in 2026," Center for American Progress, June 22, 2017.

3. Congressional Budget Office, "Budgetary and Economic Effects of Repealing the Affordable Care Act," June 2015.

4. Raj Chetty, Michael Stepner, and Sarah Abraham, "The Association Between Income and Life Expectancy in the United States, 2001–2004," *JAMA Network* (JAMA Special Communication, Volume 315, April 26, 2016): 1750–66.

5. Congressional Budget Office, "Budgetary and Economic Effects of Repealing the Affordable Care Act," June 2015.

6. Edward Harris and Shannon Mok, "How CBO Estimates the Effects of the Affordable Care Act on the Labor Market" (Working Paper 2015-09, Congressional Budget Office, Washington, DC, December 2015).

7. George Gilder, "The Feminist Economy," *National Review*, January 23, 2017; "How Does Employment, or Unemployment, Affect Health?," Robert Wood Johnson Foundation, March 2013.

8. "Obamacare Medical Device Tax," *Obamacare Facts*, last updated November 14, 2014, https://obamacarefacts.com/obamacare-medical-device-tax/; Kat Lucero, "Critics Eye Repeal of Obamacare Prescription Drug Tax," *The Hill*, January 24, 2017.

- Most of the ACA's coverage expansion occurred through Medicaid, which has a limited supply of providers and services. Those who gained Medicaid coverage via the ACA gained access to subsidized health services. But unless the number of providers, facilities, and services accessible through Medicaid grew at least as fast as enrollment did, there has been a corresponding reduction in health service availability to people previously on Medicaid.

But even a balanced attempt to weigh the ACA's net effects on longevity would be inherently problematic using the methods currently being employed to estimate them. The widely circulated figures for deaths supposedly caused by replacing the ACA are extrapolated from a study of the Massachusetts health reform experience.[9] That study found that post-reform (2007–2010) mortality rates in Massachusetts improved relative to pre-reform (2001–2005) mortality rates more than was the case in other US counties after controlling for demographic and economic conditions. The study is credible, interesting, and suggestive, but does not offer any generalizable proofs of the effects of national health policy on longevity. To the contrary, the authors state that "Massachusetts results may not generalize to other states."

The study merely shows that longevity improved within Massachusetts after health legislation, more than can be accounted for by economic and demographic trends. This indeed might plausibly have happened because of Massachusetts's particular health reforms, but—as the authors acknowledge—the situation could also have arisen from any of countless factors specific to Massachusetts. Indeed, a similar study of Oregon's experience with Medicaid expansion "did not detect clinical improvements other than depression reduction."[10] In any case, the Massachusetts study only tells us what *didn't* cause its longevity improvement; it cannot definitively explain what *did*.

But the biggest problem with the "people will die" claim is that it rests on a fundamental logical fallacy. It is related to the familiar "fallacy of

9. Crawford-Roberts et al., "Coverage Losses"; Benjamin D. Sommers, Sharon K. Long, and Katherine Baicker, "Changes in Mortality after Massachusetts Health Care Reform: A Quasi-experimental Study," *Annals of Internal Medicine*, no. 160 (May 6, 2014): 585.

10. Katherine Kaicker et al., "The Oregon Experiment—Effects of Medicaid on Clinical Outcomes," *New England Journal of Medicine*, no. 368 (May 2, 2013): 1713–22; Crawford-Roberts et al., "Coverage Losses."

composition," which any discerning interlocutor will call you on if you commit.[11] An oft-cited example of the fallacy is that the fact that a standing spectator can see a baseball game better than the patrons seated near him doesn't imply that everyone will see better if they all stand up.

The application of the fallacy to health insurance is straightforward. One cannot leap solely from the observation that "having health insurance . . . results in better health" to the conclusion that "the more we expand health insurance, the healthier we all will be."[12] Health insurance reduces the out-of-pocket costs individuals face when they buy health services. Expanded insurance coverage increases health service consumption, which, considered by itself, should improve health. But it also increases cost growth, an effect widely recognized in health expenditure forecasting.[13] People with insurance feel this cost growth through rising premiums, but the cost inflation is felt especially keenly by the uninsured, who must pay more whenever they buy health services (or receive less care for what they pay).

Thus, even if health insurance did absolutely nothing to improve national health outcomes, we'd still expect the insured to be healthier than the uninsured. Thus, the observation that the insured are relatively healthier doesn't by itself imply that expanding coverage will save lives.

There are countless potential examples of the fallacy in operation. For example, consider the current tax preference for employer-sponsored insurance. Those who receive health insurance through their employer enjoy an advantage in these benefits' exemption from taxation. This tax preference steers additional health benefits to these individuals. However, this does not mean improved health for the nation as a whole. To the contrary, the employer-sponsored insurance tax preference is widely recognized as a driver of health market inefficiency, reducing the value of health services relative to dollars spent.[14]

11. The Logical Place, "Fallacies of Composition and Division," accessed June 2017, https://yandoo.wordpress.com/2014/04/07/fallacies-of-composition-and-division/.

12. Crawford-Roberts et al., "Coverage Losses."

13. Medicare Board of Trustees, *2016 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, June 22, 2016.

14. Yevgeniy Feyman and Charles Blahous, "Replacing the Cadillac Tax: Options and Considerations" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2017); Jonathan Gruber, "The Tax Exclusion for Employer-Sponsored Health Insurance" (NBER Working Paper No. 15766, National Bureau of Economic Research, Cambridge, MA, February 2010).

Here's an even simpler example: the government could easily add to the wealth of 10 individuals by sending them each a million-dollar check. It is a non sequitur to infer from this that the national wealth would be increased by the government's sending a million-dollar check to every American.

In short, the "people will die" argument is premised on an easily recognized logical fallacy. Don't use it if you want to convince others to adopt your healthcare policy views. If you do, the only thing certain to die will be your credibility.

The Fiscal Implausibility of Medicare for All

This article was originally published at E21 on August 5, 2018.

The research described in this piece, concerning the federal budget costs of enacting single-payer health insurance along lines proposed by Senator Bernie Sanders (I-VT), has thus far been the most widely read work I have ever conducted. Within a few months of its initial publication, more than 100,000 people downloaded the original research study—an astounding number of readers for a 24-page technical paper.

The publication of the research was fortuitously timed: the paper was released just as a number of electoral candidates around the nation were embracing the Medicare for All slogan. Associated Press published an exclusive report previewing the study, from which the lower-bound estimate of $32.6 trillion in additional federal budget costs over 10 years rapidly became part of standard press descriptions of Medicare for All. The study itself did not opine on whether Medicare for All was good or bad policy, or indeed on any of the subjective value judgments associated with the proposal. The wide circulation of the findings may have occurred in part because the study stayed out of the policy and political debates, instead simply providing data, which advocates on various sides could use to make their various policy arguments. And, indeed, opposing policy advocates did exactly that.

Some have credited (or blamed) the study for a decline in support for Medicare for All after its publication. Again, if the study had this effect, this is not because it made any particular policy argument. Rather, it is in the nature of things that people are more favorably disposed to receiving something when its cost is not discussed. When the costs associated with a policy are presented, there will always be some who decide that the costs are not worth paying.

One tidbit from the study seems to have achieved particular resonance: the fact that even if all federal individual and corporate taxes were doubled going forward, federal revenue would still be insufficient to finance the costs of enacting Medicare for All. This observation, along with the lower-bound cost estimate of $32.6 trillion for Medicare for All, made its way into much reporting and commentary.

IN JULY 2018 THE MERCATUS CENTER PUBLISHED MY ESTIMATES OF THE cost of the Medicare for All (M4A) bill introduced in the US Senate by Senator Bernie Sanders (I-VT) and 16 cosponsors.[1] Although my work on the study had begun several months before that, the moment of its publication was fortuitous, coinciding with the embrace of M4A by several political candidates across the country. As a result, the level of press attention and public commentary on the study has been overwhelming. AP provided the initial coverage on July 30,[2] leading to several other good articles, such as one in The Hill.[3] On August 1 I published a summary of the results in the *Wall Street Journal*.[4] Countless pieces have been published about the study, including particularly insightful ones from Megan McArdle in the *Washington Post* and Chris Deaton in the *Washington Examiner*.[5]

In this article I will summarize the key findings of the study, provide simplified explanations of the derivations, and finally touch on a few issues that have arisen since its publication.

The Aggregate Costs of Medicare for All

First, a brief description of M4A itself. Despite its name, the legislation would bring nearly all Americans into a national single-payer health insurance system that differs from Medicare in key ways. It would provide first-dollar coverage of a widened range of healthcare services (including, for example, dental, hearing, and vision services) while stipulating (with a few exceptions) that "no cost-sharing, including deductibles, coinsurance, copayments, or similar charges, be imposed on an individual."[6] To grossly simplify the bill: instead of Americans paying for their healthcare through a combination of

1. Charles Blahous, "The Costs of a National Single-Payer Healthcare System" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, July 2018). The bill was called the Medicare for All Act of 2017, S. 1804, 115th Cong. (2015).

2. Ricardo Alonso-Zaldivar, "Study: 'Medicare for All' Projected to Cost $32.6 Trillion," Associated Press, July 30, 2018.

3. Nathaniel Weixel, "New Study Ignites Debate over Cost of 'Medicare for All,'" *The Hill*, July 31, 2018.

4. Charles Blahous, "Even Doubling Taxes Wouldn't Pay for 'Medicare for All,'" *Wall Street Journal*, August 1, 2018.

5. Megan McArdle, "Medicare for All Comes with a Price Tag—and Hard Choices," *Washington Post*, August 1, 2018; Chris Deaton, "Behind the Debate over 'Medicare for All,'" *Washington Examiner*, July 31, 2018.

6. Medicare for All Act of 2017, S. 1804.

private insurance, other government insurance programs, and out-of-pocket payments as we do now, we would instead send that money to Washington as tax or premium payments, and the federal government would pay for nearly all the health services we use, right from the very first dollar.

Unsurprisingly this proposition turns out to be very expensive, at least for federal taxpayers. The primary estimate presented in the study is $32.6 trillion over the plan's first 10 years of full implementation (which, if enacted this year, would be 2022–2031 due to the legislation's phase-in period). Important context should be attached to that number. First, $32.6 trillion would not be the federal government's total costs, but its new costs over and above what it already spends on healthcare programs and other subsidies. Total annual federal health spending under M4A would be $4.2 trillion in 2022 and would rise to $6.9 trillion by 2031. Second, the cost estimate is based on the literal language of the bill without regard to whether its intended outcomes are probable, as this article will further explain. Actual federal cost increases under M4A are likely to be substantially higher than the estimated $32.6 trillion over its first 10 years.

How best to understand the real-world magnitude of such an eye-popping number? The annual marginal cost of enacting M4A starts out at around 10.7% of GDP and rises to 12.7% of GDP within the first 10 years, continuing to grow beyond that. As the study explains, even a doubling of all projected individual and corporate income taxes would be insufficient to finance these added federal costs.

We have never undertaken a sudden, permanent expansion of government of this size. Total federal spending under M4A on healthcare alone would equal 17.9% of GDP in 2022 and would rise to 20.8% of GDP by 2031. For context, consider that *all* US government spending this year totals 20.6% of GDP. And it bears repeating: even these numbers understate the likely cost of M4A.

Breaking Down the Cost Estimate

Estimating the price tag of M4A essentially involves estimating the costs for which the federal government would be responsible under the plan, and comparing those to current federal obligations. An important step is estimating healthcare utilization. There is an extensive economics literature demonstrating that the more medical care insurance finances, the more people consume. This is true separately and apart from the services' value and efficacy: people consume more of both necessary and unnecessary services if insurance pays for them. M4A would therefore fuel a substantial increase in healthcare demand through its provision of first-dollar coverage of a widened range of services.

The utilization increase under M4A would of course be greatest among the currently uninsured, but it would also be substantial for other populations, including current Medicare participants who lack supplemental coverage, and current holders of private insurance whose consumption is presently constrained, at least somewhat, by the requirements of deductibles and copayments.

As we as a nation grapple with how to contain rising healthcare costs, it's important to understand the extent to which insurance itself drives costs upward. The increased demand that would arise under M4A's expanded coverage is substantial—adding an estimated $5.7 trillion to projected national health spending during 2022–2031, all other things being equal, an increase of more than 11%. That number is probably understated for reasons that go beyond the scope of this article.

Against that topline cost increase, M4A contains provisions designed to bring costs down. Its language directs the HHS Secretary, for example, to "promote the use of generic medications to the greatest extent possible."[7] Interpreting the "greatest extent possible" very literally as achieving 100% penetration of generics in prescription drugs, one arrives at an estimate of $0.8 trillion saved during 2022–2031 in lower drug prices. This estimate does not account for other possible, less desirable effects, such as lessened pharmaceutical innovation, nor does it allow for less-than-perfect success in replacing brand-name drugs with generics. Accordingly, it should be thought of as an upper-bound estimate of the savings possible from the bill's drug provisions.

The estimates also assume M4A would have lower administrative costs than private health insurance. I used fairly aggressive assumptions of seven percentage points for the administrative costs saved by bringing those now covered by private insurance under M4A. My study as well as a previous Urban Institute analysis explains why this is likely the upper limit of potential

7. Medicare for All Act of 2017, S. 1804.

administrative cost savings under the plan.[8] The savings projected under this assumption are roughly $1.6 trillion over 2022–31.

Now we come to an important comparison. While it is sometimes said that M4A's elimination of private-sector profit and overhead would bring national health costs down, that is not what the numbers indicate; more specifically, to the extent lower administrative expenses do reduce total costs, these would be more than offset by the higher service demand under M4A. Even under the fairly aggressive cost-saving assumptions outlined above, the potential savings from lower administrative costs and lower drug prices combined are less than half the additional costs expected to arise from expanding the scope of insurance.

This is where the factor of provider payment rates comes in. The text of the M4A bill specifies that healthcare providers will be paid at Medicare payment rates, which are roughly 40% lower than the rates paid by private insurance. Previous studies published by the Urban Institute as well as by Emory University professor Kenneth Thorpe (prior to the bill's introduction) assumed this would not be possible, because such dramatically reduced payment rates would be well below providers' reported costs of delivering services.[9] My study took first a literal interpretation of the bill's text: that these dramatic provider cuts would be implemented immediately.

It need hardly be said that cutting provider payment rates by roughly 40% for those now working through private insurance—down to below their reported costs of providing services—while at the same time increasing service demand by 11% would have potentially dire and unforeseeable effects on the availability, timeliness, and quality of healthcare. Understand, these are not gradual cuts in the manner of the Affordable Care Act, but rather immediate cuts upon implementation of M4A. We simply do not know what would happen if the literal text of the M4A bill were carried out. But obviously, if we assume provider payments are suddenly cut by 40%, national health expenditures would naturally fall relative to current projections.

In recognition of the unlikelihood of such dramatic provider cuts being implemented as written, the study contains an alternate scenario in which

8. John Holahan et al., "The Sanders Single-Payer Health Care Plan: The Effect on National Health Expenditures and Federal and Private Spending" (Research Report, Urban Institute, May 2016).

9. Holahan et al., "Sanders Single-Payer Health Care Plan"; Kenneth E Thorpe, "An Analysis of Senator Sanders Single Payer Plan," January 27, 2016.

payments to providers remain unchanged as a national average. Under that scenario, national health expenditures under M4A would rise even faster than under current law, and the price tag for federal taxpayers would rise to $38 trillion.

Some have suggested that the study provides evidence for the view that replacing for-profit private health insurance with administratively efficient single-payer insurance will enable more people to receive better benefits for less money.[10] That is incorrect or, at best, an incomplete interpretation. Per above, my study found instead that the potential administrative efficiencies of M4A could only save much less than the induced additional service utilization would cost. It is not the single-payer system itself, but rather cutting payments to hospitals, doctors, and nurses that would produce a scenario showing lower national health spending. Without those payment cuts, projections for M4A show not only dramatically higher federal costs but higher national costs as well. Moreover, even with such payment cuts assumed, we still couldn't say that Americans would get better benefits for less money under M4A, because we simply do not know how many providers would continue to provide services once their income is cut so sharply.

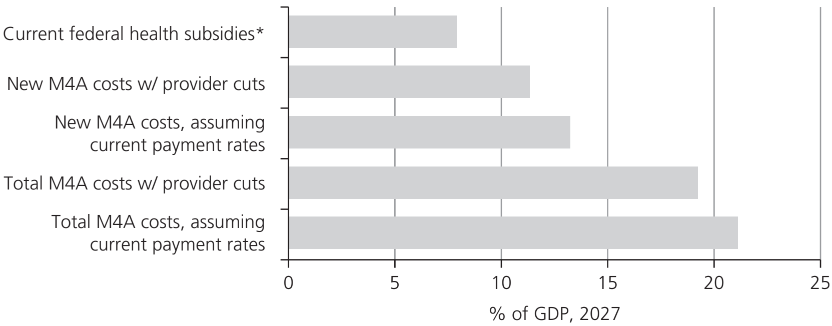
Returning to the derivations, the net federal cost is determined by comparing federal costs under M4A to those the federal government would carry under current law. This calculation requires adjustments reflecting M4A's stipulations that the federal government wouldn't pay for absolutely all national health spending. (As one example, the M4A bill requires that states continue to fund current long-term supports and services—LTSS—through Medicaid, and also allows out-of-pocket payments for LTSS to continue.) The resulting federal costs under M4A are compared with current federal healthcare subsidies, including not only direct spending on programs like Medicare and Medicaid but also subsidies delivered through the tax code, such as the tax preference for employer-sponsored insurance.

Figure 1 attempts to simplify and contextualize the results, using the year 2027 as an example. The graph shows the net additional costs of M4A, as well as the total federal costs of M4A, both with and without the assumption of roughly 40% provider payment cuts.

As can be readily seen from figure 1, enacting M4A would be an unprecedented expansion of federal spending. Figure 2 compares both the additional

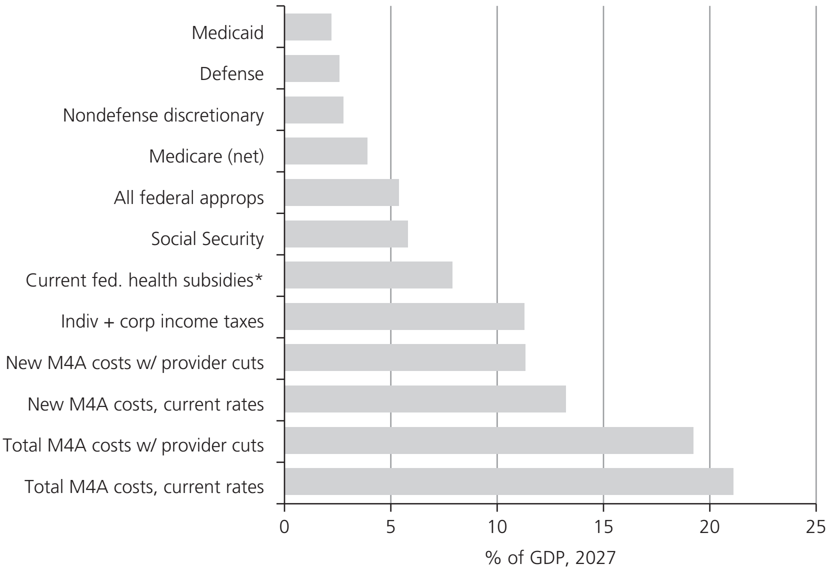
10. Matt Bruenig, "Even Libertarians Admit Medicare for All Would Save Trillions," *Jacobin*, July 30, 2018.

Figure 1. Federal Health Spending without/with Medicare for All (M4A)



* This category includes tax subsidies such as the tax preference for employer-sponsored insurance.

Figure 2. Medicare for All (M4A) vs. Other Federal Budget Categories



* This category includes tax subsidies such as the tax preference for employer-sponsored insurance.

and total federal costs of M4A with those projected for various other categories of the federal budget. There are several striking comparisons in this graph, but a few stand out: even assuming the dramatic provider payment cuts, net new costs under M4A would exceed all projected (individual and corporate) federal income taxes, as well as being more than four times as large as the entire defense budget.

How Should People React to These Findings?

These numbers are intended to provide information that members of the public can use to inform their thinking about M4A. How people receive the numbers is up to them. My own reactions to these findings needn't determine the reactions of others.

Information about M4A's costs is nevertheless important to have, irrespective of whether one supports or opposes M4A. Those who are concerned about federal finances and skeptical of M4A should know the extent to which their concerns are well founded. M4A proponents, too, should know the costs of making their vision a reality, and understand the questions it raises about whether financing M4A is feasible. Perhaps even more importantly, undecided citizens should have an opportunity to understand the cost implications before becoming invested in one position or the other.

If healthcare utilization rises under M4A, it means more people are getting care that they need. That's good. But the other side of the coin is more health spending, as well as additional utilization of less-effective and less-necessary services, creating more competition among patients for access to care—especially if the supply of healthcare providers proves inadequate to meet increased demand.

M4A's effect on federal finances and its effect on national health expenditures are both important considerations. Some commentators have implied that the potential benefit of a (slight) reduction in national health expenditures (even if driven exclusively by provider payment cuts) is all that really matters, irrespective of the strain on federal finances. Most readers will understand why that interpretation is impracticably narrow. After all, the federal government must be able to finance its operations. If it cannot handle the extra burden of financing $33 trillion to $38 trillion in spending over 10 years, it doesn't really matter whether that federal spending would have brought about a 4% acceleration or a 4% deceleration in national health spending. What matters first is whether the federal government can even do it.

A primary effect of M4A would be to replace private spending on healthcare with government spending financed by federal taxpayers. Americans would pay for no deductibles or cost-sharing, but they would pay much higher taxes. This change dwarfs any projected changes in national health spending, which in turn are a highly contingent, unpredictable function of whether and how deeply provider payments are cut. The observation that Americans are already paying for most of these expenses, while technically true, by itself glosses over the important question of whether they are willing to have their taxes raised sufficiently to have the government pay for them.

An analogy might help frame the choice. Suppose, for example, that a government representative came to your door and said, "We've totaled up all the money you spend each year on food. We think you're wasting money paying for restaurants', grocery stores', and farms' costs of doing business, as well as for the costs of others in the food industry. We think we can do this more efficiently. So we're going to raise your taxes by that amount of money, and we'll provide all your food to you for free. And we'll also be able to take care of those Americans who don't have enough access to food. We're planning to cut all payments to restaurants, grocery stores, farms, and other food providers by about 40%, and if we do that we might be able to cut 3%–4% off your total food bill." Would Americans take this deal?

Maybe some would. But it's nearly certain many would not. First, it's a huge amount of money to turn over to the government. Even if they were shown how much they were already spending, it doesn't necessarily follow that Americans would want to pay that much in additional taxes. The potential for a 3%–4% reduction in their food costs might not make up for surrendering all control over how they spend on food. Second, they would be correct not to trust the government to follow through with those 40% payment cuts, once lobbyists for the food industry enter the picture—and if the government didn't do so, then their food costs would rise at the same time that they lost a great deal of control. Third, if the payment cuts do go through, Americans might worry that their favorite restaurant would close and that they'd not be able to eat there anymore. They might also worry about the lines that would form at grocery stores and restaurants as 40% cuts send many of those establishments out of business. Finally, some may simply not want to give up their remaining power to choose how much to spend on food, no matter how the numbers shake out.

An important thing for Americans to know is that financing M4A would require more funds than doubling all projected individual and corporate federal income taxes would generate, and indeed that the actual financing required would likely be significantly greater even than that, depending on how deeply the government is willing to cut payments to doctors, nurses, hospitals, and other healthcare providers. On the other side of the coin, Americans would be excused from paying for healthcare in the many ways they currently do. As the idea of M4A is discussed, financing the unprecedented federal cost should be considered whenever and wherever there is a discussion of its potential benefits.

Questions and Answers about Medicare for All's Costs

This article was originally published at E21 on August 21, 2018.

Press and social media coverage of major public policy issues or events tends to play out in stages. Initial descriptions and commentary may draw from the primary information source, but thereafter much of the subsequent reporting and discussion references previous commentary rather than the original source. This happened with my Medicare for All study. First there was an initial burst of straight press reporting on the study, but soon the social media conversation was dominated by policy advocates commenting on it. During that subsequent conversation various themes, questions, and points of confusion arose, necessitating clarification from time to time. The piece reproduced here attempted to elucidate some of those issues.

Some Medicare for All advocates mistakenly asserted that the study showed that Medicare for All, despite its enormous additional costs for the federal government, would actually slow the growth of national health spending. The study didn't actually say that or show it. It did present a lower-bound estimate in which various favorable assumptions would bring about that result, but I made clear throughout that this was a lower-bound estimate, and that the range of likely outcomes encompassed substantially higher projected national costs. This misunderstanding resulted in Medicare for All advocates being corrected by several fact-checker sites, an unforced error that hurt their policy case. This piece devoted considerable space to citing numerous passages from the original study that were drafted specifically to preempt such confusion.

Other controversies dealt with in this piece concerned the magnitudes of provider payment cuts that Medicare for All would impose and whether the widely cited estimates represented total Medicare for All costs or just the incremental costs above and beyond current federal health-related spending. (Answer: the latter.)

MY JULY 2018 ESTIMATE OF THE FEDERAL COSTS OF MEDICARE FOR ALL (M4A) received widespread public and press attention.[1] The ongoing discus-

1. Charles Blahous, "The Costs of a National Single-Payer Healthcare System" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, July 2018). For examples of attention it has received, see Brian Riedl, "No, 'Medicare for All' Is Still Not Plausible," Foundation for Economic Education, August 13, 2018; *Washington Post*, "The Cosmically Huge 'If' of Medicare for All," August 12, 2018.

sion prompted a number of common questions about the study, which this article attempts to answer.

Q: Does the estimate account for what the federal government is already spending on healthcare?

A: Yes. The study's federal cost projection of $32.6–$38.0 trillion over 10 years[2] is an estimate of *additional* federal healthcare obligations, above and beyond current federal expenditures on programs such as Medicare and Medicaid, as well as current tax code–based subsidies such as those for employer-sponsored and Affordable Care Act insurance policies. Total federal costs under M4A would be substantially greater ($54.6–$59.9 trillion) than the study's projections of the additional federal costs alone.

Q: How much would the M4A bill cut payments to providers?

A: The M4A bill specifies that healthcare providers would be paid at Medicare payment rates, which are substantially lower than those paid by private health insurance.[3] The study analyzes the projected results of this specification, explaining its problematic implications for patients' access to care, the unlikelihood that such drastic cuts would be immediately implemented as written, and the fiscal outcomes if they were not. The CMS Medicare actuary documents that hospital payment cuts would average roughly 40% at first and grow steeper over time, for treating patients now covered by private insurance.[4] Assuming M4A is fully implemented by 2022, physicians would initially be reimbursed at rates averaging about 30% lower than they would have been paid by private insurance, and those cuts would also grow to exceed 40% within the first 10 years.[5] Because all providers would be reimbursed at Medicare rates, this would (obviously) not mean payment reductions for services already covered by Medicare. The study also explains that the imposition of Medicare payment rates would produce a temporary increase in payments for physician services now provided through Medicaid, but those too would eventually turn into net payment cuts and become more severe over time.[6]

2. Blahous, "Costs of a National Single-Payer Healthcare System."
3. Medicare for All Act of 2017, S. 1804, 115th Cong. (2015).
4. Figure 1 in John D. Shatto and M. Kent Clemens, Office of the Actuary, Centers for Medicare & Medicaid Services, memorandum, "Projected Medicare Expenditures under an Illustrative Scenario with Alternative Payment Updates to Medicare Providers," June 5, 2018.
5. See figure 2 in Shatto and Clemens, memorandum, 8.
6. Blahous, "Costs of a National Single-Payer Healthcare System."

Q: Does the cost estimate reflect a particular policy perspective, or is it generally in line with estimates put forward by others?

A: Credible studies of M4A's costs tend to produce qualitatively similar results. My estimates are generally in line with those generated by other experts spanning a wide range of affiliations and policy views. Such differences as there are arise primarily because different studies examine different years, and because studies that were completed prior to the M4A bill's introduction needed to make speculative assumptions about provider payment rates and long-term care provisions.

The M4A bill introduced in the Senate has a four-year phase-in period, which means that if it were enacted today M4A's first 10 years of full implementation would be 2022–2031. My study's estimates of $32.6–$38.0 trillion in additional federal costs would have been smaller ($25.2–$28.9 trillion) during 2017–2026 if M4A had been fully effective during those years, as assumed in prior studies, because healthcare costs tend to grow over time. Adjusting for implementation dates and alternative payment rate assumptions, my estimates closely resemble those generated by the Urban Institute,[7] the Center for Health and Economy,[8] and Emory University professor Kenneth Thorpe,[9] who has characterized his own estimate of spending on the previously uninsured as being "likely low."[10] (See table 1.)

Q: Would eliminating private health insurance profit and administrative overhead produce enough savings to finance the coverage expansion under M4A?

A: No. The study makes a very aggressive assumption for national administrative cost savings under M4A ($1.6 trillion over 10 years).[11] Nevertheless, these potential savings are but a fraction of the projected additional health spending M4A would precipitate by covering the currently uninsured and by expanding the scope and generosity of coverage for the currently insured ($5.7 trillion).

7. John Holahan et al., "The Sanders Single-Payer Health Care Plan: The Effect on National Health Expenditures and Federal and Private Spending" (Research Report, Urban Institute, May 2016).

8. "Medicare for All: Leaving No One Behind," Center for Health and Economy, May 1, 2016.

9. Kenneth E Thorpe, "An Analysis of Senator Sanders Single Payer Plan," January 27, 2016.

10. Kenneth E Thorpe, "Why Sanders's Single-Payer Plan Would Cost More Than His Campaign Says," *American Prospect*, February 29, 2016.

11. Blahous, "Costs of a National Single-Payer Healthcare System."

Table 1. Alternative Estimates of First 10-Year Federal Costs of M4A, If the First 10 Years of Full Implementation Had Been 2017–2026

Study	Estimate
Urban Institute (without long-term care)	$29.1 trillion
Blahous (without provider cuts)	$28.9 trillion
Center for Health and Economy	$27.3 trillion
Blahous (with provider cuts)	$25.2 trillion
Thorpe	$24.7 trillion

Sources: John Holahan et al., "The Sanders Single-Payer Health Care Plan: The Effect on National Health Expenditures and Federal and Private Spending" (Research Report, Urban Institute, May 2016); Charles Blahous, "The Costs of a National Single-Payer Healthcare System" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, July 2018); "Medicare for All: Leaving No One Behind," Center for Health and Economy, May 1, 2016; Kenneth E Thorpe, "An Analysis of Senator Sanders Single Payer Plan," January 27, 2016.

Q: Aren't we paying for most of these costs already, in other ways? Even if Americans' federal taxes had to rise to pay for M4A, wouldn't Americans save money on the other end by no longer having to pay for things like employer-provided health insurance, state-funded programs, and out-of-pocket healthcare expenses out of their take-home pay?

A: Yes, and the study discusses these offsetting effects.[12] But, while Americans are already shouldering the vast majority of these costs in other ways, it does not necessarily follow that they would be comfortable with transferring virtually all these personal and societal resources to the federal government to redistribute in the form of health benefits. Among other considerations, there is the sheer magnitude of the change, which would expand federal government obligations to such an extent that even doubling all projected federal individual and corporate income taxes could not adequately fund it. The federal government also has yet to demonstrate it can successfully finance the future budget commitments scheduled under current law,[13] let alone added costs of this unprecedented magnitude. How

12. Blahous, "Costs of a National Single-Payer Healthcare System."

13. Congressional Budget Office, "The Budget and Economic Outlook: 2018 to 2028," April 11, 2018.

Americans may weigh these various considerations is beyond the scope of the study.

Q: Did your study find that M4A would reduce national healthcare costs by $2 trillion over 10 years?

A: No, as various fact-checking articles have pointed out.[14] This is made clear by contrasting the specific language and findings of the study with the claim of $2 trillion in savings.[15] More specific details are provided below, but the correct reading of the study is that such savings would be highly unlikely to materialize.

The study's purpose was to produce a federal budget cost estimate, this being a critical factor that would guide legislative procedures in the event lawmakers attempt to enact M4A. The study included a federal cost estimate of $32.6 trillion over 10 years, emphasizing repeatedly that this was a lower-bound estimate and that actual costs would likely be substantially greater. (To further illustrate this potential variance, the study also included a $38.0 trillion estimate.) The following quotations from the study are representative of how the $32.6 trillion figure is presented.

- "It is likely that the actual cost of M4A would be substantially greater than these estimates."[16]
- "Conservative estimates";[17] "conservative estimates."[18]
- "It is likely that the actual cost of M4A would be substantially greater."[19]
- "These cost estimates essentially represent a lower bound."[20]
- "Actual savings (from lower drug prices) are likely to be less than assumed under these projections."[21]
- "This is an aggressive estimate of administrative savings that is more likely to lead to M4A costs being underestimated than overestimated."[22]

14. Glenn Kessler, "Democrats Seize on Cherry-Picked Claim That 'Medicare-for-All' Would Save $2 Trillion," *Washington Post*, August 2, 2018; Ricardo Alonso-Zaldivar, "AP Fact Check: Sanders Spins Savings in Medicare Plan," AP, August 8, 2018.

15. Blahous, "Costs of a National Single-Payer Healthcare System."

16. Blahous, "Costs of a National Single-Payer Healthcare System," abstract.

17. Blahous, abstract.

18. Blahous, 3.

19. Blahous, 3.

20. Blahous, 4.

21. Blahous, 14.

22. Blahous, 14.

- "The resulting implicit estimates of national and federal spending on LTSS should be regarded as conservative."[23]
- "This study's assumption of no net increase in LTSS benefit utilization . . . is an additional factor contributing to these projections' being more likely to underestimate costs than to overestimate them."[24]

The study contains other passages detailing some of the reasons why the $32.6 trillion figure likely represents a substantial underestimate:

> The adoption of Medicare payment rates would represent a substantial reduction in provider reimbursements for care provided to everyone now covered by private insurance. . . .
>
> . . . It is not precisely predictable how hospitals, physicians, and other health care providers would respond to a dramatic reduction in their reimbursements under M4A. . . . By 2019, over 80 percent of hospitals will lose money treating Medicare patients—a situation M4A would extend, to a first approximation, to all US patients. Perhaps some facilities and physicians would be able to generate heretofore unachieved cost savings that would enable their continued functioning without significant disruptions. However, at least some undoubtedly would not. . . .
>
> Anticipating these difficulties, some other studies have assumed that M4A payment rates must exceed current-law Medicare payment rates to avoid sending facilities into deficit on average. . . .
>
> . . . The resulting cost estimates would be substantially larger.[25]

Some M4A proponents are hopeful that having the federal government take on this enormous cost burden might produce a broader societal benefit of a net reduction in national health spending, and have sought accordingly to convert the study's federal cost estimate into an estimate of national health expenditure savings.[26] However, if the study's framing were to change from a cost estimate to a savings estimate, then all the study's other descriptions

23. Blahous, 17.
24. Blahous, 17.
25. Blahous, 10–13.
26. Kessler, "Democrats Seize on Cherry-Picked Claim."

must also flip accordingly. The lower-bound cost estimate would become an upper-bound savings estimate, and the study's finding that "the actual cost of M4A would be substantially greater" would become a finding that "actual savings would be substantially less." Such accuracy is especially important in this context, for the study makes clear that total national health spending under M4A would be much more likely to increase than to decrease relative to current law. This can be seen by noting that the $2 trillion in proponents' hoped-for national expenditure savings could not be achieved without more than $6 trillion in provider payment cuts and drug price reductions—savings the study describes as uncertain at best.[27]

Of course, none of this should inhibit M4A proponents from exercising their prerogative to believe and to argue that M4A can achieve net national cost savings—to argue, in effect, that the best-case fiscal scenario of massive provider payment cuts and drug price reductions would actually come to pass—provided, of course, that this conclusion is not attributed to the study. The study states throughout that the actual costs of M4A would likely be substantially greater, in which case the purported $2 trillion in savings would not materialize.

I hope that these answers and clarifications further public understanding of the estimated costs of M4A.

27. Blahous, "Costs of a National Single-Payer Healthcare System."

PART 2

Social Security

Slowing Down Social Security's Retirement Age Increase

This article was originally published at E21 on November 18, 2010.

In 2010 the Simpson-Bowles fiscal responsibility commission, formed by President Obama, issued its recommendations for repairing the federal budget outlook. These included recommendations to balance the finances of Social Security, the federal government's largest mandatory spending program. The plan contained a provision to very gradually increase the Social Security eligibility age.

Whether you like or dislike the commission proposals, some of the shriller attacks on them bore little reasonable relationship to the commission's recommendations or their broader policy context. In particular, this piece points out that the allegedly heartless eligibility age increases proposed in Simpson-Bowles were actually more gradual than ones already in the midst of taking effect under current law, without significant public outcry or notable hardship. While there are many other policy issues in our national policy discussion that suffer from insufficient seriousness, debates over Social Security's eligibility age have long remained among the most intemperate, to our shared detriment.

HERE'S A MULTIPLE-CHOICE TEST QUESTION ON THE RECENT PROPOSAL from Alan Simpson and Erskine Bowles, cochairs of the president's fiscal responsibility commission.

Complete the following sentence correctly. The Simpson-Bowles proposal would

A. sharply accelerate future increases in Social Security's normal retirement age (NRA) relative to those already occurring in the near term under current law.
B. slightly accelerate future retirement age increases relative to those already occurring in the near term under current law.
C. continue at the same rate future retirement age increases already occurring in the near term under current law.
D. slow down future retirement age increases relative to those already occurring in the near term under current law.

The correct answer is . . . D.

Surprised? Based solely on public commentary about the proposal, nearly anyone would be. AFL-CIO President Richard Trumka declared that the commission had told working Americans to "Drop Dead" and suggested that its draconian plan "would have killed" his coal miner father.[1] Dr. Paul Krugman charged that the commission had been "hijacked" and asked rhetorically of the retirement age increase: "Is that reasonable? The answer is no."[2] And one news report after another has talked of "dramatic" changes the blueprint would make to Social Security.

The fact is that the Simpson-Bowles proposal would effect a slower future increase in the retirement age than that already occurring under current law. Do you remember the hue and cry when the Social Security retirement age rose by two months each year early in the first few years of the twenty-first century? Most likely not, because there was very little. Meanwhile, the rate of change proposed by Simpson and Bowles is actually four times slower than the aforementioned increase, and slower on average than the current-law increases set to occur throughout the entire first quarter of the 21st century.

Let's examine this in somewhat greater detail. Figure 1 is a graph of the proposed Simpson-Bowles NRA change, by worker birth year.

Under current law the NRA is rising by two years, phased in from those born in 1937 to those born in 1960. Under Simpson-Bowles, a subsequent two-year increase in the NRA would be phased in from those born in 1961 to those born in 2007. This is thus a substantial deceleration in the currently ongoing rate of increase. For perspective, consider that Simpson-Bowles would affect the NRA for today's 26-year-old worker by a grand total of one year.

The NRA, while important, is not the primary determinant of when individuals file for Social Security benefits. The majority of claimants file at early eligibility age (EEA), now 62. Simpson-Bowles would also increase this EEA. Figure 2 shows historic and proposed ages for earliest Social Security benefit claims (we'll refer to male workers for purposes of illustration).

When Social Security was first established, benefits could not be claimed until age 65. The 1956 Social Security amendments allowed women to claim benefits as early as age 62, an option extended to men in the 1961 program

1. Kathy Kiely, "Trumka on Social Security: Don't Raise Retirement Age," *National Journal*, November 11, 2010.

2. Paul Krugman, "The Hijacked Commission," *New York Times*, November 11, 2010.

Figure 1. Current Law and Proposed Changes in the Normal Retirement Age (NRA)

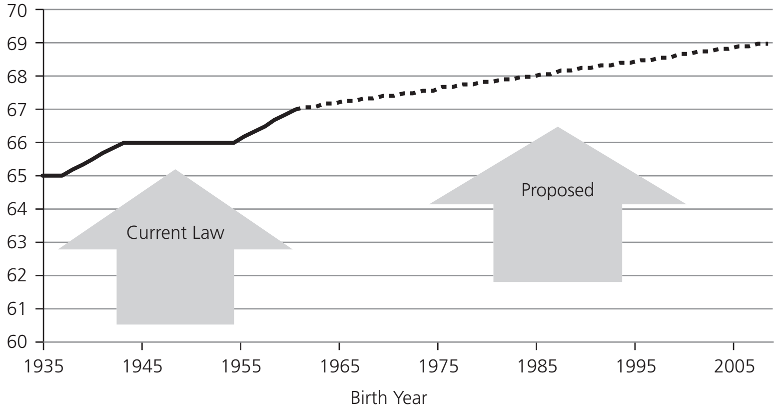
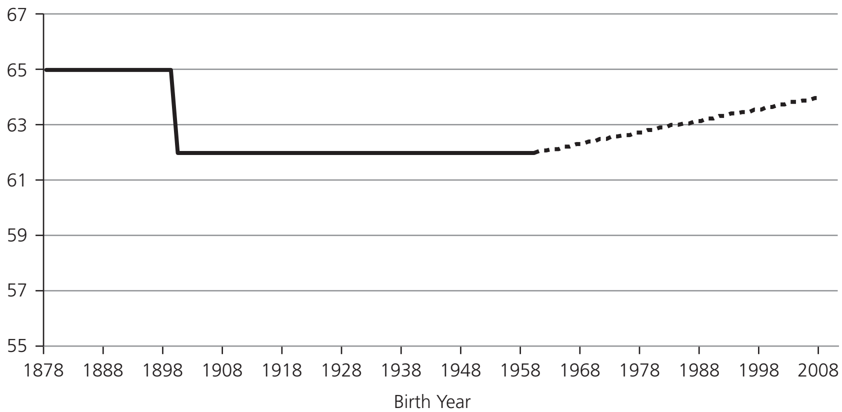


Figure 2. Historic and Proposed Ages of Earliest Benefit Eligibility



amendments.[3] Under Simpson-Bowles, the earliest age at which workers could claim benefits would gradually drift up again to approach—by the 21st century's end—only what it was originally under FDR. My four-year-old daughter would still be able to claim retirement benefits at an earlier age even than members of the generation that fought the Spanish-American war.

3. Library of Congress Congressional Research Service, Summary of Major Changes in the Social Security Cash Benefits Program: 1935–1996, December 20, 1996.

Is this "reasonable," given changes in worker health and longevity since Teddy Roosevelt's heyday, or should we avoid this adjustment and just hike my daughter's taxes instead? Let's remind ourselves of how longevity has changed over the last 70 years. For simplicity we'll use "period life expectancy," which only incorporates life expectancy changes to date rather than those anticipated over the rest of an individual's lifetime. (See figure 3.)

Clearly we are generally living much longer than when Social Security's retirement age of 65 was first established. This is one reason why the 1980–1981 Social Security Commission (less famous than the Greenspan Commission) recommended that Social Security's full eligibility age be raised to 68 by 2012.[4] Yet Dr. Krugman recently referred to the members of the Simpson-Bowles commission as "unserious people," in part for even considering a retirement age increase.[5]

We all have our own definitions of what constitutes "seriousness," but one of mine is that when one cites factual evidence in support of a policy argument, the evidence should actually substantiate that policy argument. In his criticism, Dr. Krugman argued that "the proposal seemingly ignores a crucial point: while average life expectancy is indeed rising, it's doing so mainly for high earners, precisely the people who need Social Security least. Life expectancy in the bottom half of the income distribution has barely inched up over the past three decades. So the Bowles-Simpson proposal is basically saying that janitors should be forced to work longer because these days corporate lawyers live to a ripe old age."[6]

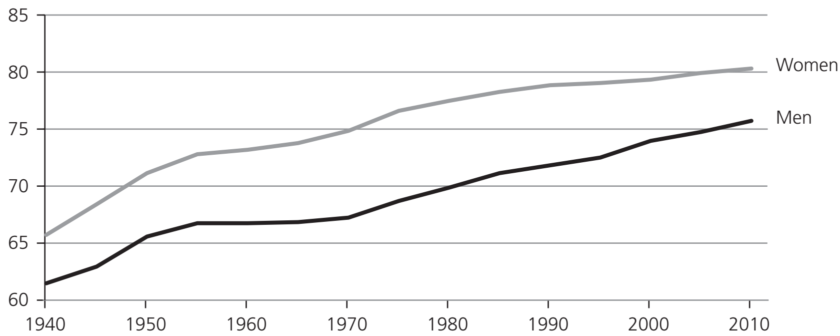
A perceptive reader presumably does not need to have the logical fallacy here spelled out, but let's do so anyway. Dr. Krugman's statement conflates two very different concepts:

1. There are mortality differences between professions and income levels,
2. Social Security's eligibility age for retirement benefits should not rise.

From a purely logical standpoint, the leap from concept 1 to concept 2 is a non sequitur. The fact that there are mortality differences does not by

4. National Commission on Social Security, *Social Security in American's Future*, March 1981.
5. Paul Krugman, "The Conscience of a Liberal," *New York Times*, November 10, 2010.
6. Krugman, "Hijacked Commission."

Figure 3. Period Life Expectancy by Birth Year



itself tell us what Social Security's eligibility age should be. It doesn't tell us whether it should be higher, lower, or the same as it now is.

Moreover, it would clearly make little sense to argue that simply because there is someone in America who is suffering from physical debilitation, the government should provide for subsidized retirement at age 62 for everyone. We arrive at sensible policies by determining what makes the most sense in the general case, and by providing for sufficient policy flexibility to address variations in individual experience.

The empirical evidence is clear that a physical inability to work is not the sole or even the primary determinant of workforce participation rates for those in their 60s. In 1955, 57% of American males aged 65–69 were in paid employment. By 1975, this had declined to 32%. This wasn't because American workers in 1975 were suddenly breaking down where those in 1955 had been leading comfortable, sedentary lives. Instead, this reflected a number of factors—including the increasing generosity of Social Security retirement benefits.

In any case, the Simpson-Bowles plan does not "ignore" the differential mortality issue. While it would gradually increase the retirement eligibility age in recognition of longer life spans, it would also provide physical laborers with greater flexibility in benefit claims with a new "phased retirement option" through which they could claim "half their benefits early and the other half at a later age."[7] The plan would furthermore direct the Social

7. "Co-chairs' Proposal," draft document, November 10, 2010.

Security Administration to design a new method to provide for early retirement benefits for those in "physical labor jobs."[8]

Thinking through the policy issues requires recognition that the Social Security program contains different components: a disability insurance component for those physically incapable of paid employment and an "old-age and survivors insurance" (OASI) program that provides benefits for individuals irrespective of their physical capacity to work. The Simpson-Bowles proposal to increase the eligibility age applies to the old-age program, not to the disability benefits for those physically unable to work.

Some may not realize that current Social Security law already facilitates a more lenient application of disability standards for physical laborers if the retirement age is increased. The Social Security Act is explicit that the age of the applicant is a factor in disability determinations.[9] Social Security Administration regulations also specify that the disability criteria applied at "advanced age" (over 55) are more lenient that those applied to young workers (and those applied to individuals "closely approaching retirement age" are more liberal still),[10] resulting in a greater likelihood of benefit awards for workers toward the end of their careers.

As American society ages, the question of Social Security's benefit eligibility ages reflects an important national value judgment. One possible choice is for us to translate our longer, healthier lifetimes solely into longer periods of paid retirement, resulting in substantially higher tax burdens on workers. A theoretical opposite choice would be to translate our longer, healthier lifetimes solely into longer working careers, lowering tax burdens per worker.

But while different individuals are entitled to make different judgments about the merits of these choices, no one is entitled to mischaracterize the judgments in the Simpson-Bowles proposal: that plan would still result in 21st century Americans spending a much greater share of their lives in retirement than they did in the 20th century. The Simpson-Bowles proposal does not ignore—but rather provides for—circumstances facing physical laborers. And their proposal is for a slower retirement age increase than the one already on the books.

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8. "Co-chairs' Proposal."

9. Social Security Administration, "Compilation of the Social Security Laws Disability Insurance Benefit Payments," https://www.ssa.gov/OP_Home/ssact/title02/0223.htm.

10. 45 Fed. Reg. 55584 (August 20, 1980), as amended at 56 Fed. Reg. 57944 (November 14, 1991); 68 Fed. Reg. 51164 (August 26, 2003); 73 Fed. Reg. 64197 (October 29, 2008).

Is It Becoming Too Late to Fix Social Security's Finances?

This article was originally published at E21 on August 31, 2012.

This next piece has a theme of substantial importance to a public that cares deeply about Social Security—and a theme that requires no especial expertise to be grasped. Its message warrants far more attention than it generally receives.

The piece's essential point is that, for various reasons, our national window of opportunity to maintain Social Security's historical financing structure is now in the process of closing. Whereas previous program rescues occurred when it was still possible to repair program finances without significant near-term disruptions, waiting this time around until trust fund depletion is imminent will create a financing gap simply too large to close. This would likely require lawmakers to bail out Social Security from the general government fund, forever ending the perception of Social Security as a self-financed earned benefit—a perception that has historically given the program its unique political strength.

Properly understood, the reason Social Security finances are not now being dealt with is not because the problem is distant, but because the problem has already grown too large for elected officials to repair within the constraints of contemporary politics.

ONE OF MY DUTIES AS A PUBLIC SOCIAL SECURITY TRUSTEE IS TO EXPLAIN the program's financial condition, both formally as a signer of the annual board report and less formally in published summaries, articles, interviews, and congressional testimony.[1] This evaluation is written pursuant to that responsibility.

1. OASDI Board of Trustees, *The 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, April 25, 2012; Social Security and Medicare Boards of Trustees, "A Summary of the 2012 Annual Reports," 2012, Social Security Administration, https://www.ssa.gov/OACT/TRSUM/2012/index.html.; Charles Blahous, "A Guide to the 2012 Social Security Trustees Report," E21 (Manhattan Institute for Policy Research), April 26, 2012; Stephen Ohlemacher, "Social Security Surplus Dwarfed by Future Deficit," *Post-Bulletin*, August 16, 2012; Charles Blahous, "Statement of Charles P. Blahous, Public Trustee for Social Security, before the Subcommittee on Social Security of the U.S. House of Representatives Committee on Ways and Means," June 21, 2012.

Social Security's future, at least in the form it has existed dating back to FDR, is now greatly imperiled. The last few years of legislative neglect—due to a failure of national policy leadership coming just as the baby boomers have begun to retire—have drastically harmed the program's future financial prospects. Individuals now planning their financial futures, whether as taxpayers or as beneficiaries, should be pricing in a substantial risk that the federal government will not be able to maintain Social Security as a self-financing, stand-alone program over the long term. If Social Security financing corrections are not enacted in 2013, or at the very latest by 2015, it becomes fairly likely that they will not be enacted at all.

Below I will first explain how the Social Security shortfall is usually described and approached. Then I will explain why Social Security's financial prospects are much grimmer than is commonly understood. Finally I will explain why this matters: that is, the likely consequences if the president and Congress continue to fail to balance its books.

Common Measures of the Social Security Shortfall

Social Security's long-term financing shortfall is now estimated at 2.67% of the program's tax base (worker wages). Insolvency of the program's combined trust funds is now projected for 2033 (2016 for its disability program). Figures such as 2033 and 2.67% make it appear—incorrectly—as though there are several years remaining to act, and only a modest problem to solve.

Multiple Solutions

There is no shortage of Social Security reform proposals that would, at least on paper, successfully shore up program finances. I personally have put forward some, and the Social Security Actuary has scored several others.[2] Proposals from the right tend to focus on cost containment (e.g., slowing the growth of benefits and/or raising eligibility ages), whereas proposals from the left tend to focus on raising taxes.[3] As I explain below, this multitude of proposals in no way implies that a solution is readily achieved.

2. Charles Blahous, *Social Security: The Unfinished Work* (Stanford, CA: Hoover Institution Press, 2010); Social Security Administration, "Office of the Chief Actuary's Estimates of Proposals to Change Social Security," https://www.ssa.gov/OACT/solvency/index.html.

3. Peter Diamond and Peter Orszag, "No Revenue Means Steep Social Security Cuts under Romney," *Bloomberg View*, March 27, 2012.

Why a Solution Is Rapidly Becoming More Difficult

There are several reasons.

- The baby boomers are starting to retire. Lawmakers have historically been very reluctant to cut benefits for beneficiaries once they start receiving them. This means that any sacrifices will likely be concentrated on younger generations who already face net income losses through Social Security as it is.[4] With every further year of delay, lawmakers must therefore consider sharper benefit growth reductions and/or tax increases.
- A solution requires substantial compromise by one or both sides. If one person (or a unified political party) commanded total political power and was willing to use it, they could impose a preferred solution on those who disagreed. The last such opportunity was probably 2009–2010 when Democrats controlled both chambers of Congress and the White House. Had they so chosen, they could have shored up Social Security on their own terms. No such attempt was made. Today no one expects that either party will single-handedly control the White House, the House, and 60 votes in the Senate within the next few years. Thus if Social Security finances are to be repaired, someone must dramatically compromise: progressives must accept substantial benefit growth reductions, conservatives must accept substantial tax increases, or both. Unfortunately, as I will show below, we are already long past the point where there is precedent for a compromise of this magnitude.
- There is a huge disparity between the problem's urgency and the rhetoric applied to it by substantial factions of the body politic. Even as time is running out for a workable compromise, some continue to play a high-stakes gamble: that if the urgency is downplayed and action delayed past the next few elections, it can be dealt with when the political alignment may be more advantageous to one side.[5] This gambit has now been extended to the point of imperiling Social Security's long-term outlook. Too many key players, however, do not yet realize this.

4. OASDI Board of Trustees, *The 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds,* April 25, 2012, B. Long-Range Estimates.
5. Jacob Lew, "Opposing View: Social Security Isn't the Problem," *USA Today*, February 21, 2011.

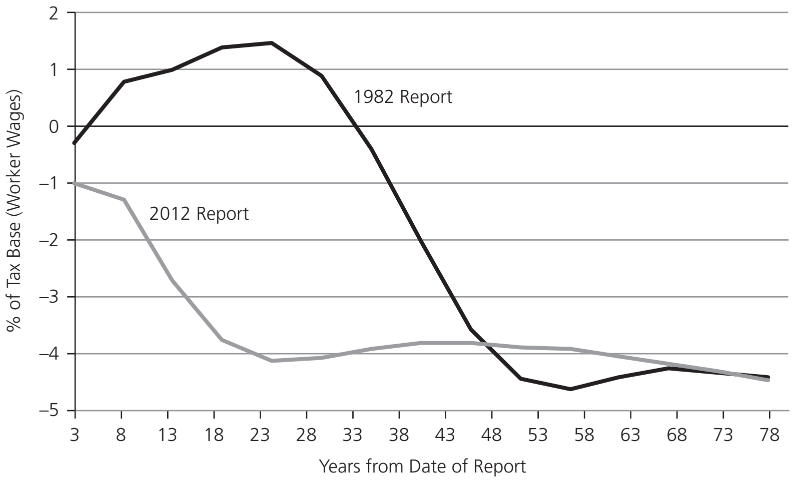
No Bipartisan Grand Bargain Has Ever Eliminated a Social Security Shortfall This Large

The historical high-water mark for a comprehensive bipartisan rescue was the 1983 Social Security amendments. The program was then saved from the brink of insolvency. Benefit checks had literally been just months away from being interrupted. Both sides agreed on the urgency and immediacy of the crisis, yet very nearly failed to reach agreement.

The program's long-term shortfall in 1982 was measured as 1.82% of the program's tax base. Today it's measured as 2.67%—much larger even on the surface. Yet many don't realize that the trustees' methodologies were changed in 1988 to make the shortfall appear smaller. If we still measured as was done in 1983, today's shortfall would be 3.5% of the tax base—nearly twice as large as the 1983 gap.

Figure 1 compares current projections with those made at the time of the 1982–1983 crisis, specifically for the 75-year period immediately following each report. The graph shows projected differences between annual "non-interest" income (payroll taxes, benefit taxes, and any general revenues) and the cost of paying benefits, in relation to the program's tax base. Points above the zero line indicate an annual surplus; points below indicate an annual

Figure 1. Projected Social Security Annual Balances (2012 vs. 1982 Reports)



deficit. Because in 1982 long-term projections were only specified for years that were multiples of 5 (2015, 2020, etc.), I mark the estimates at spans of 3, 8, 13, etc., years from the dates of the respective reports.

It's immediately visually apparent that today's long-term problem is not only worse than in 1982–1983, but much worse. Shortfalls over the long term equal roughly 4% of the program's tax base in either case. The big difference is in the near term; we're now 20 years closer to deficits of that magnitude than policymakers were then, and must effectuate large corrections much more rapidly.

In the early 1980s policymakers merely had to get through a relatively small near-term solvency crisis before entering decades of previously projected surpluses as the baby boomers moved through the workforce. The 1983 reforms could thus be much gentler than those required today.

Yet even the 1983 adjustments were nearly more than the political system could bear. Lawmakers had to delay cost-of-living adjustments by six months, bring federal employees (and their payroll taxes) into the program, and expose beneficiaries to new benefit taxation, among other measures. These measures were intensely controversial and strained the limits of political salability—yet were far less drastic than a solution today requires.

A solution enacted today would require Left and Right to cede roughly twice as much ground as they did in the 1983 reforms, or one side must cede still more. Each year that passes, influential players must retreat still further from their preferred policies. At some point (which we may well be past already), one side, the other, or both will reach the limit of how much it is willing to swallow.

The fate of the Simpson-Bowles Social Security proposal exemplifies how difficult forging a compromise has become.[6] That proposal, developed by the bipartisan cochairs of President Obama's fiscal responsibility commission, was Solomonically divided almost 50–50 between revenues and cost constraints (46–54, exactly). The Obama White House distanced itself from the proposal after it was repeatedly attacked by many of the president's political allies.[7] It failed to receive the requisite support on the commission, with defections on both the Republican and Democratic sides. Such political

6. Social Security Administration Office of the Chief Actuary, *Letter to the National Commission on Fiscal Responsibility and Reform*, December 1, 2010.

7. "Strengthen Social Security . . . Don't Cut It: The Bowles-Simpson Plan Would End Social Security as We Know It," *Strengthen Social Security*, accessed May 31, 2012.

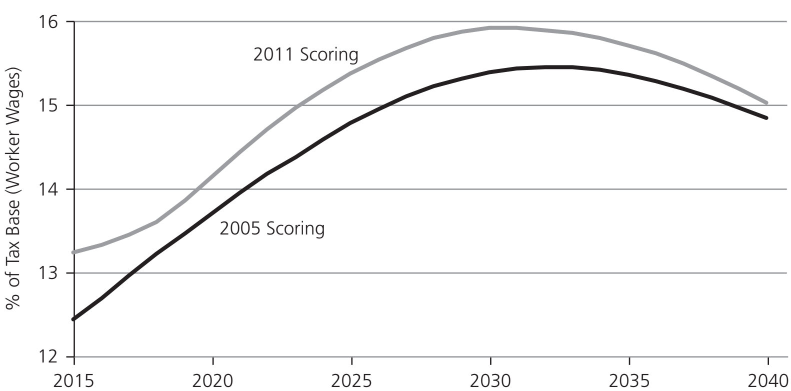
heat is only going to grow more intense: due to subsequent deterioration in system finances, the next solution debated will need to impose even tighter financing constraints than Simpson-Bowles proposed.

Some of the Toughest Solutions Proposed Already No Longer Work

As another illustration of the growing difficulty of solution, let's look at the competing approaches of containing cost growth and raising taxes. One longstanding proposal has been to slow future benefit growth to the rate of price inflation for high earners, while allowing low-income earners the higher growth rate of wage inflation and leaving previous beneficiaries unaffected. But already, even if we slowed everyone's benefit growth—from the poorest to the richest—to price inflation, we could no longer maintain solvency while holding harmless those over the age of 55. (See figure 2.)

The graph shows how six years of delay have increased the cost of this particular approach. Had across-the-board price indexing been enacted in 2005, it could have kept Social Security fully solvent, left those over 55 untouched, and generated additional funds to provide for faster benefit growth on the low-income end. Enacted last year, however, such across-the-board price-indexing would no longer be enough; costs would be substantially higher and the trust funds would be depleted in 2040 unless further measures were taken. And if rescored under 2012 assumptions, this proposal would fare still worse.

Figure 2. Annual Social Security Costs If Benefits Are Indexed to Prices



The efficacy of tax-increase solutions is also fading with delay. Advocates on the Left sometimes argue to increase the amount of Social Security wages subject to the payroll tax. The most extreme version of this proposal would be to raise the amount of wages subject to the full 12.4% payroll tax—$110,100 today—up to infinity. Yet even this drastic measure would now fail to keep Social Security in long-term balance.

We are thus approaching the point where each side would have difficulty balancing Social Security finances even if it could dictate the solution—and rapidly passing the point where a compromise solution remains reasonably likely. What does this mean for Social Security's future?

Toward a Very Different Social Security Program

If a financing solution cannot be reached, then Social Security's self-financing construct would need to be abandoned. Assuming the program continues to pay benefits, it would have to permanently rely on subsidies from the general fund, as Medicare now does. This would be a valid policy choice, but it carries unavoidable consequences. It would mean an end to one of the program's foundational principles: the requirement that Social Security pay its own way through a separate trust fund. It would also mean an end to FDR's conception of an "earned benefit" program in which workers are seen to have paid for their own benefits.

Upon merging into the general fund, Social Security benefits would be far less secure going forward. Benefit payments would have to compete with other annual spending priorities, and would be limited to those deemed affordable given pressures elsewhere in the budget. They would thus be much more susceptible to sudden reductions, means-tests, and other episodic changes to which general fund–financed programs have long been subjected.

If this all happens, and renders tomorrow's Social Security benefits less secure than today's, it would be a tragic irony: the outcome would have been brought about largely by supporters of Social Security having countenanced the tactics of delay to the point that the program's unique political protections could no longer be preserved. Those who care about the Social Security program need to clearly understand the consequence of this ongoing neglect: that time for a realistic financing solution has nearly run out.

The End of Social Security Self-Financing: What Next?

This article was originally published at E21 on October 10, 2012.

As with several other pieces in this volume, this article was based on a longer study performed for the Mercatus Center. The title of the piece was deliberately provocative, perhaps best understood as half a description of what has already taken place and half a prediction of what will become inevitable. Its purpose was to acquaint readers with a critical divide that has recently opened: While on the one hand most people still think of Social Security as a standalone system, on the other hand its self-financing framework is eroding, both in terms of concrete policy changes and as a governing philosophical ethic.

Growing sections of the body politic are no longer willing to sustain Social Security's self-financing framework in practice even as they express support for it in principle. A smaller but also-growing political faction is abandoning the self-financing principle itself. The result, for better or for worse, is that Social Security is likely in the process of becoming a dramatically changed system without most of the public even being informed of the change, much less approving it.

TODAY [OCTOBER 10, 2012] THE MERCATUS CENTER IS RELEASING MY study titled "The End of Social Security Self-Financing: What Does It Portend for Social Security's Future?"[1] The piece explores the implications of the Obama administration and Congress having recently cut the Social Security payroll tax and financed benefit payments from the general government fund, thereby ending decades of bipartisan commitment to FDR's original vision for Social Security—that it be a self-financing program in which total benefits were limited by the amount of worker contributions. This financing change has the potential to fundamentally transform the future Social Security debate, possibly affecting important policy choices ranging from its rate of benefit growth to whether a contribution-benefit

1. Charles Blahous, "The End of Social Security Self-Financing: What Does It Portend for Social Security's Future?" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012).

link is maintained to how eligibility ages are set to whether formal means-testing is adopted.

News reports indicate that the payroll tax cut will be allowed to expire at the end of this year.[2] There are, however, no indications that lawmakers will reverse the substantial general revenue subsidies that were deposited in the Social Security trust funds to compensate for it. Approximately $217 billion in such subsidies have been provided to Social Security. These subsidies do not reflect any incoming tax collections and their costs are simply being added to the national debt. Moreover, because these transfers to the trust funds earn interest, by 2033 they will have compounded to require future taxpayers to subsidize roughly $600 billion in Social Security benefit payments beyond what beneficiaries paid for. It remains to be seen what effect this policy change will have on public perceptions that Social Security is an "earned benefit."

My study details the following aspects of the policy change.

The Long History of the Self-Financing Principle

A foundational idea underlying Social Security historically was that it was not supposed to be welfare. In a welfare program it's not required that tax contributions and benefit payments balance, individually or collectively. One individual might receive benefits despite having never paid taxes, whereas another might contribute taxes but draw no welfare benefits. FDR wanted Social Security to be different. He insisted that it be financed under contributory insurance principles, with total benefits limited to the amount of worker contributions plus interest. The perception that workers had—at least as a group—paid for their benefits was FDR's means of safeguarding the program's political support. As he put it,

> We must not allow this type of insurance to become a dole through the mingling of insurance and relief. It is not charity. It must be financed by contributions, not taxes. . . . I expressed my opinion that full solution of this problem is possible only on insurance principles. It takes so very much money to provide even a moderate pension for

2. Annie Lowrey, "Payroll Tax Cut Is Unlikely to Survive into Next Year," *New York Times*, September 30, 2012.

> everybody, that when the funds are raised from taxation only a "means test" must necessarily be made a condition of the grant of pensions.[3]

For decades, a strong, bipartisan majority remained firmly committed to FDR's vision. The political Right valued the contribution-benefit link as ensuring critical fiscal discipline, whereas the Left valued it for protecting benefits from having to compete annually with other programs for funding. Social Security advisory councils over the decades repeatedly endorsed self-financing, up to and including President Clinton's 1994–1996 council, which unanimously opined that Social Security should be financed "without other payments from the general revenue of the Treasury."[4]

Cracks in the Consensus

This consensus commitment to self-financing first began to erode in the late 1990s. In 1999 President Clinton proposed transferring general revenues to the trust funds to "save the surplus" for Social Security. In the following decade many other left-of-center advocates suggested breaking the program's contribution-benefit link by having higher-income taxpayers contribute additional taxes to the program without earning associated benefits.[5]

As the commitment to Social Security self-financing ebbed in some quarters, there arose a parallel desire to cut low-income workers' payroll tax burdens. This occurred for several reasons.

- One was a misperception that the payroll tax was "regressive." Actually, Social Security net tax burdens (taxes net of benefits) are quite progressive, as figure 1 shows. The misperception that its financing system is regressive is based on viewing only one side of the equation: the payroll tax assessments but not the benefits they create. Because the Social Security payroll tax would clearly never

3. Social Security Administration, "FDR's Statements on Social Security," https://www.ssa.gov/history/fdrstmts.html.

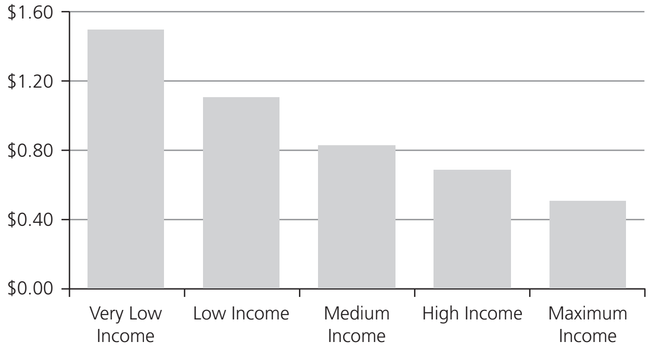
4. Social Security Administration, *Report of the 1994–1996 Advisory Council on Social Security*, vol. 1, *Findings and Recommendations*, January 1997.

5. Social Security Administration, "Memorandum on Estimates of Financial Effects for a Proposal to Restore Solvency to the Social Security Program," October 8, 2003; Social Security Administration, "Memorandum on Estimated OASDI Financial Effects for a Proposal with Six Provisions That Would Improve Social Security Financing," April 14, 2005; Social Security Administration Office of the Chief Actuary, Letter to Rep. Peter DeFazio, March 3, 2011; Social Security Administration Office of the Chief Actuary, Letter to Senator Bernard Sanders, September 7, 2011; Social Security Administration Office of the Chief Actuary, Letter to Rep. Robert Wexler, July 2, 2009.

have been established without accompanying benefits, this one-sided view is incomplete at best.

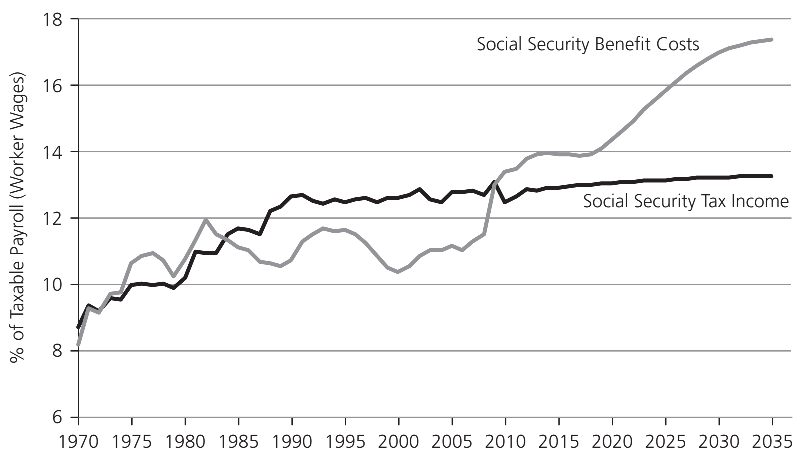
- Second, Social Security benefits have steadily risen to levels requiring higher tax burdens than lawmakers remain comfortable assessing throughout good times and bad. (See figure 2.)

Figure 1. Lifetime Benefits Received for Each $1 of Payroll Tax Contributions (Two-Earner Couple, Birth Year 1964)



Source: Social Security Administration Office of the Actuary.

Figure 2. Annual Social Security Cost Burdens Relative to Worker Wages



Source: Social Security trustees' report.

- Third, policymakers intermittently wish to provide "tax relief" to workers who pay no income taxes—a contradiction often resolved by misportraying refundable tax credit payments as payroll tax relief (even when policymakers had no intention of actually cutting income to the Social Security Trust Fund, nor the benefits these payroll taxes finance).
- Finally, some (especially younger) left-of-center advocates now take it for granted that Social Security's ongoing political support will remain strong even if the historical self-financing principle is abandoned.

The rising desire to replace Social Security's contributory payroll tax financing with general fund subsidies was by no means shared by all left-of-center Social Security policy advocates. Some, such as Nancy Altman, strongly criticized the recent payroll tax cut out of a conviction that Social Security's self-financing principle remained the cornerstone of its future viability and political strength.[6]

Abandoning Self-Financing

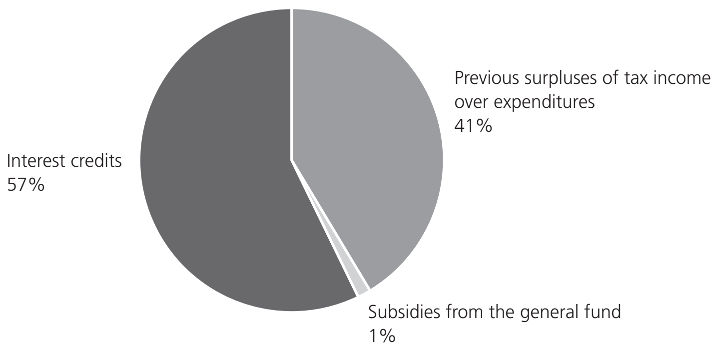
In 2011–2012 lawmakers cut the Social Security payroll tax to its lowest level in decades. The legislation included the following language:

> There are hereby appropriated to the Federal Old-Age and Survivors Trust Fund and the Federal Disability Insurance Trust Fund established under section 201 of the Social Security Act (42 U.S.C. 401) amounts equal to the reduction in revenues to the Treasury by reason of the application of subsection (a). Amounts appropriated by the preceding sentence shall be transferred from the general fund at such times and in such manner as to replicate to the extent possible the transfers which would have occurred to such Trust Fund had such amendments not been enacted.

Overnight this provision transformed Social Security from a program in which general revenue financing had historically been negligible to one that relied significantly on subsidies from the general fund. By the end of 2012, only 28% of the Social Security trust funds balance will reflect prior surpluses of Social Security tax income over expenditures. (See figures 3 and 4.)

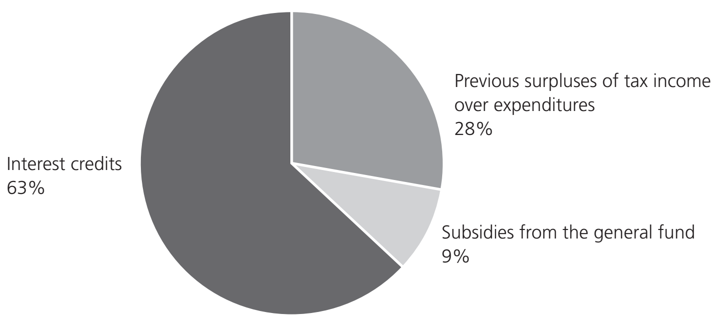
6. Nancy Altman, "The End of Social Security," *Shadow Proof*, December 7, 2010.

Figure 3. Components of the Social Security Trust Funds, End of Year 2010



Note: Percentages do not sum to 100 due to rounding.

Figure 4. Components of the Social Security Trust Funds, End of Year 2012



Potential Policy Implications

There are essentially four possible future courses for Social Security policy, given the recent incorporation of substantial general revenue subsidies.

1. *Continuation*. Social Security continues to receive substantial subsidies from the general fund while its historical ethic of self-financing is tacitly abandoned.
2. *Recurrence.* The current general revenue subsidies are allowed to terminate on schedule, but a precedent is established whereby lawmakers feel few inhibitions about resuming such subsidies whenever they believe other policy considerations warrant doing so.

3. *Termination with lasting policy effects.* The general revenue subsidies terminate on their current schedule and are not revived, but public perceptions of Social Security's role are significantly affected by awareness that benefit payments have been subsidized from the general fund.
4. *Termination with no lasting policy effects.* The general revenue subsidies terminate on their current schedule, public awareness of the subsidies remains limited, and lawmakers henceforth treat the 2011–2012 practice as a one-time exception to longstanding policy.

There is no way to know which course will be taken, but under three of these four scenarios Social Security's future is likely to be quite different from its past. Historically, programs financed from the general fund have been treated very differently from Social Security. These differences reflect a dynamic in which general fund financing induces many lawmakers to value the interests of income taxpayers on a par with those of beneficiaries.

Benefits in general-fund-financed programs have historically been much more changeable than Social Security's, with revisions of eligibility criteria and means tests being particularly frequent. Moreover, certain features of current Social Security benefit growth (such as wage-indexing of its initial benefit formula) are extremely atypical of other federal programs, which are usually indexed to grow more slowly. Finally, if it is no longer required that Social Security tax collections be sufficient to finance its benefit payments, the historical pattern of payroll tax rate and base increases may well discontinue.

Table 1 summarizes possible changes to Social Security policy in the post-self-financing era.

A fuller discussion of why general revenue financing may lead to these specific policy changes is included in my study.[7]

In sum, the recent policy of cutting the Social Security payroll tax and financing the program from the general fund represents a fundamental departure from its longstanding financing basis and a philosophical break with the vision of FDR. The long-term policy implications are not yet clear.

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7. Blahous, "End of Social Security Self-Financing."

Table 1. Possible Changes to Historical Social Security Policy Principles under General-Fund Financing

Policy factor	Historical principle	Possible change
Payroll taxes	Raise periodically as necessary to finance scheduled benefit obligations.	Argument for future payroll tax increases weakened; acceptable for payroll tax collections to fall short of benefit obligations.
Means testing	Full benefit eligibility for all contributors regardless of non-Social Security income.	Eligibility based in part on need in the manner of other general revenue–financed programs.
Wage indexing of initial benefit formula	Benefits indexed to remain a constant share of pre-retirement wages.	Benefits grow with price inflation in the manner of other general revenue–financed programs.
Contribution-benefit link	Benefit entitlement a reasonably direct function of individual payroll tax contributions.	Formula redrawn to provide limited safety-net benefit for all, irrespective of individual tax contributions.
Eligibility ages	Set to ensure that vast majority can withdraw old-age benefits.	Raised to target benefits on those most at risk of outliving pre-retirement savings.

To the extent, however, that the current general-fund subsidies are either precedential or undermine perceptions of Social Security as an earned benefit, they could mean an end to political dynamics that historically have rendered Social Security unique, prompting renewed consideration of policy options traditionally applied only to what have been popularly thought of as welfare programs.

Understanding Social Security Benefit Adequacy: Why Benefit Growth Should Be Slowed

This article was originally published at E21 on January 31, 2013.

This is probably one of the more important pieces in this collection, insofar as it draws on substantial research performed for the Mercatus Center, presenting Social Security benefit information not widely available elsewhere. Often lost in the recurring debate over whether and how to adjust Social Security benefit schedules is a broader explanation of the speed at which benefits grow already under current law. Many people are vaguely aware that Social Security benefits are indexed to grow automatically in some way, but discussions of proposed reforms still foster the misimpressions that changes would result in "cuts" from current benefit levels or reductions relative to the rising cost of living. Neither perception is typically accurate.

The piece explained three phenomena concerning Social Security benefits: first, that the rate of benefit growth is already sufficiently rapid that the burden of financing its costs causes worker standards of living to decline relative to retirement benefits; second, that current policy pushes low-income people into suboptimal choices with respect to savings and workforce participation; and third, that Social Security over time pays rising benefits for a given real wage level. Thus, as the piece notes, the program's benefit formula implicitly reflects a highly questionable value judgment that "as society grows generally richer, the federal safety net should expand so that benefits for workers with a given real wage level automatically become more generous." The system operates counter to the value judgment many people make instinctively, that poorer people need more government assistance, and thus that a wealthier society should need less.

MANY FEDERAL POLICYMAKERS ARE AWARE THAT THE SOCIAL Security program faces a substantial financing shortfall requiring correction.[1] Correction would involve either increasing program taxes or slowing the growth of benefits—most likely both, given the size to which the shortfall

1. Social Security and Medicare Boards of Trustees, "A Summary of the 2013 Annual Reports," 2013, Social Security Administration, https://www.ssa.gov/OACT/TRSUM/2013/index.html.

has already grown in addition to the fact that neither party enjoys sufficient political power to impose its preferred solution on the other.

Social Security tax increases and benefit growth restraints are both politically unattractive; but at least one or the other is necessary to balance the program's books if we intend to maintain Social Security as a self-financing program. Tax increases have obvious downsides that I have written about elsewhere and are not the subject of this article.[2] The consequences of slowing benefit growth also concern many policymakers—specifically, whether Social Security can continue to offer adequate income protections if current benefit growth schedules are slowed.

As it turns out, however, it is not only possible to preserve Social Security benefit adequacy while slowing benefit growth, it is actually necessary if policymakers wish to avoid forcing participants into sub-optimal outcomes.[3] This is good news, suggesting that Social Security cost restraints may embody a rare "win-win" policy opportunity. By slowing benefit growth, lawmakers can improve not only system finances, but the treatment of individual participants as well.

Background: Replacement Rates

To fully understand the issue of Social Security benefit adequacy, some familiarity is required with the "replacement rate" concept. Very loosely, a replacement rate is the ratio of one's post-retirement to pre-retirement income. Financial planners often invoke the concept when advising individuals on how much to save for their retirement. A typical financial planner might suggest that retirement income needs to be at least 70%–80% of pre-retirement income to maintain a consistent standard of living.

The current Social Security benefit formula is designed to hold replacement rates constant across time for certain similarly situated workers (as I will show, a very important specification) if benefits are claimed at the normal retirement age (NRA). To accomplish this, benefits are indexed under current law to grow with the national average wage index from one class of retirees

2. Charles Blahous, "Why Raising Social Security's Tax Cap Wouldn't Eliminate Its Shortfall," E21 (Manhattan Institute for Policy Research), April 12, 2011.

3. Charles Blahous, "Understanding Social Security Benefit Adequacy: Myths and Realities of Social Security Replacement Rates" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012).

to the next. Since wages tend to rise over time relative to price inflation (CPI), this formula produces benefits that grow faster than consumer prices. (This wage-indexing of the initial benefit formula should not be confused with the often-discussed issue of what version of CPI should be used to calculate annual Social Security cost-of-living adjustments).[4]

Occasionally it is mistakenly said that Social Security benefits are scheduled to "decline" because under current law replacement rates at a fixed age, such as 65, will decrease.[5] This is not actually a benefit decline but an artifact of the fact that under current law Social Security's NRA will rise gradually to 67 by the early 2020s. Thus, individuals who retire at 65 thereafter will be subject to the reduction applied to early retirement benefits.

Calculating replacement rates at age 65 is clearly not the right way to measure benefit adequacy when the NRA is rising to 67. The scheduled NRA increase reflects a policy reality that, as Americans live longer lives, the optimal age for entering retirement also rises; no sensible retirement planning strategy calibrates benefits at a forever-unchanging retirement age without taking into account how long individuals are expected to live. It also makes little analytical sense to assume the policy goal is to enable individuals to retire at age 65 with a full benefit when lawmakers have deliberately chosen to raise the NRA to 67.

For these and other reasons, Social Security replacement rates—if invoked at all—are properly calculated at the NRA, when the individual is first eligible for full Social Security benefits. From this vantage point, there are a number of reasons why current-law Social Security benefit growth should be slowed, purely from a benefit-equity perspective.

Reason 1: The Current Formula Causes Pre-retirement Standards of Living to Decline Relative to Post-retirement Living Standards

The idea behind the current wage-indexing formula was to preserve benefit equity between generations; that is, to ensure that later cohorts received

4. Charles Blahous, "Reforming CPI: Not a 'Grand Bargain' but a Prudent Reform," E21 (Manhattan Institute for Policy Research), July 12, 2011 (republished in this collection).

5. John A. Turner, "Social Security Financing: Automatic Adjustments to Restore Solvency" (Research Paper #2009-01, AARP Public Policy Institute Pension Policy Center, Washington, DC, February 2009).

benefits that were as high a percentage of their pre-retirement earnings as previous generations did.

This, however, neglects the important factor that as the number of beneficiaries increases, the cost of maintaining wage-indexed benefits imposes larger tax burdens. Table 1 shows the rising cost burden successive generations must carry to fund the current benefit formula. The existing formula does not create income equity; instead it forces later generations to accept relatively lower pre-retirement living standards. It actually causes retirement benefits to grow faster than pre-retirement after-tax income. To correct this requires a reduction in the rate of benefit growth.

Reason 2: Social Security Replacement Rates Are Higher Than Commonly Assumed and Force Many Low-Income Workers into Suboptimal Income and Consumption Patterns

Most financial planners calculate retirement income replacement rates as a percentage of individual earnings prior to retirement. Social Security instead reports replacement rates as a percentage of an obscure and poorly understood figure named the average indexed monthly earnings (AIME), which adjusts one's prior earnings for intervening growth in the average wage index. As a result, Social Security replacement rates are typically around 20 points higher than they are often misunderstood as being—indeed, they are high enough to cause many low-wage workers to have less income while working than they expect after claiming Social Security benefits.

Table 1. Current Social Security Benefit and Cost Schedules

Year worker turns 65	Benefit replacement rate as % of pre-retirement earnings	Approximate Social Security cost burden during working years	Benefit replacement rate as % of after-Social-Security-tax pre-retirement earnings
1985	41.5%	5.9%	44.1%
2020	40.0%	11.8%	45.4%
2055	41.1%	16.2%	49.0%

Andrew Biggs and Glenn Springstead found that when Social Security replacement rates were calculated as done in typical financial planning, and taking into account the sharing of taxes and benefits by married couples, individuals in the lowest income quintile expect Social Security benefits equal to 137% of their pre-retirement earnings (77% for individuals in the second-lowest quintile).[6] This creates obvious disincentives for individuals either to extend their working careers or to engage in discretionary retirement saving. Perhaps most importantly, however, it means that the cost of supporting this level of Social Security benefits forces many low-income individuals to suffer lower living standards when working than they later experience as beneficiaries. Again, to correct this situation would require reductions in the growth of scheduled benefits.

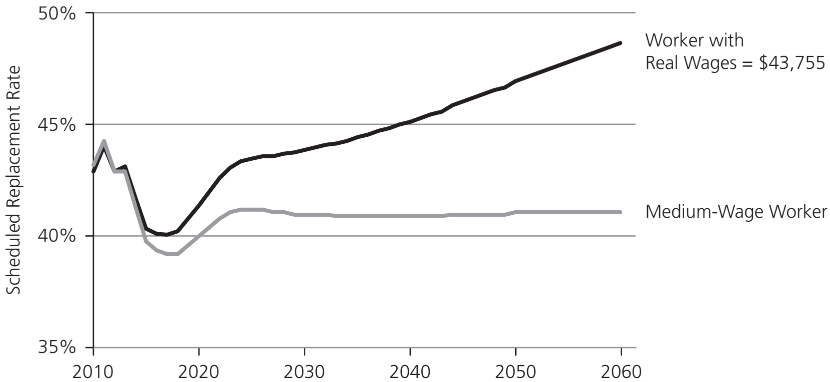
Reason 3: Real (Inflation-Adjusted) Social Security Benefits Are Growing Relative to Real Wages

It is sometimes inaccurately assumed that, because Social Security benefits are tied to wage growth, individuals with the same real wages must receive the same real benefits. This is not true. The current benefit formula causes Social Security replacement rates to rise over time relative to a given level of real wages. It is designed to pay the same replacement rates to so-called "similarly situated workers," not to two workers with the same real wages born in different years. (See figure 1.)

The current Social Security benefit formula implicitly reflects a subjective value judgment that as society grows generally richer, the federal safety net should expand so that benefits for workers with a given real earnings level automatically become more generous. This is clearly not the only value judgment that could be made. One could alternatively argue that a given level of real wages should always return the same level of real benefits. One could just as reasonably argue that as society grows wealthier and more self-sufficient, individuals should receive relatively less in government benefits rather than more, relative to the real value of their Social Security contributions. Under either of these latter approaches, considerable reductions in Social Security benefit growth would be in order.

6. Andrew G. Biggs and Glenn R. Springstead, "Alternate Measures of Replacement Rates for Social Security Benefits and Retirement Income," *Social Security Bulletin* 68, no. 2 (2008).

Figure 1. Scheduled Replacement Rates, Workers Retiring at Normal Retirement Age



Source: Author's calculations based on data from the 2012 Social Security trustees' report.

Policy Corrections

Whether the policy goal is to prevent pre-retirement living standards from declining relative to retirement benefits, to keep from forcing low-wage workers into suboptimal lifetime income patterns, or to maintain a constant relationship between real wages and real benefits, Social Security benefit growth must be slowed substantially. Doing so would not only produce substantial systemic cost savings—e.g., maintaining constant replacement rates for a constant real wage would itself solve the majority of the financing shortfall—it would improve equity across generations.

Perhaps most importantly, a Social Security solution can honor the focus of left-of-center policy advocates on benefit adequacy, while also addressing the cost-containment concerns of right-of-center advocates. The first necessary step in such a discussion is to fully appreciate the limitations of certain common benefit adequacy measures as well as the adverse consequences that arise under current benefit formulas.

For more details, see my November 2012 paper on this subject published with the Mercatus Center.[7]

7. Blahous, "Understanding Social Security Benefit Adequacy."

Don’t Worsen Social Security’s Soaring Cost Problem

This article was originally published at E21 on December 23, 2013.

There are many symptoms of growing political polarization. One of them is the increasing tendency of political parties to adopt positions rendering it more difficult to hammer out reasonable bipartisan compromises to critical national challenges. This article addresses one example—the drive by some advocates to render Social Security’s worsening financial problems even more intractable by increasing benefits above and beyond already-unaffordable schedules. For many years there was a shared bipartisan understanding that the growth of Social Security obligations was outpacing projected revenues, meaning that cost growth must be slowed, revenues must be increased, or some combination of these two actions must be taken. This latest push to expand benefits seeks to redefine the realm of political possibilities so as to shatter this historical bipartisan consensus.

The most obvious problem with proposals to expand Social Security benefits is that all evidence points away from the conclusion that our political system is willing to tax American workers at a level sufficient even to fund now-scheduled benefit obligations. But, as the previous piece details and this piece implies, the policy problems do not end there. Even if benefit growth above and beyond current schedules can be afforded, it would exacerbate a number of serious policy problems—including inequities across generations, imbalances in the treatment of workers and beneficiaries, and workforce participation and saving behavior. One need only look at the many troubled state and local pension plans around the nation to see the inevitable consequences of politicians promising benefits that they have no plan for financing.

FOLLOWERS OF POLITICS MAY HAVE NOTICED A RECENT PUSH FROM the left to expand Social Security benefits above and beyond the current-law growth schedule (which itself remains unfinanced). Such an expansion has received support from MoveOn.org, Paul Krugman, and even some sitting US senators.[1] While expanding a popular program carries an obvious

1. Nick Berning, “New MoveOn.org TV Ad: Let’s Increase Social Security Benefits,” *MoveOn.org*, December 11, 2013; Paul Krugman, “Expanding Social Security,” *New York Times*, November 21, 2013; Greg Sargent, “Elizabeth Warren: Don’t Cut Social Security. Expand It!” *Washington Post*, November 18, 2013.

political utility, any reasonably careful analysis of Social Security reveals the idea to be highly problematic at best. Listed below are 10 factors to bear in mind whenever proposals to change Social Security benefits are discussed.

Factor 1: On the Positive Side, These Proposals Acknowledge That the Social Security Benefit Formula Should Be Changed

Historically, partisan advocates have too often fueled the misperception that any changes to Social Security benefits violate what Americans "paid for" based on the amount of their tax contributions. This is incorrect, as these latest proposals implicitly acknowledge. Over the years the program's benefit formula has changed repeatedly; it does not even attempt to reflect the amounts each worker's contributions have earned. Proof of this lies in the fact that scheduled Social Security benefits exceed the value of total worker contributions by trillions of dollars.[2] Thus, a review of Social Security's benefit formula is a good thing; the question is what changes to it would treat participants more equitably.

Factor 2: Social Security Benefits Are Already Increasing Substantially under Current Law, and Would Continue to Increase under Various Proposals to Maintain Solvency

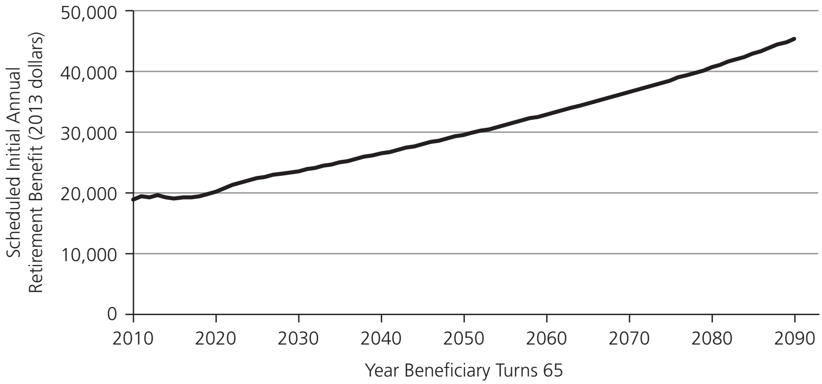
The basic benefit formula is indexed to growth in the average wage index, which tends over time to rise faster than price inflation. As a result, real per-capita Social Security benefits are already rising substantially under current law. Partisans sometimes apply the misleading terminology of "benefit cuts" to proposals to adjust benefit growth to sustainable rates, but the reality is that under virtually any plausible reform scenario, benefits will still rise in real terms relative to what seniors receive today. (See figure 1.)

Factor 3: Unless Current-Law Benefit Increases Are Substantially Slowed, Younger Workers Will Shoulder Unprecedented Cost Burdens

The number of Social Security beneficiaries is increasing dramatically as the large baby boom generation hits the benefit rolls. Paying rising per capita

2. OASDI Board of Trustees, *The 2013 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, May 31, 2013.

Figure 1. Real Social Security Benefits Increase under Current Formula



Note: Calculations are for a scaled medium earner.

benefits to a swelling beneficiary population comes with a heavy price. When the boomers began to hit the rolls in 2008, the cost of financing Social Security benefits amounted to 11.6 cents of each taxable dollar American workers earned. Per figure 2 (from the latest trustees' report), unless benefit growth is slowed the cost of financing scheduled benefits will rise to 17 cents on the dollar by the mid-2030s.[3]

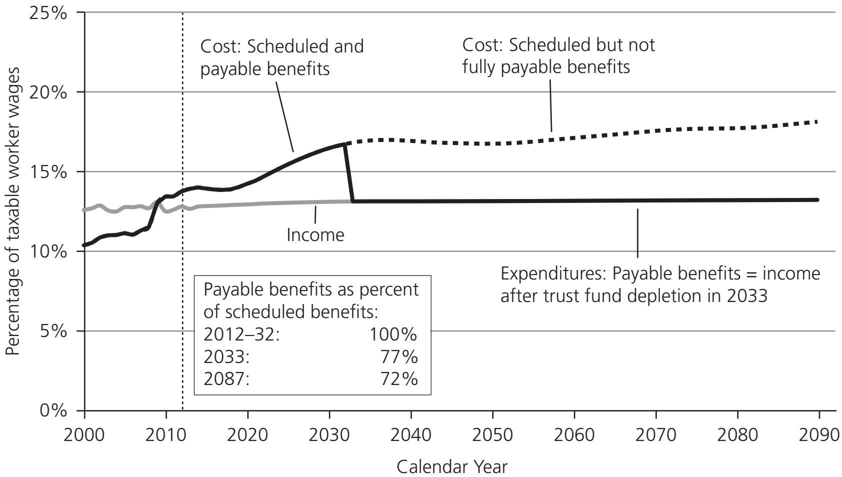
Factor 4: The Left's Latest Proposals Embody a Conscious Effort to Recast the Social Security Debate by Adopting a Policy Position Well Outside of Longstanding Mainstream Opinion

For years, policy analysts have grappled with how to reconcile the growing gap between Social Security's scheduled benefits and the financial resources available to pay for them. Conservatives generally prefer to slow cost growth and progressives to raise taxes, while bipartisan proposals such as Simpson-Bowles land roughly halfway in the middle.[4] By their own account, the

3. OASDI Board of Trustees, *2013 Annual Report*, table VI.F2: "OASDI and HI Annual Income Rates, Cost Rates, and Balances Calendar Years 1970–2090," https://www.ssa.gov/oact/TR/2013/lr6f2.html.

4. Charles Blahous, "In Defense of the Simpson-Bowles Social Security Plan: Part 2," E21 (Manhattan Institute for Policy Research), March 2, 2011.

Figure 2. Social Security Cost and Tax Income



Note: This figure shows hypothetical combined trust funds as a percentage of taxable worker wages.

Source: OASDI Board of Trustees, *The 2013 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds,* May 31, 2013, 12.

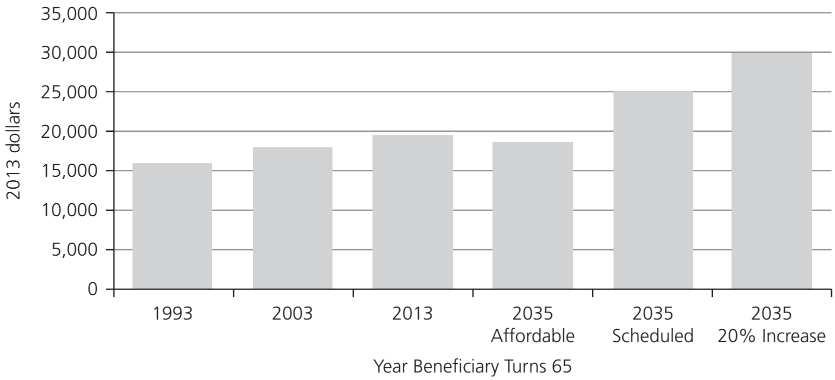
backers of these latest benefit-expansion proposals are trying to reset the Social Security debate by positioning themselves far afield from this bipartisan ground.[5]

Figure 3 gives a sense of how radical this attempted paradigm shift is. Social Security benefits have been growing steadily relative to inflation for many years. Even if Social Security were denied additional tax revenue to maintain solvency, beneficiary standards of living in 2035 would be nearly what they are today; by contrast, the program's scheduled benefit growth could only be funded with a substantial tax increase. Further increasing benefits by, hypothetically, 20% would mean more than a 50% rise in beneficiary living standards by 2035, and would also require workers to provide over 20% of their taxable wages to support one federal program.

In some respects the recent maneuvering repeats the tactic employed with the Affordable Care Act. Prior to the ACA, mainstream analysts had debated how much of the government's enormous healthcare financing

5. Michael Lind, "Take That, Paul Ryan! Elizabeth Warren Beats Back Social Security Plot," *Salon*, December 15, 2013.

Figure 3. Initial Benefits at Normal Retirement Age



Note: Calculations are for a medium wage earner.

shortfall should be closed by raising taxes, and how much by slowing benefit growth. The ACA leapfrogged previous bipartisan discussion by increasing federal health spending commitments even beyond those deemed unaffordable under prior law.[6] That radical shift is one reason why the ACA lacked bipartisan support, why its passage polarized the body politic, and why opposition to it remains entrenched within the political center and Right nearly four years later. Proposals to further increase Social Security benefits represent a similar effort to dismiss bipartisan standards of fiscal responsibility.

Factor 5: Looking Solely at Social Security Benefits Is Uninformative; a Meaningful Analysis Must Compare Both Ends of the Equation—the Taxes Social Security Collects from Workers as Well as the Benefits It Later Pays

This seems obvious, but it is striking how many discussions revolve around the adequacy of Social Security benefits without considering their relationship to the taxes required to finance them.[7] If Social Security benefits could materialize from thin air, then obviously everyone could be made better off by increasing them. But they do not; proposals must therefore be evaluated for whether Social Security benefit levels justify the worker tax burdens associated with them.

6. Congressional Budget Office, *Letter to Speaker of the House John Boehner*, July 24, 2012.
7. Lind, "Take That, Paul Ryan!"

Factor 6: Further Increasing Social Security Benefits Does Not Increase Total Resources Available to Finance Retirement Income

Theoretically, a belief that retirement security is inadequate could justify proposals to increase national retirement saving. But Social Security is not a savings program; to the contrary, most analyses find that Social Security reduces national saving.[8] Accordingly, further increasing Social Security benefits at best simply increases some participants' retirement security at the expense of others'. The important thing to know is whether such additional income transfers would improve or worsen program equity.

Factor 7: Further Increasing Social Security Benefits for Current Participants Would Worsen Existing Inequities

Because of how Social Security is financed (i.e., by having younger generations pay for the benefits of older generations), those now entering employment can expect to lose over 4% of their lifetime wages (net of benefits received) through the program under current law.[9] For younger Americans, the program will lower lifetime income and reduce economic security. These income losses can only be ameliorated if benefit growth is slowed for current participants. If instead current participants' benefits are further increased, younger Americans' net income loss through Social Security will worsen, further undermining the program's long-term efficacy as income protection.

Factor 8: Social Security Benefits and Cost Burdens Are Already Increasing Faster Than Participants' Pre-retirement Income

The growth of per capita benefits in excess of price inflation, coupled with the rising number of beneficiaries, causes workers' Social Security tax burdens to rise over time, reducing their after-tax income. As a result, the current benefit formula causes Social Security retirement benefits to grow faster than pre-retirement income—in effect, steadily depressing pre-retirement living

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8. Congressional Budget Office, "CBO Memorandum on Social Security and Private Saving: A Review of the Empirical Evidence," July 1998.

9. OASDI Board of Trustees, *2013 Annual Report*.

standards relative to post-retirement living standards.[10] Further increasing Social Security benefits would worsen this problem. (See figure 4.)

Factor 9: Social Security Benefits and Costs Have Already Risen to the Point of Destroying Many Individuals' Ability and Incentive to Save

The continual lowering of worker living standards relative to beneficiary living standards is a particular problem for low-income individuals. Andrew G. Biggs and Glenn R. Springstead have shown that individuals in the lowest income quintile experience lower standards of living as taxpaying workers than they expect as Social Security beneficiaries.[11] This creates obvious disincentives for individuals to remain in the workforce, to engage in discretionary saving, and to contribute to economic growth. It is small wonder that recent research has found that many low-income groups have no significant savings at all;[12] this is the predictable result of imposing high tax burdens on limited incomes to support a retirement program that does no saving. Further increasing Social Security benefits and costs would worsen this trend of forcing low-income individuals into lower standards of living as workers than as beneficiaries.

Factor 10: Social Security Benefits Are Already Growing So Fast That Americans' Reliance on Social Security for Retirement Income Increases Even as National Incomes Rise

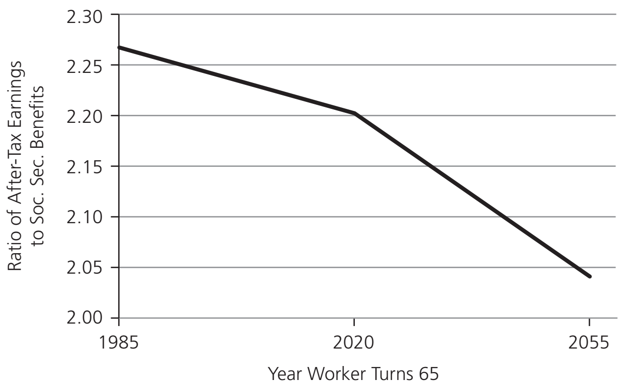
If a central purpose of social insurance programs is to provide protection against need, then logically it follows that a wealthier society should be relatively less dependent on such programs. But that is not what happens under current Social Security law; instead, Social Security is designed to expand automatically as American incomes grow. Specifically, as worker incomes rise, Social Security automatically pays higher benefits for a constant level of worker wages. (See figure 5.)

10. Charles Blahous, "Understanding Social Security Benefit Adequacy: Myths and Realities of Social Security Replacement Rates" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012).

11. Andrew G. Biggs and Glenn R. Springstead, "Alternate Measures of Replacement Rates for Social Security Benefits and Retirement Income," *Social Security Bulletin* 68, no. 2 (2008).

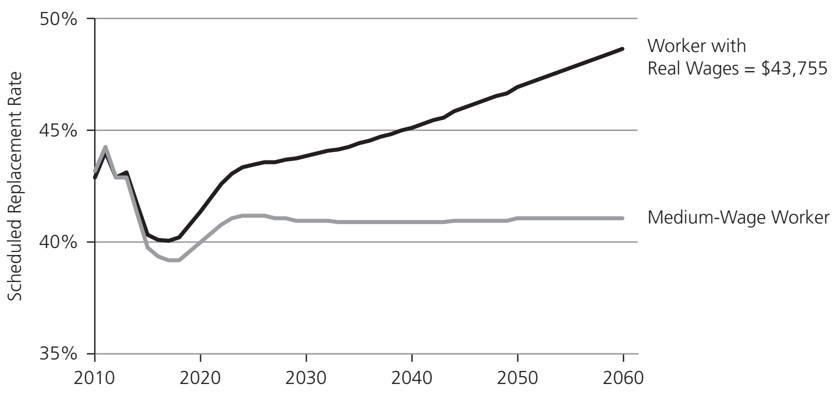
12. Michael A. Fletcher, "Many Blacks, Latinos Have No Retirement Savings, Report Finds," *Washington Post*, December 9, 2013.

Figure 4. Worker Standards of Living Relative to Social Security Benefits



Note: This figure shows career average (wage-adjusted) earnings after Social Security taxes for a medium-wage worker retiring at the normal retirement age.

Figure 5. Social Security's Benefit Formula Causes Benefits to Increase for a Given Real Level of Wages



Note: Calculations are for workers retiring at the normal retirement age.

Source: Author's calculations based on data from the 2012 Social Security trustees' report.

Further increasing Social Security benefits only makes sense if we believe that, as American society grows wealthier, individuals should become more reliant on government and less on their own saving. If we do not believe this, benefit growth should be significantly slowed from current schedules.

Summary

Backers of proposals to expand Social Security benefits acknowledge their intent to recast the Social Security debate to draw new attention to thinking well outside the longstanding spectrum of bipartisan opinion.[13] But there are good reasons why such proposals have not been supported by mainstream Social Security analysts to date. Not only would such a benefit expansion render it still more difficult to maintain Social Security solvency without large, economically damaging tax increases, it would worsen many existing program inequities, depress worker living standards, and further undermine low-income individuals' ability and incentive to put aside savings of their own. Though such proposals may have a superficial political attraction for some, the policy consequences of their actual enactment would be hugely damaging.

13. Lind, "Take That, Paul Ryan!"

Warning: Disability Insurance Is Hitting the Wall

This article was originally published at E21 on January 15, 2015.

Before congressional action in 2015 to shore up the Social Security Disability Insurance (DI) trust fund, I and the other five Social Security trustees had warned of its impending depletion. As the threat grew imminent we intensified these alarms, calling for prompt legislation to shield vulnerable disabled beneficiaries from sudden interruptions in benefit payments.

As trustees, our primary responsibilities pertained to presenting program financial information to lawmakers. Public trustees (of which I was one of two) also performed a more informal role as curators of relevant policy history. This role became more important during this period. In the time leading up to the aforementioned legislation, some advocates had argued that lawmakers should do nothing more than reallocate taxes from Social Security's OASI trust fund to its DI trust fund to paper over the DI shortfall. Some even suggested that this was the standard method historically for dealing with such shortfalls.

These advocates' representations were incorrect. Standalone tax reallocations between the trust funds do not represent the historical norm. To the contrary, past inter-fund tax reallocations typically took place only in the context of other actions to address Social Security's larger financial operations. It would have been an especial departure from precedent to enact a reallocation solely for the purpose of postponing necessary financial corrections. Accordingly, the House of Representatives adopted a rule to ensure that appropriate precedent would be followed, and that Social Security's financial balance would be improved in the course of any tax reallocation. This piece detailed the relevant background on the historical handling of similar situations, emphasizing the positions adopted by our predecessors as public trustees.

FOR YEARS SOCIAL SECURITY'S TRUSTEES (OF WHICH I AM ONE) HAVE warned that lawmakers must act to address the troubled finances of the program's disability insurance trust fund.[1] Congress has nearly run out of time to do so. Legislation will be required during this Congress or, at the

1. Social Security and Medicare Boards of Trustees, "A Summary of the 2014 Annual Reports," 2014, Social Security Administration, https://www.ssa.gov/OACT/TRSUM/2014/index.html.

very latest, in a rush at the beginning of the next one to prevent large, sudden benefit cuts. The House of Representatives recently passed a procedural rule to prepare for the coming legislative debate.[2] In this article I explain the issues in play.

The Problem

The problem in a nutshell is that Social Security's disability trust fund is running out of money. The latest trustees' report projects a reserve depletion date in late 2016. By law, Social Security can only pay benefits if there is a positive balance in the appropriate trust fund. (There are two trust funds: one for old-age and survivors' benefits, the other for disability benefits.) Absent such reserves, incoming taxes provide the only funds that can be spent. Under current projections, by late 2016 there will be only enough tax income to fund 81% of scheduled disability benefits. In other words, without legislation, benefits will be cut by 19%. (See figure 1.)

The Cause

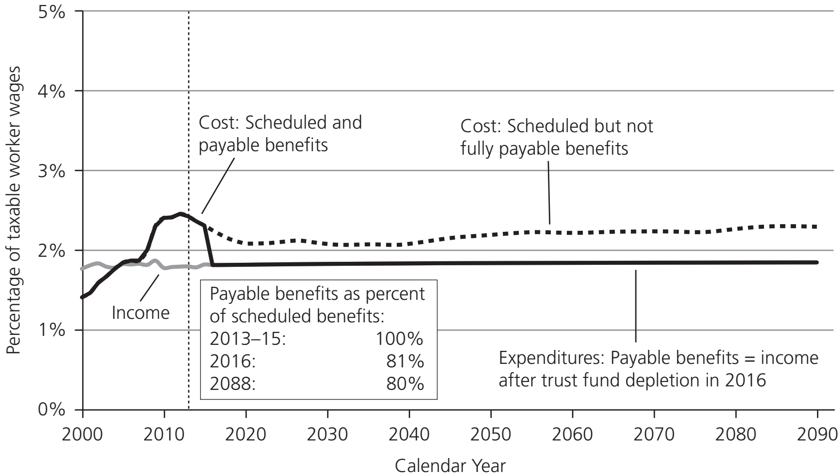
The cause of the problem is that DI costs have grown faster than the program's revenue base. In 1990, the cost of paying DI benefits equaled 1.09% of taxable wages earned by workers. This year the relative cost is more than double that: 2.37% of the tax base. (See figure 2.)

The detailed reasons for the cost increase are beyond the scope of this column. (A good first source on these issues is the Social Security chief actuary.)[3] The biggest reason is the growing number of beneficiaries, though real per capita benefits are also growing. Disabled population growth reflects several factors, including most notably the historically large baby boom generation moving through the ages of peak disability incidence (45–64). In addition, today more women have been employed long enough to be insured for disability benefits than was the case in earlier decades.

2. H. Res. 5 (2015).

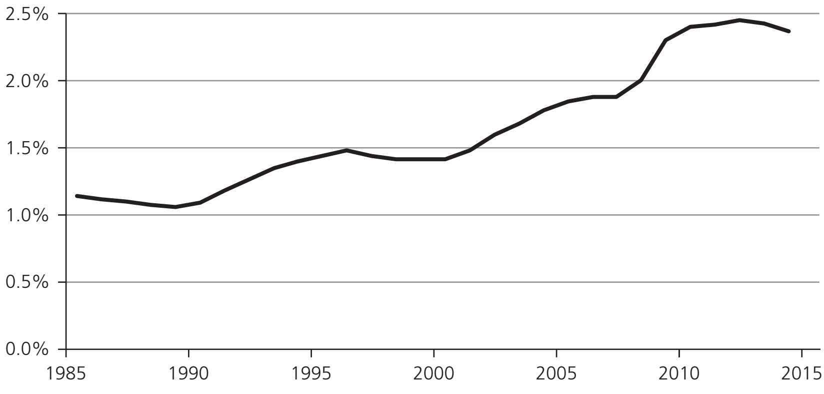
3. Stephen C. Goss, "Statement of Stephen C. Goss, Chief Actuary, Social Security Administration, before the House Committee on Ways and Means, Subcommittee on Social Security," March 14, 2013.

Figure 1. Projected Disability Insurance Income, Cost, and Expenditures as a Percentage of Taxable Worker Wages



Source: Board of Trustees, *The 2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, July 28, 2014, 13.

Figure 2. Disability Insurance Benefit Costs as a Percentage of Taxable Worker Wages



The growth in beneficiaries exceeds prior projections even after taking these factors into account. For example, the chief actuary reports that "the prevalence of disability among insured workers on an age-sex adjusted basis" rose by 42% from 1980 to 2010, even though there is no evidence suggesting that actual disability is much more common than it was 30 years ago. Instead, the rise reflects causes ranging from a liberalization of eligibility criteria in 1984 to a surge in disability benefit applications when unemployment rose during the Great Recession.[4]

Policy Ideals

Let us set aside political considerations from the outset and focus only on good policy. From a pure policy perspective the best solution is comprehensive reform shoring up Social Security financing on both sides (OASI and DI). Annual trustees' reports have made it clear that "lawmakers should address the financial challenges facing Social Security and Medicare as soon as possible" and that "earlier action will also help elected officials minimize adverse impacts on vulnerable populations."[5]

The worsening Social Security shortfall has already grown roughly twice as large as the one corrected with so much difficulty in 1983.[6] Further delay in enacting comprehensive reforms would mean that still larger adjustments to taxes and benefits are required. Procrastinating for much longer worsens the risk that Social Security's shortfall cannot be corrected at all, and that its historical financing structure will eventually have to be abandoned.

The integration of the disability and retirement components of Social Security also warrants a comprehensive response. The two sides use the same basic benefit formula to prevent discontinuities in benefit levels when the disabled reach retirement age. Criteria for benefit eligibility are integrated as well. A failure to address the two sides in tandem runs the risk of creating unintended inequities.

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4. David H. Autor and Mark G. Duggan, "The Rise in the Disability Rolls and the Decline in Unemployment," *Quarterly Journal of Economics* 118, no. 1 (February 2003); Goss, "Statement of Stephen C. Goss."

5. Social Security and Medicare Boards of Trustees, "A Summary of the 2014 Annual Reports," 2014, Social Security Administration, https://www.ssa.gov/OACT/TRSUM/2014/index.html.

6. Charles Blahous, "Is It Becoming Too Late to Fix Social Security's Finances?," E21 (Manhattan Institute for Policy Research), August 31, 2012 (republished in this collection).

Reallocating Taxes Isn't a Fix by Itself

Some have suggested that DI's funding problem be addressed merely by giving DI some of the taxes now going to OASI (currently DI receives 1.8 points of the 12.4% payroll tax, OASI 10.6 points).[7] As I have explained before, this suggests a misdiagnosis of the problem.[8] The problem is not that DI commands too small a share of the tax relative to its obligations; to the contrary, OASI actually faces the larger actuarial imbalance. DI is hitting the wall first largely because the baby boomers hit their peak disability years before their retirement years; it is the first crisis triggered by the unsustainable financing arrangements threatening DI and OASI alike. Transferring funds from OASI to DI would weaken Social Security's retirement component, which is in even worse long-term condition.

Lawmakers face a spectrum of choices. The most responsible and ambitious choice would be comprehensive reform shoring up Social Security as a whole. The most irresponsible (other than doing nothing at all) would be reallocating funds between DI and OASI for the purpose of delaying these necessary reforms, further increasing the risk of the shortfall growing too large to fix. The latter would be a national version of the tactics of avoidance that led to crises in many state pension plans.[9]

Congress must determine the highest point on the responsibility scale at which it can produce legislation. Many outside experts are putting forth proposals to help lawmakers in this effort.[10] The recently passed House rule allows for the full spectrum of responsible options, precluding only the worst outcome of making no net financing improvements whatsoever. Specifically, the rule requires that any tax reallocation occur in the context of broader

7. Shawn Fremstad, "A Simple but Critical Fix Is Needed Now for the Nation's Disability System," *National Journal*, September 11, 2014.

8. Charles Blahous, "A Guide to the 2014 Social Security Trustees Report," E21 (Manhattan Institute for Policy Research), August 4, 2014.

9. *The Economist*, "Illinois Risks Default If It Doesn't Tackle Its Public Pension Crisis," *Business Insider*, December 28, 2014.

10. Rollcall staff, "A Repair Plan for the Social Security Disability Insurance Program," *Roll Call*, September 17, 2014; Bipartisan Policy Center, "Commission on Retirement Security and Personal Savings"; Jason S. Seligman and Jason Fichtner, "Public Disability Insurance Programs in the Context of Pension Reforms," in *Pensions: Policies, New Reforms and Current Challenges*, ed. Thom Reilly, 167–85 (Hauppauge, New York: Nova Science, 2014).

reforms to improve Social Security finances, as recommended by the program's six trustees in our annual message:

> Lawmakers may consider responding to the impending DI Trust Fund reserve depletion, as they did in 1994, solely by reallocating the payroll tax rate between OASI and DI. Such a response might serve to delay DI reforms and much needed financial corrections for OASDI as a whole. However, enactment of a more permanent solution could include a tax reallocation in the short run.[11]

The Historical Record

Some have suggested that a stand-alone payroll tax reallocation would be a routine action in keeping with historical precedent.[12] This reflects substantial confusion about the historical record, which tells a wholly different story.

The last time Social Security taxes were reallocated was 20 years ago, in 1994. The situation then (and surrounding other reallocations) was very different from today. DI costs had risen after the 1984 legislation liberalizing award determinations, rising further during a subsequent recession. Unlike the situation today, DI's actuarial imbalance had then grown rapidly worse than OASI's and much worse than prior projections.

In response to that looming insolvency threat, the program's trustees recommended a number of actions, including a reallocation of taxes from OASI to DI. They were explicit that this proposed tax reallocation was to buy time (specifically, 10 years) to enable comprehensive reforms.

In written testimony before Congress in 1993, the public trustees stated that while comprehensive reforms were the appropriate goal, there was yet "insufficient information to design specific proposals for the long term. . . . The proposed reallocation for the short term will provide the time and opportunity to prepare and enact any needed changes in a careful and orderly manner."[13] The trustee present at the hearing, Stan Ross, cited a "prudent"

11. Social Security and Medicare Boards of Trustees, "A Summary of the 2014 Annual Reports."

12. Michael Hiltzik, "On Day One, the New Congress Launches an Attack on Social Security," *Los Angeles Times*, January 6, 2015.

13. Social Security Board of Trustees Recommendation to Reallocate a Portion of the Social Security Payroll Tax to the Disability Insurance Trust Fund, 103rd Congress (April 22, 1993).

goal "to meet short-term solvency so that both funds meet the 10-year test, and then to work on the long-term problems of both funds."

In their 1994 message, the public trustees again voiced support for a temporary tax reallocation to avoid insolvency projected for 1995, but spent more of their message stressing that the purpose was to buy time for broader reforms:

> The 1994 Report continues to project that the DI fund will be exhausted in 1995. Therefore, we again strongly urge that action be taken as soon as possible to ensure the short-range financial solvency of the DI trust fund. We also strongly urge the prompt completion of the research efforts undertaken by the Administration at the Board's request. This research may assist the Congress as it considers the causes of the rapid growth in disability costs and addresses, as necessary, any substantive changes needed in the program. Disability Insurance under Social Security is nearly 40 years old. While some reforms have taken place over the years, the public is entitled to a thorough policy review of the program. The recent dramatic growth suggests the possibility of larger underlying issues related to the health and employment circumstances of workers and the need for responsive adjustments in the program.[14]

As recommended, lawmakers reallocated OASI/DI taxes in 1994. Rather than treat this as a resolution, the public trustees in their 1995 message made a further point of stressing that the tax reallocation was intended only to buy enough time for lawmakers to analyze, design, and implement comprehensive reforms to control program cost growth:

> While the Congress acted this past year to restore its short-term financial balance, this necessary action should be viewed as only providing time and opportunity to design and implement substantive reforms that can lead to long-term financial stability. The research undertaken at the request of the Board of Trustees, and particularly of the Public Trustees, shows that there are serious design and administrative problems with the DI program. Changes in our society, the workforce and

14. Social Security and Medicare Board of Trustees, "A Message to the Public [Summary of the 1994 Annual Reports of the Social Security and Medicare Trust Funds]."

> our economy suggest that adjustments in the program are needed to control long-range program costs. Also, incentives should be changed and the disability decision process improved in the interests of beneficiaries and taxpayers. We hope that this research will be completed promptly, fully presented to Congress and the public, and that the Congress will take action over the next few years to make this program financially stable over the long term.[15]

Despite these warnings, lawmakers have not yet implemented reforms as recommended by the trustees for several years. To reallocate taxes again in the absence of such reforms would be in direct conflict with the express purpose of the last reallocation. Clearly the last thing intended then was for lawmakers today to simply reallocate the taxes yet again, further postponing necessary reforms until both trust funds are on the precipice of insolvency.

Conclusion

The recently enacted House rule conforms to the guidance repeatedly given by the program's trustees on a bipartisan basis over several years. Those who suggest that DI's impending reserve depletion warrants no action beyond taking revenues away from the Social Security retirement fund appear to be unfamiliar with the basis for the current allocation as enacted in 1994. Lawmakers should begin work now, with the assistance of responsible outside experts, on a bipartisan package of reforms to strengthen the disability program and Social Security as a whole.[16]

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15. Social Security and Medicare Board of Trustees, "A Message to the Public [Summary of the 1995 Annual Reports of the Social Security and Medicare Trust Funds]."

16. Rollcall staff, "Repair Plan."

Future Work Still Needed after Budget's Disability Fix

This article was originally published at E21 on November 2, 2015.

One of the more curious episodes of my public policy career played out in 2016 during Senate consideration of the nominations of my co-trustee Robert Reischauer and myself to serve second terms. Representations were made that I had fought against lawmakers' recent actions to shore up the DI trust fund. This was a bizarrely false allegation, for not only had I not fought against congressional action, I had occasionally taken the lead role among the trustees in calling for it. Indeed, a central portion of my remarks at the 2015 press conference on the annual trustees' reports' release was devoted to calling for legislation to shore up DI. I had also (in the previous piece in this collection) explained why the procedural approach the House had adopted, which governed the contours of the eventual fix, was in keeping with both historical precedent and the recommendations of previous public trustees.

After the fix became law I published this piece, expressing support for the action and explaining how it improved the outlook for DI finances. Yet, even to this day, a quick internet search for my stance on disability policy will turn up several claims that I had fought against the legislation. There isn't a shred of truth to the charge, but this hasn't stopped the story from circulating online.

THE BIPARTISAN BUDGET BILL JUST PASSED BY CONGRESS CONTAINS several provisions affecting Social Security disability insurance (DI) operations as well as Social Security finances generally. The purpose of this piece is to explain key effects of the disability provisions. I will not speak to the merits of the budget deal as a whole, which is already the subject of many others' analysis and commentary.[1]

1. "Budget Deal Truly Offsets Only Half Its Cost," Committee for a Responsible Federal Budget, October 25, 2015.

The details of the disability provisions are complex and likely of interest only to those steeped in Social Security disability policy. So before proceeding to describe them, I will stress three bottom-line conclusions:

1. The provisions represent a slight improvement to disability program operations.
2. The provisions represent a substantial improvement over the likely result if legislative action had been further postponed until nearer to projected DI trust fund depletion in late 2016.
3. Passage puts the program in better condition, but it will rapidly grow worse unless legislators enact further Social Security reforms in short order (e.g., after next year). This worsening has nothing to do with the budget bill provisions. It is because time is the enemy of Social Security finances. Until comprehensive corrections are enacted, the shortfalls facing Social Security, including disability, will continue to grow worse.

Some background may clarify these points.

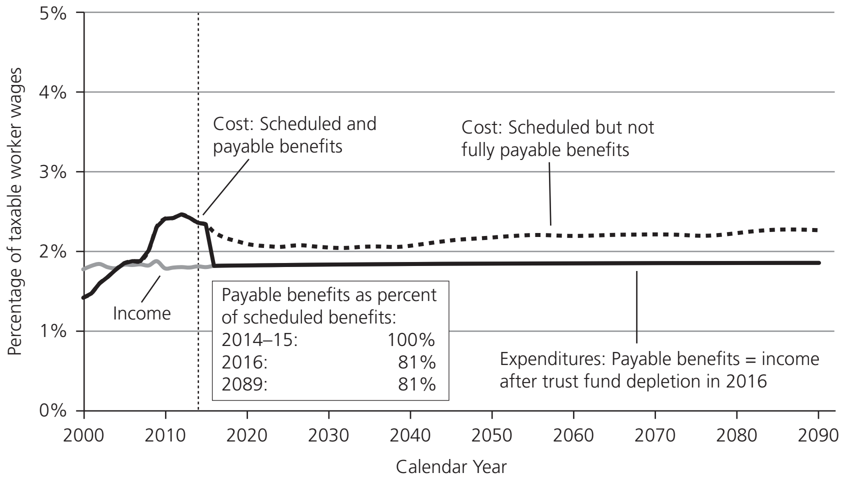
Social Security DI has been running a deficit of tax income relative to benefit spending, forcing the program to draw down the spending authority of its trust fund at a rate that would result in depletion in late 2016. This threatened beneficiaries with sudden benefit reductions of approximately 19%. (See figure 1, reproduced from the 2015 trustees' report.)

Second, while the disability component of Social Security faces insolvency soonest, the program's retirement trust fund is in even worse long-term condition. As I noted in a previous piece, the retirement side "actually faces the larger actuarial imbalance. DI is hitting the wall first largely because the baby boomers hit their peak disability years before their retirement years."[2] Figure 2 (also from the trustees' report) shows shortfalls in Social Security's combined trust funds emerging later but also being larger than those in disability alone. Thus, shifting funds from Social Security's retirement side to its disability side wouldn't by itself fix the underlying problem—it would merely facilitate further delay in dealing with it.

A third critical point is that continued delays would render these problems much more difficult to solve. As I noted in another previous piece, "If

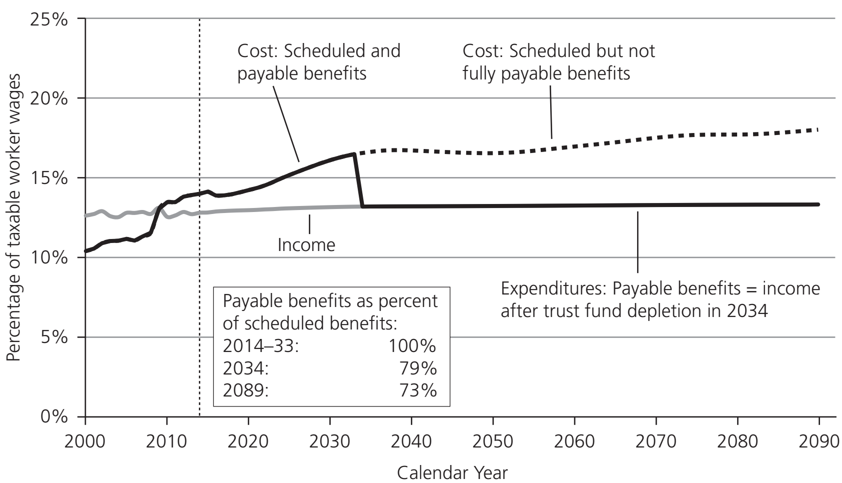
2. Charles Blahous, "Warning: Disability Insurance Is Hitting the Wall," E21 (Manhattan Institute for Policy Research), January 15, 2015 (republished in this collection).

Figure 1. Disability Insurance Income, Cost, and Expenditures as a Percentage of Taxable Wages



Source: OASDI Board of Trustees, *The 2015 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, July 22, 2015, 14.

Figure 2. Social Security Income, Cost, and Expenditures as a Percentage of Taxable Wages



Source: OASDI Board of Trustees, *The 2015 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, July 22, 2015, 13.

legislation enacted today held current [Social Security] beneficiaries harmless, long-range financial balance could be restored by reducing scheduled benefits for future beneficiaries by 19.6%.[3] If, however, such a strategy were attempted after employing delaying tactics until 2034, by then even 100% elimination of benefits for new claimants would be insufficient to avoid depletion of the combined trust funds."[4]

These factors framed a spectrum of choices facing legislators confronting the projected depletion of DI's trust fund next year:

- The most responsible and ideal result—but also the most ambitious and politically difficult—would have been comprehensive legislation shoring up the entirety of Social Security's finances, as last occurred in 1983.
- The worst choice would have been inaction, allowing 11 million Social Security disability beneficiaries to experience interruptions of their benefits, effectively reducing their Social Security income by 19%.
- The second worst choice would have been to do nothing other than paper over the problem for several years into the future by shifting funds between Social Security's accounts. This would irresponsibly allow the shortfalls in disability, and in Social Security as a whole, to grow to the point where they could no longer plausibly be corrected.

Negotiators opted for incrementalism, introducing some slight improvements to program finances while transferring just enough funds between Social Security accounts to ward off a disability financing crisis in the near term, but without sanctioning an extended period of destructive, and potentially fatal, further delays.

Let's now return to and explain the bottom-line conclusions.

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3. OASDI Board of Trustees, *The 2015 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, July 22, 2015.

4. Charles Blahous, "Time Is Running Out to Fix Social Security," E21 (Manhattan Institute for Policy Research), July 28, 2015.

Conclusion 1: The Provisions Represent a Slight Improvement to Disability Program Operations

As seen in the Social Security chief actuary's memorandum on the bill, its dent in Social Security's long-term shortfall is very small (between 1.0% and 1.5%) but there will be some expected improvements in program integrity.[5] The biggest savings come from two provisions. One closed loopholes that had allowed Social Security benefits to be claimed and suspended in ways causing higher-than-intended benefit payments to secondary household beneficiaries. The other would require that the medical portion of disability reviews be completed by an appropriate physician, psychiatrist, or psychologist. Other provisions, not scored as achieving significant savings, would expand the use of electronic payroll data and cooperative disability investigations units to "reduce fraud and overpayments." Still others would allow for demonstration projects aimed at clearing the way for disabled individuals to return to work. It is reasonably possible that these reforms, taken together, could produce more savings than now projected for them, but Social Security's financial shortfalls are far too large to be corrected by such program integrity measures alone.

Importantly, unlike a standalone reallocation of revenues between Social Security's trust funds, this bill would improve both disability and combined Social Security finances without significant weakening of the program's retirement trust fund. The bill does this by generating savings within the retirement trust fund that are roughly comparable to the revenues being shifted to disability (specifically, 0.57% of workers' taxable wages from 2016 to 2018, enough to extend projected DI solvency until 2022).

Conclusion 2: The Provisions Represent a Substantial Improvement over the Likely Result If Legislative Action Had Been Further Delayed

Although the provisions represent only a slight immediate financial improvement, it's important to bear in mind that without action things were about to get worse in a hurry. Disability trust fund depletion and 19% benefit cuts were projected for late 2016—an intolerable result legislators would

5. Stephen C. Goss, Chief Actuary of the Social Security Administration, to John Boehner, Speaker of the House, October 27, 2015.

almost certainly not have permitted. In a last-minute election-year crisis situation, it would likely be prohibitively difficult to legislate reasonable reforms, increasing the risk of simply papering over the problem by shifting funds between Social Security accounts (allowing overall program finances to grow still worse).

The bill's combination of modest reforms and a modest tax reallocation is only a slight improvement over previous law. But it is worlds better than bailing out disability with retirement trust fund revenues with no reforms at all, which is quite possibly where we'd otherwise be headed.

Conclusion 3: After an Initial Improvement, Things Are Going to Get Rapidly Worse Again Unless There Is Prompt Follow-Up Action (Presumably after 2016)

With this bill's passage, it's unlikely Congress will act again on Social Security disability before the 2016 elections. But lawmakers can't afford to wait much longer after that, and certainly not to dither until DI's new projected insolvency date of 2022. Consider, for example, that the budget deal improves Social Security finances by something less than 0.04% of taxable worker wages, whereas the program's long-range shortfall grows by 0.06% of wages every year.[6] Even this understates the actual worsening because, by the time the program's combined trust funds are projected to be insolvent, annual deficits requiring closure look to be well over 3% of taxable worker wages. Given that reasonable proposals to restore long-term solvency tend to reduce annual deficits to not much more than 1% of wages by the 2030s, we basically have less than 20 years to effectuate annual improvements equaling over 2% of wages.[7] In other words, the practical task currently grows more difficult by at least 0.11% of wages every year, an annual worsening roughly triple the improvement in the budget bill. Remember also that the current

6. OASDI Board of Trustees, *The 2015 Annual Report*, table IV.B7, "Reasons for Change in the 75-Year Actuarial Balance, Based on Intermediate Assumptions," https://www.ssa.gov/oact/TR/2015/IV_B_LRest.html#219298.

7. Stephen C. Goss, Chief Actuary of the Social Security Administration, Alice H. Wade, Deputy Chief Actuary, and Christopher J. Chaplain, Supervisory Actuary, to Kay Bailey Hutchison, US Senator, October 27, 2015.

shortfall is already substantially larger than the one closed with so much difficulty in 1983. Clearly we don't have further time to waste.[8]

Brokering a comprehensive solution to Social Security's financing shortfalls will be difficult. At the same time, there is clearly still some low-hanging fruit available. For example, President Obama's proposal to prevent double-dipping in DI and unemployment insurance benefits, also supported by Congressman Sam Johnson and Senator Orrin Hatch, remains out there to be enacted.[9] (Disability benefits are intended only for those who cannot engage in meaningful employment, whereas unemployment benefits are supposed to be available only to those currently searching for work; the two programs are drawn up such that individuals should only be able to receive from one or the other.) Again, however, savings from such program integrity provisions would be modest.

In sum, the budget deal slightly improves the outlook for Social Security disability. Things will shortly resume worsening, however, requiring legislators to return to this vital work after 2016.

8. Charles Blahous, "A Guide to the 2014 Social Security Trustees Report," E21 (Manhattan Institute for Policy Research), January 15, 2015.

9. Ian Smith, "Lawmakers Want to Stop 'Double Dipping' of Disability Benefits," *FedSmith.com*, February 13, 2015; Orrin Hatch, US Senator, "Hatch, Johnson, Ryan Introduce Bill to Prevent 'Double Dipping' in Disability Benefits," February 12, 2015.

How Social Security's COLA Politics Leads to Bad Policy

This article was originally published at E21 on November 22, 2015.

This piece might seem comparatively dry, but some policymakers have pointed to it as especially useful given recurring political difficulties surrounding annual cost-of-living adjustments (COLAs) to Social Security benefit levels. As many readers may know, each year Social Security benefit levels are automatically adjusted for changes in national price inflation as reflected in the consumer price index (CPI). That much is relatively straightforward and broadly understood. But the law also contains a number of counterintuitive, arbitrary, and problematic connections between the annual COLA calculation and several other features of Social Security and Medicare operations.

In general, when the Social Security COLA is small or (on rare occasion) zero, this a signal to a number of special interest groups to complain loudly and demand additional compensation for seniors. Yet, as this piece explains, for a number of quirky reasons years without COLAs are actually more good for seniors than bad. Such years produce some strange results that are perhaps undesirable from a larger policy perspective, but they do not harm most seniors.

ON OCTOBER 15, 2015, THE SOCIAL SECURITY ADMINISTRATION announced that there would be no cost-of-living adjustment for 2016.[1] Many perceived this as signifying a hardship for seniors.[2] Lawmakers afterward included a provision in the budget deal to prevent some seniors from facing huge Medicare premium increases, which were among the perverse effects that otherwise would have arisen from the zero COLA.[3] This piece explains the basics of Social Security COLAs, as well as how zero-COLA years can lead to confused politics and strange policy.

1. LaVenia J. LaVelle, *Law Does Not Provide for a Social Security Cost-of-Living Adjustment for 2016* (Washington, DC: Social Security Administration, 2015).

2. Nancy LeaMond, "With No COLA Increase, Congress Should Pass Medicare Fix," AARP, October 15, 2015.

3. House Amendment to the Senate Amendment to H.R. 1314, Offered by Mr. Boehner of Ohio (2015); Bipartisan Budget Act of 2015, Pub. L. No. 114-74, 129 Stat. 584 (2015).

How COLAs Work

The annual Social Security COLA is calculated by comparing the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) in the third quarter of the most recent year to its level in the third quarter of the previous year.[4] CPI-W is just one of multiple measures of general price inflation maintained by the Bureau of Labor Statistics.[5] Most economists believe it is less accurate than other measures, including the Chained Consumer Price Index for All Urban Consumers (C-CPI-U).[6] It just so happened that Social Security COLAs were first established in law before the other, more refined measures were developed.[7]

Other quirks of law surround Social Security COLAs. One is that when there is no COLA, neither is there an increase in the amount of wages subject to the Social Security payroll tax—even though normally the automatic annual tax base increases are computed differently from the COLA or CPI.[8]

Another provision of law (the so-called "hold harmless" provision) prevents most beneficiaries' monthly Social Security benefit checks, net of Medicare Part B premiums, from declining. This means that whenever there is a zero-COLA year, roughly 70% of seniors do not face a Medicare premium increase even though their benefit costs have likely gone up.[9] Under law, the resulting revenue loss to Medicare is supposed to be made up by higher premiums from high-income seniors and on behalf of low-income seniors (whose premiums are paid for them under Medicaid by the states). This in turn can mean huge premium increases for a minority of seniors on opposite ends of the income spectrum, as would otherwise have happened this year. These various provisions do not add up to a coherent policy, but rather

4. Social Security Administration, "Average CPI by Quarter and Year," https://www.ssa.gov/oact/STATS/avgcpi.html.

5. Stephen B. Reed and Kenneth J. Stewart, "Why Does BLS Provide Both the CPI-W and CPI-U?," *Bureau of Labor Statistics: Beyond the Numbers* 3, no. 5 (2014).

6. US Bureau of Labor Statistics, "Table 5. Chained Consumer Price Index for All Urban Consumers (C-CPI-U) and the Consumer Price Index for All Urban Consumers (CPI-U): U.S. City Average, All Items Index," https://www.bls.gov/news.release/cpi.t05.htm.

7. Social Security Administration, "Cost-of-Living Adjustment (COLA) Information," https://www.ssa.gov/news/cola/; Marc Goldwein, Jason Peuquet, and Adam Rosenberg, *Measuring Up: The Case for the Chained CPI* (Washington, DC: Committee for a Responsible Federal Budget, March 19, 2013).

8. Social Security Administration, "Cost-of-Living Adjustments (COLA) Information."

9. Social Security Administration, "Cost-of-Living Adjustments (COLA) Information."

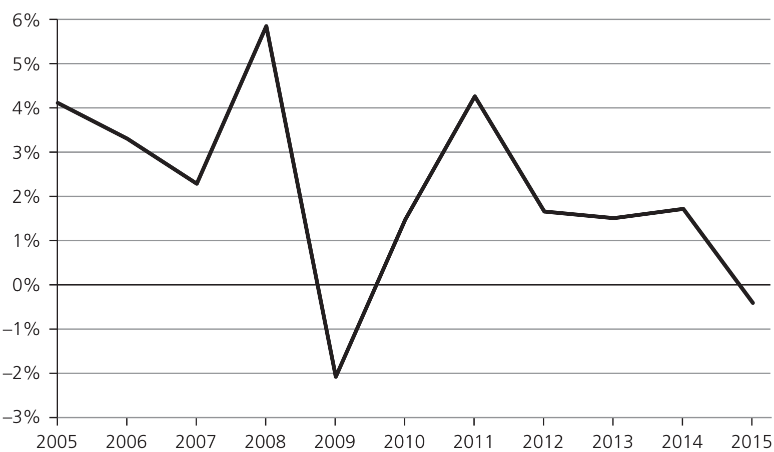
embody a patchwork of responses to the perceived policy and political challenges that accompany zero-COLA years.

Zero COLAs Are Usually More Good Than Bad for Seniors, Part 1

Despite what advocacy groups often say, a year without a COLA usually reflects a situation more good than bad for seniors. This is because there is no provision in law allowing for a negative COLA. Thus, if prices rise by a large amount one year but fall the next, beneficiaries get a large COLA after the first year but no reduction for the second year. This means that seniors receive higher benefit payments than they would have if current price levels had instead been reached via persistent, regular price inflation. Seniors continue to receive these higher payments in a lower-price environment, with this (usually very small) bonus never taken away.

As figure 1 shows, prices typically rise by a small percentage each year. But in 2015 prices (per CPI-W) have gone down slightly, modestly increasing beneficiaries' purchasing power. A similar, but more extreme, situation previously arose in the 2008–2011 period. Prices rose swiftly in 2008, producing a large COLA for 2009 even though prices went down during that year. Prices didn't return to 2008 levels until 2011 because the increase in 2010

Figure 1. Annual Percentage Change in CPI-W



was not as great as the decrease in 2009 had been. As a result, the purchasing power of Social Security benefits outpaced inflation during that period.

Zero COLAs Are Usually More Good Than Bad for Seniors, Part 2

As mentioned earlier, under law Medicare Part B premiums can't rise for most beneficiaries whenever there is no COLA. This is a clear advantage to seniors, who receive benefits of higher value without paying higher premiums.

Our Political Discussion Often Confuses the Concepts of Prices, Costs, and Spending

Economists generally agree that CPI-W overstates price inflation relative to a chained index such as C-CPI-U.[10] Yet whenever the annual COLA is zero or quite small, longstanding arguments reemerge that CPI-W actually understates price inflation as experienced by seniors. AARP, for example, has argued that an experimental senior price index (CPI-E) would be better, saying that CPI-W "does not accurately represent the buying habits of seniors," largely because seniors spend more of their income on healthcare, where costs tend to rise more rapidly.[11]

Much of this discussion confuses the different concepts of prices, costs, and spending. COLAs are intended to reflect price changes rather than other factors that increase total costs. Indeed, much healthcare cost growth does not arise from price inflation but rather from the adoption of new technologies.

In general, whether we spend more on any area depends on many factors other than prices. This year you might spend a lot more on plumbing services than you did last year—but not necessarily because the plumber's prices went up. Instead, this may simply reflect your greater need for plumbing services, or the plumber having new services to offer. The fact that seniors spend more on healthcare as technology progresses in response to their growing needs is indeed an important policy concern. But how much to help seniors afford

10. There isn't space in this piece to review the details, but the Committee for a Responsible Federal Budget explains some: see Goldwein, Peuquet, and Rosenberg, *Measuring Up.*

11. Nancy LeaMond, "With No COLA Increase, Congress Should Pass Medicare Fix," AARP, October 15, 2015.

rising healthcare costs is primarily an income support issue or a healthcare policy issue. It is not primarily an issue of price inflation measurement.

Our Perplexing System for Assessing Medicare Part B Premiums Makes It Difficult to Construct Sensible Policy

As earlier noted, whenever there is no COLA, about 70% of Medicare beneficiaries are excused from financing a proportionate share of program cost increases. Under law the revenue loss is to be made up by assessing higher premiums on those who are not so excused: low-income beneficiaries (whose premiums are paid by Medicaid) and higher-income beneficiaries (who pay larger income-related premiums).

In 2015 the premium hikes would have been enormous had Congress not acted. The trustees' report contains an estimate that the relevant premium would have had to rise from $104.90 to $159.30 even without accounting for the still-higher premiums facing those on the high-income end.[12] Joseph Antos has estimated that monthly premiums would have risen to over $500 in the top bracket.[13]

Faced with this situation, lawmakers acted to limit the standard premium to about $120 (higher-income beneficiaries will still pay substantially more). The revenue loss resulting from the premium relief would jeopardize program finances, so lawmakers enacted a loan to Medicare from the general Treasury, charging affected beneficiaries an additional $3 a month until the loan is repaid.[14]

If you are confused by all this, you're not alone. Medicare costs keep rising even in a zero-COLA year, but the law's complexities make it very difficult to discern who pays for them. Most beneficiaries aren't doing so, due to the hold-harmless provision. Lawmakers also just excused high-income beneficiaries from much of the burden of doing so. High-income seniors will still pick up a bit of the cost, as will states (through Medicaid), which will then pass the cost on to their residents in various hard-to-track ways. Some of the

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12. Medicare Board of Trustees, *2015 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, July 22, 2015.

13. Joseph Antos, "No Medicare Premium Spike . . . for Now," *US News and World Report*, October 29, 2015.

14. Bipartisan Budget Act of 2015.

rest is being picked up by loans from the general US Treasury—for which all Americans must pay, though none of us knows our own share. None of this is a recipe for transparency.

The policy ideal would be a Medicare system in which costs do not rise faster than the ability of senior premium payers to bear. This would require tough decisions about fundamental reforms, eligibility rules, and benefit growth rates that the body politic has thus far been unwilling to make. Failing this ideal, the next best outcome would be a system in which beneficiaries and taxpayers each shoulder an appropriate and transparent proportionate share of rising program costs. But this in turn would mean Social Security checks net of premium payments declining in some years, the optics of which have long made for prohibitive politics. As a result, the opaque and seemingly arbitrary process of Medicare premium setting is likely to continue for some time.

A Balanced Bipartisan Compromise for Strengthening Retirement Security

This article was originally published at E21 on June 23, 2016.

Good policy writing should generally focus on educational information rather than commentary, for the simple reason that the author's subjective policy views are no better than anyone else's. This piece nevertheless seemed worth publishing as a demonstration of how a reasonably designed bipartisan Social Security financing solution might be constructed. For roughly two years I had worked with a commission convened by the Bipartisan Policy Center (BPC) on a package of retirement security policy recommendations. The work was arduous and time-consuming, but was made fulfilling by the skilled bipartisan leadership of Kent Conrad and James Lockhart.

Retirement policy considerations aside, the commission experience was instructive of how successful negotiations can be conducted among a diverse array of experts embodying a wide spectrum of views. Adroit leaders such as Conrad and Lockhart listen carefully to where everyone is coming from and fashion a compromise reflecting the areas of common ground.

THE BIPARTISAN POLICY CENTER'S *SECURING OUR FINANCIAL FUTURE* report offers a new set of recommendations to strengthen Americans' retirement income security.[1] The report was developed by the BPC's 19-member Commission on Retirement Security and Personal Savings, cochaired by former Senator Kent Conrad (D-ND) and James Lockhart, former principal deputy commissioner of the Social Security Administration. I served as one of the commission members and was deeply impressed by the cochairs'

1. Commission on Retirement Security and Personal Savings, *Securing Our Financial Future: Report of BPC's Commission on Retirement Security and Personal Savings* (Washington, DC: Bipartisan Policy Center, June 2016). See especially the executive summary. See also the useful compendium of graphical information about the recommendations at Bipartisan Policy Center, "The 6 Challenges to Retirement Security," https://bipartisanpolicy.org/the-6-challenges-to-retirement-security/; as well as the video at the Bipartisan Policy Center website, "Securing Our Financial Future: Report of the Commission on Retirement Security and Personal Savings," June 9, 2016, https://bipartisanpolicy.org/report/retirement-security/.

leadership and process acumen, as well as by the other commission members and an exceptionally capable team of staff.

As the commission included experts holding a wide range of policy views, a consensus report was only possible because its work was relentlessly data-driven, and because the cochairs skillfully incorporated input from the entire commission to forge balanced compromise. It is fashionable in political circles to characterize genuine compromise as containing something for everyone to dislike; a more accurate description in this case is that compromise would lead to far better results than either Left or Right would receive under the status quo.

The commission's recommendations were organized into six main themes:

1. Improve access to workplace retirement savings plans, largely by making it easier for employers to offer plans and to enroll workers in them, and by simplifying the decisions facing participants.
2. Promote personal savings for short-term needs and preserve retirement savings for older age, largely by making it easier for workers to manage, shift, and maintain savings among their various retirement accounts.
3. Reduce the risk of outliving savings, largely by facilitating the offering of retirement plan distribution options that would provide income over a retiree's full lifetime.
4. Facilitate the use of home equity for retirement consumption, largely through the use of reverse mortgages.
5. Improve financial capability among all Americans, largely by implementing the recommendations of the President's Advisory Council on Financial Capability and by clarifying the nomenclature used in key government programs such as Social Security.
6. Strengthen Social Security's finances and modernize the program by balancing its income and expenditures and by targeting its benefits more directly at needy households.

The commission report provides full details of the recommendations in all six areas.[2] Here I will focus on Social Security, where my expertise is

2. Commission on Retirement Security and Personal Savings, *Securing Our Financial Future.*

concentrated. The BPC Social Security recommendations involve far more details than can be covered here. However, they can be roughly defined by the following general parameters.

Parameter 1

The proposals would strengthen Social Security finances through a roughly 50–50 blend of changes to revenues and costs (per the Social Security chief actuary, 54% revenues vs. 46% cost containment).[3] Under current law, per Urban Institute projections, Social Security costs would rise from 4.8% of GDP today to roughly 6.2% of GDP by 2034 when the program's combined trust funds would be depleted and benefits reduced by roughly 22%. Afterward the financing gap would continue to grow, with eventual costs (6.4% of GDP) being only 73% funded by income (4.7% of GDP) at the end of the valuation period. Under the commission proposals, costs would instead rise more gradually to 5.8% of GDP (at the peak of baby boomer retirements in the mid-2030s) and stabilize thereafter, hovering around 5.5% of GDP for most of the mid-21st century. The biggest revenue changes would be increases in the Social Security payroll tax rate (from 12.4% to 13.4%) and wage base (to $195,000 by 2020). The biggest cost containment mechanism would be a gradual indexing of the normal retirement age to national longevity gains, raising it by one month every two years starting in 2022. Per convention, this was counted by the commission as a benefit constraint—although in practice, an individual receives higher annual benefits if he or she delays his or her initial benefit claim. The second largest cost containment provision would be to link annual COLAs to the chained consumer price index (C-CPI-U), so that they more closely track national price inflation. (See figure 1.)

Parameter 2

Under the commission proposals, real per capita benefits would grow substantially. Under current law, program costs would grow at rates beyond what revenues can finance, resulting in sudden benefit reductions upon

3. Stephen C. Goss, Chief Actuary of the Social Security Administration, to Kent Conrad and James B. Lockhart III, Cochairs of the Commission on Retirement Security and Personal Savings at the Bipartisan Policy Center, June 9, 2016.

trust fund depletion. Under the commission proposals, individuals would be spared these benefit reductions, allowing seniors' Social Security benefits and total disposable income to both grow steadily relative to price inflation. (See figure 2.)

Figure 1. After the Baby Boomers Retire, the Commission Proposals Would Stabilize Social Security Costs/Revenues as a Share of GDP

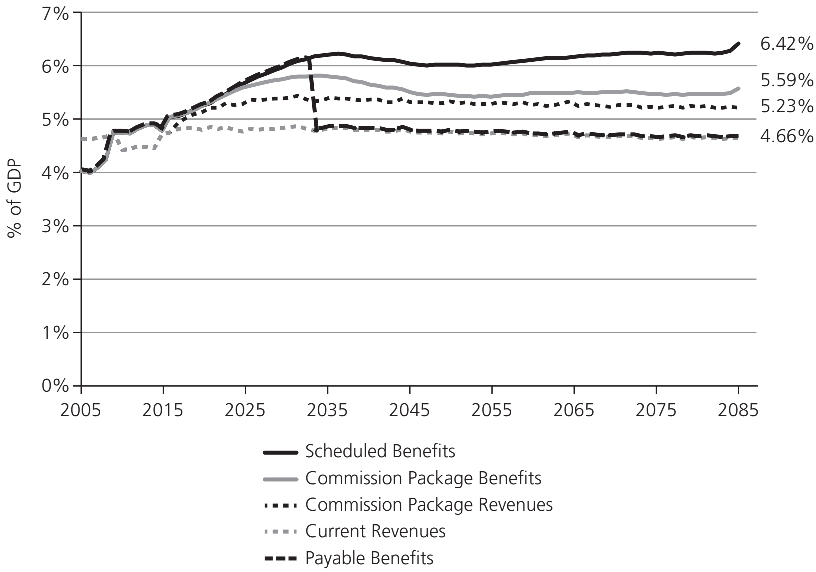
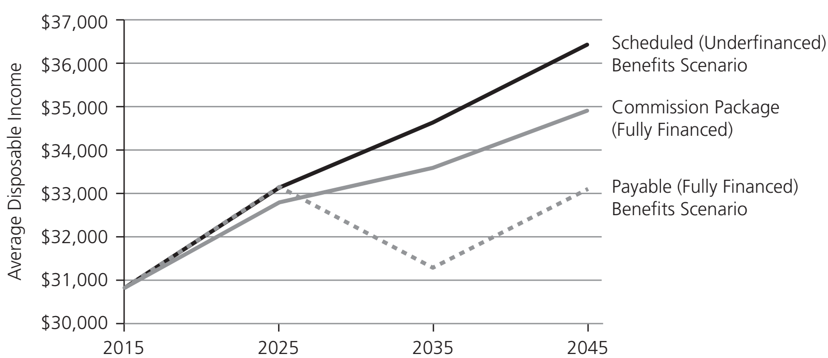


Figure 2. Projected Average Disposable Income (in 2015 Dollars) for Individuals 62 and Older



Parameter 3

The commission proposals would target benefit growth on low-income households and significantly reduce elderly poverty. For example, a two-earner couple born in 1993, in the bottom income quintile, working for 40 years with equal earnings would receive benefits 63% higher than could be paid under current law. Those in the second income quintile would receive a 49% benefit increase. Not only would these benefits be substantially higher than could be paid under current law, they are even higher (24% and 12% higher, respectively) than the current-law benefit formula that is significantly underfunded. Because of this faster benefit growth for low-income households, senior poverty levels would be substantially lower under the commission proposals, not only relative to current law but even relative to an imaginary scenario in which all Social Security's currently unfinanced benefits were somehow fully funded. (See figure 3 and table 1.)

Parameter 4

Returns on work would be higher under the commission proposals. It is often extremely difficult to design proposals that would provide substantial support

Figure 3. Senior Poverty Would Be Markedly Reduced under the Commission Proposals

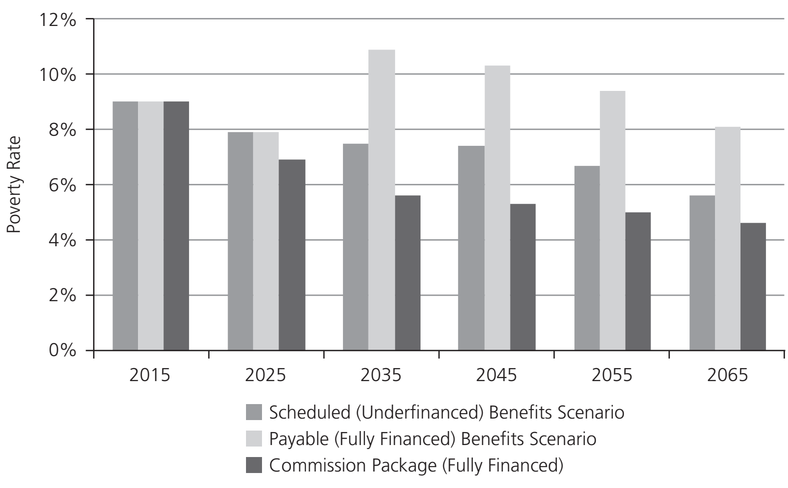


Table 1. Projected Lifetime Social Security/SSI Benefits for Workers Born in 1993

	Commission Proposals Relative to Benefits Payable under Current Social Security Law									
	Single individual					Two-earner couple (equal earnings)				
Work years	Bottom quintile	2nd quintile	3rd quintile	4th quintile	Top quintile	Bottom quintile	2nd quintile	3rd quintile	4th quintile	Top quintile
25	153%	156%	145%	127%	85%	152%	137%	127%	115%	81%
30	159%	156%	139%	120%	88%	151%	137%	127%	116%	90%
35	166%	153%	135%	118%	94%	153%	138%	131%	120%	98%
40	175%	158%	140%	125%	103%	163%	149%	142%	130%	108%
45	168%	147%	140%	128%	105%	159%	152%	147%	135%	110%

for low-income individuals while also providing adequate returns as individuals engage in paid employment. Table 1, however, shows that throughout the income spectrum, individuals would receive larger increases under the proposals the more years that they work. This is in sharp contrast with current law, in which returns on work decline dramatically for seniors, at precisely the point in their lives when they must make decisions about whether to remain in the workforce.[4] The commission proposals would accomplish this by reforming the benefit formula to accrue benefits with additional years of work rather than basing benefit levels solely on career average earnings.

Conclusion

The BPC retirement security commission proposals reflect a roughly 50–50 compromise between Left and Right as to how to shore up the finances of Social Security. All program participants would benefit from the stabilization of program finances, with the largest gains accruing to low-wage workers.

4. Charles Blahous, *Social Security: The Unfinished Work* (Stanford, CA: Hoover Institution Press, 2010).

Stabilizing Social Security without Raising Taxes

This article was originally published at E21 on January 4, 2017.

This piece can be thought of as a sort of companion to the previous one. Whereas the previous piece described a compromise Social Security financing plan as it emerged from two years of bipartisan negotiations, this one shows how a proposal might look if it reflected a particular viewpoint—in this case, former Representative Sam Johnson's goal to repair Social Security finances without imposing a tax increase.

This piece also walks through the general value judgments that must be made while putting together any Social Security reform package and explains where Johnson's proposal falls on the spectra of available choices.

THE INCOMING CONGRESS AND TRUMP ADMINISTRATION HAVE THEIR hands full with an ambitious economic policy agenda topped by, among other things, repealing and replacing the Affordable Care Act. However, a recent report by the Congressional Budget Office reminds us also of the worsening financial condition of Social Security, as did the annual trustees' report earlier this year.[1] This month Congressman Sam Johnson, chairman of the House Ways and Means Social Security Subcommittee, offered a detailed proposal to tackle the problem.[2]

Social Security reform proposals can be quite complex. It is often helpful to understand them in terms of the bottom-line value judgments they reflect. This article attempts to explain the Johnson proposal in those terms.

1. Congressional Budget Office, *CBO's 2016 Long-Term Projections for Social Security: Additional Information*, December 2016; OASDI Board of Trustees, *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, June 22, 2016.

2. Stephen C. Goss, Chief Actuary of the Social Security Administration, to Sam Johnson, Chairman of the Committee on Ways and Means, Subcommittee on Social Security, December 8, 2016.

Value Judgment 1: The Total Sacrifices Required

This list begins with a trick entry. The total changes required to restore Social Security to financial balance do not actually embody a discretionary judgment. The Social Security shortfall is what it is; legislators can choose how to allocate the effects of closing it, but can't control the magnitude of the required corrections. When critics attack reform proposals for the hardships they allegedly inflict, they are being disingenuous in that any workable plan must require equally stringent measures.[3] If a plan makes fewer changes to benefits, it must make up the difference with larger tax increases. If a plan seems to require fewer corrections overall, it merely means additional income losses will be imposed on participants later that aren't yet being disclosed.

There's really only one way policymakers can affect the total measures required: by choosing when to act. Assuming we're not going to go back and cut benefits for people already collecting them, continued delay means greater income losses for those affected by measures required to maintain solvency. Thus, no one who offers a plan for action can rightly be blamed for imposing undue hardships. That blame belongs to those who delay the necessary corrections.

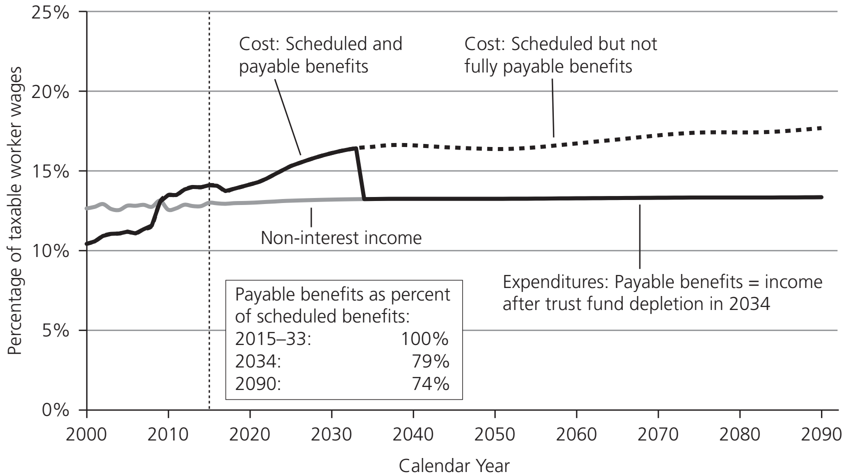
Before we move on, one quick technical point about the shortfall. The Social Security actuary tracks two measures of the long-term financing gap: the average gap over 75 years (2.66% of taxable worker wages) and the gap between taxes and expenditures in the 75th year (4.35% of taxable worker wages). (See figure 1, taken from the trustees' report). To achieve sustainable financing, a plan must eliminate both shortfalls, as the Johnson proposal would. Some proposals would close the shortfall by one measure but not the other.[4] Under such proposals, additional losses would await participants as the program's financing shortfalls later reemerge.

Value Judgment 2: Raising Taxes vs. Slowing Cost Growth

This is one of the most fundamental choices facing plan authors. Under current law, the cost of paying scheduled benefits well exceeds projected

3. John Wasik, "How GOP Social Security Cuts Will Hurt You," *Forbes*, December 14, 2016.
4. Stephen C. Goss, Chief Actuary of the Social Security Administration, to Representative Reid Ribble, December 8, 2016.

Figure 1. Social Security Income, Cost, and Expenditures as a Percentage of Taxable Wages



Source: OASDI Board of Trustees, *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds,* June 22, 2016, 13.

program revenues. Should the gap be closed by slowing the growth of program costs, raising taxes, or some combination of the two?

The Johnson proposal would close the gap entirely on the cost containment side, without tax increases. One provision would calculate COLAs for most recipients using the chained CPI recommended by the Bureau of Labor Statistics as the best measure of inflation.[5] Another provision would phase in benefit formula changes to slow benefit growth for higher-income earners. Another provision would gradually increase the normal retirement age by three months a year starting in 2023 until it reaches 69 in 2030 (workers could still choose to claim benefits as early as age 62). Other provisions would affect program expenditures in roughly equal positive and negative amounts.

Existing plans run the gamut from those that would balance the system solely through cost containment to those relying on tax increases, with

5. Erica L. Groshen, "Statement of Erica L. Groshen, Commissioner, Bureau of Labor Statistics, U.S. Department of Labor" (Testimony before the House Committee on Ways and Means, Subcommittee on Social Security, April 18, 2013).

others roughly splitting the difference.[6] (In recent years, there have also been proposals to increase total costs even faster than current schedules, which would require still larger tax increases to sustain. These proposals have not generally been offered in a financially sustainable form.)[7]

There are of course arguments for every approach. The main arguments for Congressman Johnson's cost containment approach are

- the general desirability of keeping program cost growth from outpacing national economic growth (even a solution like Congressman Johnson's, based entirely on cost containment, will still see cost burdens rise through the late 2020s due to ongoing baby boomer retirements);[8]
- more equitable treatment of different generations (this is because the current shortfall consists entirely of an excess of scheduled benefits over taxes for people already in the system,[9] and leaving benefit schedules unchanged would lock in larger net income losses for younger generations as they are forced to make up the difference);
- Social Security cost burdens are already depressing after-Social-Security-tax wage growth relative to benefit growth, a situation that would be exacerbated by a tax-increase approach;[10]
- Social Security is an income transfer program rather than a savings program: hence, a tax-increase-based solution causes retirement benefit promises to increase without an accompanying increase in the national economic resources available to finance them.

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6. Stephen C. Goss, Chief Actuary of the Social Security Administration, to Kent Conrad and James B. Lockhart III, Cochairs of the Commission on Retirement Security and Personal Savings at the Bipartisan Policy Center, October 11, 2016.

7. Stephen C. Goss, Chief Actuary of the Social Security Administration, to Representative Linda Sanchez, December 8, 2016.

8. Stephen C. Goss, Chief Actuary of the Social Security Administration, to Sam Johnson, Chairman of the Committee on Ways and Means, Subcommittee on Social Security, December 8, 2016.

9. OASDI Board of Trustees, *The 2015 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, table VI.F2, "Present Values of OASDI Cost Less Non-interest Income and Unfunded Obligations for Program Participants, Based on Intermediate Assumptions," https://www.ssa.gov/oact/tr/2015/VI_F_infinite.html#1000308.

10. Charles Blahous, "Understanding Social Security Benefit Adequacy: Myths and Realities of Social Security Replacement Rates" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012).

Value Judgment 3: Who Should Pay to Close the Shortfall

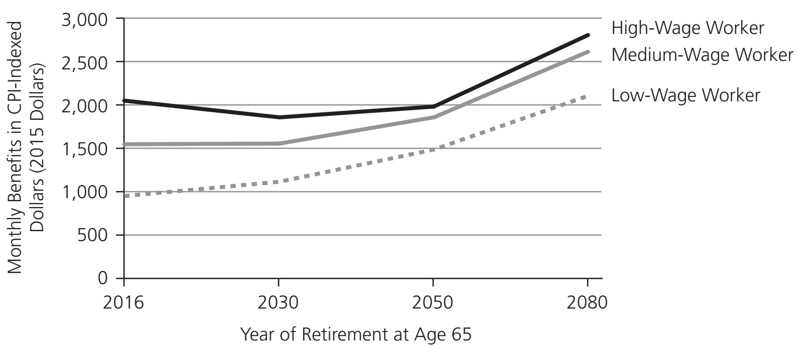
In the Johnson plan, the answer is very clear: higher-income beneficiaries. The proposal would eliminate COLAs for the highest-income participants who pay income-related Medicare Part B premiums. The plan's benefit formula constraints would impact roughly the upper half of income earners. Benefits for high-income, nonworking spouses would also be constrained to not exceed those earned by a low-income worker over a full career of program contributions. An increased special minimum benefit would be created for lower-income workers, growing with the number of their work years. The oldest beneficiaries at greatest risk of poverty would also receive a targeted benefit increase.

As a result, low-income workers working a full career would expect substantial benefit increases under the Johnson proposal, while the cost of restoring the system to financial balance would be borne by higher-income workers. (See figure 2.)

Value Judgment 4: Work Incentives

Another value judgment facing plan authors is whether, in the course of enacting financial corrections, to also correct other problems Social Security experts have identified. The Johnson proposal, like the BPC retirement

Figure 2. Monthly Benefits for Full-Career Worker, in 2015 Dollars



security commission plan released earlier in 2016, attempts to repair specific work disincentives under current law.[11]

Experts have long understood that Social Security imposes a high marginal tax rate on employment earnings at precisely the moment in life when many are contemplating whether to retire,[12] and that individuals do respond to these incentives by leaving the labor market. Part of the problem is that Social Security calculates benefits based on lifetime average earnings rather than allowing individuals to accrue additional benefits with each further year of work, as the Johnson plan would. The Johnson plan would also eliminate the program's penalty for earnings after early retirement age, and give beneficiaries the option of receiving some delayed retirement credits as a lump sum, something other experts (such as Olivia Mitchell) suggest is attractive to workers.[13]

Conclusion

Reasonable people can and do make different value judgments about how best to stabilize Social Security finances. But for those who want to avoid tax increases, wish to correct problematic work disincentives, and wish to protect low-wage workers while requiring those with higher incomes to bear the cost of achieving financial stability, the Johnson proposal shows how these goals can be achieved.

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11. Charles Blahous, "A Balanced Bipartisan Compromise for Strengthening Retirement Security," E21 (Manhattan Institute for Policy Research), June 23, 2016 (republished in this collection).

12. See, for example, Gopi Shah Goda, John B. Shoven, and Sita Nataraj Slavov, "Removing the Disincentives in Social Security for Long Careers," in *Social Security Policy in a Changing Environment*, ed. Jeffrey Brown, Jeffrey Liebman, and David A. Wise (Chicago: University of Chicago Press, 2009), 21–38.

13. James J. Green, "To Delay Social Security Claiming, Offer Lump Sum Benefit: Report," *ThinkAdvisor*, December 10, 2015.

Taxing More Earnings Won't Fix Social Security's Finances

This article was originally published at E21 on November 21, 2017.

H. L. Mencken memorably stated that "there is always a well-known solution to every human problem—neat, plausible, and wrong."[1] In Social Security policy, that solution is raising the annual earnings threshold above which Social Security taxes currently no longer apply. This purported answer to Social Security's financing shortfalls consistently polls better than any other, as most respondents believe it would only affect people richer than themselves. Virtually any discussion of the Social Security financing challenge features at least one individual advocating a taxable wage cap increase as the only necessary solution.

This collection includes another article sympathetic to the work of a Bipartisan Policy Center commission (on which I served) that included a Social Security tax cap increase among its recommendations.[2] But the fact remains that lifting the cap would fix very little of Social Security's long-term shortfall. Consequently, even proposals leaning heavily on that particular mechanism must also include other strong measures—usually ones the sponsors are less eager to discuss.

I published a previous article on this same subject back in 2011. Since that earlier publication, a focus on raising the tax cap has persisted on the left half of the American political spectrum. But at the same time the total Social Security shortfall has grown, rendering a tax cap increase even less effective for closing the shortfall. This piece, published in late 2017, updated the earlier material for more recent data and projections.

A FEW YEARS AGO, I EXPLAINED WHY THE FREQUENTLY FLOATED IDEA of increasing the amount of worker earnings subject to the Social Security tax would not fix much of the program's large and growing financing shortfall.[3] It seems worthwhile to update this information in the context of the evolving political climate surrounding Social Security, for two reasons. One

1. H. L. Mencken, *Prejudices: Second Series*, vol. 2 (New York: Alfred A. Knopf, 1920), 158.

2. Charles Blahous, "A Balanced Bipartisan Compromise for Strengthening Retirement Security," E21 (Manhattan Institute for Policy Research), June 23, 2016 (republished in this collection).

3. Charles Blahous, "Why Raising Social Security's Tax Cap Wouldn't Eliminate Its Shortfall," E21 (Manhattan Institute for Policy Research), April 12, 2011.

reason is that the idea continues to turn up in more places, including congressional proposals, opinion columns, and options lists compiled by government scorekeepers.[4] The second reason is that Social Security's financial situation has deteriorated further since the original piece, so a tax cap increase today would solve even less of the problem than it would have back then.

The purpose here is not to oppose legislated adjustments to Social Security's maximum taxable annual earnings. To the contrary, I recently served on a Bipartisan Policy Center commission that included a tax cap increase in a package of retirement security recommendations I believe are worthy of lawmakers' strong consideration.[5] Moreover, political realities are such that virtually any bipartisan grand bargain to repair Social Security finances is likely to include such a provision. The purpose of this piece is instead narrowly informational: to explain why increasing (even eliminating) the cap wouldn't accomplish nearly as much financial improvement as many people believe.

Background

The 12.4% Social Security payroll tax is assessed on worker earnings up to an annual limit currently set at $127,200.[6] The cap is statutorily indexed to grow (with rare exceptions) with growth in the national average wage index.[7] A worker's eventual benefits are based in large part on his or her career earnings subject to payroll taxation.

The reason the cap exists is rooted in Social Security's historical design as a contributory insurance program rather than a welfare program. President Franklin D. Roosevelt and other program founders wanted to ensure that

4. Stephen C. Goss, Chief Actuary of the Social Security Administration, to Representative Charlie Crist, August 2, 2017; Stephen C. Goss, Chief Actuary of the Social Security Administration, to Representative Ted Deutch and Senator Mazie K. Hirono, July 20, 2017; Mark Miller, "Time to Raise—or Scrap—the Social Security Payroll Tax Cap," *Reuters*, April 15, 2014; Congressional Budget Office, "Increase the Maximum Taxable Earnings for the Social Security Payroll Tax," December 8, 2016.

5. Commission on Retirement Security and Personal Savings, *Securing Our Financial Future: Report of BPC's Commission on Retirement Security and Personal Savings* (Washington, DC: Bipartisan Policy Center, June 2016).

6. Social Security Administration, "Benefits Planner: Maximum Taxable Earnings," accessed November 2017, https://www.ssa.gov/planners/maxtax.html.

7. Social Security Administration, "National Average Wage Index," accessed November 2017, https://www.ssa.gov/OACT/COLA/AWI.html.

Social Security covered and would have wide support from Americans, rich and poor.[8] As a result, workers at all income levels pay into Social Security, and workers at all income levels earn benefits as they do so. Past a certain point, higher-income people don't need extra benefits, so both their contributions and their benefits stop.

Financial Effects of Raising the Cap

Absent fundamental changes to Social Security's design, raising the cap on taxable wages would bring in more revenue up front but trigger additional outlays later on. This is because to a first approximation, the more you pay in, the greater the benefits you earn. Raising the cap both delays and modestly reduces Social Security's financing shortfalls, with the modest improvements coming primarily because less generous benefit returns are provided for tax contributions at the upper-income end. There is also a sense in which part of the apparent financial improvement is illusory—i.e., an artifact of actuarial calculations that capture several cohorts' increased tax obligations but not their additional benefit accruals.

Overall, a tax cap increase is a very inefficient way to improve system finances because it increases both tax collections and benefit expenditures for those who need them least. (A further factor is also relevant: that higher-income people's longevity improvements are outpacing those of poorer people;[9] if that trend continues, raising the tax cap—and thereby paying more benefits throughout higher-income people's longer lives—would be even less efficient in improving program finances.)

Graphs published by the office of the Social Security chief actuary illustrate the inefficiency of a tax cap increase. Figure 1 shows the projected effects of an often-floated proposal to raise the cap to cover 90% of all national wages. CBO has estimated this would require raising the cap to roughly $245,000.[10]

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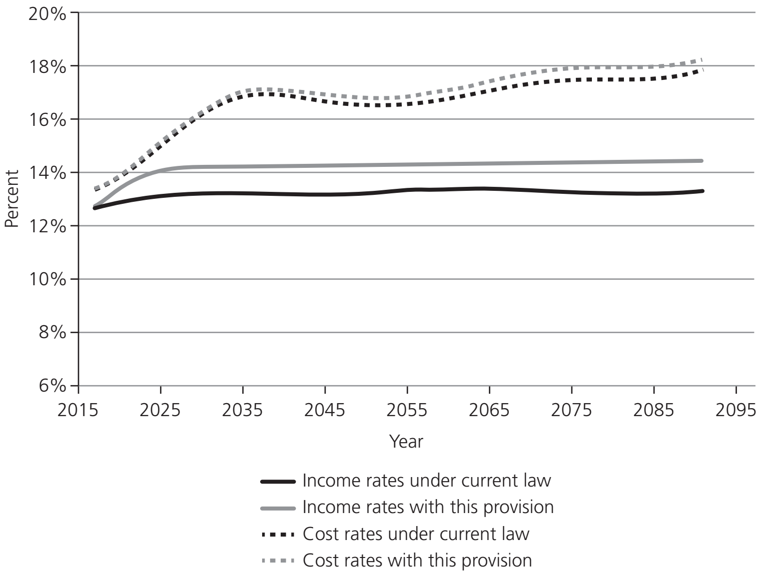
8. Franklin D. Roosevelt, "Address to Advisory Council of the Committee on Economic Security on the Problems of Economic and Social Security," November 14, 1934.

9. Steven H. Woolf, "How Are Income and Wealth Linked to Health and Longevity" (Income and Health Initiative Brief 1, Urban Institute and Center on Society and Health, April 2015).

10. Congressional Budget Office, "Increase the Maximum Taxable Earnings for the Social Security Payroll Tax," December 8, 2016.

Figure 1. OASDI Cost Rates and Income Rates (as a percentage of taxable payroll)



Note: "This provision" refers to the proposal to raise the cap on taxable wages to cover 90% of all national wages.

Source: Social Security Administration, "Summary Measures and Graphs," https://www.ssa.gov/OACT/solvency/provisions/charts/chart_run273.html.

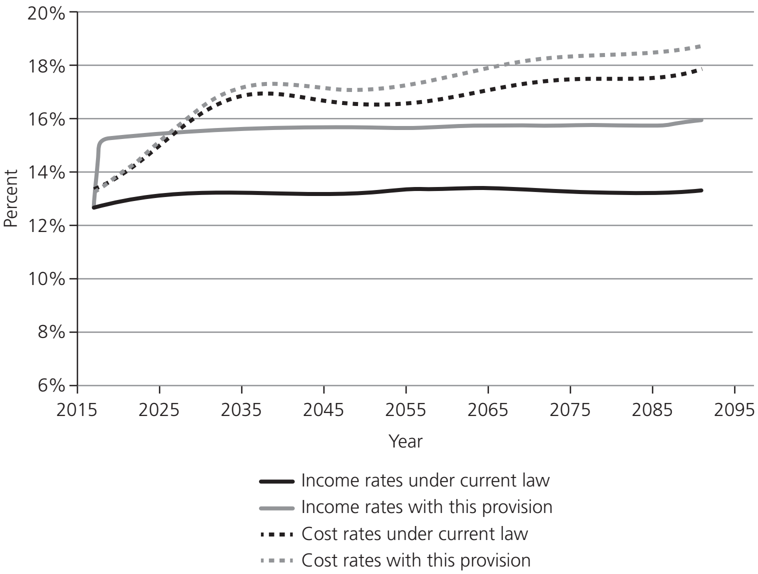
As figure 1 shows, raising the cap would cause tax collections to increase almost immediately (from the solid black line to the solid gray line) but would also cause expenditures to grow (from the dashed black line to the dashed gray line), reducing net annual shortfalls over the long run by only 14%.[11]

Even total elimination of the cap and exposing all US salary income to taxation (right on up to every last such dollar paid to Bill Gates) wouldn't fix most of the shortfall. In the out years, the annual gap between income and outgo would be reduced by roughly 36%,[12] leaving nearly two-thirds of the long-run financing problem in place. (See figure 2.)

11. Social Security Administration, "Summary Measures and Graphs," https://www.ssa.gov/OACT/solvency/provisions/charts/chart_run273.html.

12. Social Security Administration, "Detailed Single Year Tables," https://www.ssa.gov/OACT/solvency/provisions/charts/chart_run191.html.

Figure 2. OASDI Cost Rates and Income Rates (as a percentage of taxable payroll)



Note: "This provision" refers to the proposal to raise the cap on taxable wages to cover all national wages.

Source: Social Security Administration, "Detailed Single Year Tables," https://www.ssa.gov/OACT/solvency/provisions/charts/chart_run191.html.

The Hobson's Choice

Because of the situation illustrated above, proposals to raise the cap on taxable wages confront policymakers with a Hobson's choice between two alternatives:

- credit the additional contributions toward benefits, consistent with Social Security's historical design; or
- don't credit the additional contributions towards benefit, thereby abandoning Social Security's historical design.

Both choices are highly problematic. As noted above, choice 1 is very inefficient from a financing perspective, paying additional benefits to people who generally don't need them. Most experts would say choice 2 is even worse, because it would be a radical change to Social Security policy that leaves every participant's benefits less secure.

If and once the link between contributions and benefits were broken, this step almost certainly couldn't be undone. Moreover there is no reason to believe, once contributions above a certain income threshold are no longer counted toward benefits, that the specific dollar-amount cutoff will be set in stone forever. Ongoing financing pressures would virtually guarantee that the cutoff is frequently and perpetually adjusted downward, so that all of us would be at permanent risk of being forced to pay taxes into the program without receiving anything for those contributions.

There is a potential way out of this dilemma. An increase in the cap on taxable wages could be coupled with reductions in benefit accrual rates for higher earners. That way, less of the additional revenues collected would be sent inefficiently back out the door in the form of higher benefits. This would not fundamentally change Social Security's design, because higher earners already receive a lower return rate than lower earners: it would just be a matter of changing the number in the formula. A number of bipartisan proposals containing changes to the earnings cap have included variations on this approach, including that of the BPC retirement security commission as well as of the Simpson-Bowles commission.[13] On the other hand, one needn't raise the tax cap to slow the growth of higher-income participants' benefits in this way, improving finances and increasing program progressivity at the same time.

In any event, a tax cap increase by itself does very little to fix Social Security's financing problem. The pitfalls of the approach do not end there; they also include likely adverse effects on personal savings and economic growth, as well as the unwanted distributional outcome of hitting the upper middle class harder than the so-called 1%.[14] Still, the idea will undoubtedly remain part of the Social Security discussions because of the attractiveness to some of further taxing the rich. It just wouldn't do much to mitigate the other tough choices required to balance Social Security finances.

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13. Commission on Retirement Security and Personal Savings, *Securing Our Financial Future;* National Commission on Fiscal Responsibility and Reform, *The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform*, December 2010.

14. Charles Blahous, "Why Raising Social Security's Tax Cap Wouldn't Eliminate Its Shortfall," E21 (Manhattan Institute for Policy Research), April 12, 2011.

Seven Social Security Myths

This article was originally published at E21 on June 26, 2018.

This piece generated a surprising amount of positive feedback from colleagues, friends, and social media acquaintances. I had written in the past about persistent Social Security myths, but one resurgent internet trope—that Social Security, the prototypical federal entitlement program, somehow isn't an entitlement—was generating increased attention, prompting me to take on Social Security mythmaking in general. It won't be a surprise to most readers that a great many of the things written and circulated online about Social Security are simply wrong. This piece attempted to correct a few of the more prevalent myths in circulation.

AMONG PUBLIC POLICY ISSUES, SOCIAL SECURITY IS ESPECIALLY BESET BY myths and urban legends. These myths inhibit the enactment of legislation necessary to close its substantial financing shortfall. Press, public, and policymakers alike would do well to disabuse themselves of the following widely circulated canards.

Myth 1: Social Security Is Not an Entitlement

This is one of the more baffling myths in circulation of late. One encounters it on social media, on op-ed pages, even from members of Congress.[1] Social Security is not only an entitlement program, it is the largest and most prototypical federal entitlement program. Virtually any credible glossary of federal budget terminology will point to Social Security as the leading example of an entitlement (specifically, an entitlement is a program in which payments are obligated to beneficiaries according to eligibility criteria set

1. Bill Cruice, "Social Security Is Not an Entitlement," *Patriot-News*, February 21, 2013; Michael McIntee, "Video Replay & Transcript: Rep. Nolan Debates Challengers Mills & Sandman in Duluth," *The Uptake*, October 7, 2014.

in law, without requiring annual legislation to appropriate funds).[2] Those who object to Social Security being referred to as an entitlement are in effect trying to change the definition to mean something other than what it always has. Whether a program is an entitlement has nothing to do with whether beneficiaries made previous contributions to it. In fact, in Social Security's case, it's precisely the individual entitlement to benefits arising from those contributions that makes it an entitlement program.

Myth 2: Social Security Wouldn't Be in Financial Trouble If Politicians Hadn't Stolen and Spent Its Money

There is actually a small kernel of truth underlying this myth: specifically, Social Security trust fund reserves are by law invested in US Treasury securities, which finance federal government spending. Furthermore, economists who have studied the issue generally conclude that government access to those revenues stimulated more federal spending than would have occurred otherwise.[3] But this phenomenon has nothing do with Social Security's shortfall. Social Security still owns all that money and earns interest on it. Whenever Social Security tax revenues fall short of its benefit obligations, as they have since 2010,[4] Social Security taps both the interest and principal of its trust funds to pay benefits. Social Security's shortfall exists *despite* the government's repaying those funds to Social Security, not because it won't. The program's financing problems arise instead from its benefits exceeding the revenue (including interest) that it generates.[5]

Myth 3: Participants Have Paid for Their Benefits

Again, there is a kernel of truth in this myth. Workers covered by Social Security contribute payroll taxes, which establish an entitlement to benefits for themselves and certain dependents. However, this does not mean they

2. Congressional Budget Office, "Glossary," January 2012; Office of Management and Budget, *OMB Circular No. A-11*, 2016, § 20; Bill Heniff Jr., "Basic Federal Budgeting terminology" (CRS Report for Congress, Congressional Research Service, November 26, 2012).

3. Kent Smetters, "Is the Social Security Trust Fund Worth Anything?" (NBER Working Paper No. 9845, National Bureau of Economic Research, Cambridge, MA, July 2003).

4. Social Security and Medicare Boards of Trustees, "Status of the Social Security and Medicare Programs," accessed June 2018, https://www.ssa.gov/OACT/TRSUM/tr18summary.pdf.

5. OASDI Board of Trustees, *The 2018 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, June 5, 2018.

have paid for the full amount of their scheduled benefits. Many beneficiaries receive far more in benefits than their own contributions could ever fund, while others receive less. But, more importantly, Social Security has a shortfall precisely because in the aggregate, workers have *not* paid for their benefits: total scheduled benefits well exceed what workers' tax contributions, plus interest, can finance. So the existence of benefits has been earned, but the *scheduled amounts* have not. Benefit schedules would need to be substantially reduced from current law in order to match the benefit amounts workers have actually funded.[6]

Myth 4: Social Security Is Solvent until the 2030s, So There Is Still Plenty of Time to Fix It

One of the most misguided aspects of much press reporting on Social Security finances is the routine citation of its projected insolvency date (2034 in the latest report) as a proxy for its financial condition.[7] How soon Social Security's trust funds run out and how soon we must act are two entirely different things. By the time its trust funds are depleted, annual income and costs will be so far apart that there is no realistic chance of legislation closing the shortfall.[8] For example, even if all new retirees in 2034 were denied benefits, delaying corrective action until then would leave Social Security without enough revenue to continue sending the checks on time to those previously receiving them. When we must act is a function of how long the problem is still soluble, not when the funds finally run out. The window of opportunity for correction is closing now, if it hasn't closed already.

Myth 5: Because Social Security Is Self-Financing, It Doesn't Add to the Federal Budget Deficit

It is true that Social Security is technically "off budget" and has its own separate tax base and trust fund. But because the trust funds are invested in the federal Treasury, the general government fund plays a substantial role in Social Security financing. In the years before 2010, when Social Security ran

6. OASDI Board of Trustees, *2018 Annual Report*.
7. Mary Beth Franklin, "2034 Is a Pivotal Year for Social Security," *InvestmentNews*, June 5, 2018.
8. Bipartisan Policy Center, "Trustees Reports Highlight Social Security, Medicare Trust Fund Challenges," July 13, 2017.

a surplus, its operations reduced federal borrowing from the public. Since 2010, as Social Security's costs have exceeded its tax revenue, the federal government has been running larger deficits to fund the payments it owes to Social Security so that the program can continue to pay full benefits. A personal finance analogy might help. Suppose that during one month, you charge something to your credit card; then in subsequent months, you pay off the credit card debt, plus interest. In a certain sense you simply borrowed money from your bank that first month, then in the following months you paid it back. But during the months you are paying off that credit card debt, you tangibly experience a new and real financial strain, despite the fact that you were previously on the receiving end of credit. It's the same with the federal budget. The fact that the federal budget benefited from Social Security surpluses in the past doesn't make its ongoing deficit-worsening outlays, during the years it pays Social Security back, any less real.

Myth 6: Taxing Rich People More by Raising the Cap on Taxable Wages Will Fix the Problem

There's a statutory cap on each worker's annual earnings subject to Social Security taxes—it's $128,400 this year[9] and is indexed to grow automatically in most years. Above the cap, workers neither pay additional taxes nor accrue additional benefits, reflecting the program's design as a floor of income protection rather than an all-encompassing pension benefit. Whenever Social Security's shortfall is discussed, someone usually suggests raising this cap, to collect more taxes from the rich. That could certainly be done in the context of a solvency plan, but it doesn't solve much of the problem. Raising the taxable maximum from today's level all the way to about $350,000 in 2022 would only eliminate about 14% of the structural deficit,[10] in part because a worker's benefits are linked to his or her tax contributions and thus the tax increase would generate higher benefits for the well-off. That cost increase could of course be prevented by changing the benefit formula on

9. Social Security Administration, "Table 2.A3. Annual maximum taxable earnings and contribution rates, 1937–2018," https://www.ssa.gov/policy/docs/statcomps/supplement/2018/2a1-2a7.html#table2.a3, accessed June 2018.

10. Stephen C. Goss, Chief Actuary of the Social Security Administration, to Representative Reid Ribble, July 13, 2016; Social Security Administration, Office of the Chief Actuary, "Summary Measures and Graphs: Category of Change: Payroll Taxes (Including Maximum Taxable)," July 13, 2017.

the high-income end; nevertheless, the point remains that without benefit formula changes, a tax cap increase by itself doesn't accomplish very much.

Myth 7: Social Security Privatization Is a Live Option

During election seasons there are always some partisans claiming that Social Security is at risk of being "privatized."[11] That was never true, and the claim is particularly absurd now. Many years ago when Social Security was running surpluses, presidents such as Bill Clinton and George W. Bush suggested that workers be given the option of saving them in personal accounts to shelter that money from being used to finance federal spending (see myth 2).[12] None of those proposals involved privatization, but instead would have allowed for individual saving within a publicly administered system. That opportunity vanished in 2010 when Social Security began running cash deficits. Since then there have been no surplus Social Security contributions to save, and every program tax dollar collected now is immediately sent out the door to pay current benefits. Despite the fact that this has long been a dead issue, occasional "privatization" fear-mongering continues.

The late Senator Daniel Patrick Moynihan was fond of saying, "everyone is entitled to their own opinions, but they are not entitled to their own facts." Social Security policy and politics are treacherous enough even when everyone agrees to respect the facts. If we are to see Social Security through to financial safety, we can no longer afford to indulge these seven myths.

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11. Nancy Altman, "Trump and Ryan Agree: Let's Dismantle Social Security," *HuffPost*, May 16, 2016.

12. William J. Clinton, "Remarks by the President via Satellite to the Regional Congressional Social Security Forums," Albuquerque, New Mexico, July 27, 1998; George W. Bush, State of the Union address, February 2, 2005.

PART 3

The Federal Budget

Reforming CPI: Not a "Grand Bargain" but a Prudent Reform

This article was originally published at E21 on July 12, 2011.

The consumer price index, used not only to calculate Social Security COLAs but also to index many other federal operations, is one of several federal policy issues that inevitably engender widespread confusion. Press coverage around the time this article was published depicted a recent presidential proposal to employ a reformed CPI in a variety of ways: as a policy concession by President Obama to congressional Republicans, as a first move on major entitlement reform, and as a cruel cut in seniors' Social Security benefits.

As this piece explains, the proposals under consideration were none of those things: CPI reform favors neither Democrats nor Republicans because it has roughly equal effects on spending and revenues. It is also not a major entitlement program reform but simply a technical correction to reflect wide expert agreement that the inflation indices currently in use tend to overstate national price inflation. As the title of this article states, reforming CPI would be a prudent move, but has little to do with any grand fiscal bargain between the political parties.

RECENT REPORTS INDICATE THAT THE BUDGET/DEBT NEGOTIATIONS will not produce a "grand bargain."[1] At best, they will produce a smaller set of targeted reforms slightly improving but not correcting the unsustainable trajectory of federal finances. But whether the budget discussions produce a big deal or a small one, both sides would do well to implement a more accurate measure of economy-wide inflation, namely the "chained" C-CPI-U.

Basic Background

Many aspects of federal law, from income tax brackets to Social Security payments, are indexed to grow each year with price inflation—more specifically with the consumer price index (CPI). There are different versions of CPI now in use, including CPI-U (measuring inflation facing all urban

1. Scott Wilson and Lori Montgomery, "Debt Reduction Talks in Limbo as Clock Ticks toward Aug. 2 Deadline," *Washington Post*, July 10, 2011.

consumers) and CPI-W (measuring inflation facing urban workers). Some programs use one of these and some the other, but generally the two are close in value anyway.

Over the years, many economists have noted that these measures tend to overstate actual price inflation as felt by consumers. Simplifying considerably, this is because the rising price of one item often causes consumers to buy a different item instead—one whose price hasn't risen as much. The mix of items that consumers buy thus changes over time, meaning the increase in the total cost of living is less than if no purchase substitutions had occurred.

Over the years the Bureau of Labor Statistics, which calculates these various inflation measures, has implemented improvements to correct for these changes in buying patterns. The current CPI-U and CPI-W, however, do not adequately account for changes across purchasing categories. That is to say, consumers don't limit their purchasing substitutions merely to other items within the same spending category; they also shift their purchasing preferences between categories according to inflation trends within each. To address this, the Bureau of Labor Statistics developed another index known as the superlative or chained CPI (C-CPI-U), which accounts for cross-category substitutions.

This C-CPI-U has averaged something close to 0.3 percentage points per year less than CPI-U or CPI-W in the years since 2000.[2] Advocates of its adoption across federal programs argue that not only would C-CPI-U more faithfully reflect inflation than measures now in use, but it would substantially reduce federal deficits as well due to its effects on outcomes ranging from income tax bracket growth to Social Security COLAs.

Press articles recently reported that the Obama administration suggested the adoption of chained CPI in the ongoing budget discussions. Unfortunately, the reform was described in the worst possible way—as the administration having proposed "Social Security cuts" rather than merely the next technical improvement in the implementation of current policies.[3] This led to an immediate denunciation of the idea by congressional Democrats, considerably lessening its chances of being adopted.[4]

2. Adam Rosenberg and Marc Goldwein, "Measuring Up: The Case for the Chained CPI," Moment of Truth Project, May 11, 2011.

3. Lori Montgomery, "In Debt Talks, Obama Offers Social Security Cuts," *Washington Post*, July 6, 2011.

4. Robert Pear, "Democrats Oppose Talk of Cuts to Social Security," *New York Times*, July 7, 2011.

This is highly unfortunate, as CPI's refinement is a reform whose time ought to have come. It would improve the accuracy of federal processes, improve the budget outlook, and serve the interests of negotiators on both sides of the table. It is strongly to be hoped that the option can be kept alive. The following are some reasons why.

C-CPI-U Is the Most Accurate Available Estimate of Economy-Wide Inflation

Some federal policies (like the fixed income thresholds for the recently enacted 0.9% Medicare surtax) aren't indexed at all. Others (like Social Security's benefit formula) are indexed to wage growth. But currently expressed policy in many other areas of the federal budget is to index for general price inflation, no more and no less. To use the best available measure of such inflation is therefore not a "benefit cut" or a "tax increase" as much as it is the most faithful available method of complying with the policy basis of various statutes.

CPI-U and CPI-W weren't originally inserted into existing laws because their sponsors thought that they overstated inflation; they were inserted because the sponsors were attempting to capture inflation, and those metrics were the best available at the time. To now use the more recently developed C-CPI-U is, in effect, to better conform these various aspects of federal law to congressional policy intent.

The Purpose of CPI-Indexation Is Not to Attain Targeted Benefit or Tax Levels

Many on the Left oppose using C-CPI-U because the continued use of CPI-W would lead to higher Social Security benefits, especially among the oldest seniors. Many on the Right are similarly concerned about C-CPI-U because continuing to use current CPI-U would constrain the growth of federal revenue collections, relatively speaking. I share the policy goals of keeping tax burdens manageable and of ensuring adequate benefits for the most vulnerable seniors. But continuing to overstate inflation is not the appropriate means of achieving these goals—even with respect to these respective policy advocates' interests.

The policy goal of increasing benefits for the oldest seniors is more efficiently pursued by changing Social Security's benefit formula to do so, rather than by overstating inflation in the COLAs provided to all beneficiaries.

Income taxes are also better contained by lowering marginal rates than by faulty indexing. Moreover, pressure for higher taxes is driven predominantly by growth in federal spending, and federal spending would grow faster under current CPI indexing than under an accurate CPI. Both sides of the aisle will also find it easier to argue for their respective policy priorities in an improved fiscal environment.

A case could be made that income tax levels should rise with average income, rather than prices, to prevent bracket creep from steadily increasing individual tax burdens. But as long as the current policy is to index for inflation, the most accurate available measure should be used. No particular policy rationale is served by indexing for inflation inaccurately.

The Federal Balance Sheet Would Improve, Especially over the Long Term

Deficit reduction alone is not a dispositive reason to embrace C-CPI-U. The fact that its adoption would improve the fiscal outlook is, however, a substantial benefit. To more fully appreciate this, imagine the opposite scenario: imagine that federal laws were currently indexed to C-CPI-U. A proposal to switch to CPI-U or CPI-W would then rightly be criticized both for resulting in less accurate indexing and for adding recklessly to projected long-term deficits. If C-CPI-U were the measure already on the books, there would be hardly any question that it should be the operative method going forward.

Proposals to Adopt an Alternative Measure of Inflation Would Produce Absurd Results

Some have argued that an experimental index of inflation developed specially for seniors (CPI-E) should be used to index Social Security COLAs, even though doing so would increase costs and worsen Social Security's projected shortfall. Methodologically, however, the experimental CPI-E suffers from the same problems as CPI-U and CPI-W in that it fails to account for upper-level product substitutions.

Even if the CPI-E didn't suffer from significant methodological shortcomings, however, it could not sensibly be applied to Social Security benefits. Social Security beneficiaries come in various forms, from retirees to the disabled to child survivors. It would make no methodological sense to use a purchasing index for the elderly to adjust benefits for child survivors, nor would it make sense for the young disabled. It would also create a nightmare of complexity to have different beneficiary populations using different measures of CPI, shifting between them as they move from one category to the other (e.g., from disabled to old-age benefits). The purpose of inflation indexation is not to model the purchasing patterns of every individual or subgroup but to model general price inflation, which C-CPI-U does better (even for Social Security's beneficiary population, on average) than CPI-E.

C-CPI-U Has Distributional Advantages Also

Although the method of indexation should not be chosen based on distributional considerations, it should be said in response to some concerns raised that C-CPI-U does carry distributional benefits. Lowering deficits, debt, and long-term spending levels would all reduce tax burdens on younger generations. And on the Social Security side, the biggest existing distributional inequity is the net income loss faced by younger generations as a result of the excess of benefits over taxes contributed for earlier generations. Under current benefit formulas, people who have already entered the Social Security system will receive $18.8 trillion ($2011 present value) more than the amount of taxes contributed over their lifetime, creating a deficit that would subtract roughly 4% from the lifetime wage income of younger generations, even if those generations receive all benefits now being promised.[5] We needn't "cut" the benefits for people now on Social Security, but formulaically exaggerating inflation will grossly exacerbate the program's intergenerational inequities.

CPI reform is not Social Security reform, and for both tactical and substantive reasons should never have been presented as such. By itself, it won't fix the long-term budget outlook—that task requires serious further reforms of Social Security and the healthcare entitlements. It would, however, improve the long-term outlook for the federal budget as well as for Social Security.

Not every distributional consequence of CPI reform will be to everyone's liking, but that is true of any technical refinement of the federal government's indexing methods. Altogether, CPI reform is a long-overdue correction that would serve the interests of negotiators on both sides of the aisle, of taxpayers, and of the nation as a whole.

5. OASDI Board of Trustees, *The 2011 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, May 13, 2011, § IV.B.5.

Should Congress Change CBO's Scorekeeping Rules?

This article was originally published at E21 on May 29, 2012.

This article has proved to be one of the more evergreen pieces in this collection. The impetus for it was my earlier study of the fiscal consequences of the ACA, which showed that the ACA only appeared to reduce federal budget deficits because Congress's scorekeeping methods compared it to a somewhat contrived budget baseline rather than to the actual stipulations of prior Medicare law. I had intended that study to be explanatory rather than to advocate for a process change. However, as events unfolded, the problems with the existing scorekeeping methods and the need to change them became clearer. Several of these problems are detailed in this piece.

Since its publication, this material has taken on an interesting role, at least among budget nerds. Although some ACA advocates took umbrage at my original findings about the ACA's fiscal effects, an increasing number of people gradually accepted them. As I noted earlier (in the preface to "The Fiscal Consequences of the Affordable Care Act"), the Committee for a Responsible Federal Budget later called for the aforementioned scorekeeping loophole to be closed, and Tom Price, then chairman of the House Budget Committee, subsequently introduced legislation to do so. Others who have written in this area have also acknowledged the problematic inconsistencies in existing scorekeeping methods.

The point of this article, that Congress's scorekeeping methods distort budget policy choices and do not accurately reflect existing law, has continued to arise in other contexts. In 2017, congressional Republicans unleashed a vigorous debate among budget watchdogs about what scorekeeping baseline should be used for tax policy changes. During that debate this piece was circulated anew, to remind participants of the inconsistencies between the current scoring treatments of the revenue and spending sides, respectively, of the budget equation.

ON MAY 21, 2012, I PARTICIPATED IN A CONSTRUCTIVE DEBATE WITH JARED Bernstein,[1] sponsored by E21, about my paper, "The Fiscal Consequences

1. Jared Bernstein and Charles Blahous, "Medicare Numbers Examined: Blahous and Bernstein Discuss the Fiscal Consequences of the Health Care Law," debate sponsored by E21 (Manhattan Institute for Policy Research), May 21, 2012.

of the Affordable Care Act."[2] For those unfamiliar with my paper, it shows that the enactment of the 2010 healthcare law will add more than $340 billion to federal deficits over the next 10 years, an adverse fiscal consequence disguised by Congress's current scorekeeping conventions.

Without getting too far into the weeds, the main scorekeeping issue involves the treatment of Medicare. Social Security and Medicare are financed under law from special trust funds and are only permitted to pay benefits to the extent that they have resources in those trust funds. The scorekeeping conventions currently in use ignore these constraints. They instead implicitly assume that all financing discipline imposed by the trust funds under current law will be overridden by future Congresses.

Relative to this hypothetical scenario, the 2010 healthcare law would indeed produce lower deficits. That scenario, however, does not represent prior law, nor does it reflect prior historical practice. Relative to actual law and to how lawmakers have operated these programs to date, the healthcare law will substantially worsen federal deficits.

During the question-and-answer period after the debate, American Enterprise Institute economist Alan Viard challenged me as to whether and how I thought these scorekeeping rules should change. I gave essentially the same answer I'd given in my paper, which is that I thought the scoring rules made sense for most policy evaluation purposes, but they simply had a drawback in the particular case of the ACA. I wasn't seeking to change them, only to inform the public of fiscal effects that they miss.

Here's how I put it in the paper:

> There are many reasons the CBO's and trustees' scoring convention is appropriate in many circumstances. Among these reasons is that without it, policymakers would not receive appropriate credit for tough choices made to correct the fiscal imbalances of Social Security and Medicare and would thus be less likely to make them. . . . Without the usual scoring convention, both CBO and the trustees would effectively assume that the program's imbalance vanishes by itself as a result of benefit cuts upon Trust Fund depletion.[3]

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2. Charles Blahous, "The Fiscal Consequences of the Affordable Care Act" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012).

3. Blahous, "Fiscal Consequences," 16.

I am now, however, reconsidering this position. The position I outlined in the ACA paper reflects my primary objective of explaining scorekeeping rules rather than criticizing them. But I am now coming around to the view that Congress should give serious consideration to changing the scorekeeping rules under which CBO operates, to reflect literal law for Social Security and Medicare in the same way literal law is reflected elsewhere in the federal budget. Here's why.

1. The Current Rules Are Internally Inconsistent

The current rules oblige CBO to take a literal view of current law in some areas but not in others. These inconsistencies are not justifiable based on past practice—quite the opposite.

Take, for example, the alternative minimum tax. Under current law, the income thresholds for this tax would capture huge numbers of new taxpayers starting at the end of this year. The current scoring rules assume this will happen, even though lawmakers have repeatedly overridden it.[4] Similarly, the current scoring rules assume that physician payments under Medicare's sustainable growth rate formula will be cut dramatically starting next year, as they would be under literal current law—even though, again, this has been repeatedly overridden.

On the other hand, the scoring rules assume that Social Security and Medicare will be allowed to spend far in excess of their trust fund resources, though this is not current law and in the past Congress has generally not overridden these constraints.[5]

In sum, the rules assume that many aspects of current law will be observed even though they have been overridden in the past, while other aspects of current law will be overridden even though they have been upheld in the past. That's a problem.

2. The Current Rules Distort Policy Decisions

Under current rules, if you want to extend current income tax rates, your proposal is scored as adding to the federal deficit. The same is true for further patches of the alternative minimum tax income thresholds or if you

4. Congressional Budget Office, "CBO's 2011 Long-Term Budget Outlook," June 2011.
5. Congressional Budget Office, "CBO's 2011 Long-Term Budget Outlook."

want to override an impending cut to Medicare physician payments. This is all defensible.

But the same rules assign no penalty to other similar actions, like overriding impending cuts in Social Security or Medicare Hospital Insurance benefits. Such overrides are selectively treated as not adding to the deficit. This inconsistent treatment distorts policy decision-making. It makes it easier to increase spending in some parts of the budget than in others, and also easier to do so than to maintain current tax policies.

3. The Current Rules Incent Irresponsible Fiscal Practices

The current rules incent lawmakers to enact the most irresponsible resolutions of Social Security and Medicare shortfalls—namely, to completely abandon all spending discipline imposed by their trust funds and to bail out the programs with debt-financed general revenue commitments. This incentive is created by the scorekeeping rules that essentially assume this outcome and thus assign no scoring penalty to it.

The rules also incent other fiscal equivalents of these irresponsible outcomes—for example, extending the spending authority of Social Security and Medicare with genuine cost-saving measures, but simultaneously spending the proceeds of those savings on other programs. This has exactly the same adverse effect on the overall budget as would the hypothetical debt-financed bailout of Social Security and Medicare described in the previous paragraph. A version of this tactic was employed, unfortunately, in the 2010 healthcare law.

4. The Current Rules Dampen the Urgency That Should Appropriately Be Associated with Impending Insolvency of Social Security and Medicare

There is a lot of discussion right now about the impending fiscal "cliff" if certain tax and spending provisions are allowed to expire at the year's end. But there are other cliffs looming in the years to come—among them sudden reductions in Medicare HI spending in 2024 and sudden cuts in Social Security disability benefits in 2016. Awareness of these "cliffs" is dimmed because our so-called current-law baseline doesn't show the cuts happening, even though under law they would.

Nor do current methods reflect the additional spending authority granted whenever Medicare or Social Security are permitted to pay additional benefits for more years into the future, as the healthcare law did by extending Medicare HI solvency from 2016 to 2024. With other programs, we generally show the consequences of impending cuts and the budgetary costs of postponing them; we don't with Social Security and Medicare.

5. The Current Rules Allow for Misleading, Demagogic Politics

To take but one example: proponents of Social Security reform are often attacked for proposing to cut future benefits by huge amounts, when they would do no such thing. There have been claims this year, for example, that certain political candidates' proposals would cut Social Security benefits by 40%.

These claims are nonsensical. They are produced by comparing benefits under a proposed, solvent Social Security system with benefits currently "scheduled" for some long-distant year like 2085 but that would not be paid under existing law. Scorekeeping rules ought not to legitimize the demagoguery of claims that benefits would otherwise be paid where there is no legal authority to do so.

One argument against changing the rules to reflect literal current law that incorporates impending benefit cuts in Social Security and Medicare is that this scenario is both politically unrealistic and paints an overly rosy fiscal picture. As some critics pointed out in response to my study, much of our projected fiscal problem disappears if one assumes that current law plays out exactly as written.[6]

This isn't, however, a good reason to keep using a current-law baseline that reflects current law only in certain selective ways. First, realistic or not, lawmakers should know what current law requires. Second, CBO can elsewhere inform lawmakers of the costs of unfunded Social Security and Medicare benefit promises in its alternative fiscal scenario, just as it does with other reasonably probable overrides of existing law. Third, we already know that the current-law scenario is politically unrealistic: it still ought to

6. Committee for a Responsible Federal Budget, "The Affordable Care Act and the HI Trust Fund," April 10, 2012.

be applied consistently across federal programs. Surely it ought to include financing constraints that have historically been respected if it also includes many that have not been.

In sum, our current scorekeeping rules are internally inconsistent, they create an unlevel playing field between policy choices, they incent irresponsible fiscal practices, and they can too easily be used to support misleading political demagoguery. By employing a baseline that more accurately reflects current law, the fiscal picture would indeed look unrealistically rosy—but the fiscal consequences of costly budget gimmicks would be far more transparent. For these reasons—and certainly before the next round of possible changes to Social Security and/or Medicare—Congress should carefully consider changing its scorekeeping rules.

How Did Federal Surpluses Become Huge Deficits? (Hint: It Wasn't Because of Tax Cuts for the Rich)

This article was originally published at E21 on August 20, 2012.

Among the best subjects for a writer to address are those about which the writer believes that the conventional wisdom is wrong. I'm not suggesting that writers should take pleasure in being contrarian. Rather, I mean that when a writer already agrees with the conventional wisdom, there is simply less value he or she can add by writing about that topic. It's best to engage a subject when the ongoing national dialogue is missing something important.

This piece was written to address such a subject. During the administration of George W. Bush, a significant amount of press coverage bought into opposition spin that a benign federal fiscal outlook had been recklessly destroyed by President Bush's irresponsible tax cuts for the rich. The truth was much more complicated, and bore scant resemblance to that story.

The article walks through, in rather picayune detail, the various factors that changed the fiscal outlook from one of permanent surpluses to large permanent deficits. The bottom line: yes, tax relief played a role, but it was less than one-quarter of the story, and the Bush administration wasn't even responsible for all of that portion. The vast majority of the deterioration in the fiscal outlook was attributable to subsequently enacted spending increases and simple CBO projection error.

NONPARTISAN ANALYSTS AGREE THAT THE FEDERAL GOVERNMENT faces an enormous budget shortfall.[1] This shortfall cannot be resolved unless we accurately diagnose its causes and devise solutions that address them.

Discussions about federal deficits too often feature partisan blame-laying when what is needed is problem-solving analysis. To prevent a future fiscal meltdown, we must address the causes of unsustainable future deficits. On this question there is little disagreement among nonpartisan scorekeepers. The Congressional Budget Office projections show that future fiscal strains

1. Congressional Budget Office, "CBO's 2012 Long-Term Budget Outlook," June 2012.

will be driven almost entirely by growth in federal entitlement spending, driven in turn by population aging and by the growth of federal health benefits per capita. Under current law, the projected problem is not one of insufficient taxes (which would grow to far exceed historical norms) or appropriated spending (which would shrink relative to the economy). Seriously addressing the long-term fiscal problem means restraining entitlement spending growth, plain and simple.

We spend a great deal of time, however, debating not the future of the budget but past policy choices. How is it that we have such large deficits already? The two parties debate this in part to establish their own relative credibility as future stewards of the nation's finances. This debate also affects perceptions of which policies are thus far "at fault," and thus of who can fairly be asked to sacrifice going forward.

This discussion often intensifies when the time comes to decide whether to continue a current policy, repeal it, or allow it to expire. Two prominent examples are current income tax rates (which many Democrats argue should rise via expiration) and the 2010 healthcare reform law (which many Republicans argue should be repealed). Even in this context, however, there's a limit to how useful a debate about the past can be. Most of the 2010 healthcare reform law's costs, for example, haven't yet begun to show up on the federal ledger and thus are missed in any discussion of past or current deficits. But the debate over the past will always continue. As long as it does, we all have a stake in having an accurate picture of how things have played out so far.

One of the most common narratives about the federal budget is as follows: back in the halcyon days of early 2001, we were facing large surpluses lasting as far as the eye could see; by a series of policy blunders, these were transformed into the gargantuan deficits we see today. The two parties naturally blame one another for the fiscal deterioration. But objectively, what happened to turn those projected surpluses into huge deficits?

Thanks to a recent report from CBO, we now have a comprehensive, nonpartisan answer to that question. I will walk through it step by step, using graphs to illustrate the CBO findings.[2]

The order in which one does this can affect one's impressions of the analysis. So first I will do it one way, then at the end of this piece I'll show

2. Congressional Budget Office, "Changes in CBO's Baseline Projections since January 2001," June 7, 2012.

the reverse view. On the first run-through, I'll hold the 2001–2003 tax reductions (the so-called Bush tax cuts) for last, to isolate their effects. I do this in deference to the rhetorical attention that this tax relief has received as a possible contributor to our current fiscal problem.

First, let's compare the 2001 projections as a whole to what actually happened. As shown in figure 1, in 2001 CBO was anticipating a total of $5.6 trillion in surpluses from 2001 to 2011, including a surplus of nearly $900 billion in 2011 alone. Instead, we ran $6.1 trillion in deficits, including deficits exceeding $1 trillion in each of the years from 2009 to 2011. This was a dramatic worsening of our fiscal outlook.

The first thing to understand is that, like most projections, the 2001 projections were simply wrong. CBO now identifies over $3.2 trillion in "economic and technical changes" in the subsequent projections, a polite way of saying "correcting for prior projection inaccuracy." So, even if there had been no tax relief or additional spending, a good portion of 2001's projected surpluses would never have materialized. Had this then been known, the 2001 outlook would have looked like the solid gray line in figure 2. (In all of these graphs, for consistency, the bottom "actual" line will be a dashed gray line.)

Forecasters in early 2001 failed to anticipate the bursting of the 1990s' dot-com stock bubble, which by itself eliminated the surpluses projected for

Figure 1. Federal Surpluses and Deficits, 2001–2011

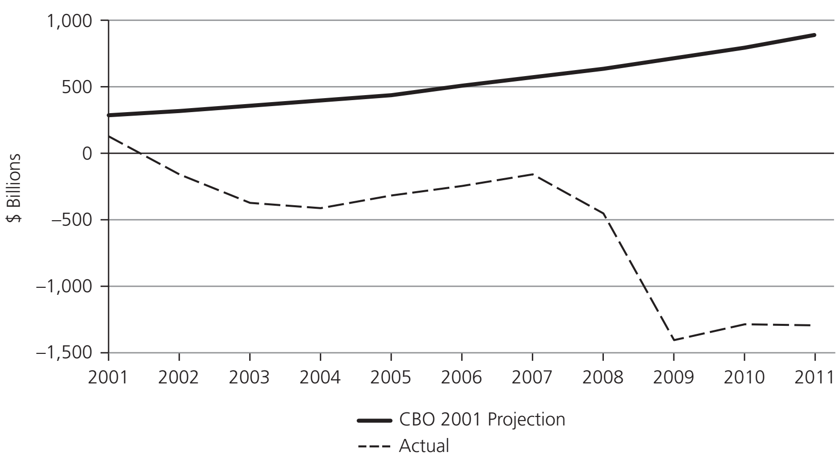
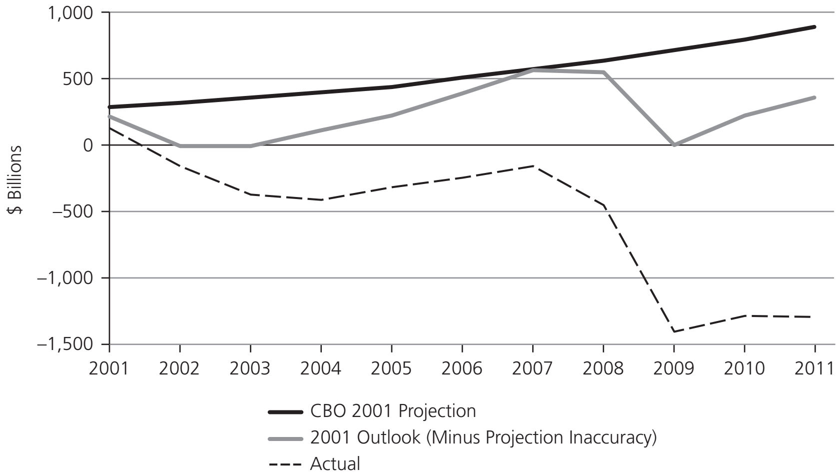


Figure 2. Federal Surpluses and Deficits, 2001–2011



2002 and 2003. The 2001 projections also contained other inaccuracies, and (understandably) failed to anticipate our most recent recession.

One major factor that worsened the fiscal outlook was a large increase in federal discretionary spending. Much of this, of course, happened after the United States was attacked on September 11, 2001. The United States thereafter conducted major military operations in Afghanistan and Iraq, and also increased expenditures on homeland security. These policies were enacted with bipartisan support, including bipartisan decisions to add their costs to the federal deficit. Discretionary spending increases further accelerated in 2009–2011. (See figure 3.)

There were other spending increases as well, in mandatory spending. Three significant increases involved the Medicare prescription drug benefit, the Troubled Asset Relief Program (TARP) financial sector bailout, and the 2009 stimulus. First I'll add the effects of all mandatory spending increases other than these three big-ticket items: see figure 4. Then I'll add in TARP (the financial sector bailout), which mostly just moves the 2009 number: see figure 5. Next I'll include President Obama's 2009 stimulus package, which added to the 2009–2011 deficits: see figure 6. (See how the thin black line is below the heavy dashed black line in 2009–2011.)

Figure 3. Federal Surpluses and Deficits, 2001–2011

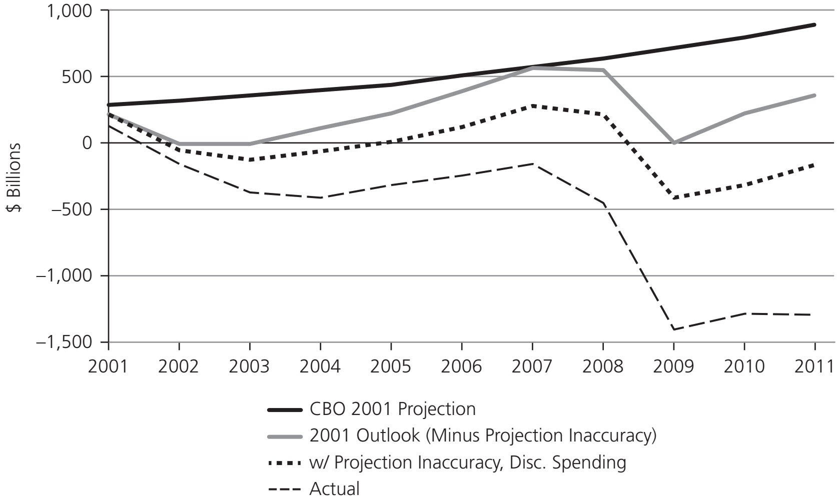


Figure 4. Federal Surpluses and Deficits, 2001–2011

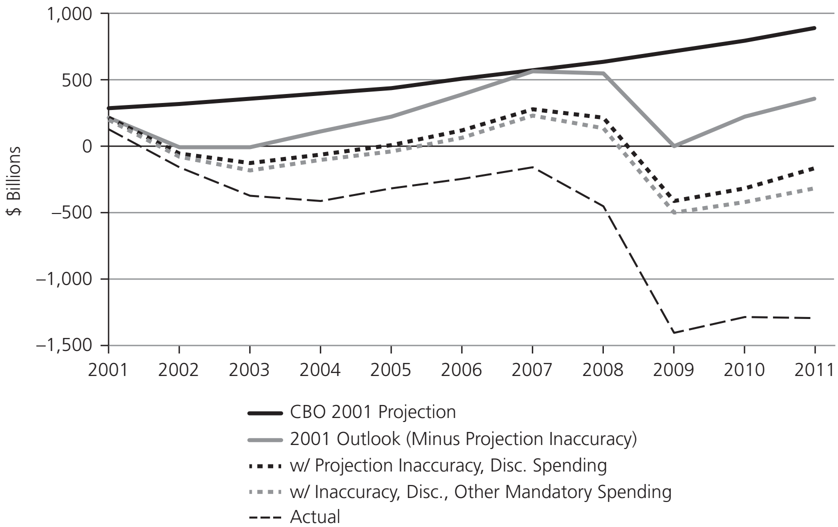


Figure 5. Federal Surpluses and Deficits, 2001–2011

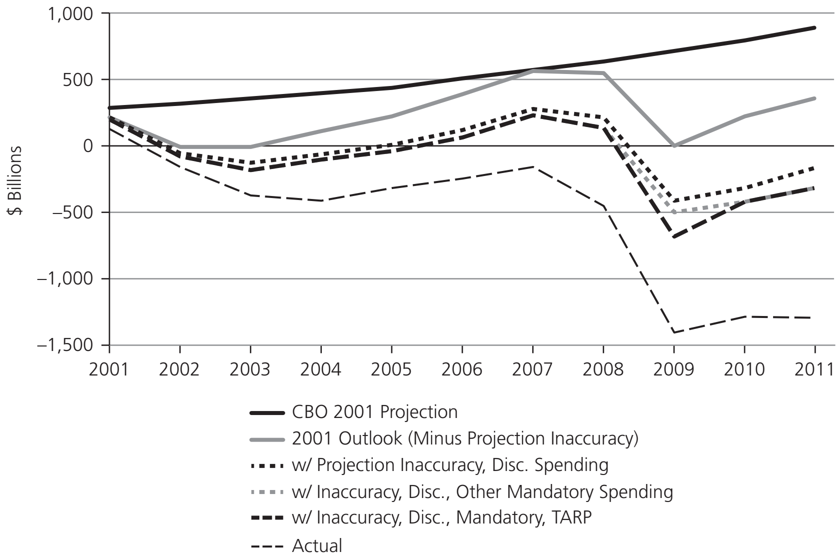
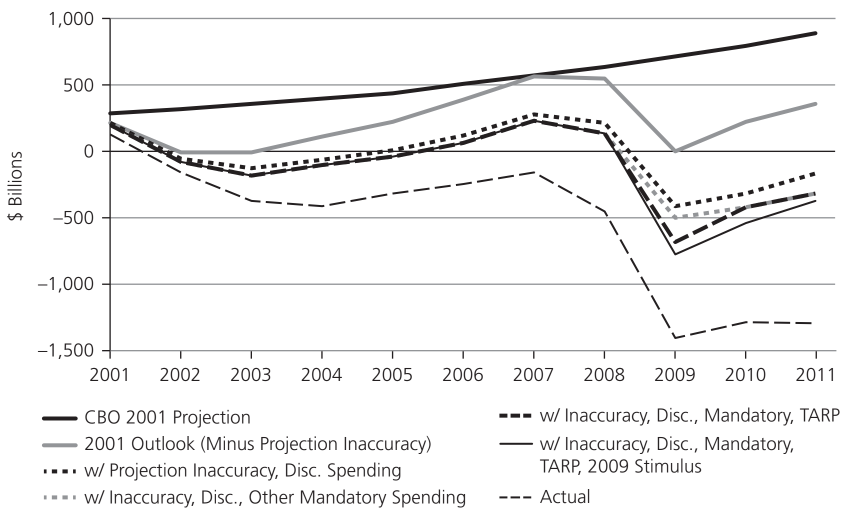


Figure 6. Federal Surpluses and Deficits, 2001–2011



I've held the Medicare prescription drug benefit for last among the spending items because of the attention it has received as a contributor to deficits. Including it completes the changes in the outlook due to noninterest spending: see figure 7.

We have another spending component to add: interest on the debt. Though both spending and revenues affect the size of the debt, interest payments are classified as mandatory spending. Adding in the effects of interest payments, we have incorporated all the subsequent worsening of the 2001 outlook arising from projection errors and additional federal spending: see figure 8.

That's a lot of lines for one graph, so I'll clean it up. Figure 9 summarizes all changes to the 2001 fiscal outlook arising from increased federal spending and corrections of projection inaccuracy. Again, the heavier dashed line at the bottom is what actually occurred, while the lighter dashed line just above it is where we would have been based on spending increases and projection corrections alone.

Let's look a bit closer at figure 9 before moving on. A few critical points are clear. One is that the two dashed lines are qualitatively similar: that is, the vast majority of the deterioration in the fiscal outlook would have occurred

Figure 7. Federal Surpluses and Deficits, 2001–2011

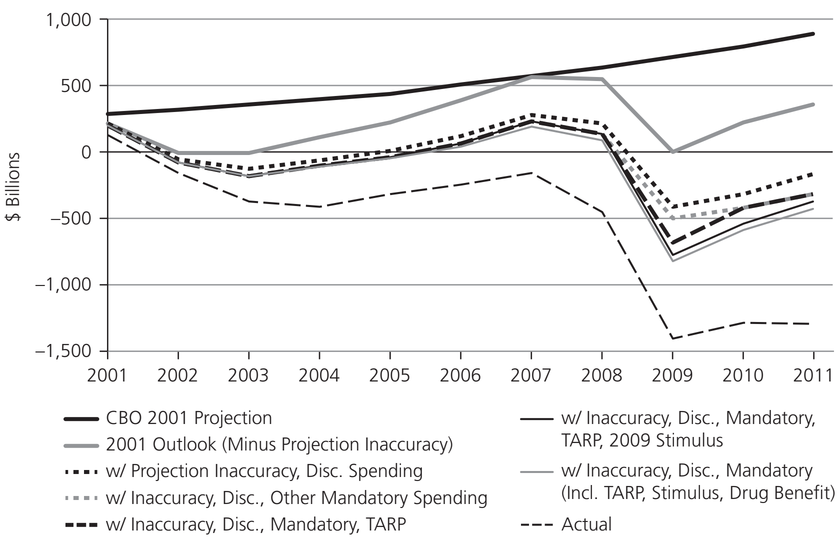


Figure 8. Federal Surpluses and Deficits, 2001–2011

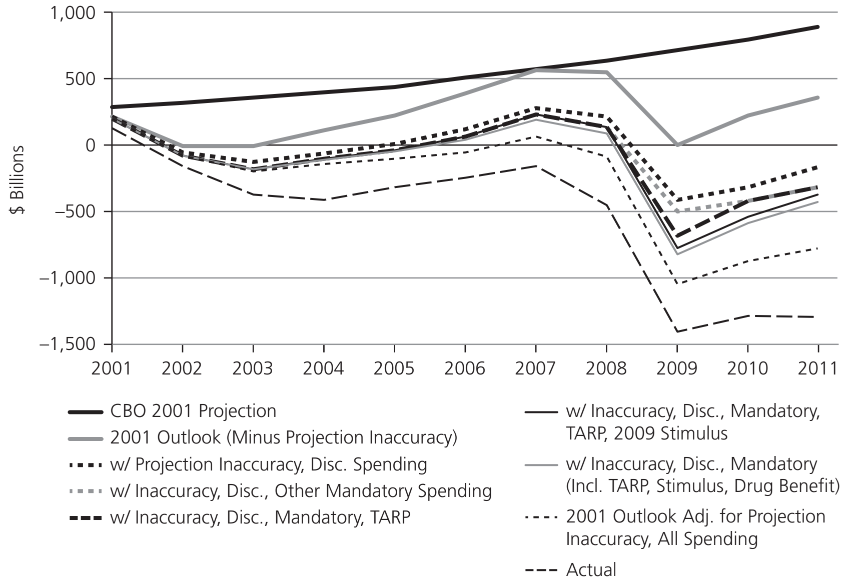
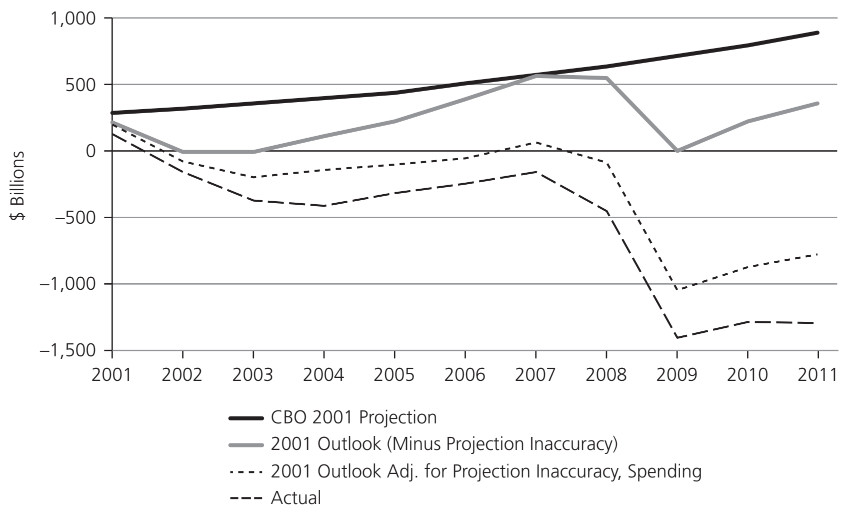


Figure 9. Federal Surpluses and Deficits, 2001–2011



even if there had been no tax relief in 2001 or 2003. This is first because the 2001 projections were quite wrong and second because federal spending increases were more than sufficient to eliminate projected surpluses.

Let's now look at the often-discussed effect on the deficit of the 2001–2003 tax relief laws, and of their extension in 2010. I'll isolate the effect of the 2001, 2003, and 2010 laws by first incorporating the effects of all other tax legislation enacted since 2001—including the 2004 Working Families Tax Relief Act, the 2008 stimulus, and the tax portion of the 2009 stimulus. The result is shown in figure 10.

So, how much did the 2001–2003 tax cuts contribute to our current budget predicament? The difference between the bottom two lines in figure 10 represents the maximum possible answer. The bottom darker dashed line shows the deficits we've had. The lighter dashed line just above it shows the deficits we would have had without the 2001, 2003, and 2010 tax relief laws. Clearly, the post-2001 fiscal deterioration had comparatively little to do with the 2001–2003 tax cuts.

A few words of clarification are in order on the difference between the bottom two lines in figure 10. The tax rates created in 2001 and 2003 were extended by another law in 2010. That law also contained other unrelated tax reductions, including a significant Social Security payroll tax cut. Thus, even if one counts the 2010 extension as part of the "cost" of the 2001–2003 tax cuts, the narrow difference between the bottom two lines in figure 10 is actually somewhat larger than the 2001–2003 tax relief's total fiscal effect.

The CBO report allows us to sum the reasons that the surpluses projected in 2001 never transpired.[3] Figure 11 summarizes CBO's findings. Roughly half of the reason the surpluses never materialized is that federal spending was subsequently increased. (Over half of this total increase was concentrated in the three years of 2009–2011.) A little over one-quarter of the projected surpluses disappeared because of subsequent corrections to the 2001 projections. Less than one-quarter of the fiscal deterioration was due to tax relief of any kind—and only a little more than half of that small fraction is directly attributable to the 2001 and 2003 tax relief packages (see figure 12).

My goal in this analysis has been to isolate the effects of the 2001–2003 tax cuts by showing where we would have been without them. Now I'll take

3. Congressional Budget Office, "Changes in CBO's Baseline Projections since January 2001."

Figure 10. Federal Surpluses and Deficits, 2001–2011

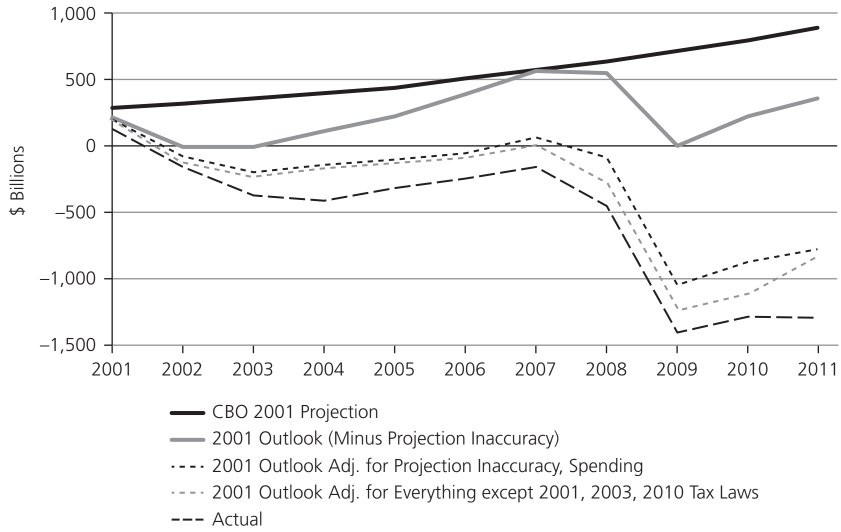


Figure 11. Federal Surpluses and Deficits, 2001–2011

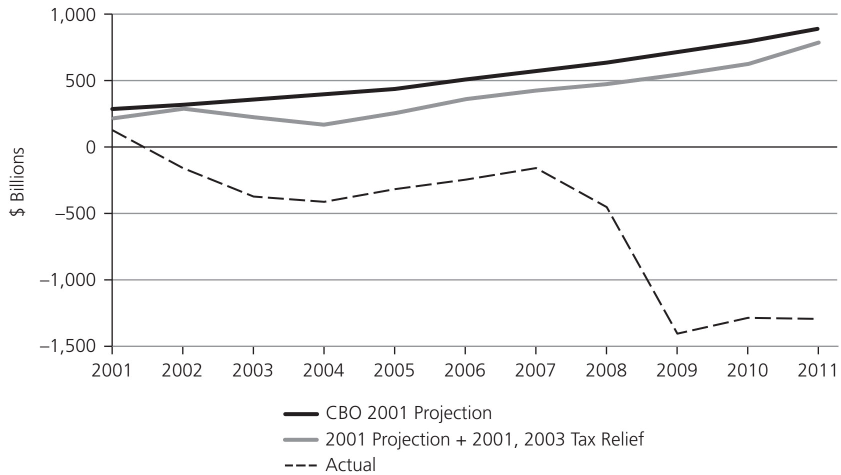
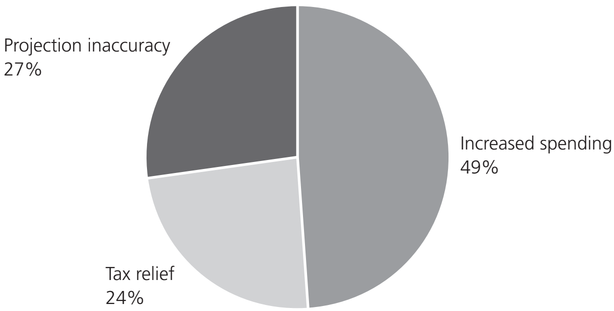


Figure 12. Reasons for Deterioration of Surpluses Projected in 2001



exactly the opposite perspective. Let's assume that only the 2001–2003 tax cuts had been enacted, with no other changes in spending or in the underlying projections. Had that been the case, our budgetary situation would have looked like figure 11.

As before, the bottom line shows what actually happened. The middle line, rising nearly as rapidly as the top one, shows the rising surpluses that would have occurred if tax relief had been the only change to the 2001 outlook.

There are thus two opposite ways we can look at the effect of the 2001–2003 tax relief on our current fiscal situation:

- Had the tax relief never been enacted but had everything else happened as it has, we still would face enormous deficits today.
- Had only the tax relief been enacted, we would still have enjoyed large and growing surpluses.

Various advocates have their own reasons for wanting the tax rates established in 2001 and 2003 to either be extended or expire. But the CBO analysis should finally put to rest any misperception that tax cuts were the leading driver of our currently enormous budget deficits.

The Federal Fiscal Predicament: What Seems Better Is Actually Worse

This article was originally published at E21 on June 27, 2013.

In recent years behavioral economists have been especially prolific and interesting, explaining to us why what we believe to be true so often isn't. One of the more peculiar manifestations of this phenomenon occurred during the second term of the Obama administration, when many press reports—influenced by aggressive political messaging—adopted the viewpoint that the federal fiscal outlook was becoming benign and federal finances no longer needed to be a subject of national concern.

This was, of course, untrue. Federal finances were on an unsustainable, troubling trajectory even before the Great Recession of 2007–2009 began, and the recession (along with the federal policy response to it) made the fiscal outlook far worse. After the recession, federal finances recovered somewhat, as they always do—but still remained far worse than what most everyone had agreed was a dire outlook before the recession hit. In other words, the recession had made a bad situation far worse on balance, but because it had made things temporarily even worse than that, much of the nation irrationally (but naturally) perceived the situation as improving. This piece walks through what exactly had happened and why the US fiscal situation isn't actually "better" simply because things had temporarily looked even worse.

OF LATE THERE HAS BEEN A GREAT AMOUNT OF DISCUSSION ABOUT whether federal deficit reduction should remain a national policy priority. While bipartisan fiscal watchdog groups like the Committee for a Responsible Federal Budget continue to argue that it should be, there have been plenty to argue that it should not.[1] Some of the latter have even suggested that the deficit problem is now essentially under control, and that arguments to

1. Committee for a Responsible Federal Budget, "The Debt Won't Magically Solve Itself," June 18, 2013; Paul Krugman, "Fight the Future," *New York Times*, June 16, 2013; Michael Linden, "It's Time to Hit the Reset Button on the Fiscal Debate," Center for American Progress, June 6, 2013.

contain further federal debt accumulation serve a "political calculus" rather than a substantive need.[2]

The debate is intriguing because of what it reveals about the complex relationship between perceptions and reality. To gain some perspective on this, consider the projection of federal debt as a percentage of GDP shown in figure 1.

Virtually any economic policymaker would look at this projection and see cause for deep concern. It shows federal debt rising uncontrollably in relation to our total economic output, a trend that can only result in a crowding out of national savings, slower economic growth, lower standards of living, and an ultimate inability to sustain our debt payments.

This projection was in fact made. And when it was, there was wide agreement that it represented an unsustainable fiscal situation that threatened our economic well-being and warranted legislated corrections. Peter Orszag, then director of the Congressional Budget Office, testified about this projection that "a substantial reduction in the growth of spending, a significant increase in tax revenues relative to the size of the economy, or some combination of the two will be necessary to maintain the nation's long-term fiscal stability."[3] The Brookings Institution's Tax Policy Center also declared flatly of this projection, "current budget policy is not sustainable."[4] They, and many others who made similar statements, were right.

The projection displayed in figure 1 and referenced in the aforementioned quotes is actually from CBO's *The Long Term Budget Outlook*, published in December 2007—specifically from its fiscal scenario that assumed the continuation of then-current tax and spending policies.[5] (That fiscal scenario was widely held to be more realistic than CBO's other "extended baseline" scenario in which, among other unlikely outcomes, then-current tax rates would all have been allowed to expire at the end of 2010.[6] Throughout this

2. Ezra Klein, "How Republicans Stopped Worrying and Learned to Love Big Government," *Washington Post*, June 21, 2013.

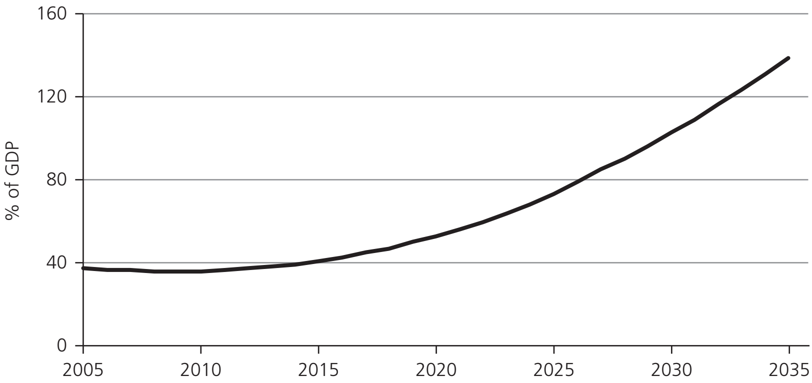
3. Quoted in Abisalom Omolo and Andrew Taylor, "Congressional Budget Office Predicts Deficit Will Rise to $250 Billion for This Budget Year," *Indiana Daily Student*, January 23, 2008.

4. Tax Policy Center, "The Tax Policy Briefing Book: A Citizens' Guide for the 2008 Election and Beyond," Urban Institute and Brookings Institution, December 31, 2007.

5. Congressional Budget Office, "The Long Term Budget Outlook," December 2007.

6. Richard Kogan and Gillian Brunet, "How Projected Surpluses Became Deficits," *Center on Budget and Policy Priorities*, September 12, 2008; Tax Policy Center, "The Tax Policy Briefing Book."

Figure 1. Federal Debt as a Percentage of GDP, December 2007 Projection



article I will refer to various updates of CBO's projections; to maintain consistency I will always refer to this particular projection scenario.)

What has happened since these dire projections were released? The fiscal picture has become worse—much worse. The worsening was due to the severity of the Great Recession, the tepid recovery that followed it, and aggressive federal deficit spending in response to it. The fiscal picture deteriorated markedly from December 2007 to June 2009, as shown in figure 2's updated projections for federal debt.[7]

This worsening happened because, between these two CBO reports, the federal government engaged in a burst of deficit spending partially caused by, and partially a deliberate policy response to, the recession. Though some argued that the long-term fiscal picture might actually be improved by increased federal "stimulus" spending in the near term, the spending binge greatly accelerated the approach of the previously projected debt crisis.

One additional year later—as of June 2010—nothing had happened to improve the fiscal outlook.[8] Instead, projections of federal debt accumulation had grown slightly worse. (See figure 3.)

7. Congressional Budget Office, "The Long-Term Budget Outlook," June 2009.
8. Congressional Budget Office, "The Long-Term Budget Outlook," June 2010.

Figure 2. Federal Debt as a Percentage of GDP

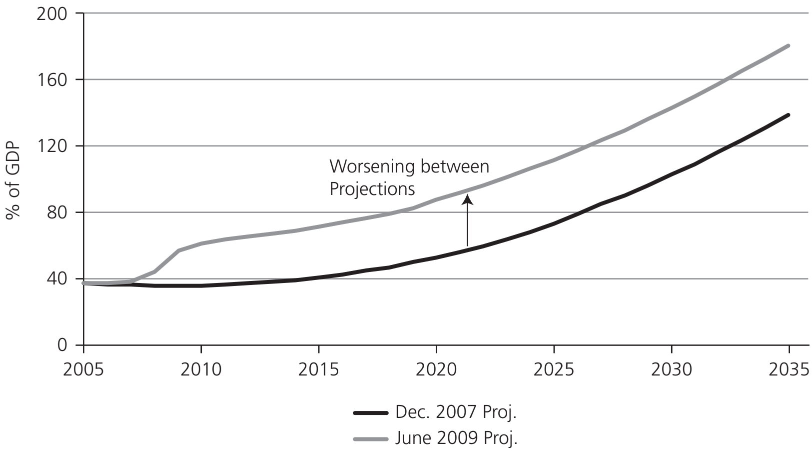
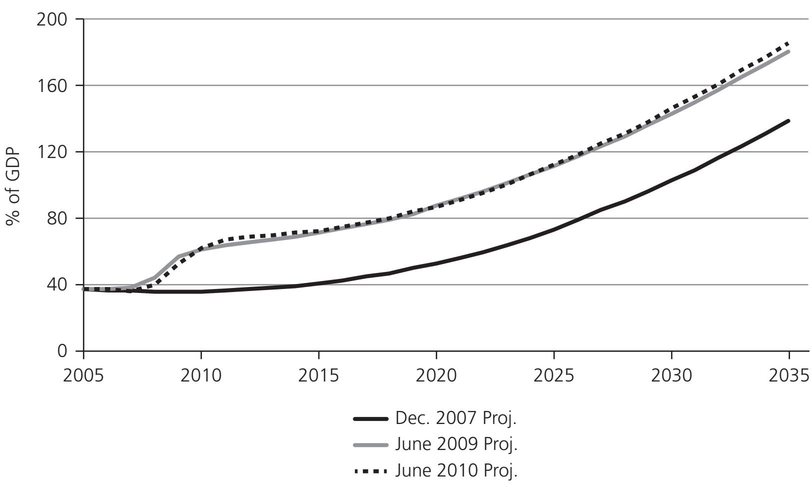


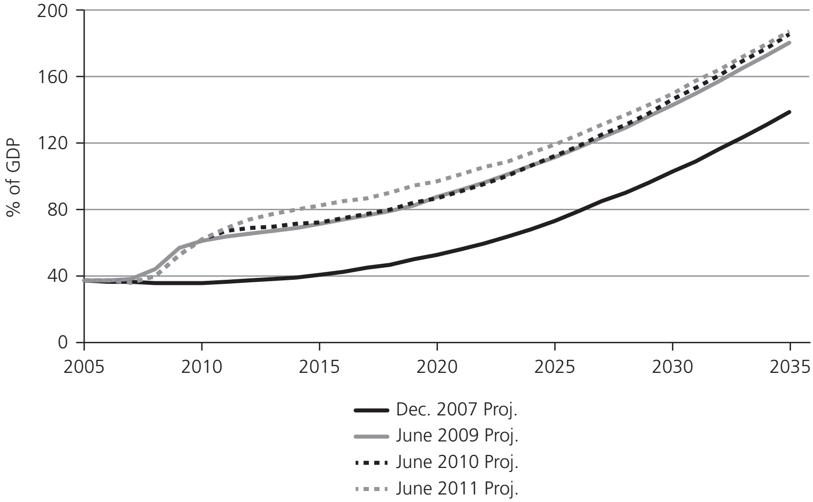
Figure 3. Federal Debt as a Percentage of GDP



CBO next updated these long-term projections in June 2011.[9] Doing so showed that the long-term fiscal picture had grown still worse, with the near-term debt picture looking substantially worse. (See figure 4.)

9. Congressional Budget Office, "CBO's 2011 Long-Term Budget Outlook," June 2011.

Figure 4. Federal Debt as a Percentage of GDP



In June 2012, CBO updated its long-term projections again.[10] The worsening of the near-term outlook shown in its 2011 report remained on the books. The long-term picture remained extremely bleak: slightly better than in the 2011 and 2010 reports (due in part to some fiscal discipline enacted as part of the 2011 Budget Control Act), but a little bit worse than the 2009 projections and still much worse than the late 2007 projections that had been understood to represent a dire fiscal threat. (See figure 5.)

CBO has not yet updated its long-term budget outlook published in 2012.[11] Its latest projections show the projected fiscal outlook over just the next 10 years (through 2023).[12] Figure 6 cuts off at year 2023 for that reason. That's a lot of clutter for one graph, so let's reduce it to two lines—the earliest projection and the latest one—to see how things have evolved since we were warned of an unsustainable fiscal outlook in December 2007: see figure 7.

Figure 7 shows that we are in much worse fiscal shape now than we thought we would be before the Great Recession hit, though even back then

10. Congressional Budget Office, "The 2012 Long-Term Budget Outlook," June 2012.

11. Douglas W. Elmendorf, Congressional Budget Office Director, to Paul Ryan, Speaker of the House, June 13, 2013.

12. Congressional Budget Office, "Updated Budget Projections: Fiscal Years 2013–2023," May 2013.

Figure 5. Federal Debt as a Percentage of GDP

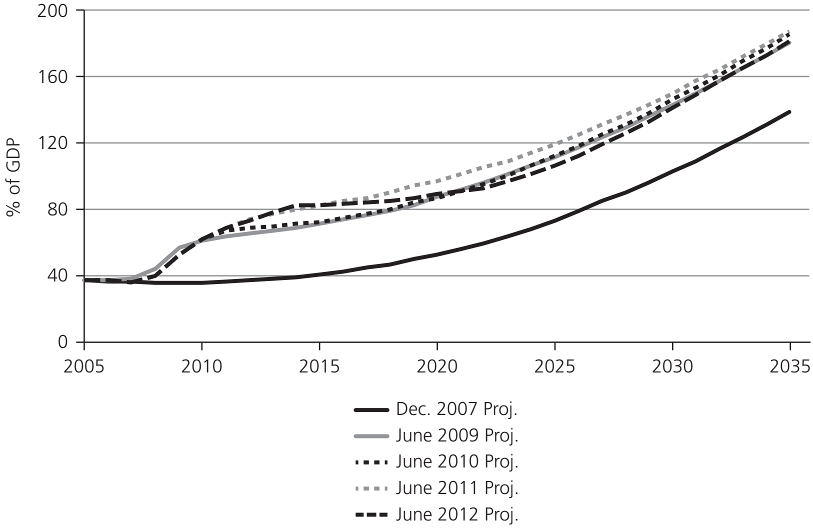


Figure 6. Federal Debt as a Percentage of GDP

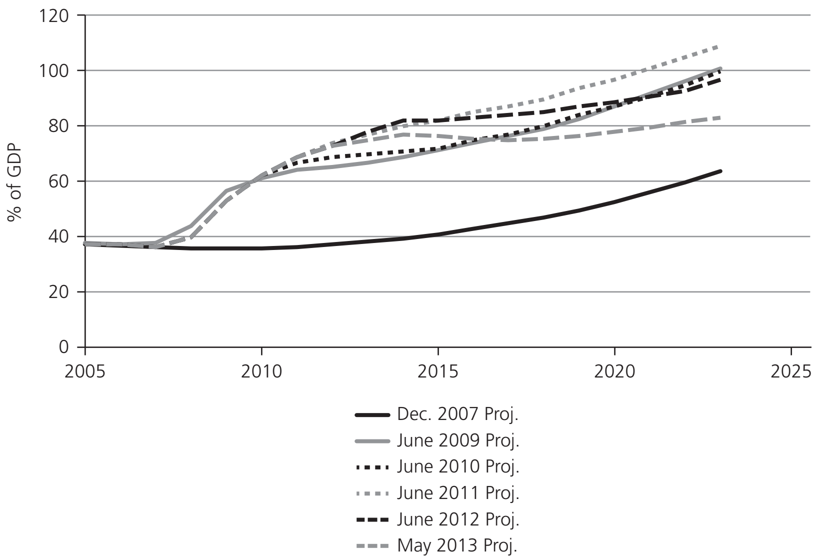
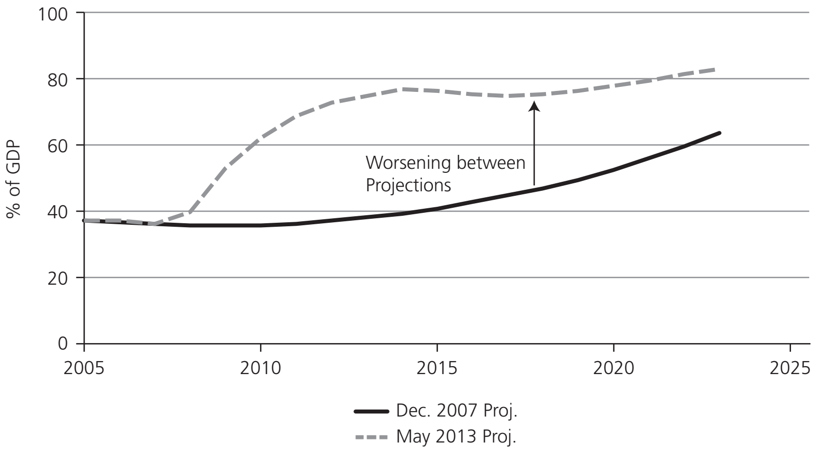


Figure 7. Federal Debt as a Percentage of GDP



it was understood that our fiscal path was unsustainable. Following are some of the salient details of the comparison:

- Our near-term debt situation is now much worse than was foreseen at that time.
- Our long-term debt outlook is also worse than was foreseen at that time.
- The fiscal picture has grown so much worse that federal debt as a percentage of GDP has already far surpassed levels that the dire projections of late 2007 didn't foresee happening until more than a decade from now.
- By any objective measure, if the fiscal picture was serious in late 2007 and warranted substantial deficit-reduction measures, it is far more serious now and requires more aggressive corrections.

Despite all this, as mentioned above, there are some today who are arguing that the fiscal challenge is now so well under control that policymakers should put it aside for now and concentrate on other concerns.[13] Given the data, how can this be?

13. Michael Linden, "It's Time to Hit the Reset Button on the Fiscal Debate," Center for American Progress, June 6, 2013.

The answer may be rooted in the cognitive phenomenon of "anchoring," well-known in behavioral economics. Anchoring is basically a cognitive illusion in which an initial perception distorts our evaluation of subsequent data.[14] An individual who believes he will end a transaction with $10 but comes away with $50 is happy. The same individual, if he previously believed he would end the transaction with $100, will come away unhappy with the same $50. The actual welfare of the individual is the same in both cases, but his subsequent attitude about the transaction is heavily influenced by his prior expectations.

Since December 2007 we've had several CBO reports in which the fiscal outlook has grown much darker, but also some recent ones in which it briefly appeared a little bit worse than it now is. This phenomenon can create skewed perceptions of federal finances. The last few years of massive deficit spending have objectively made our fiscal situation much more problematic. But at the same time, they have caused the large deficits we now continue to run to be misperceived by some as a return to reasonable fiscal health.

Rationally, it cannot be the case that our fiscal situation was made better by being made worse. But that is exactly the misperception that our last few years of massive deficit spending have apparently created in some quarters. As policymakers look at our fiscal situation, they need to remain on guard against illusion, recognize an untenable fiscal outlook for what it is, and take responsible action to deal with it.

14. David McRaney, "Anchoring Effect," *You Are Not So Smart*, July 27, 2010.

Why We Have Federal Deficits

This article was originally published at E21 on November 14, 2013.

The study on which this article was based might be my personal favorite among all the studies I have conducted—perhaps largely because it involved such extensive, arduous labor. I also found the results genuinely fascinating, insofar as they simultaneously illuminated (at least for me) many interesting aspects of our political history as well as of current federal policy.

My objective was to study and quantify nothing less than all the federal fiscal policy decisions over the years leading to our current problematic fiscal outlook, while also cataloguing who was responsible for those decisions. To perform this analysis, I studied every Office of Management and Budget and CBO annual budget report stretching back over more than four decades, along with many other sources. It was exhaustive and exhausting, and had I anticipated the amount of work I was taking on, I probably never would have begun the project.

The fascinating finding was that, while today's Republicans and Democrats exchange impassioned charges of culpability for our current fiscal problems, the vast majority of the decisions causing them were made in the seven years spanning from 1965 to 1972. This period covered the latter part of the Johnson administration and the first term of the Nixon administration, each administration working with a Democratic Congress. Since then, other elected officials have certainly contributed to our fiscal challenges, but they have also taken many actions to clean up the damage caused by legislation enacted during that 1965–1972 period.

This article describes the study's major findings—to get the full picture, see the full study, published by the Mercatus Center.

TODAY (NOVEMBER 14, 2013) THE MERCATUS CENTER IS RELEASING A study I completed earlier this year that comprehensively analyzes the policy decisions underlying federal deficits.[1] Too often partisan advocates focus on a limited time period to purposely throw blame on a targeted political figure.

1. Charles Blahous, "Why We Have Federal Deficits: The Policy Decisions That Created Them" (Mercatus Research, Mercatus Center at George Mason University, Arlington VA, November 14, 2013).

Instead I dissected the entire budget, identifying deficit-driving policies regardless of when they were enacted. The study was a mammoth undertaking; it required the digestion of practically every Congressional Budget Office and Office of Management and Budget budget report published over the past 40 years.

The striking finding is that more than three-quarters of our long-term fiscal problem derives from a set of policy decisions made over a period of just seven years, 1965 to 1972. The year 1965 saw the establishment of Medicare and Medicaid, advocated for and signed by President Lyndon B. Johnson. Both of these programs were later expanded in 1972 during the Nixon administration, as was Social Security. Nothing done by any recent president or Congress carries long-term fiscal consequences as daunting as those arising from these 1965–1972 decisions.

The study examined deficits from three different vantage points. The first was to analyze the specific policy decisions that moved us from budgeting norms practiced over the last 40 years to current projections of untenable long-term deficits. The second was to analyze the policy decisions that led to the current 2013 deficit. The third was to analyze which officeholders ran the largest deficits when they were responsible for federal budget policy. These methodological details are accessible in the full study.[2]

The Long-Term Deficit

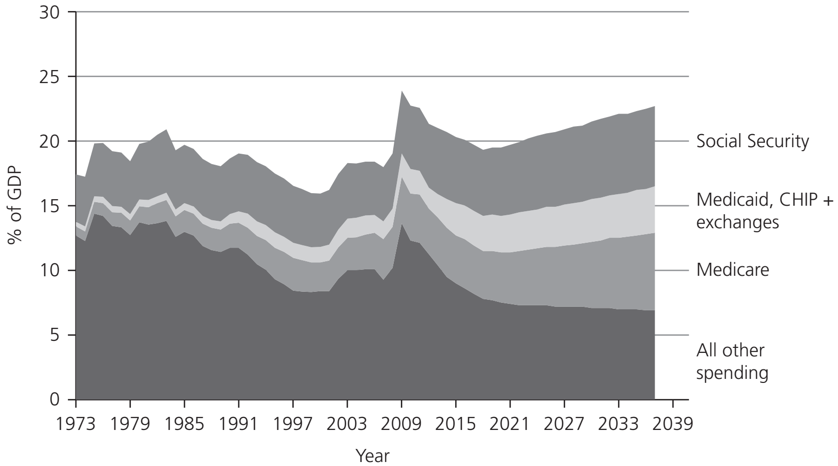
Our long-term deficit problem turns out to be pretty simple. It consists entirely of spending growth in Medicare, Medicaid, Social Security, and the new health insurance exchanges established in the 2010 Affordable Care Act. If it were not for spending growth in these four programs, we would not have a long-term budget problem. Under current law, tax revenues will well exceed historical averages going forward, and spending in all other areas will be far less, as a percentage of GDP. (See figure 1.)

Let us review these contributors one by one:

- *Medicare.* Medicare is the single biggest contributor to our long-term deficit problem. The vast majority of currently projected Medicare costs derive from the program's original enactment in 1965. There was a significant Medicare expansion in 1972, and

2. Blahous, "Why We Have Federal Deficits."

Figure 1. Components of Federal Noninterest Spending, Historical and Projected (as a Percentage of GDP)



Source: Figure 4 in Charles Blahous, "Why We Have Federal Deficits: The Policy Decisions That Created Them" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, November 14, 2013), 34. The data are from Congressional Budget Office, "The 2012 Long-Term Budget Outlook," June 2012; Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2013 to 2023," February 2013.

its Part D prescription drug benefit was added in 2003. Most Medicare legislation in recent decades has reined in projected cost growth rather than added to it.

- *Medicaid and the ACA health insurance exchanges.* Around 30% of the projected excess spending growth in this combined category is due to the ACA, which dramatically expanded Medicaid and established new health insurance exchanges. Most of the other costs here derive from Medicaid's original enactment in 1965. Medicaid also underwent an expansion in 1972, and a series of smaller-scale expansions from 1985 through 1990.
- *Social Security.* If its pre-1972 benefit formula were still on the books, projected Social Security spending would be well within affordable historical norms. Legislation in 1972 increased benefits by 20% across the board, in addition to introducing annual COLAs and indexing the growth of benefits paid to new claimants.

The Current-Year Deficit

The causes of the current-year deficit are more diffuse. As with the long-term deficit, growth in Medicare, Medicaid, and Social Security is a big part of the problem. In addition, growth in income security programs as well as lower-than-typical tax revenue collections have played a role. Legislation enacted by the last outgoing Congress and signed by President Obama is primarily responsible for the tax side. Some of the recent growth in income security spending is attributable to expansions of the earned income tax credit (EITC) and child tax credit and extensions of unemployment insurance during the Obama administration. Another significant portion traces back to an expansion of the EITC enacted in 1993 under President Clinton. Notably, even with ongoing military operations abroad, all current appropriations spending remains within levels affordable within a balanced budget, assuming current interest rates and historical spending prioritization.

Allocating Responsibility

The study assumes that 50% of the responsibility for fiscal policy decisions resides with the president, 25% with the House majority party, 20% with the Senate majority party, and 5% with the Senate minority party. Those assumptions produce an allocation of responsibility for our deficit predicament that is accessible in the full study. For example, the study finds that the individual who bears the greatest responsibility for our long-term imbalance (28.6%) is President Johnson.

Fiscal Stewardship Track Records

Due to the last five years of record deficits, deficit responsibility shares have been much higher on an annual basis during the Obama administration than during any other administration studied, by a wide margin.

In sum, the fiscal problems now bedeviling policymakers are largely those created during the seven-year span of 1965–1972. We will not solve our deficit problem until we scale back the spending commitments originally made to Medicare, Medicaid, and Social Security during those years, in addition to scaling back the ACA's health insurance exchanges. From a budgetary perspective, everything else is mere distraction.

To Understand the Federal Budget, Get Past the Baseline Game

This article was originally published at E21 on April 9, 2014, as "The Secret Assumptions behind Federal Budgets."

The details of federal budget baselining are probably of interest only to the wonkiest of wonks. Nevertheless, they drive the directions of public debate and therefore of policy itself. Whenever one reads in the paper, "Party X offered $3 of spending cuts for every $1 in tax increases," there are lot of assumptions implicit in those numbers, some of which will violate the reader's instincts about common sense.

This piece attempts to flesh out these assumptions, to better inform newsreaders, and to equip them to make sense of what they read and hear about federal budgeting.

OUR NATIONAL DIALOGUE OVER FEDERAL POLICY SUFFERS FROM A huge information gap when it comes to understanding the federal budget. This information gap afflicts not only the general public and the press but also much of Washington's policy-insider community. At the very start of my 11 years on the Senate staff, I quickly learned that if one can master Congress's arcane budget rules, one will command knowledge that even many legislators lack. To put it bluntly, far too few people understand how the federal budget works, how budget-related legislative procedures work, and how scorekeeping works. This article represents an effort to fill in some of that information gap.

Often one will read sentences such as the following in published commentary, reflecting both (a) incomplete understanding of the budget and (b) ongoing political spin: "We have enacted about $2.5 trillion in deficit reduction with about three-quarters coming from spending cuts."[1] Or, "In

1. Michael Linden, "It's Time to Hit the Reset Button on the Fiscal Debate," Center for American Progress, June 6, 2013.

February, the President released the Fiscal Year 2013 Budget, which does the following: . . . Cuts $2.50 for every $1 of additional revenue."[2]

Such statements are usually misleading because they do not illuminate the absolute levels of spending and revenues implicitly being referenced. They only describe spending, revenues, and deficits relative to an alternative scenario known in wonk parlance as a "baseline." This is a problem for a number of reasons:

- The baseline is a purely hypothetical, counterfactual scenario.
- It has limited utility and meaning.
- It doesn't represent current law or the continuation of current policy or what would happen in the absence of further legislation.
- It is constructed in ways that exaggerate the fiscal prudence of lawmakers and, specifically, the amount of deficit reduction achieved under proposed changes in law.

What we ought to do whenever public officials put forth budget proposals is to discuss the total amount of spending and taxation involved, and whether that represents a sensible policy. Instead we often compare those budget proposals to spending and taxes assumed in the so-called baseline. Why is this done? Ideally, it is so that policymakers have a sense of the course we are on now, and of how a specific proposal would redirect that course.

Importantly, however, this scorekeeping baseline deviates from current law as well as from a "no action" scenario in several key ways. For example, under law, appropriations spending must be renewed annually (via either new appropriations bills or a continuing resolution)—or else it terminates, precipitating a so-called government shutdown. But the Congressional Budget Office does not assume that appropriations spending will actually stop upon the expiration of current appropriations authority. Instead, CBO projects what are deemed to be realistic spending levels going forward. These spending levels may indeed be plausible, but they are not current law, nor are they what would happen under a "no action" scenario. These assumptions have very influential effects in that they are the levels to which legislative proposals are compared.

2. White House Archives, "Obama Administration Record on Fiscal Responsibility," accessed April 2014, https://obamawhitehouse.archives.gov/sites/default/files/docs/fiscal_record.pdf.

Similar issues are even more significant with respect to the largest federal entitlement programs, Social Security and Medicare. Congress's scorekeeping rules require CBO to assume a high rate of growth for spending in these areas—and specifically, that certain cost-constraint mechanisms in both programs will be overridden in future legislation.[3] These assumed changes in law to increase future Social Security and Medicare spending have no historical precedent. Accordingly, when one hears of proposed "cuts" in these programs, these are not being quantified in comparison with actual law but with a hypothetical baseline at considerable variance with law and historical practice.

CBO is always diligent about disclosing that its baseline projections for Social Security and Medicare do not reflect the dictates of actual law. For example, in its recent Budget and Economic Outlook, CBO notes,

> In keeping with the rules in section 257 of the Deficit Control Act of 1985, CBO's baseline incorporates the assumption that payments will continue to be made after the trust fund has been exhausted, although there is no legal authority to make such payments.[4]

This is more than a minor footnote. It means that CBO is directed to assume in its baseline that Social Security and Medicare payments will be trillions of dollars higher than they would be under existing law. The assumption that legislators will enact legislative changes allowing for trillions in additional spending has a huge effect on the evaluation of any legislation affecting Social Security and Medicare.

Misunderstanding of these conventions is at the root of common misperceptions, among those unfamiliar with congressional scorekeeping practices, that CBO found that the Affordable Care Act would reduce federal deficits.[5] CBO actually found that the ACA would reduce federal deficits only relative to other Medicare spending increases assumed in its baseline. Relative to previous law, the ACA unambiguously increases deficits because it authorizes

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3. Charles Blahous, "Should Congress Change CBO's Scorekeeping Rules?," E21 (Manhattan Institute for Policy Research), May 29, 2012 (republished in this collection).

4. Congressional Budget Office, "The Budget and Economic Outlook: 2014 to 2024," February 2014.

5. Brad DeLong, "Pro Tip for Charles Blahous: You Have Just Made One of the Misrepresentations That Makes Me Stop Reading . . . ," *Brad DeLong's Grasping Reality*, October 9, 2013.

more additional spending than it would generate in additional taxes.[6] The illusion that the ACA would reduce deficits arises solely because of the scorekeeping convention according to which CBO is directed to assume that some of those spending increases would have happened anyway.

Similar misperceptions are at the root of occasional representations that the federal government has been practicing "austerity" in recent years.[7] By any objective standard, federal spending and deficits have been at historic highs. It is only in comparison with baseline projections made on the basis of even higher recent deficits that it appears that lawmakers have been practicing fiscal prudence.

Accordingly, readers who wish to understand competing budget presentations would do well to discount any claims made in relation to these baselines, be they claims about ratios of proposed spending cuts to tax revenues or claims about net amounts of deficit reduction. The only way to really understand the federal budget is to look at absolute spending and revenue levels.

Figures 1 and 2 are depictions of spending and revenues under President Obama's and House Budget Committee Chairman Paul Ryan's proposed budgets.[8] Ryan's budget estimates are based on CBO projections; CBO has not yet scored the president's budget, so here I will use Office of Management and Budget projections (which employ different economic assumptions). This is thus not a strictly apples-to-apples comparison, but it is the one we have readily available.

President Obama proposes to continue to spend more than historical averages as a share of the economy, Chairman Ryan somewhat less.

The projected tax picture is interesting. Under either budget, Americans will carry higher tax burdens going forward than they have historically. The

6. Charles Blahous, "The Fiscal Consequences of the Affordable Care Act" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012); Charles Blahous, "The Fiscal Consequences of the Affordable Care Act," E21 (Manhattan Institute for Policy Research), April 10, 2012 (republished in this collection); Charles Blahous, "Yes, the Health Law Worsens the Deficit," E21 (Manhattan Institute for Policy Research), April 18, 2012.

7. Charles Blahous, "Record-High Deficits Are Not 'Austerity,'" E21 (Manhattan Institute for Policy Research), February 21, 2014.

8. Office of Management and Budget, *Fiscal Year 2015 Budget of the U.S. Government*, 2014; US House of Representatives, *FY2015 House Budget*, accessed April 2014.

Figure 1. Past/Projected Federal Spending as a Percentage of GDP

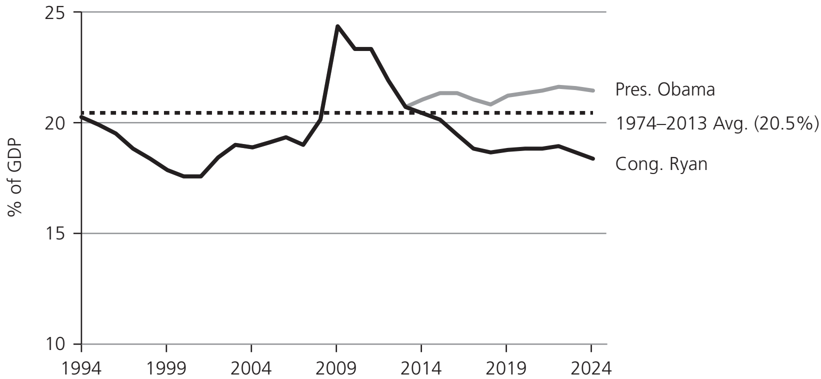
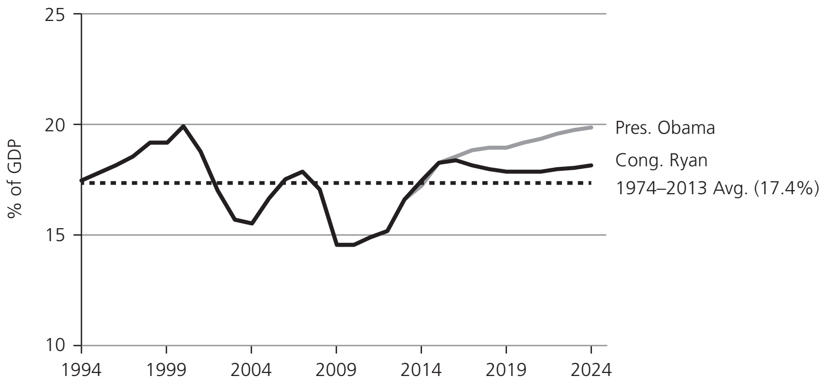


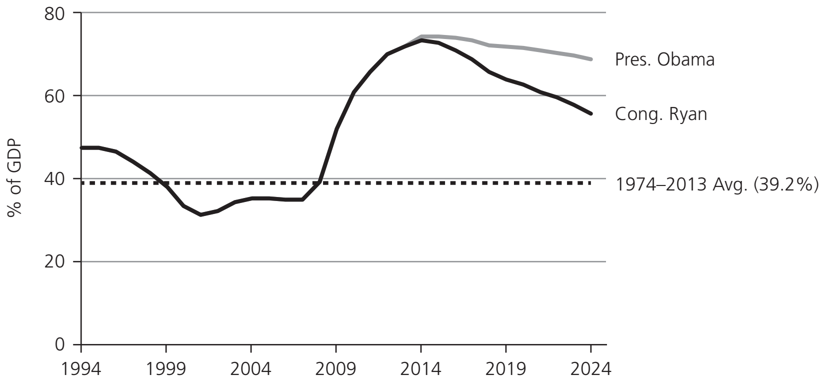
Figure 2. Past/Projected Federal Revenues as a Percentage of GDP



main difference is that under President Obama's proposal, the tax burden would be a lot higher.

The two approaches differ with respect to deficit spending. Chairman Ryan's proposal to balance the budget by 2024 would put public debt on a path back toward historical norms. President Obama's would keep it at permanently elevated levels. (See figure 3.)

Figure 3. Past/Projected Public Debt as a Percentage of GDP



The next time you hear political advocates making claims about how much deficits and spending are being cut, remember that these claims are being made in comparison to fictitious, somewhat arbitrary baselines. Ask them how much total spending and taxation would occur under their plans, and compare their answers. That is the only way to really understand the budget debate.

Mindless Yes, Austerity No: The Real Budget Problem

This article was originally published at E21 on February 19, 2015.

The late Senator Daniel Patrick Moynihan used to speak of what he termed "semantic infiltration." Basically, this meant the adoption of terminology inherently favorable to one side in a contentious debate. Once that was accomplished, Moynihan used to observe, the favored side was well on its way to winning the argument.

Shortly after 2010 there was tremendous consternation among some policy advocates about the fiscal "austerity" allegedly being practiced by Western governments, including the United States. News reports adopted the term as though it represented agreed-upon fact. In truth, there was nothing austere about the US federal budget. In the wake of the Great Recession, federal policy had pushed deficits and debt to unprecedented levels.

Now, it certainly was true that federal appropriated spending has been squeezed more and more over the years—not because of austerity but because it has been crowded out by rising spending on programs such as Medicare, Medicaid, Social Security, and the ACA. This article walks through the data to demonstrate why recent federal practices are the furthest thing from austerity.

WHEN HIS BUDGET PROPOSALS WERE RELEASED IN FEBRUARY 2015, President Obama stated, "I want to work with Congress to replace mindless austerity with smart investments that strengthen America."[1] That quotation neatly summarizes how the White House is framing the basic tradeoff faced in federal budgeting: between "austerity" (i.e., severe cuts in spending and deficits) and "investments" (i.e., spending on things needed to support future prosperity). The real tradeoff we face, however, is fundamentally different.

It should be recognized up front that the president makes an important point. To see this, let's put aside for a moment the semantic battle between Right and Left over whether to call government outlays "spending" (with

1. David Nakamura, "Obama's Shift from 'Mindless Austerity' Derided by GOP as 'Envy Economics,'" *Washington Post*, February 2, 2015.

its negative connotations) or "investments" (with its positive ones). Let's also put aside important policy questions such as the relative efficiency of public versus private investments in areas ranging from transportation infrastructure to education. The president is correct to suggest there has been a protracted decline in the share of our economic output going toward this type of federal expenditure.

Figure 1 shows total federal domestic appropriations as a percentage of GDP. This budget category essentially includes (among others) the categories of spending described in the president's budget as "investing in America's future"—among them education, manufacturing research, and transportation infrastructure.[2] This category does not include mandatory autopilot spending such as Social Security, Medicare, and interest payments on the debt. The long-term trend for appropriated nondefense spending has indeed been down, at least as a share of our economic output, despite surging after President Obama took office. Under current Congressional Budget Office projections, this downward trend will continue: less of our output will be going toward such federal expenditures than was formerly the case.

This is not because we have been shifting our resources from domestic needs to fight wars. Spending on defense did increase after the 9/11 attacks, but overall the relative decline in defense spending has been even steeper than the decline in domestic appropriations. In other words, there has not been a shift of butter to guns; quite the opposite, as figure 2 shows.

Is it correct, then, to say that our ability to spend/invest in the areas favored by the White House has been constrained by the practice of fiscal austerity? Decidedly not. Federal deficit spending has instead risen persistently, soaring to a post–World War II high in the first years of the Obama administration. It has abated in the past few years but CBO finds that it will resume rising in the years ahead. (See figure 3.)

These historically large deficits have produced historically large debt. Federal indebtedness to the public is now 74% of GDP, over twice the share of our economy that it was just seven years ago. CBO projects it will rise to roughly 79% of GDP by 2025, a level not seen this side of a world war. (See figure 4.)

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2. Office of Management and Budget, *Fiscal Year 2016 Budget of the U.S. Government*, 2015, 15.

Figure 1. Past/Projected Federal Nondefense Appropriations

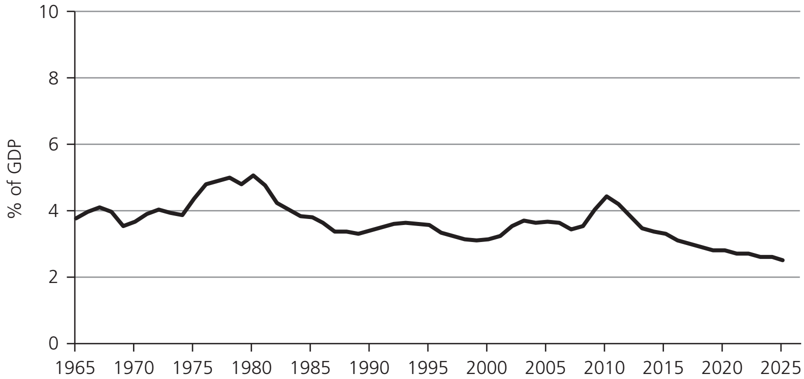
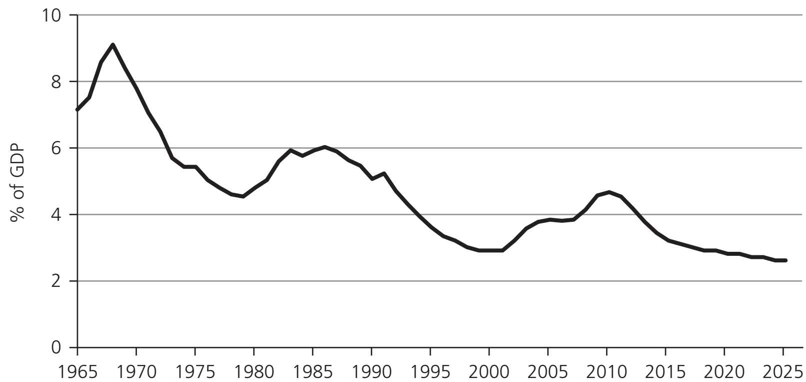


Figure 2. Past/Projected Federal Defense Appropriations



Taken together, figures 1–4 reveal that the fundamental tradeoff we face is not between spending on education, innovation, and infrastructure on the one hand and "mindless austerity" on the other. To the contrary, prioritization of such federal spending has declined during the same period that federal indebtedness has soared to historic highs.

Is this happening because Americans, specifically rich Americans, aren't being taxed enough? No. In 2014 federal revenues equaled 17.5% of GDP,

Figure 3. Past/Projected Federal Budget Deficits

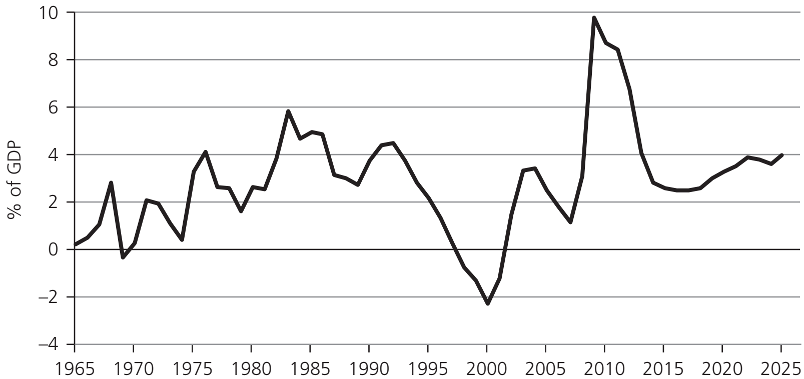
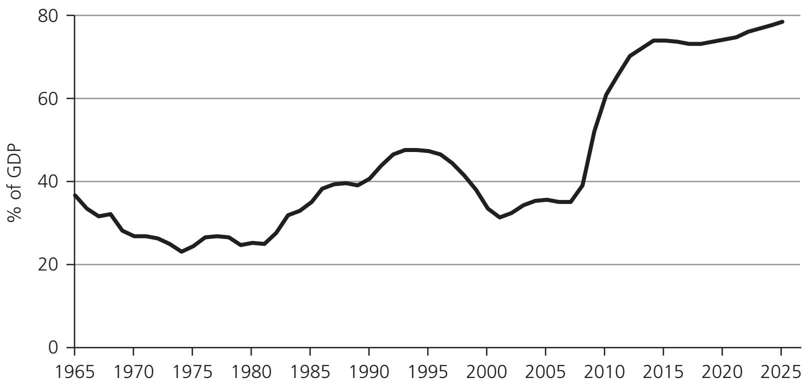


Figure 4. Past/Projected Federal Debt Held by the Public



a little above the average (17.4%) over the last 50 years. Looking forward to when various current-law tax increases fully kick in, CBO projects revenue collections will reach 18.3% of GDP, well above historical norms. In other words, federal debt will be at historic highs while appropriated spending is lower than historically normal and taxation is higher than historically normal. Clearly these variables alone don't explain what is going on. (See figure 5.)

Our debt has exploded because total federal spending, beyond those areas many define as "investments," is rising faster than our economic output or our revenue base can sustain. (See figure 6.)

This unsustainable spending growth occurs because we continue to increase spending on Social Security, on Medicare, on Medicaid, and now on the massive expansion of federal health spending embodied in the Affordable Care Act. Growth in these four categories of federal entitlement spending accounts for our whole fiscal imbalance.

Figure 5. Past/Projected Federal (Tax) Revenues

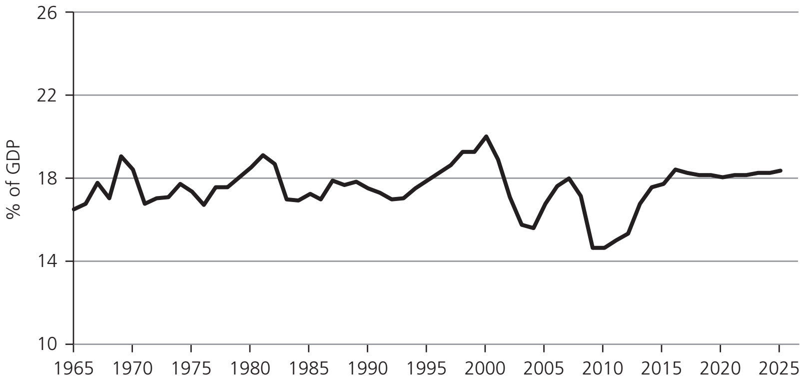


Figure 6. Past/Projected Total Federal Spending

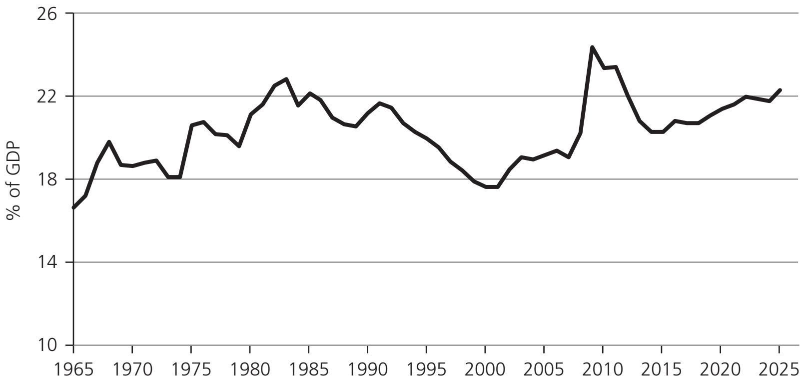


Figure 7. Past/Projected Social Security, Medicare, and Medicaid, ACA Net Spending

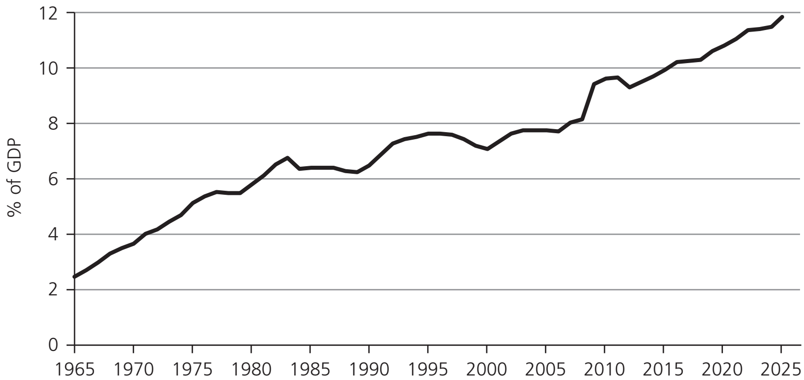


Figure 7 shows the essence of our budget problem. It reveals that the barriers confronting those who want to see more federal spending on education and infrastructure have little to do either with austerity or with insufficient taxes paid by rich people. Both taxation and debt are heading to historic highs despite the relative declines in the aforementioned spending. The reason we are spending relatively less on defense, education, and highways is purely that we are continually spending more on Medicare, Medicaid, Social Security, and the ACA.

A dialogue between Left and Right will not change this dynamic because the areas of strongest disagreement between Left and Right—taxation and alleged austerity—are not at the root of the problem. The dynamic will only change if the conversation within the political left changes; specifically, when left-of-center thinkers decide that rising entitlement spending is a problem because it steadily degrades our capacity to spend on other priorities. This would not require those on the Left to abandon their philosophical commitment to Social Security, Medicare, Medicaid, or the ACA—it would only require that they recognize that these programs cannot perpetually grow faster than our ability to finance them, without undesirable consequences for the rest of the budget.

To date this conversation has yet to be seriously engaged in. Certain narrative fictions persist, for example that the only thing preventing us from having enough money to spend on highways and community colleges is that the rich aren't paying enough taxes. Though this fiction may suit certain political interests, it does not serve the interests of those serious about addressing other societal needs. Even if one believed this narrative, the fact remains that our abilities to tax and to issue debt are not unlimited. Plus, there are practical limitations that the political center will impose that the political left, left to its own devices, would not. It is not realistic to believe that our untenable entitlement spending growth path can remain in place and that we will also find more money to invest in roads and bridges.

The evidence of these dynamics is clearly visible. In 2011, Democrat and Republican negotiators both well understood that entitlement spending growth was driving our fiscal imbalance. Still they could not agree on even modest corrections. Raising taxes on the rich, as President Obama succeeded in doing in early 2013, has not meaningfully changed the long-term trend. Even with these tax increases in hand, the burden of meeting fiscal targets under the Budget Control Act is falling primarily on the discretionary spending accounts, especially defense. This has meant across-the-board spending cuts (sequestration), mostly in appropriated spending, while entitlement spending continues to rise unchecked.

As long as spending growth in Social Security, Medicare, Medicaid, and the ACA continues unabated, we can expect the share of national resources devoted to other federal government priorities to continue to decline. As former President Clinton might say, "It's arithmetic."

The One Budget Reform That Matters

This article was originally published at E21 on October 10, 2016.

If you hang around Washington long enough, you see certain policy initiatives rear their heads so many times, only to collapse in failure or inefficacy, that you risk becoming jaded about them.

One of those recurring initiatives is budget process reform. Granted, we absolutely do need a better federal budget process, and many earnest experts on both sides of the aisle have poured gallons of sweat into efforts to create one. But at the same time, we must be clear-sighted about the fact that our current fiscal predicament hasn't arisen primarily because our budget process is broken. It has arisen primarily because the people's representatives, for better or for worse, have chosen to engage in large amounts of deficit spending. The process we have is reflective of the policy approach legislators have adopted.

While budget process reform can be important, it is equally important not to mistake advocacy of process reform for fiscal responsibility. It's much easier to propose changes to the process than it is to make the tough calls to restrain the spending growth at the heart of federal deficits—in Medicare, Medicaid, Social Security, and the ACA. As this article points out, the only budget process reforms that will ultimately help, from a fiscal perspective, will be those that provide more effective checks on the uncontrolled growth of entitlement spending.

PROPOSALS TO REFORM THE FEDERAL BUDGET PROCESS ARE MUCH IN the air these days.[1] While there is a widespread belief that the process is broken, definitions of that breakage vary widely. Complaints include arguments that the process is overly complex, cumbersome, and outdated; that it promotes short-term thinking over long-range planning, that it lacks transparency and accountability; that it fails to uphold Congress's constitutional powers; that it fails to advance national priorities; and that it promotes bad

1. James C. Capretta, "Reforming the Budget Process," *National Affairs*, 2014; House Budget Committee, "Budget Process Reform," https://republicans-budget.house.gov/initiatives/budget-process-reform/; Center for a Responsible Federal Budget, "Chairman Enzi Proposes Budget Process Reforms," July 14, 2016.

fiscal outcomes.[2] Because budget reform proposals reflect such a wide range of motivations, they take a wide variety of forms. Yet if a central goal is to meaningfully improve federal financial management, only one reform is likely to matter: in the words of Rudy Penner and Gene Steuerle, restoring "more discretion to the federal budget."[3] More on that later.

Though many budget process reforms might be desirable for various reasons, this does not mean they will necessarily result in better budgeting. For example, it may be good government practice to publicly disclose the texts of budget resolutions and amendments before they are considered; there is no guarantee that doing so will result in more public pressure for fiscal responsibility rather than in more interest-group pressure to relax fiscal constraints. Similarly, biennial budgeting may free lawmakers' time to consider legislation more thoroughly. Whether this would result in more or less deficit spending remains to be seen.

Even well-considered legislation to improve Congress's appropriations process may have minimal impact on federal finances. This is because appropriations—basically the spending Congress determines anew each year—already represent a deteriorating percentage of total federal spending. Even if the appropriating process were perfected, we could still end up with uncontrolled federal spending and deficits due to the automatic growth of entitlements under existing law.

Entitlement programs are those automatically authorized to continue to spend funds, often in increasing amounts, without further legislative action. Some of the biggest examples include Social Security, Medicare, and Medicaid. Figure 1 shows how, over time, automatic growth in such programs has precipitated a corresponding relative decline in discretionary/appropriated spending. (Interest costs are grouped with entitlements here because they are also mandatory spending; their inclusion does not affect the qualitative trend.) Figure 2 shows that, under current projections, mandatory spending will continue to absorb an ever-greater share of budget resources. In sum, unless and until the laws governing mandatory entitlement programs are changed, lawmakers will only exert annual control over a shrinking fraction of the budget.

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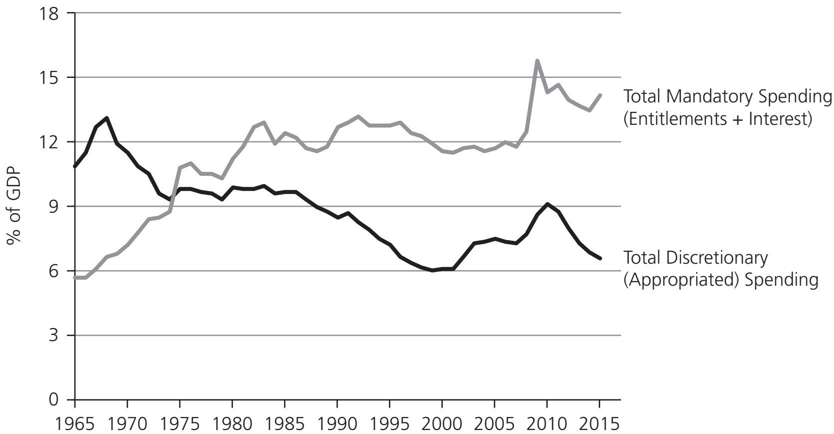
2. Peter G. Peterson Foundation, "Budget Processes Solutions," https://www.pgpf.org/finding-solutions/budget-process-reforms.

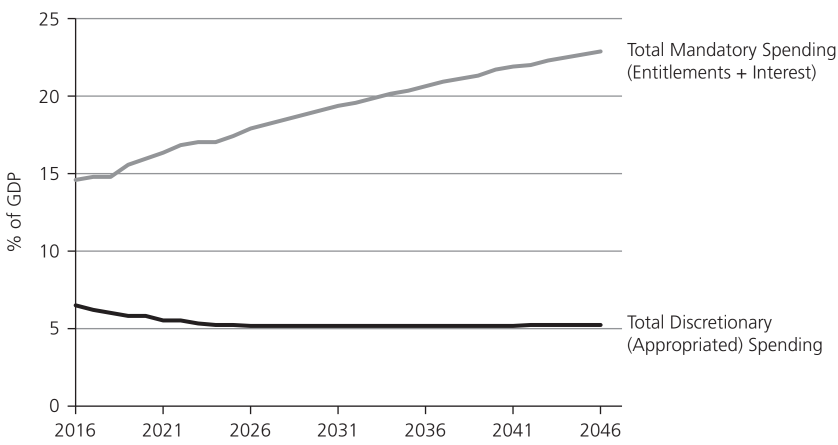
3. Rudolph G. Penner and C. Eugene Steuerle, "Options to Restore More Discretion to the Federal Budget" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2016).

Figure 1. Historical Federal Spending as a Percentage of GDP



Source: White House Office of Management and Budget.

Figure 2. Projected Federal Spending as a Percentage of GDP



Source: Congressional Budget Office.

Reasonable people can and do differ over what constitutes responsible fiscal policy. Because of these differences, budget reforms designed to advantage one side's fiscal views will be resisted by the other. The current process, however, is an equal-opportunity offender: it does not readily allow any legislative coalition's fiscal policy views to be implemented. This is because the vast majority of the budget does not reflect the decisions or even the consent of current lawmakers; rather, it reflects decisions made many years ago by legislators possessing information since rendered obsolete. Unless a new legislative coalition can be formed to change those laws, that problem automatically worsens.

Members of Congress on both sides of the aisle share a stake in fixing this. Believers in a more activist government, for example, would like to see consistently greater spending on transportation infrastructure.[4] But because of the automatic growth of entitlement spending, this has not happened, and won't without a process change. Believers in a more restrained government would like to reduce the drag of taxes on economic growth. Again, because of automatic entitlement spending increases, this has not happened and will not happen without precipitating larger deficits. Under current practices neither side gets what it wants, nor do the two sides get a compromise between what each respectively wants.

Because of this dynamic, lawmakers would do well to shed a zero-sum view of fiscal policy, in which one side's gain is perceived as the other's loss. It might well have once been true that the mandatory spending system advantaged the perspectives of those on the political left. Now that such spending has grown to where it paralyzes progressives' attempts to spend on their chosen priorities, that is no longer the case. Both sides lose under the current system, and both sides would gain by reforming it.

Previous lawmakers attempted to impose fiscal discipline on mandatory spending by establishing trust funds for such items as Social Security, Medicare, and highway spending. The idea was that these programs would be forbidden to spend in excess of the revenues raised for their respective trust funds. Unfortunately, this attempt at fiscal discipline has largely failed. Many trust funds, such as those for Medicare Parts B and D, impose no constraints at all because the federal government's general fund automatically gives them whatever money they lack to meet expenses. Lawmakers have also supplemented Social Security's trust funds with hundreds of billions of general fund dollars.[5] At this point, whether a program has a trust fund provides no meaningful information about whether it strains the general federal budget.

The recent Penner-Steuerle paper, "Options to Restore More Discretion to the Federal Budget," offers several proposed reforms to address these

4. Derek Thompson, "One Issue Trump and Clinton Agree On," *The Atlantic*, August 16, 2016.
5. Committee for a Responsible Federal Budget, "General Revenue & the Social Security Trust Funds," August 19, 2014.

Table 1. Sources and Uses of Changes in Budgetary Resources, 2016–2026

Sources	Real dollar increases (billions)	Uses	Real dollar increases (billions)	Percentage of increase
Revenues	781	Social Security	421	31.1
Deficits	571	Major healthcare programs	462	34.2
		Other mandatory spending	53	3.9
		Defense discretionary	3	0.3
		Domestic discretionary	–24	–1.8
		Net interest	437	32.3
Total	1,352	Total	1,352	100.0

Source: Rudolph G. Penner and C. Eugene Steuerle, "Options to Restore More Discretion to the Federal Budget" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2016).

challenges.[6] These include, among others, automatic triggers to slow the growth of federal mandatory spending and of tax-code entitlements and requiring periodic congressional votes on whether to allow full scheduled increases in program spending. Of particular interest are the authors' presentational recommendations. Penner and Steuerle would have Congress supplement the current confusing "budget baseline" methodology with other presentations disclosing the budget's areas of real growth. Having the Congressional Budget Office routinely release such reports could potentially further essential public and media awareness of the drivers of fiscal pressures.[7] (See table 1.)

6. Penner and Steuerle, "Options to Restore More Discretion."
7. Penner and Steuerle.

Penner and Steuerle summarize the table aptly as showing that, over the next 10 years,

> almost one-third of the increase in budgetary resources will be devoted to Social Security, one-third to major healthcare programs, and one-third to interest on the debt. Close to nothing is left for everything else, including most programs for education, infrastructure, the environment, and energy. Social Security and healthcare entitlements may be good and popular programs, but should the federal government really be spending almost all new resources on them and on interest?[8]

Different people will have different answers to those questions. But at the very least, they should be discussed and deliberately decided. Our failure to address such questions has resulted in a budget process that has spiraled ever more wildly out of control. Unless and until we address the mandatory spending framework that undercuts lawmakers' ability to manage the federal budget, no other process reforms are likely to matter.

8. Penner and Steuerle.

Rising Entitlement Spending Is Straining the Budget

This article was originally published at E21 on April 18, 2018.

It has proved necessary from time to time to publish articles reminding policymakers, press, and public that the structural federal fiscal imbalance is driven by cost growth in mandatory spending programs (e.g., Social Security, Medicare, and Medicaid) exceeding growth in our economic capacity. It is very easy to lose sight of this in the midst of ongoing policy debates in other areas, such as tax policy and appropriated spending.

The two major political parties have significant differences over optimal tax policy and appropriations levels. Moreover, it is true that both higher appropriations spending and lower tax collections cause deficits to be higher than they otherwise would be. But trends in both of these areas of contention are small potatoes from a fiscal perspective, relative to entitlement spending growth. The press tends to focus more on recent battles over taxes and appropriations, where each party is eager to distinguish its position from the other's. But it's important not to let these less significant fiscal policy arguments distract us from the far larger fiscal strains caused by entitlement spending, which only the bravest politicians are willing to tackle.

The two parties frequently hurl charges at each other of irresponsibility and hypocrisy on fiscal issues. There is certainly plenty of irresponsibility and hypocrisy to go around, but there is also room for honest differences over optimal tax collection and appropriations levels. Legislators who reach differing conclusions on these questions are not necessarily irresponsible hypocrites. As this piece details, the acid test for whether someone is truly serious and committed to fiscal consolidation is whether he or she is willing to address the entitlement spending growth that is the root cause of the fiscal imbalance.

AN IMPASSIONED ARGUMENT BROKE OUT IN EARLY SPRING 2018 OVER THE federal budget. It was precipitated by an op-ed in the *Washington Post* by five prominent economists from the Hoover Institution, warning of a coming debt crisis and pointing the finger of blame at runaway federal entitlement spending.[1] A riposte appeared in the *Washington Post* soon after, by several

1. Michael J. Boskin et al., "A Debt Crisis Is on the Horizon," *Washington Post*, March 27, 2018.

prominent left-of-center economists, headlined "Don't Blame Entitlements" and highlighting the role of tax cuts in worsening federal deficits.[2] Since then, several others have weighed in on the controversy, including my E21 colleague Brian Riedl, my Mercatus colleague Veronique de Rugy, James Capretta, and Ryan Ellis. John Cochrane, a member of the original Hoover group, also published a further rejoinder.[3]

The bottom line after all the back-and-forth: the Hoover economists and those who have written in support of them are correct. (Disclosure: I am a visiting fellow with the Hoover Institution but have not communicated with the Hoover authors about their op-ed.) The budget problem we face is almost entirely an entitlement spending problem, and it is critically important to understand this reality if we are to devise effective repairs. For clarity, one must distinguish between three concepts:

1. whether we face a nascent fiscal crisis,
2. what is causing that fiscal crisis, and
3. what we should do about it.

Fortunately for the purposes of our understanding, both sides in this argument agree, when addressing issue 1, that federal finances are in dire shape. The Hoover group finds that "unchecked, such a debt spiral raises the specter of a crisis,"[4] while their critics agree that "growing debt will take an increasing toll on the ability of government to provide for its citizens."[5]

Naturally, there are strong disagreements over issue 3: what we should do about it. Those on the Right generally prefer to restrain spending growth, whereas those on the Left prefer to lean more heavily on tax increases. We need to hash out those policy differences, but it's important not to let them confuse us about issue 2, the underlying causes of the problem.

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2. Martin Neil Baily et al., "A Debt Crisis Is Coming. But Don't Blame Entitlements," *Washington Post*, April 8, 2018.

3. Brian Riedl, "Yes, Entitlements Are Driving the Long-Term Debt," E21 (Manhattan Institute for Policy Research), April 9, 2018; Veronique de Rugy, "To Infinity and Beyond: Are Trillion-Dollar Deficits the New Norm?," *Townhall*, April 12, 2018; James C. Capretta, "CBO Forecast Leaves No Room for Wishful Thinking," *RealClearPolicy*, April 13, 2018; Ryan Ellis, "CBO Confirms That Mandatory Spending Drives the Budget Deficit," *Forbes*, April 10, 2018; John H. Cochrane, "Why Not Taxes?," *Grumpy Economist*, April 11, 2018.

4. Boskin et al., "Debt Crisis Is on the Horizon."

5. Baily et al., "Debt Crisis Is Coming."

Of course, there is a certain tautological sense in which one can always trivially define the budget problem as being equally one of taxes and spending, thereby implying that equal attention must be given to each when crafting solutions. After all, by definition the deficit is the difference between spending and revenues, so a $1 change on either side will affect the deficit by $1.

It does not follow from this, however, that both sides of the budget are equally or even comparably to blame for the problem. To understand why, simply imagine that each year you get a nice healthy raise, but that you nevertheless go more deeply into debt because your spending rises even faster. You might try to manage this problem by taking a second job or seeking a higher-paying one. This wouldn't change the root cause of your problem—your failure to moderate the growth of your spending. And, unless you have a magic way of making more money every year forever, you can't avoid the need to eventually restrain the growth of your spending habits.

With the federal budget, too, the problem is spending growth—specifically, entitlement spending growth. Entitlement programs are those in which ongoing spending is automatically authorized by law, without lawmakers needing to appropriate funds each year.[6] The Congressional Budget Office and other nonpartisan budget analysts have been documenting this runaway spending growth for some time. The federal fiscal imbalance is driven by that growth, especially in Social Security and the "major health care programs," to use CBO's parlance.[7]

One need not look for long at the contours of federal budget operations to see this. Consider tax collection patterns first. Figure 1 shows that nothing historically aberrant is happening on the tax side to bring about our huge deficits.

As figure 1 shows, federal tax policy has been largely consistent throughout modern history—collecting between 16% and 19% of GDP in the vast majority of years. Even with the recent tax cut, this pattern is projected to continue going forward. Indeed, tax burdens will remain generally on the rise as a share of national economic output. In 2017 they were almost exactly at the historical average; now they are projected to dip somewhat lower in the next few years, then rise faster than GDP to climb above historical norms in

6. Congressional Budget Office, "Glossary," January 2012.
7. Congressional Budget Office, "The 2017 Long-Term Budget Outlook," March 2017.

2024 and beyond. If we are facing a debt explosion, it is not because we're eschewing taxation in any historically significant way.

Nor, as figure 2 shows, is appropriated/discretionary spending the problem. Aside from a onetime surge in such spending early in the Obama administration, federal discretionary spending—including both defense and domestic spending—has steadily shrunk as a share of the budget and relative to our economic output.

Figure 1. Federal Tax Collections: Historical/Projected Federal Revenues as a Percentage of GDP

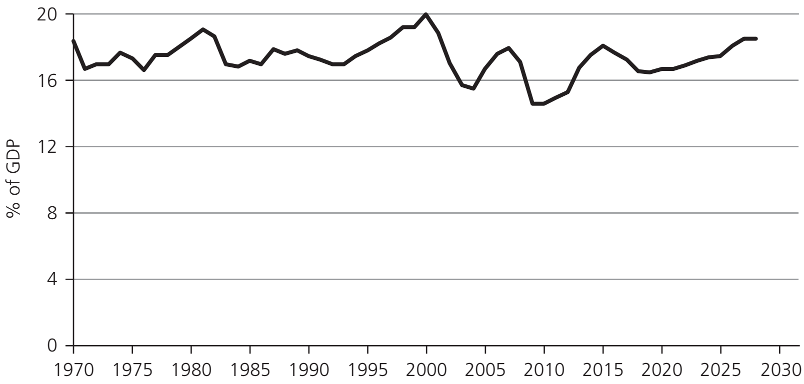
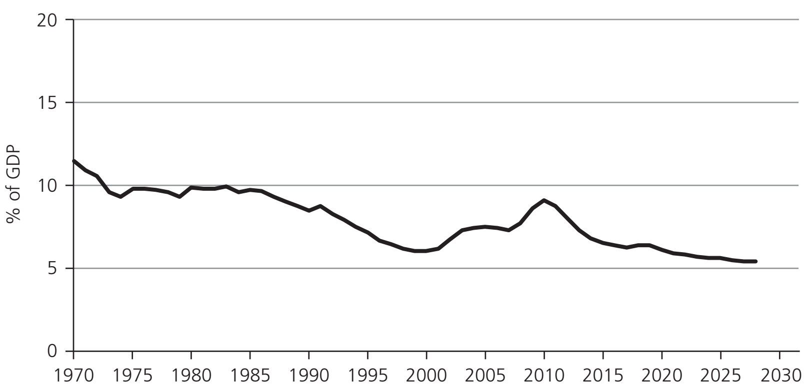


Figure 2. Federal Discretionary Spending: Historical/Projected Federal Discretionary Spending as a Percentage of GDP



If national tax burdens have remained roughly consistent, and discretionary spending has become relatively more affordable, why have deficits climbed into the stratosphere? The answer is straightforward and is evident in figure 3.

Figure 3 shows the source of our budget problems in a nutshell. They exist because year after year we are spending more on entitlements—not only as a share of the federal budget but as a share of our overall economy.

Some numbers from the latest CBO report amplify the point. There is wide bipartisan consternation over the latest CBO projections, which show annual federal deficits climbing from 3.5% of GDP last year to 5.4% of GDP by 2022.[8] Yet entitlement spending alone in 2022 is projected to be 13.8% of GDP, and just the *growth* in such spending relative to GDP over the past few decades is larger than the entire projected 2022 deficit.

It is worth emphasizing that this way of measuring actually understates the point. All of these graphs and numbers are expressed as a percentage of GDP, which means they erase from the picture any growth in revenues and spending in step with national economic growth. If we instead showed the growth in real (inflation-adjusted) revenues and spending, entitlement spending would appear the culprit even more strongly.

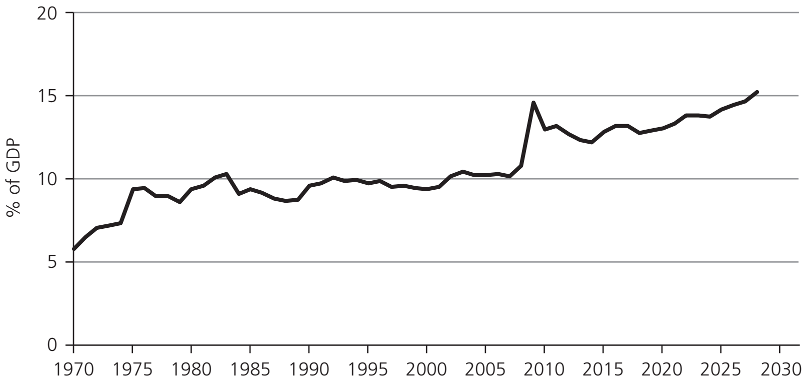
Given the widespread evidence of the dominant role played by spending growth, why do some argue that tax policy is a comparable contributor to the budget problem? There are many reasons, but a couple that stand out are probably best described as analytical mistakes.

One mistake is to frame the question not in terms of the overall drivers of budget deficits but in terms of policy decisions made only within a certain time frame. Tax cuts and appropriations increases do raise the deficit whenever they are enacted—as they were last year—even if they are not of a magnitude comparable to entitlement spending. So if instead of asking "What is driving the budget deficit?" we ask only "What caused the deficit picture to worsen over the past year?" we are going to get a different answer: a distorted picture that reveals only a small fraction of the legislative decisions fueling our growing deficits, while ignoring all the others.

Excluding all policy decisions made outside a chosen time frame grossly exaggerates the relative effects of any decisions made within that time frame.

8. Congressional Budget Office, "The Budget and Economic Outlook: 2018 to 2028," April 2018, 4.

Figure 3. Federal Entitlement Spending: Historical/Projected Federal Mandatory (Entitlement) Spending as a Percentage of GDP



While some might prefer revisiting policy decisions made during the past year to revisiting those made at other times, that subjective preference should not distort our understanding. To see the whole picture, one must look at all policies affecting the budget, not just those one is inclined to change.

The other mistake is to dismiss the primary drivers of the problem by treating them as unchangeable, while treating only some other policies as open to renegotiation. Hoover's critics commit this mistake when they suggest that Social Security, Medicare, and Medicaid benefits must inevitably grow more expensive because of "the aging of the population and the increase in economywide health costs."[9] They are mostly right in their analysis of the causes of program cost growth (though these programs are also delivering rising per capita benefits), but their analysis is only an explanation; it doesn't undo the reality of the situation—nor does it mean these trends cannot be moderated.

Current law implicitly makes various questionable policy choices: that virtually all of our improved national health and longevity should translate into greater fractions of our lives spent in government-subsidized retirement, and that government should fuel excess healthcare inflation by perpetually ratcheting up the amount of health services purchased through government-subsidized insurance. Some might see less political resistance to raising taxes

9. Baily et al., "Debt Crisis Is Coming."

than to moderating these spending policies, or might simply prefer to leave them unrestrained. Either way, these programs are still driving the budget problem.

We need an open national discussion about whether to address the fiscal gap mostly by slowing the growth of government spending or by raising taxes. It is legitimate for anyone to argue that a certain amount of additional government spending growth is desirable and that we should raise taxes to meet it. This doesn't mean, however, that spending increases are not driving our budget strains. Nor does it mean that we can continue perpetually to allow entitlement spending growth to outrun our capacity to finance it.

PART 4

Other Economic Issues

The Real Bipartisan Compromise: Cut Spending on the Rich

This article was originally published at E21 on May 11, 2011.

Of the pieces in this collection, this one provoked some of the most favorable responses from people outside the political class. While the Left argues for increased income redistribution and the Right argues for smaller government, there is an obvious way to meet both sides' objectives: reduce government spending on upper-income beneficiaries. Such policy changes run into enormous opposition from entrenched political interests, but they sound eminently sensible to nonpolitical people. This piece details how the task could be approached.

BIPARTISAN EFFORTS AT FEDERAL DEFICIT REDUCTION WILL FACE stronger headwinds as the 2012 election approaches. Public statements even of those pledging an immediate focus on fiscal repairs are already exhibiting the increasing influence of political considerations. President Obama's April 2011 budget address, for example, incongruously referenced opposition "presidential candidates" and was more specific in its criticisms of Congressman Paul Ryan's budget framework than it was revealing of the administration's own policy ideas. Even members of the bipartisan Senate "Gang of Six" are dropping hints that their proposed implementation of the Simpson-Bowles commission recommendations may largely omit Social Security reform—an especially stark concession to political concerns, considering that Social Security cost growth over the next decade will exceed that of any other federal program.

The essential problem is that the two major parties are now seeking to distinguish themselves on politically sensitive tax and entitlement policies at precisely the time that bipartisan cooperation on such issues is becoming most necessary. And yet there is a clear path available for the two parties to cooperate to improve the fiscal outlook while still preserving the cores of their respective political messages: namely, by cutting the growth of federal spending on "the rich."

The central budget messages of the two parties are distinct but not necessarily in irreconcilable conflict:

- Democrats are largely stressing distributional issues. They charge Republicans with pursuing "tax cuts for the rich" and with plotting to cut vital spending on the poor. Democrats, at the same time, deny Republican charges that they (Democrats) are indifferent to the exploding growth of federal spending.
- Republicans are generally focusing on the size of government. They charge Democrats with supporting runaway spending. They in turn deny Democratic charges that they are insensitive to the vulnerabilities of the poor.

These two messages run along different axes: one being from bigger government to smaller government, the other from rich to poor. This ideological geometry allows for substantive common ground. Specifically, if the two parties agree to cut federal spending (meaning actual outlay spending, as opposed to simply closing tax loopholes) on higher-income Americans, they can simultaneously advance Republican objectives of containing the growth of government while also advancing the Democratic message of targeting federal resources at those of greatest need—and all while reducing federal deficits.

Both parties could actually benefit with their core constituencies from such a deal, by showing they can reduce the structural deficit without betraying their core principles. Each party would also acquire a new defense against one of the other side's primary political attacks: Democrats would have shown a willingness to address runaway spending growth while Republicans would have demonstrated their willingness to go after "the rich."

Substantively, what could such a deal contain? As it happens, the two largest and fastest-growing areas of federal spending, Social Security and Medicare, are both ones for which the wealthiest Americans are fully eligible for rising benefits. Both programs are, to be sure, of extreme political sensitivity. But the financial imbalances in these two programs require correction by elected officials in any event. To the extent that spending on the wealthy is constrained within these programs, it will reduce the financial pressure for even more politically sensitive changes to them.

The essence of what is required is for the two parties to agree on how many high-income individuals to affect and on how much. Social Security provides a ready case study in how this could be done. Many Democrats, for example, have expressed sympathy with the concept of raising the current $106,800 limit on the amount of wages subject to the Social Security tax. Such a measure would affect roughly 20% of workers (the number who have wages above the current limit at some point in their careers). Legislators could therefore choose instead to slow the growth of benefits—perhaps for that same number of workers, or the top 20% of the wage spectrum. (It is best to set the target in terms of the wage percentile rather than a dollar amount of wages because Social Security benefits are calculated based on an average-wage figure called the AIME, which typically includes several zero-earnings years that bring down one's career average, and which does not count any earnings above the wage cap. Accordingly, AIME dollar figures are much smaller than most people tend to associate with real-world earnings patterns. To avoid bipartisan discussions being hung up on such confusion, the parties would do well to first determine the percentile that they wish to affect, and then have the Social Security actuaries produce the implementing dollar figures after such conceptual bipartisan agreement has been reached.)

How much should the growth of such benefits be slowed? It is not financially necessary to reduce Social Security benefits from current levels. Current Social Security proposals, for example, that employ "progressive indexing" would only impose price-indexation on less than 1% of workers, with everyone else receiving faster benefit growth. Limiting the highest-income 20% to inflation-adjusted benefits and allowing gradually faster growth for workers below that level could by itself eliminate well more than half of the entire Social Security shortfall.

As for Medicare, Democrats and Republicans fiercely disagree on whether cost containment is best achieved via a premium support model or by the federal government's imposing price controls within the program's current design. But they do agree on the need for cost containment itself. Already certain features of federal healthcare law, such as the exemption from the "Cadillac plan tax" and the vouchers provided under the new health entitlement, will grow only with CPI, despite the fact that historically health cost inflation has exceeded economy-wide CPI.[1] If it is politically acceptable to restrict these forms of federal healthcare support to CPI growth,

1. Douglas W. Elmendorf, Director of the Congressional Budget Office, to Nancy Pelosi, Speaker of the House, March 18, 2010; Compilation of Patient Protection and Affordable Care Act (as amended through May 1, 2010) (June 9, 2010).

surely Medicare direct spending on the highest-income beneficiaries could similarly be limited. (This cost containment could be achieved most neatly by changing the rate of growth for income-related Part B premiums so as to hold the growth rate for total Medicare per capita expenditures to CPI for the highest-income beneficiaries.)

Though these are the largest federal spending programs, and though most other direct spending is not targeted at the rich by any definition, savings from direct payments to higher-income individuals need not end there. Agriculture support payments, for example, are currently made to farmers with adjusted gross farm incomes as high as $750,000 (and allowing for an additional $500,000 in non-farm income).[2] At a time when so many continue to struggle amid a weak economy, when federal finances are in desperate condition, and when many talk of the necessity of raising taxes on millionaires, it is difficult for taxpayers to understand why direct payments to millionaires continue. It is encouraging that reports on nascent bipartisan deficit talks indicate that such excessive farm subsidies are potentially on the chopping block.

A bipartisan effort to restrain entitlement spending on the rich will not draw unanimous praise. Some on the far left will see such reforms as part of an insidious plot to weaken popular support for cherished programs. But even objection from these quarters is potentially useful and informative. As a nation, we must decide whether our loyalties attach to the programs in the abstract or to the individuals affected by them, both as beneficiaries and as taxpayers. We need an informed debate over whether the costs of government should rise to unprecedented levels simply because of the political importance some might attach to buying the support of those who least need assistance.

A lasting bipartisan deal to constrain the growth of federal spending on the rich may be a bridge too far before the 2012 elections. But it is an answer that will resonate with the typical, politically independent American, who is concerned about deficits, sympathetic to Republican concerns about runaway spending, and yet responsive to Democratic warnings about potential effects on the poor. If the parties could simply agree to cut spending on the rich, they could do themselves and the nation a world of good.

2. US Department of Agriculture Economic Research Service, "2008 Farm Bill Side-by-Side," last updated December 11, 2008.

Does the Government Really Need More Help Than the Private Sector?

This article was originally published at E21 on June 14, 2012.

This piece was published in response to a fairly fleeting political argument, so one might have expected it to have less staying power than others in this collection. Yet it reads especially well after the fact, and I am pleased to have the opportunity to reproduce it here as one of the better pieces.

The piece concerns a specific comment made by President Obama, echoing arguments by some policy advocates, that the private sector was faring better than the public sector in the aftermath of the Great Recession. The dispute over the truth of that statement was moderately interesting, but more intriguing to me was how one's perception of things can be enormously affected simply by how one chooses to view the data. We all must constantly bear in mind the temptation to examine data in ways prejudicial to our policy views, and be prepared to make compensating analytical adjustments to correct for our own biases. In this particular case, how the data are presented proved to be an especially important factor as well.

MUCH HAS ALREADY BEEN SAID AND WRITTEN ABOUT PRESIDENT Obama's statements of June 8, 2012, that "the private sector is doing fine. Where we're seeing weaknesses in our economy have to do with state and local government."[1] I am disinclined to critique the president's choice of words, which are routinely scrutinized to a degree that very few of us could withstand. I am nevertheless reminded of Michael Kinsley's definition of a *gaffe* as being when a politician accidentally tells the truth—or, in this instance, what he believes to be true.

President Obama's comment did not come out of thin air. For several months many policy advocates have argued that government cutbacks are hampering economic recovery and that the federal government should provide more aid to states and localities. The president's statement signals that he has internalized this view. This policy view is important—more important

1. "Obama: The Private Sector is Doing Fine," *RealClearPolitics*, June 8, 2012.

than an inartful choice of words—because it pertains to a fundamental disagreement about the appropriate roles of the private and public sectors in our economy.

In recent months several left-of-center economics blogs have presented graphs somewhat similar to figure 1, reproduced from St. Louis Federal Reserve data by Joe Weisenthal at *Business Insider.*[2] At first glance this graph appears to substantiate President Obama's remarks—that the private sector is doing much better than the public sector. Underneath the graph Weisenthal states, "Note we're not making any conclusions. Just showing the data."

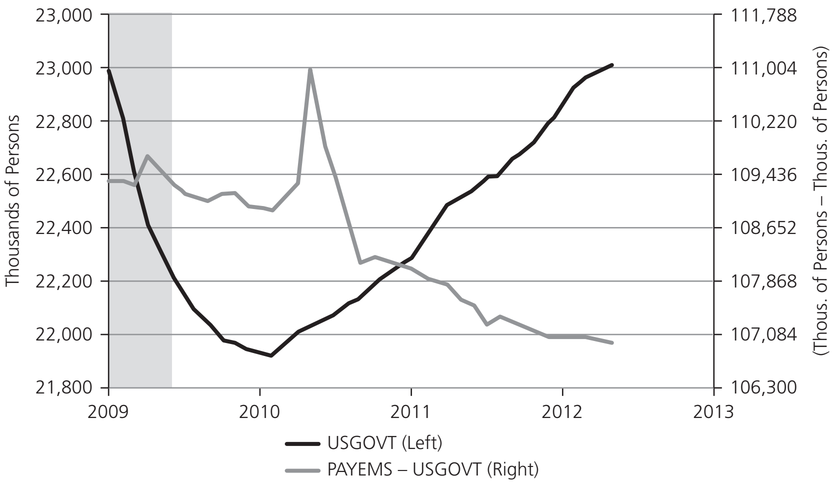
But how one presents the data can have a strong impact on how it is received. Three elements of figure 1 could well distort the reader's reaction to it. First, this is a two-axis graph, in which the scale of the private sector is compressed to seem comparable to the public sector, despite the reality that the private sector is five times as large. Second, although the graph appears at first to compare relative public and private employment to the situation in early 2009, it really doesn't. The January 2009 starting point for private-sector employment on this graph is placed visually higher than the starting point for public-sector employment. A more accurate graph would look like figure 2.

Third and most importantly, figure 1 begins in January 2009. This is critical because the decline in private-sector employment started after January 2008, and was most rapid in that year. While President Obama faces greater political accountability for events since he took office, from an economic standpoint there is no intrinsic reason to start with 2009. Quite the opposite, because looking only from 2009 onward produces a misleading picture by leaving out the critical pre-2009 decline in private employment.

To illustrate this, consider the same data when viewed from two other starting dates. I'll also add a third line for total US employment. Figure 3 shows how employment has changed since January 2008, and figure 4 shows how it has changed since January 2006.

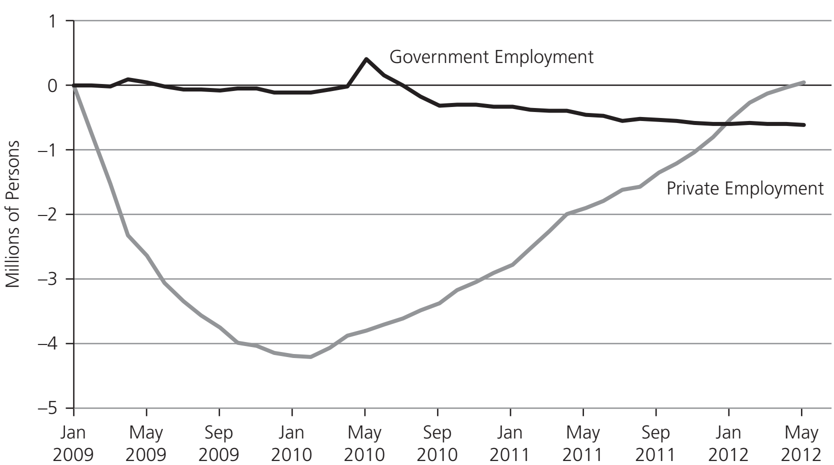
2. Matthew Yglesias, "Public and Private Employment," *Think Progress*, July 8, 2011; David Leonhardt, "Private Hiring and Government Layoffs," *New York Times*, February 22, 2011; Joe Weisenthal, "The Chart: Public Sector vs. Private Sector Employment," *Business Insider*, June 8, 2012.

Figure 1. Public Sector and Private Sector Employment



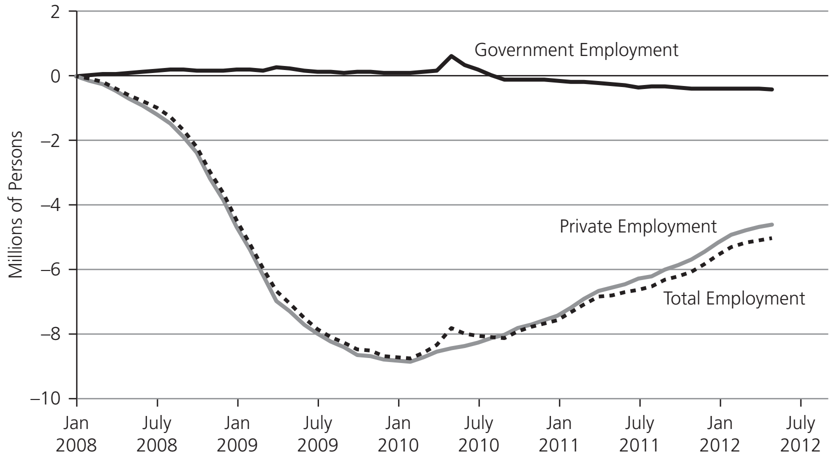
Note: Shaded area indicates a US recession.

Figure 2. Changes in Employment since January 2009



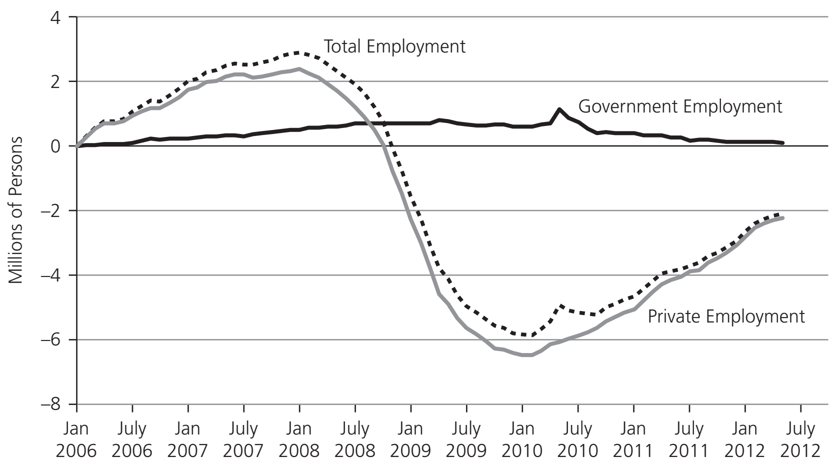
Source: US Bureau of Labor Statistics.

Figure 3. Changes in Employment since January 2008



Source: US Bureau of Labor Statistics.

Figure 4. Changes in Employment since January 2006



Source: US Bureau of Labor Statistics.

The additional context provided by these pictures suggests that the public-sector workforce has actually been, relative to the private sector, largely shielded from the recession. It is almost inevitable that the post-2010 jobs recovery would occur in the private sector because, after all, that's where all the pain was.

One can quite easily argue that the past few months represent not only a natural but a desirable correction—a belated movement from public-sector employment into private-sector employment, restoring some equilibrium that had been disrupted by the recent recession. If on the other hand one sees a given level of government-supported employment as intrinsically desirable, one is more likely to look at recent trends with alarm.

The current debate reveals that policymakers are divided on the roles they would assign to the private and public sectors. It is natural, for example, for public employee representatives to see the recent decline in government-supported employment as a problem in and of itself; some other left-of-center advocates appear to be sympathetic to this view.

That vantage point is reflected in statements like those of Vice President Biden, arguing for increased federal support to state governments by referencing sympathetic constituencies like teachers, police, and firefighters.[3] The position is further reflected in the administration's continued push for federal bailout funds for state governments.[4] Left-of-center thinkers also often express a broader view that taxpayers will in the future need to contribute more tax revenue to ensure that government can function as desired. In short, this viewpoint generally holds that the private sector needs to do more to support the public sector.

An opposing viewpoint is expressed by some right-of-center proponents, including governors Scott Walker and Chris Christie. They argue that the public sector should be trying to alleviate the burdens of the private sector rather than the other way around.

These advocates argue for restraining the growth of government so that the private sector is not ultimately required to make disproportionate further sacrifices in the form of higher taxes. They argue, echoing Ronald Reagan, that the problem isn't that the private sector has lived too well; it's

3. Seung Min Kim, "Biden Plugs Jobs Bill at Hill Rally," *Politico*, October 19, 2011.
4. David Rogers, "W.H.'s Late Push for $26B State Aid Bill," *Politico*, August 1, 2010.

that government has been living better than ordinary Americans have been. These governors have come under rhetorical fire from some public employee advocates and from some elected officials who have come to speak for those government employees' interests.

Left-of-center advocates will sometimes argue that the interests of the private and the public sector are complementary—that greater spending by states and localities will fuel economic recovery in the private sector as well. Their frequent comparisons of private-sector and public-sector workforce sizes, however, appear to reflect a zero-sum mindset about the relative importance of the public and private sectors. From a right-of-center viewpoint, there is no inherent problem if the private sector begins to grow faster than the public sector. But some left-of-center thinkers react with concern to any such trend, even when it simply reflects the private sector belatedly recovering from a painful ordeal.

There is little disagreement on the facts. There is no question that the public sector is now experiencing fiscal constraints from which it was earlier protected, both during the recession and during the subsequent government spending surge. There is also no question that the private sector was hit far harder by the recession itself, and that it has still not fully recovered.

The basic argument is this: should the public sector be given more relief—for which taxpayers must ultimately pay—or should we be trying instead to relieve the private sector of part of the accumulating bill for record public-sector spending? Specifically with respect to jobs, should our aim be to enable government to maintain recent levels of employment, or should we instead focus on enabling the private sector to recover and return to prior levels of employment? In short, should elected officials treat the government sector or the private sector as their principal client interest?

These are fundamental economic policy questions that are likely to grow more salient in the months to come.

Minimum Wage Laws Are Barriers to Employment

This article was originally published at E21 on April 25, 2016.

The behavioral economist Daniel Kahneman writes of the phenomenon of "associative coherence"—our tendency to see information more readily when it reinforces our prior conclusions than when it contradicts them. This is a dangerous characteristic when it comes to shaping public policy, because every policy choice has downsides. Rational policy making requires us to carefully weigh a policy's upsides against its downsides, which is very difficult to do if we are comparatively blind to the downsides of policies we have already decided we favor.

The minimum wage debate is a prototypical example of a policy issue afflicted by our tendency toward associative coherence. People have various valid reasons for wanting government to mandate a higher minimum wage, but the policy has important tradeoffs, especially affecting low-skill laborers who are prevented by such laws from holding certain jobs. Rather than acknowledging, measuring, quantifying, and weighing these tradeoffs, it's too tempting to simply argue that they don't exist—that the government can raise the minimum wage without any costs to employment.

This article summarized the state of understanding of the issue as of spring 2016. Since it was published, there has been a more recent, sensational flap surrounding Seattle's aggressive increase in its local minimum wage. A study commissioned by the city found that the minimum wage increase was, on balance, harmful to low-wage workers by pricing them out of full employment. In response, many advocates denounced the study—and the city simply commissioned another one.

MINIMUM WAGE LAWS ARE MUCH IN THE NEWS THESE DAYS. NEW YORK, California, and various US cities have recently enacted legislation to raise minimum wage requirements to $15 an hour.[1] In this context it is especially worthwhile to revisit the purpose and effect of minimum wage laws.

1. Jennifer Peltz and David Klepper, "Backers of $15 Minimum Wage Eye More States," *USA Today*, April 3, 2016.

Two policy questions are closely connected to the minimum wage debate:

- Whether government should ensure that workers receive no less than a certain amount of compensation for their labor, and
- Whether government should establish a price barrier to employment, and if so how high it should be.

The minimum wage debate is often reported as though it is about the first of these two policy issues. It is actually about the second.

If society's pertinent policy objective were to ensure that workers receive a minimum level of support for their labor, we would almost certainly pursue this objective very differently than through minimum wage laws. Federal or state governments could provide direct income support to workers, which could be designed to be a function of their employment earnings or even of total work hours.[2] Society could make a transparent value judgment about how to balance the income needs of workers with the level of support others are willing to finance. The costs of this support could be broadly distributed among all taxpayers rather than concentrated on certain business activity. Importantly, such a policy would not create direct barriers between low-income workers and jobs.

Thus we don't enact minimum wage laws primarily to ensure income adequacy for workers, which could be done in less problematic ways. The more accurate way to think of minimum wage law is as a government decision to prohibit low-wage employment. Such a law expressly prevents an employer from hiring a worker for a job earning less than the legislated minimum wage, even if that worker would otherwise consider it in his or her interest to accept the job.

Government does not and cannot compel employers to hire workers and pay them a given wage. What government does instead through minimum wage laws is to prohibit employment at lower wages. There is no guarantee that every job made illegal by this prohibition will be replaced by another higher-paying one. Indeed, it is a virtual certainty that at least some jobs will not be.

Thus, minimum wage laws reduce employment.[3] Even without an advanced mastery of economics, it is easy to understand how. If the price of

2. Richard V. Burkhauser, "The Minimum Wage versus the Earned Income Tax Credit for Reducing Poverty," *IZA World of Labor*, May 2015.

3. Congressional Budget Office, "The Effects of a Minimum-Wage Increase on Employment and Family Income," February 18, 2014.

something (in this case labor) is raised, a purchaser (in this case a potential employer) is not only less willing but also less able to buy it. To construct a deliberately extreme example: if you could hire a plumber for $1 to unplug your drain, you would probably be delighted to do so. If instead the government required that you pay a plumber $10,000 to unplug it, you would almost certainly find a way to just do it yourself. The job would simply be eliminated. It is difficult to say for certain where this line is crossed for every job—but every job has such a line. Minimum wage laws push the lowest-skill workers from the employable to the unemployable side of that line.[4]

There is a debate among economists as to how large a minimum wage increase must be before it creates an unambiguous, measurable adverse impact upon jobs. Advocates of minimum wage increases often cite academic research by Alan Krueger and David Card suggesting that specific past minimum wage increases did not lead to increased unemployment.[5] But most academic research reaches the expected conclusion that minimum wage laws do reduce jobs, including research by Jeffrey Clemens, David Neumark, and Jonathan Meer.[6] Even Krueger recently editorialized that raising the minimum wage to $15 an hour would "risk undesirable and unintended consequences."[7] Thus economists widely agree that raising the minimum wage lowers employment; the only serious arguments are about when the effect is large enough to be discoverable.

None of this is to denigrate the motives of those who advocate raising such barriers to employment. To some eyes it is a form of exploitation if work is performed for pay below a certain level. Returning to our example of the plumber, some might regard it as unacceptably unfair to pay him

4. Jeffrey Clemens, "The Minimum Wage and the Great Recession: Evidence from the Current Population Survey" (NBER Working Paper No. 21830, National Bureau of Economic Research, Cambridge, MA, December 2015); Congressional Budget Office, "Effects of a Minimum-Wage Increase."

5. David Card and Alan B. Krueger, "Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania," *American Economic Review* 84, no. 4 (1994); David Card and Alan B. Krueger, "Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Reply," *American Economic Review* 90, no. 5 (December 2000).

6. Jeffrey Clemens and Michael Wither, "The Minimum Wage and the Great Recession: Evidence of Effects on the Employment and Income Trajectories of Low-Skilled Workers" (NBER Working Paper No. 20724, National Bureau of Economic Research, Cambridge, MA, December 2014); David Neumark, "Employment Effects of Minimum Wages," *IZA World of Labor*, May 2014; Jonathan Meer and Jeremy West, "Effects of the Minimum Wage on Employment Dynamics," *Journal of Human Resources*, August 2015.

7. Alan B. Krueger, "The Minimum Wage: How Much Is Too Much?," *New York Times*, October 9, 2015.

only $1 to unplug your drain—holding this viewpoint so strongly that they would forbid the two of you from mutually agreeing to the transaction. That the job might simply be eliminated strikes some as an acceptable price to prevent this perceived exploitation. The same logic holds that it would be preferable for a person to remain unemployed than to perform a low-wage job at, for example, Walmart or McDonald's.

This means, however, that minimum wage laws inevitably price some workers out of the job market.[8] Workers most vulnerable to displacement include those with the weakest job skills, perhaps because they lack sufficient education or training or because they are young and just entering the job market. Specific sectors such as the restaurant sector often operate with thin profit margins that leave them little room to adjust to sudden changes in their labor costs other than by eliminating jobs.[9]

An underrated problem with pricing low-skill workers out of the job market is that their earnings losses are not limited to their period of unemployment. It is usually while holding a job that an individual acquires the skills necessary to achieve higher future earnings. It is therefore usually better for that individual to be employed for a low wage than not to be employed at all. This too is widely recognized. A working paper from the Boston Fed recently found that "the earnings of displaced workers do not catch up to those of their nondisplaced counterparts for nearly 20 years."[10] As the paper further states, "the longer a worker is unemployed, the more his or her skills . . . depreciate, making the worker less valuable to a new employer."[11]

This effect is of particular concern right now when young adults—those most often harmed by minimum wage increases—are falling out of the workforce in rising numbers.[12] No one knows for sure why this is happening, but the effect on these workers will be lower earnings for many years to come. This trend, as seen in figure 1 (reproduced from the St. Louis Fed), should give lawmakers pause before they erect further barriers to employment.

8. David Neumark, "Employment Effects of Minimum Wages," *IZA World of Labor*, May 2014.

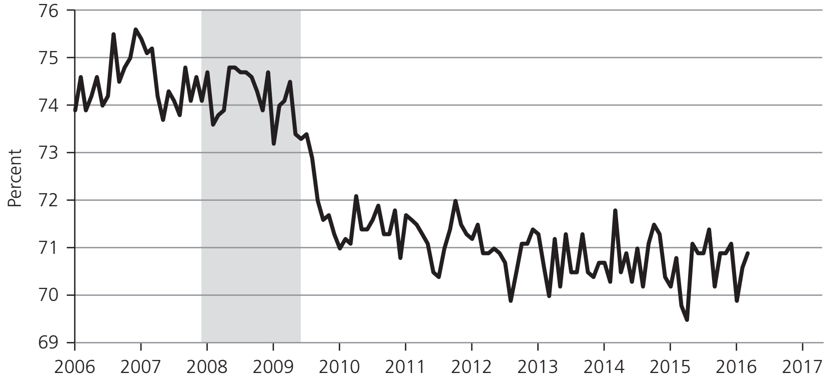
9. Kate Gibson, "How Much Will Minimum Wage Hikes Hurt Restaurants?," *CBS News Money Watch*, June 12, 2015.

10. Daniel Cooper, "The Effect of Unemployment Duration on Future Earnings and Other Outcomes" (Working Paper No. 13-8, Federal Reserve Bank of Boston, January 13, 2014).

11. Cooper, "Effect of Unemployment Duration."

12. Clemens, "Minimum Wage and the Great Recession."

Figure 1. Civilian Labor Force Participation Rate, Ages 20–24



Note: Shaded area indicates a US recession.

Source: US Bureau of Labor Statistics, "Civilian Labor Force Participation Rate: 20 to 24 Years [LNS11300036]," retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/LNS11300036.

It is appropriate for lawmakers to consider policies to raise worker living standards, including the compensation workers receive for their labor. The amount of income support low-wage workers should receive beyond the amount they can freely earn is an important societal value judgment. However, it is a separate value judgment from whether and where to set a minimum wage, which is instead effectively a decision about how stringently to prohibit individuals from working.

Keeping People Working: The Leading Economic Policy Challenge of Our Time

This article was originally published at E21 on August 24, 2016.

While income inequality has been regarded as a pressing concern in much media coverage, workforce participation is an even more fundamental economic policy challenge, bearing important implications not only for income inequality but also for societal health, wealth, and happiness.

A long-anticipated suppression of US workforce growth arising from population aging has been exacerbated by other declines in labor force participation rates, for example among young working-age males. Research by experts from across the ideological spectrum has revealed that these trends are dangerously weakening to society—worsening income inequality, dampening economic potential, and fostering social dysfunction.

Federal policy has yet to catch up to this overriding policy challenge. For the most part, policymakers have focused on ameliorating the problems of the poor—inadequate income, limited access to healthcare, and so forth—without due regard for whether our stopgap solutions are worsening the underlying problems by driving people out of the workforce, preventing them from developing critical job skills. This piece attempted to explain the stakes.

IT IS BECOMING INCREASINGLY CLEAR THAT REFORMING FEDERAL policies to keep people in the workforce is the primary economic policy challenge of our time. Americans' future quality of life will depend on our getting this right.

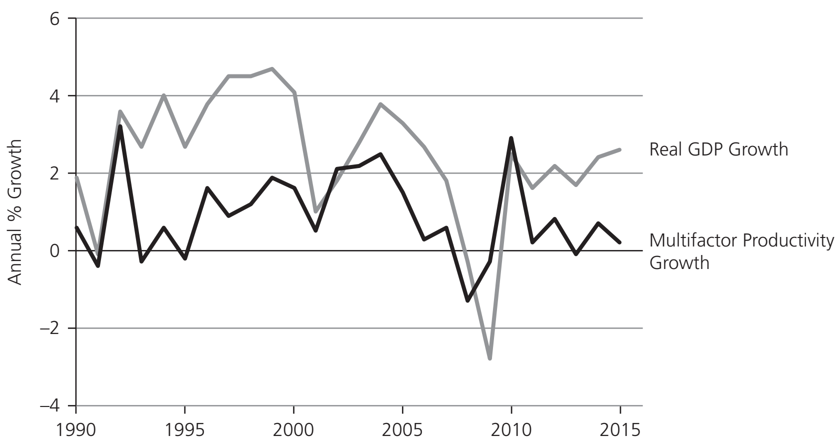
Americans' standards of living, and indeed our economic power as a nation, are reflections of our productive output. Only that which we produce can be transmuted into desirable things ranging from the goods that we buy and consume privately to the public goods that we share to the strength of our defenses in a dangerous world. While a great deal of our public policy debate focuses on how national wealth is distributed, we cannot distribute what we don't have. More fundamentally, it is our economic output that determines the quality of life Americans can enjoy.

Our economic growth is basically a function of two primary factors: how many Americans are working, and how productive we are during the hours we work. It is straightforward to understand that the more productive we are, the more wealth we will have together. Indeed, figure 1 charts recent annual growth in GDP and shows that it is generally higher when our productivity grows faster. Thus a good deal of our prosperity comes from Americans learning to work faster, better, smarter, and more efficiently. (Note: multifactor productivity incorporates not only labor productivity but also output on capital services; the GDP decline of 2008–2009 arose primarily from decline in the latter.)

As striking as the correlation is between productivity growth and total economic growth, employment growth is perhaps even more important. To be productive, Americans must work. Assuming given levels of productivity, the more Americans who are working, the more wealth our society generates. Figure 2 compares recent annual GDP growth with annual changes in total employment and renders this relationship inescapable. Our economic output generally rises (and falls) with the numbers of Americans in jobs.

This relationship is why discussions of the economy often focus on the unemployment rate, long defined as the percentage of Americans seeking

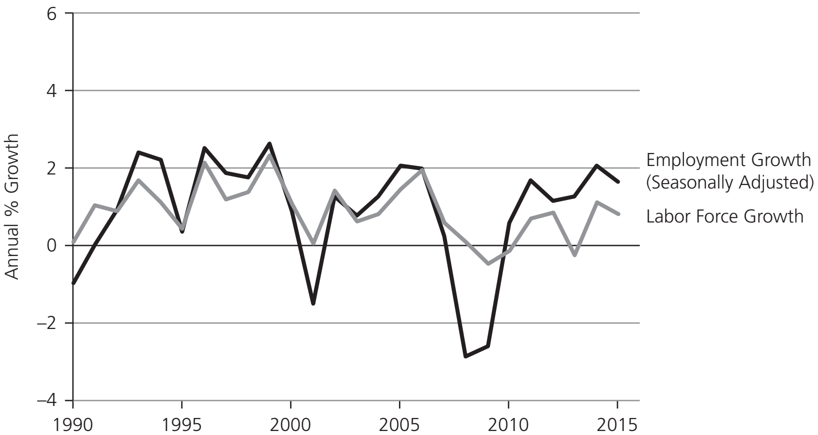
Figure 1. GDP Growth and Productivity Growth



work who are unable to secure it. In recent years it has become increasingly apparent that the health of the labor market isn't measured solely by the unemployment rate, but must account for the total numbers of Americans making themselves available for work. A quick glance shows that the growth of this available labor force is a strong determinant of the numbers of those employed: see figure 3.

Figure 2. GDP Growth and Employment Growth

Figure 3. Labor Force Growth and Employment Growth



Indeed, total labor force growth and employment growth tend to move quite closely together. The rare exceptions are years like 2008 and 2009, when unemployment rates suddenly changed.

A quick look at figure 3 shows that even though the unemployment rate has recovered from the recent recession, we have reason for continuing concern. Our total labor force—i.e., those available for employment—is no longer growing as fast as it formerly did. If we want to continue to experience improvements in our living standards, as previous Americans did, this is something we must fix.

What is behind our sluggish workforce growth? A number of things:

- Americans are spending a higher percentage of our lives out of the workforce collecting benefits from various retirement programs. This is largely because of our inadequate response to demographic change; even as longevity has increased, the age of first eligibility for such benefits as Social Security (62) and Medicare (65) has not. As a result, labor participation among seniors is lower today than it was a half-century ago, even though we generally lead longer, healthier lives.
- Various federal benefit programs are proving to be poorly designed in the sense of applying high marginal tax rates to employment earnings. Basically, this means individuals receive substantial benefits if they lack paying work, but lose them as they receive job income. This results in people making the rational decision to have less work and earnings than they otherwise would. A prominent example is the Affordable Care Act, which has been shown by the Congressional Budget Office and academic economists like Casey Mulligan to be driving many people out of the workforce.
- Other factors are not fully understood. To take but one example, it is widely documented that workforce participation has long been declining among young adult males. We do not have a single, agreed-upon explanation for this persistent participation decline.

Policy corrections to these various causes of labor participation decline will need to be implemented if the United States is to resume the economic growth rates that made us the leading economic power in the world. We simply can no longer afford to have our largest federal retirement, healthcare, and income security programs shifting people out of the workforce who, based on their health, age, skills, and general inclination, would otherwise be working. Lawmakers will have no choice but to confront these realities at some point, and would do well to do so sooner rather than later.

It is important to understand that corrections would generally tend to benefit individual program participants. This is because, while the current designs of programs from the ACA to Social Security often induce workforce withdrawal, the temporary inducement often comes at the cost of an individual's long-term interest. For example, retiring on Social Security at age 62 reduces one's annual benefits and increases the risk of outliving one's savings and experiencing poverty in old age. Similarly, those who bypass employment to receive substantial subsidies like those available through the ACA often do so at the cost of skill development that would otherwise result in higher wages later.

Only if we surmount our labor force participation challenge will we be able to successfully address other economic policy desires such as higher living standards, lower poverty, and sound federal government finances. For these and other reasons, reorienting federal policies to keep people in the workforce is likely to remain the preeminent economic policy challenge of our time.

Averting the Multiemployer Pension Solvency Crisis

This article was originally published at E21 on October 26, 2018.

This article was one of several I published in the fall of 2018 concerning a solvency crisis in private-sector multiemployer (union) pensions, which was threatening to collapse the US pension insurance system and was the focus of a special joint select congressional committee. Among those pieces, this article was selected for inclusion in this volume because it draws most heavily on research I had recently conducted and published with the Mercatus Center, and because it focused both on analyzing the problem and on presenting a framework for legislated reforms.

The long and short of the issue is that the impending insolvency of some large multiemployer pension plans was projected to be too much for the nation's pension insurance system (operated by the federally chartered Pension Benefit Guaranty Corporation) to cover. This situation threatened workers not only with the loss of pension benefits that were uninsured (because they exceeded insurance coverage guarantees) but also with the loss of those that were nominally insured (because an insolvent Pension Benefit Guaranty Corporation would be unable to cover even insured benefits).

Representatives of both employer and union interests pressed lawmakers aggressively for a bailout of insolvent pensions, a proposition that would be expensive in its own right but would also almost certainly lead to more expensive future bailouts, possibly spreading to state and local public pension systems. This piece showed that the root of the problem was that multiemployer pension sponsors had failed to fund their benefit promises—in large part because the promises themselves were a function of actuarial assumptions long known to violate well-established economic principles. Until these practices are reformed, as they were in single-employer plans through the 2006 Pension Protection Act, the multiemployer pension funding crisis will continue to grow worse.

EARLIER IN 2018, FEDERAL LAWMAKERS ESTABLISHED THE JOINT Select Committee on Solvency of Multiemployer Pension Plans to address an intensifying crisis in multiemployer pensions.[1] A primary focus of the com-

1. Joint Select Committee on Solvency of Multiemployer Pension Plans home page, US Senate and House of Representatives, accessed October 2018, https://www.pensions.senate.gov/.

mittee, which is cochaired by Senators Orrin Hatch (R-UT) and Sherrod Brown (D-OH), is the projected insolvency of our national multiemployer pension insurance system operated by the federally chartered Pension Benefit Guaranty Corporation (PBGC).[2]

PBGC's multiemployer insurance program faces a $65 billion shortfall, and insolvency by 2025, threatening the vital pension benefits of workers. Worse yet, the projected insolvency of PBGC insurance is but one symptom of systemic underfunding in multiemployer pensions themselves, which has left $638 billion in worker pension benefits—over $60,000 per worker—without financing.[3] The committee is required to vote on recommendations by the end of November 2018.[4] Last week, the Mercatus Center published my study of the crisis, which lays out the causes of the shortfall and offers a suggested framework for reform.[5] This piece summarizes the principal findings of the study.

First, some background. Multiemployer plans are private-sector defined-benefit pensions sponsored jointly by a union and multiple employers. About 10 million American workers are covered by these plans, many of these workers having held jobs in construction, mining, trucking, transportation, and other service, trade, and manufacturing industries. A distinguishing feature of multiemployer plans is that workers can continue to accrue benefits after they switch jobs to another employer participating in the same plan. A typical multiemployer plan is governed by a board of trustees, on which labor and management are equally represented. Employers usually contribute funding to plans at rates negotiated in collective bargaining agreements, though federal law may require additional contributions if a plan becomes underfunded. A central responsibility of the plan trustees is to establish a benefit structure that the employers' contributions can successfully fund.

Another distinguishing feature of multiemployer pensions is what happens when an employer withdraws from participation in a plan. In the single-employer pension world, such a withdrawal typically means that the plan is

2. Pension Benefit Guaranty Corporation home page, US Government, accessed October 2018, https://www.pbgc.gov/.

3. Charles Blahous, "Averting the Multiemployer Pension Solvency Crisis" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, October 2018).

4. Joint Select Committee on Solvency of Multiemployer Pension Plans, "Joint Select Committee on Solvency of Multiemployer Pension Plans Seeks Input from Stakeholders," press release, April 18, 2018.

5. Blahous, "Averting the Multiemployer Pension Solvency Crisis."

terminated and the PBGC assumes responsibility for paying benefits, up to limits set by law. By contrast, with multiemployer plans, what is supposed to happen is that a withdrawing sponsor makes a withdrawal payment equal to its share of the plan's unfunded vested benefits, after which its workers' benefits are paid by the continuing sponsors. In practice there are multiple loopholes in the withdrawal liability rules, with the result that multiemployer plans typically inherit increased unfunded liabilities whenever a sponsor withdraws.

PBGC's multiemployer pension insurance is essentially a last line of defense for worker benefits. The forward lines are provided by employers who continue to sponsor the plan after others withdraw, the idea being that this risk-pooling largely protects workers from the consequences of any single employer going under. Accordingly, PBGC's own insurance coverage is very limited: it covers only $12,870 in benefits for a worker who has been employed for 30 years. PBGC's financial assistance to insolvent plans takes the form of so-called loans which are, in effect, ongoing subsidies because such loans are almost never repaid.

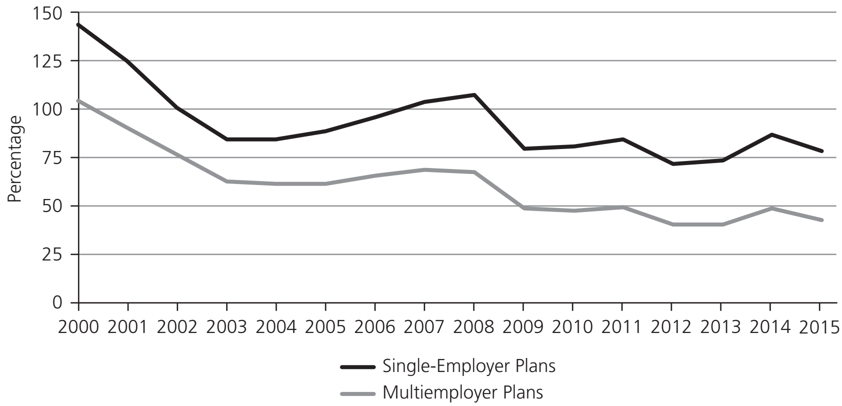
Gaps in statutory funding rules often allow multiemployer plan funding shortfalls to grow until a plan can no longer make benefit payments on its own, at which point PBGC enters the picture to provide support. PBGC currently faces projected claims exceeding $67 billion, as compared with a little over $2 billion in insurance program assets. If, as projected, PBGC is driven into insolvency by these claims, workers will not receive even their ostensibly insured pension benefits. Some estimates are that affected workers could lose up to 90% of their benefits if PBGC becomes insolvent.[6]

A good first step to finding our way out of this mess is understanding how we got here. Some assume that financial market disruptions, like the bursting of the dot-com bubble in 2000 and the Great Recession of 2007–2009, precipitated the pension funding problem. They didn't, as figure 1 makes clear.

It's true that multiemployer plans were in better shape before the stock market bubble burst in 2000, and that they took a further tumble during the 2007–2009 recession. But prudent management means anticipating inevitable market declines, and in any case the market has long since recovered from those shocks. As figure 1 shows, multiemployer plans simply started out less well funded than single-employer plans, and later failed to rebuild

6. Blahous.

Figure 1. Comparison of Single-Employer and Multiemployer Plan Funding Ratios



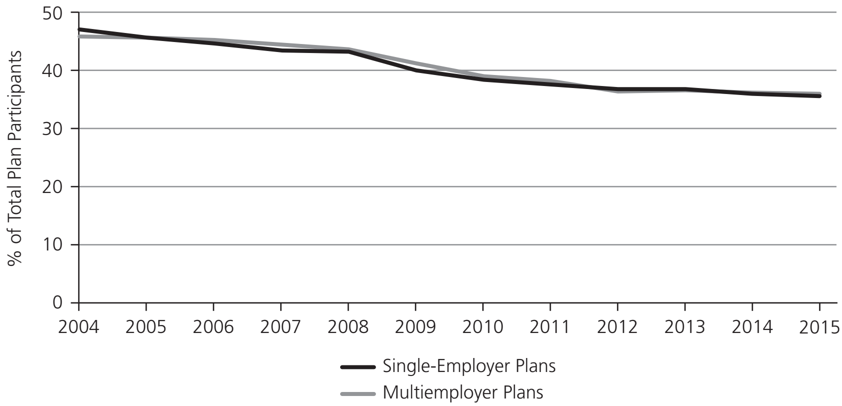
their funding levels during market recovery periods. Despite the strong stock market of recent years, the share of multiemployer plans' liabilities that are funded hasn't exceeded 70% since 2002, and declined all the way down to 43% by 2015.

It's also often noted that multiemployer plans suffer from a declining ratio of active workers to retirees, which depresses their funding contribution base. That's certainly true, but it doesn't distinguish multiemployer plans from their single-employer counterparts, which face the same problem. Single-employer plans are much better funded than multiemployer plans despite their similar demographics. (See figure 2.)

If the aforementioned factors didn't cause the multiemployer funding crisis, what did? The foremost causes are inaccurate valuations and lax funding rules. Unlike single-employer plans, multiemployer plans are permitted by law to value their assets at levels deviating by as much as 20% from current market values. But even more problematically, multiemployer plans are allowed to dramatically understate their liabilities by using inflated discount rates to translate them into present-value terms. The vast majority of multiemployer plans use discount rates of 7% or higher in their actuarial calculations,[7] roughly twice the rates used to properly calculate their current

7. Blahous.

Figure 2. Percentage of Active Workers in Multiemployer and Single-Employer Plans



liabilities. This is the biggest reason why multiemployer plans report funding percentages that are nearly 80% on average, when their true funded status averages less than 50%.

Some sources tactfully say that there are diverse views on how to correctly discount pension plan liabilities. A more accurate way to put it is that there is a firm consensus among economists on how to do it, and that most plans' actuarial practices (as well as federal funding rules) simply disregard this consensus.[8]

Multiemployer pension plans are governed by federal funding rules that are far more lax than those governing single-employer plans. Multiemployer plans are given much longer time frames to address their underfunding, and critically underfunded plans are exempted from otherwise applicable statutory penalties for inadequate contributions. Average insurance premiums paid by multiemployer plans are less than one-sixth of what they are for single-employer plans, despite an insurance program deficit nearly six times as large. Underfunded multiemployer plans are also not subject to variable rate premiums, as underfunded single-employer plans are. Finally, multiemployer plans face fewer restrictions on the growth of their benefit

8. Blahous.

promises, which allows them to dig their financial holes still deeper before (and even after) landing on PBGC's doorstep.

In addition to inaccurate valuation and lax funding rules, another factor contributing to multiemployer plan underfunding is the "orphan liability" problem—i.e., the sponsors' obligations to pay benefits to workers whose employers have left the plan. This problem is fueled by inadequate withdrawal liability assessments, meaning that it is often much less expensive for a sponsor to withdraw from a plan than to continue contributing to it. The most underfunded plans have a substantially greater share of "orphan workers" than better-funded plans, on average.[9]

The 2006 Pension Protection Act (PPA) averted a crisis in single-employer pension insurance by reforming single-employer plans' valuation requirements and funding rules. Unfortunately, the PPA did not do the same for multiemployer plans. Multiemployer plans were instead relieved of certain funding requirements and allowed to dig their underfunding holes still deeper, with the hope that the plans might invest their way out of the problem. It didn't work. With the crisis now metastasizing, it is essential that lawmakers avoid repeating this mistake on a still larger scale, and that they resist calls to bail out these troubled pensions with taxpayer-financed "loans" that are virtually certain to lead to larger future shortfalls. (See figure 3.)

My study outlines various reform principles that should underlie any committee recommendations: accuracy in asset and liability measurements, safeguards against further deterioration of underfunded plans, improved incentives for plan trustees, stronger funding requirements, and premium assessments that reflect risks to the pension insurance system.

Above all, lawmakers should signal that no taxpayer dollars will be used to bail out insolvent multiemployer pension plans. This is imperative for several reasons. First, it is fundamentally unfair—to taxpayers, and to other employers who have responsibly funded their pensions—if unions and corporations provide benefits to their workers without paying for them, and thereafter demand that taxpayers (most of whom are ineligible for such benefits) provide the funding. Second, bailing out any multiemployer pension plans will cause future pension funding to plunge, as other sponsors will then expect similar bailouts instead of financing their own benefit promises.

9. Blahous.

Figure 3. Comparison of Single-Employer and Multiemployer Insurance Deficits

Source: Annual Pension Benefit Guaranty Corporation reports.

Given multiemployer pensions' more than $600 billion in underfunding, this is an unaffordable risk.

The specific structures of multiemployer pension plans clinch the case against a federal bailout in a very particular way. Multiemployer pension plans are often built around an employer contribution rate negotiated between labor and management as part of a collective bargaining agreement. The plan trustees then translate those contribution rates into a benefit structure. When the trustees employ inflated liability discount rates in violation of established economics principles, this decision leads directly to inflated benefit promises to workers. It would be grossly inequitable to then transfer responsibility for paying these inflated benefit promises from the trustees who made them, to federal taxpayers.

Consideration should be given to deploying PBGC resources to relieve troubled pension plans of their orphan liabilities. This would recognize the role orphan liabilities have played in worsening the pension funding crisis, as well as the role of lax withdrawal rules in fostering those unfunded liabilities. This should only be done for true orphan workers—that is, those not subsequently employed by another continuing sponsor in the plan. It should also only be done to the extent that sponsors make offsetting changes to their plans, to reduce projected claims on the PBGC net of its assumption of any orphan liabilities. This could be facilitated by partitioning troubled plans into two parts: PBGC could assume responsibility for the section encompassing true orphan liabilities, while the employer sponsors would be responsible for fully funding other workers' benefits, under strengthened valuation and funding rules.

In sum, the multiemployer pension system faces a crisis threatening millions of workers' benefits, a crisis brought about by inaccurate valuation methods and lax funding practices. A solution to the pension problem will only last if it is built upon principles of measurement accuracy, transparency, damage control, and fairness. This means, first and foremost, requiring that employers and labor representatives only promise benefits that they are prepared to fully fund.

PART 5

Behind the Scenes

Why Tell-All Books Distort Rather Than Illuminate the White House Policy Process

This article was originally published at E21 on September 27, 2010.

When it comes to government operations, the knowledge gap between insider and outsider is largest not with respect to policy but to process. People observing from without are fully capable of learning extensively about public policy. Such knowledge acquired on the outside never fully substitutes for direct professional experience, to be sure, but nevertheless members of the public can amass a great deal of raw data that is similar or complementary to what insiders possess. But there is simply no substitute for holding a policymaking job when it comes to learning how things work from a process standpoint. When someone is new to a position in government, the learning curve is steepest. Indeed, a great deal of public frustration with government performance is rooted in limited understanding of what can be done reasonably well within the processes of government and what can't.

The public cannot be faulted for knowledge limitations based on lack of direct experience; very few people are lucky enough to land a top White House job. And, to their great credit, many members of the American public are hungry to learn about these processes and eagerly consume information about them even as they conduct their own busy lives. Unfortunately, as this piece documents, much of this information comes by way of publications designed to advance the author's professional reputation rather than to improve the operations of government.

IN A PREVIOUS PIECE, I EXPLAINED THE WHITE HOUSE'S ECONOMIC policy process as directed by the National Economic Council (NEC).[1] The NEC process is a critical determinant of national policies, and one worthy of greater public appreciation. A new book by Steven Rattner has emerged, purporting to shed light on this process as it related to the auto industry bailout.[2] The "tell-all" nature of published excerpts from the book is exactly the wrong way to go about this.

1. Charles Blahous, "Change at the National Economic Council: What Does It Mean," E21 (Manhattan Institute for Policy Research), September 23, 2010.

2. Steven Rattner, *Overhaul: An Insider's Account of the Obama Administration's Emergency Rescue of the Auto Industry* (New York: Houghton Mifflin Harcourt, 2010).

Rattner's accounts of the sometimes-heated deliberations among President Obama's advisers are entertaining and potentially informative for those of us on the outside looking in.[3] That said, they are profoundly damaging to the president's access to unvarnished counsel, and are therefore bad for everyone affected by the quality of the president's decision-making.

To understand why merely requires that one envision a meeting between the president and his senior advisers, at which consequential economic policy decisions are to be discussed. Now imagine that a camera is placed in the room, and the participants are told that their conversation will be aired at some unspecified future date. The inhibiting effect of this upon candid, uncensored discourse is obvious.

Those who author these "tell-all" accounts sometimes justify their conduct in the name of public transparency. Americans have a right to know, after all, how their elected leaders are making decisions. But such publications actually lead to less transparency rather than more.

The president needs to hear his advisers' unfiltered thoughts, including and perhaps especially those thoughts that might be publicly controversial. His advisers need to be free to brainstorm and to wander together down a few blind alleys before arriving at the policy that will be presented for public evaluation.

If the president cannot have these discussions with his advisers within a structured, thorough internal process, then he essentially has no alternative but to seek such counsel in ad hoc individual conversations, out of earshot of any potential "leakers." This deprives the president of the assurance that all relevant ideas have made their way to him, and also deprives him of the opportunity to have these ideas vetted in vigorous internal debate.

It is, of course, important for the administration and for Congress not only that they be publicly accountable for the decisions they make but also that they demonstrate that they have fairly considered policy alternatives. But it is important to distinguish between genuine transparency and phony transparency.

Phony transparency occurs when public events are disingenuously misportrayed as the venues in which critical decisions are made—when those critical decisions were actually made elsewhere. Voters and the press often

3. Mike Allen, "Rattner Book Details Econ. Team Infighting—POTUS: 'Larry, I've Read the Memo'—NYT Softens Lead Story after White House Flatly Denies—Cantor Op-Ed Promises GOP Spine—Crossroads Raises $32M," *Politico*, September 20, 2010.

express frustration over the "canned" remarks of officials in public settings where greater candor would be refreshing. The contemporaneous publication of "tell-all" accounts is one sure way to inject such artifice into the few settings where candor is now operative.

When, earlier this year, the administration held a televised "health care summit" to which leaders from both parties were invited, no actual policy development took place during it.[4] Elected officials instead arrived with carefully rehearsed presentations, designed to best present their own policy prescriptions to the public.

There absolutely is a role for this manner of public argument. But no one should be deceived into thinking that the White House or congressional leaders ever intended to actually develop their respective policies in that public setting. True negotiation, let alone policy development, will always to a certain extent occur within private conversations and meetings. If the president really wants to negotiate in good faith with the Republican leader, for example, he doesn't invite CNN to listen in on the call.

Accounts like Rattner's do not advance the cause of genuine transparency; they instead further a breed of phony transparency. If the president cannot receive candid advice during his own policy sessions without his staff members fearing leaks, then those musings will be driven out of those policy sessions and into private individual conversations. The inevitable result is that even the president's own staff will know less about the president's thinking than they otherwise would. This is not transparency.

Rattner's published account is especially troubling in that he describes a heated exchange between two senior advisers who still continue to serve President Obama. For these advisers, the concern about whether their counsel to the president will be broadcast is no longer abstract: it is a troubling reality that may thereafter inhibit the content and manner of their advice. The revelations are in especially poor form because we are asked to take Rattner's word that his account is accurate; the two advisers involved are not currently at full liberty to present their sides of the story.

By no means does this imply that the ideas considered and rejected by the president should be withheld from public view. But, as I found in writing my own book on Social Security policy making, it is entirely possible to provide a thorough account of the ideas considered without getting into who said what in which meeting. (This is one implicit reason why presidential archives

4. "Highlights from Obama's Health Care Summit," *CNN Politics*, February 25, 2010.

are not opened to historians for some years, after which opening them is less likely to undercut the rigor of ongoing policy deliberation.)

One hesitates to delve into the specific episode related by Rattner in his book, for fear of further publicizing his subjective take on a private exchange between individual advisers. The episode, however, does speak to a subject of legitimate general interest: specifically, the process by which the NEC acquaints the president with the range of views among his team.

In any well-functioning policy apparatus, it is rare that opinions on all details of a policy decision will be unanimous. The NEC director may make a determination that sufficient agreement exists to present the president with a recommendation fairly portrayed as a majority or consensus view. Even if this is the case, however, it is vital that alternative views be presented to the president—especially if at least one of his own advisers has found an alternative view convincing.

The reasons for this are various. One is that even if the president agrees with the majority position, he needs to be familiar with the strongest argument that will be made against it. A second is that the credibility of the NEC process depends on all participants trusting it; those in the minority must know they can make their case to the president if they so choose. Third, and especially importantly, the president might well side with a minority against a majority. (If John F. Kennedy had only been presented with the majority opinion of his own advisers during the Cuban missile crisis, there might have been an air strike that precipitated a disastrous and preventable nuclear exchange.)

There are various ways for the process to break down. One is for the adviser with the dissenting view to take it to the president without working through the NEC process. Another is for the president to be advised only of the majority view without a structured presentation of the extent of disagreement. These are equally problematic, and the NEC must take equal care to prevent both. Either can lead to uninformed decision-making, as well as bad feelings among the team.

The bottom line is that no matter how the process is conducted, the president's advisers need to be able to offer their counsel—and yes, even to have heated exchanges in the hallway—without later reading a transcript of their remarks in the newspapers. If they cannot, the presidency and the national interest are harmed.

Picking the Right CBO Director

This article was originally published at E21 on January 5, 2015.

This piece was written at a delicate moment in the federal policy process: the selection of a new director to head the Congressional Budget Office. The selection was critical because CBO acts as Congress's nonpartisan referee when it comes to scoring and evaluating legislation affecting the budget. For me the moment was especially delicate because my name had been publicly mentioned for the job (including in one article this piece linked to). My view is that people in my position should never reveal whether they are or aren't under active consideration for such posts. Doing so merely allows reporters to home in more closely on the names of the candidates in contention, thereby making it more difficult for the selection to be made with appropriate discretion, respect for privacy, and freedom from unwanted political pressure. For similar reasons, one should never reveal whether one has been asked to advise on the choice.

This piece includes one explicit, and as it turns out correct, prediction: that congressional Republicans would select a fully qualified, unbiased individual to serve as CBO director. They did: my former White House and Mercatus Center colleague Keith Hall. He is not mentioned in this piece, which was consciously written to only refer to other highly qualified individuals who had been publicly mentioned.

WITH THE TERM OF CURRENT CONGRESSIONAL BUDGET OFFICE director Doug Elmendorf expiring, incoming House Budget Committee chairman Tom Price, along with soon-to-be-named Senate Budget Committee chairman Mike Enzi, will need to choose the agency's next director. I am confident the eventual choice will be strongly credentialed and capable. This piece describes some criteria I believe should guide this critical decision.

A number of prominent Republican budget experts, including my former NEC boss Keith Hennessey, Harvard's Greg Mankiw, and the American Enterprise Institute's Alan Viard, have endorsed the reappointment of

Elmendorf.[1] I agree with their assessments that reappointing Elmendorf would have been a strong choice fully in keeping with Republican objectives of advancing conservative fiscal policy, as well as furthering Congress's longstanding interest in having impartial, credible leadership at CBO.

Hennessey and Mankiw offer the apt analogy that CBO should be thought of as the referee of the policy contest, not a participant in it. Naming an impartial referee in no way conflicts with players on both sides fighting as hard as they can to advance their preferred policies. If the referee is perceived as biased or incompetent, it hurts both sides, not least because it affects public perceptions of the integrity of the contest and the legitimacy of the result. Similarly, both sides benefit when the referee's calls are perceived as fair ones.

A related and important detail is that the referee's rulings need to be transparent and clear. In CBO's case this means that assumptions and methodologies need to be adequately disclosed, understood, and open to replication or challenge.

Hennessey offers several examples of CBO under Elmendorf publishing analyses that frustrated advocates on the Left.[2] Others have published examples of CBO's frustrating those on the Right as well.[3] All this is evidence of Elmendorf's elevation of straight-up analysis above either side's policy objectives. At the same time it should be said that it is not the CBO director's job to identify and advance the political center; he should go wherever the evidence leads, irrespective of whether this helps advocates in the center or at more distant points on the ideological spectrum.

When Hennessey and Mankiw published their pieces, the case for reappointing Elmendorf was probably stronger than it is now. Since that time a number of developments have taken place suggesting Republicans will need to go in a different direction.

In particular, some public commentary about the choice facing Republicans has been concerning. Too much of it has come dangerously close to suggesting that a director with conservative policy views is somehow less capable

1. Keith Hennessey, "Elmendorf for CBO," *KeithHennessey.com*, November 19, 2014; Greg Mankiw, "Elmendorf for CBO Director," *Greg Mankiw's Blog*, November 15, 2014; Alan D. Viard, "The Right Choice for CBO Director: Doug Elmendorf," *AEIdeas*, November 18, 2014.

2. Hennessey, "Elmendorf for CBO."

3. "The Case against Doug Elmendorf at CBO," Americans for Tax Reform, November 21, 2014.

of impartiality and objectivity than someone with center-left views.[4] Some articles have even gone so far as to refer to Republicans appointing someone new as "blocking" the reappointment of Elmendorf, as though reappointment of the other party's choice is customary rather than the highly unusual move it would be.[5] Such an approach to the selection process should concern anyone who cares about the long-term integrity of CBO.[6] If reappointing Elmendorf would perpetuate such a biased mindset, that in and of itself is a compelling reason to make a change. CBO's analyses should continually be subject to challenge, revision, and refinement irrespective of whether those challenges come from a director with right-of-center or left-of-center views.

During my career in public service I have developed a maxim: honesty is easy; it's objectivity that is hard. Washington is filled with honest people doing their level best to serve the public good. What is in shorter supply is self-awareness and objectivity. Throughout the whole political spectrum nearly everyone regards his or her own conclusions as "objective" and supported by the evidence. A good CBO director needs to be self-aware enough to understand the power of this delusion, and to continually invite challenge to his or her own analytical conclusions as well as those of the agency.

This lesson has been driven home by my experiences as a Social Security and Medicare trustee. In that work I never encounter staff who are attempting to doctor the numbers to advance their own policy views or political agenda. The barriers to impartiality are much subtler; over time certain ways of approaching things can become entrenched, and more resistant to modification and improvement. The longer this persists, the more certain it is that the simple due diligence of challenging existing methodologies provokes instinctive suspicion; longstanding practices wrongly become regarded as having an inherently superior claim to nonpartisan objectivity.

For this reason, leadership at agencies such as CBO should never be solely in one party's hands for too long. Elmendorf's commitment to continually refining CBO's methods has been exemplary; he has frequently brought in outside experts of diverse viewpoints and has on occasion revised CBO's

4. Rob Graver, "Why Budget Experts Are Worried about the Next CBO Chief," *Fiscal Times*, November 13, 2014.

5. David Weigel, "Republicans Block Reappointment of CBO Chief Doug Elmendorf," *Bloomberg Politics*, December 22, 2014.

6. Ezra Klein, "Republicans and the CBO Director," *RealClearPolitics*, December 26, 2014.

analysis in response to credible outside criticism.[7] But he is just one man. Another director would no doubt challenge CBO's staff in a different way.

The last thing that should be allowed to happen at an agency like CBO is for a certain set of analytical views to become synonymous with the nonpartisan standard, such that a challenge from a new direction is treated reflexively as ideological or political. Future CBO directors should not face staff-level inflexibility built up over a decade or more of one-party leadership. Staff should instead remain fully accustomed to and comfortable with frequent changes in the types of questions raised by the directors that move through the door.

Some have written about specific analytical changes they would like to see at CBO. I have my own views about which of Congress's scorekeeping methods warrant review; I've written about some of these, and some I have not.[8] But I don't want the director to be selected on this basis; it would be a mistake to select (or to oppose) the next CBO director based on his or her views of any particular issue. A good CBO director cannot be reluctant to publish a solid agency analysis simply because it may interfere with the advancement of the director's subjective beliefs. The director needs to be able to sit in a room with members of Congress, say, "I may (or may not) agree with your policy view, but here is what our analysis shows," and be prepared to defend that analysis—or, if not, have a plan to improve it.

The ideal candidate to succeed Elmendorf would have strong analytical credentials and a temperament combining open-mindedness and collegiality with firm resolution once an analytical conclusion has been reached. The director must be able to defend CBO's conclusions publicly while constantly improving methods behind the scenes.

Fortunately there is no shortage of candidates with these qualifications. Several weeks ago, Damian Paletta profiled five candidates at the *Wall Street Journal* online, of whom exactly four would be excellent choices.[9] Greg Mankiw's academic and temperamental qualifications are obvious, though it was always doubtful that he would accept the position, long before he

7. Congressional Budget Office, "Labor Market Effects of the Affordable Care Act: Updated Estimates," February 2014.

8. Charles Blahous, "Should Congress Change CBO's Scorekeeping Rules?," E21 (Manhattan Institute for Policy Research), May 29, 2012 (republished in this collection).

9. Damian Paletta, "Who Will Run CBO Next?," *Wall Street Journal*, November 12, 2014.

publicly endorsed Elmendorf's reappointment.[10] Donald Marron has acted as CBO director before and is widely known for impartiality and expertise. Jeff Brown (University of Illinois) possesses the academic and analytical credibility, and public appreciation for his work has soared in the wake of the *Wall Street Journal* article. Kate Baicker (Harvard) possesses all the academic credentials and temperamental characteristics needed for the post and already knows her way around CBO. Other articles have discussed additional good candidates, such as former Senate Budget Committee staff director Bill Hoagland.[11]

Reappointing Doug Elmendorf would certainly have been a strong choice, but the strongest choice would be for Republicans to appoint his analogue from across the aisle. I have complete confidence that they will do so.

10. Greg Mankiw, "Elmendorf for CBO Director," *Greg Mankiw's Blog*, November 15, 2014.
11. Rebecca Shabad, "Experts Rally in Defense of Budget Referee," *The Hill*, December 24, 2014.

Why Government Doubles Down on Policy Mistakes

This article was originally published at E21 on September 18, 2016.

This is another piece that proved to be more evergreen than expected when it was first published. It turns out that it tells a story heard again and again: the federal government creates or worsens a problem by taking some action, people face difficulties as a result, and then they and others call for additional government involvement to ameliorate the resulting problems. Consequently, politicians are drawn deeper and deeper into the issue, often worsening the situation at every step.

As this piece explains, there are many examples of this unfortunate phenomenon, and in the time since the piece was first published still more have occurred. It is a terribly difficult dynamic to correct, because correcting it requires reconsidering the premise on which the government acted in the first place, while also risking harm to those who have since become dependent on the initial government intervention. We are seeing an example right now with proposals to shore up the troubled health insurance exchanges under the ACA. The ACA, whatever its other virtues, created a number of problems such as substantial new federal spending commitments and distortions of healthcare markets. Lawmakers are currently wrestling with whether to double down on the ACA's policy approach by shoring up the law's health insurance marketplaces with still more federal government subsidies.

FRUSTRATED VOTERS OFTEN WONDER WHY, AFTER THEY ELECT well-intended lawmakers to office, so many subsequent government economic policies prove damaging. Part of the answer lies in the nearly irresistible public policy dynamic of "doubling down" on mistakes. Lawmakers, press, and the public need to understand the strength of this phenomenon and guard against it when adopting policy positions.

In simplified form, the dynamic runs as follows:

1. Government, in response to a perceived need, takes action to meet that need in a manner that distorts economic behavior and produces predictable adverse effects.

2. The public consequently experiences problems and expresses concern.
3. The problems themselves become justification for additional government actions that worsen the distortions and the resultant problems.
4. As problems worsen, the public more urgently demands corrective actions.
5. Steps 3 and 4 are repeated ad infinitum.

We have seen and continue to see this dynamic operate in many areas of economic policy. The following are but a few examples.

Worker Health Benefits

With the best of intentions, the federal government has long exempted worker compensation in the form of health benefits from income taxation. There is wide consensus among economists that the results of this policy have been highly deleterious.[1] As I have written previously, this tax exclusion "depresses wages, it drives up health spending, it's regressive, and it makes it harder for people with enduring health conditions to change jobs or enter the individual insurance market."[2] Lawmakers have reacted not by scaling back the flawed policy that fuels these problems, but rather by trying to shield Americans from the resulting healthcare cost increases. This has been done through the enactment of additional health programs and policies that further distort health markets and that themselves drive personal and government health spending still higher.

Federal Health Programs

The federal government has enacted programs such as Medicare and Medicaid to protect vulnerable seniors and poor Americans from ruinous

1. Julie Rovner, "The Huge (and Rarely Discussed) Health Insurance Tax Break," *NPR*, December 4, 2012.

2. Gary Burtless and Sveta Milusheva, "Research Summary: Effects of Employer-Sponsored Health Insurance Costs on Social Security Taxable Wages," *Social Security Bulletin* 73, no. 1 (2013); Jeremy Horpedahl and Harrison Searles, "The Tax Exemption of Employer-Provided Health Insurance" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, 2013); Joseph Antos, "End the Exemption for Employer-Provided Health Care," *New York Times*, December 6, 2016; Charles Lane, "Break the Link between Health Care and Employment," *Washington Post*, April 2, 2014.

healthcare costs.[3] The positive benefits of these programs coexist with well-documented adverse effects. For example, it is firmly established that creating these programs pushed up national health spending, driving health costs higher for Americans as a whole.[4] Consumer displeasure over these health cost increases subsequently became a rationale for still more government health spending, rather than for reducing government's contribution to the problem. Examples of this doubling down include the health exchange subsidies established under the Affordable Care Act and the further expansion of Medicaid.[5] As the problem of high healthcare costs remains, proposals have proliferated to expand government's role still further: for example, some have proposed making Medicare available to the entire US population.[6] Though intended to provide relief, such legislation inevitably adds to national health spending growth.

Education

The cost of higher education has become an increasingly salient policy issue and political issue. In an effort to broaden access to education, government has subsidized its cost with a heavy emphasis on grants and loans to students and their families.[7] It is now fairly well understood that these subsidies have had the predictable effect of increasing tuition costs.[8] Students and their families regularly complain about having to choose between footing a massive education bill or taking out student loans that create crushing levels of indebtedness. Many politicians have reacted to these trends not by reconsidering the policies that give rise to them, but by proposing dramatic further expansions of government education subsidies.[9]

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3. C. Eugene Steuerle and Rudolph G. Penner, "Restoring More Discretion to the Federal Budget," E21 (Manhattan Institute for Policy Research), September 14, 2016.

4. Amy Finkelstein, "The Aggregate Effects of Health Insurance Evidence from the Introduction of Medicare," *Quarterly Journal of Economics* CXXII, issue 1 (2007).

5. "The Bottom Line: How the Affordable Care Act Helps America's Families" (Families USA, Washington, DC, October 2011).

6. Laurence S. Jacobs, "Make Medicare Available to All," Physicians for a National Health Program, July 15, 2013.

7. Chris Edwards and Neal McCluskey, "Higher Education Subsidies," *Downsizing the Federal Government*, November 1, 2015.

8. David O. Lucca, Taylor Nadauld, and Karen Shen, "Credit Supply and the Rise in College Tuition: Evidence from the Expansion in Federal Student Aid Programs" (FRBNY Staff Reports No. 733, Federal Reserve Bank of New York, February 2017).

9. David Hudson, "The President Proposes to Make Community College Free for Responsible Students for 2 Years," White House, January 8, 2015.

Social Security

Social Security collects payroll taxes from workers and provides monetary benefits to retirees, surviving family members, and the disabled. It operates as an income transfer program rather than by building retirement savings. Because of this, whenever its benefits and tax burdens are expanded, Americans' abilities and incentives to save for retirement are reduced. This phenomenon is most pronounced with low-income, liquidity-constrained workers who, after program expansions in the 1970s, were promised Social Security benefits equaling a very high percentage of their earnings, while at the same time were left with very little surplus earnings to put aside while working.[10] There is general agreement among economists both that Social Security depresses other saving and that savings rates among Americans of modest incomes are undesirably low.[11] Paradoxically, however, many advocates cite these low savings rates as a reason to further expand Social Security.[12]

Conclusion

As these and countless other examples reveal, whenever government policies create or exacerbate adverse economic effects, the political focus often turns to relieving the consequent hardship rather than addressing its policy causes. The resulting relief is often short-lived because the remedial legislation has usually failed to correct the underlying problem and has often made it worse.

The ACA threatens to repeatedly be such a case. It is complex legislation with far-reaching consequences, both positive and negative, offering many opportunities for policymakers to double down on its more problematic policy choices. Lawmakers should resist trying to repair its problematic provisions by expanding them. Here are two examples of where the temptation is likely to be faced:

- *Fixing the ACA's work disincentives.* Experts ranging from economist Casey Mulligan to those at the Congressional Budget Office have substantiated that the ACA is driving many workers out of the

10. Charles Blahous, "Understanding Social Security Benefit Adequacy: Myths and Realities of Social Security Replacement Rates" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, 2012).

11. Congressional Budget Office, "CBO Memorandum: Social Security and Private Saving: A Review of the Empirical Evidence," 1998; Charisse Jones, "Millions of Americans Have Little to No Money Saved," *USA Today*, March 31, 2015.

12. Martin O'Malley, "Expand Social Security," *Martinomalley.com*, August 21, 2016.

workforce at a time when we can least afford it.[13] A primary culprit is the design of its health exchange subsidies, which are skewed so heavily toward the lowest-income individuals that anything they earn subjects them to a substantial loss of federal support.[14] To see the double-down instinct at work, read for example columnist Catherine Rampell, who acknowledges the work incentive problem under current federal laws but then argues that the answer lies in expanding the ACA's various subsidies (which are themselves ample work disincentives, and expansion of which would worsen the ACA's troubled finances).[15]

- *Fixing the ACA's effects on health insurance premiums.* The ACA effectuated many requirements that are causing health insurance premiums to rise.[16] Combined with this problem are many horizontal inequities arising from the law's complexities. For example, individuals with identical incomes receive different levels of support depending on whether they get insurance through exchanges or through their employer. As I noted in 2012, this creates enormous temptation for the federal government to provide relief from premium increases by expanding subsidies to those buying insurance outside the ACA's exchanges.[17] Doubling down in this manner would considerably worsen the ACA's rising price tag.

With the ACA specifically and with economic policy in general, it is vital that lawmakers understand the doubling-down trap and use their awareness to avoid it. If an economic distortion is created or exacerbated by government policy, the best first response is to look squarely at the policy that has caused the problem and consider whether it needs to be tweaked, redesigned, scaled back, or even eliminated. When instead we focus only on alleviating the hardship caused by flawed government policies, too often we perpetuate those very policy flaws while allowing the hardship to reemerge again and again.

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13. Casey B. Mulligan, "The Affordable Care Act and the New Economic Policies of Part-Time Work" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2014); Edward Harris and Shannon Mok, "How CBO Estimates the Effects of the Affordable Care Act on the Labor Market" (Working Paper No. 2015-09, Congressional Budget Office, Washington, DC, December 2015).

14. Mulligan, "Affordable Care Act and the New Economic Policies."

15. Catherine Rampell, "Part of the Safety Net Does Discourage Work. Expanding Obamacare Would Fix That," *Washington Post*, June 14, 2016.

16. Rampell, "Part of the Safety Net."

17. Charles Blahous, "The Fiscal Consequences of the Affordable Care Act" (Mercatus Research, Mercatus Center at George Mason University, 2012).

The Importance of the National Economic Council

This article was originally published at E21 on November 21, 2016.

Americans know far too little about the National Economic Council relative to its importance. Other cabinet officials are seen and heard in public much more frequently than NEC chairs, because the NEC does its vital work mostly behind the scenes. Yet it's the NEC, more than any other department or policy council, that often does the most to shape administration economic policy.

By the end of the George W. Bush administration, the NEC process ran impressively smoothly and well. However, it has generally taken costly time for each incoming White House to get the NEC's role quite right. Every presidency should be expected to have growing pains in this area. This article was written in a preemptive effort to positively influence these dynamics from the outside upon a change of administration and to help mitigate difficulties—to the limited extent that such pieces can have that influence.

OVER THE PAST SEVERAL DAYS THERE HAVE BEEN MULTIPLE announcements of president-elect Trump's intended appointments. The purpose of this piece is to draw public attention to another yet-unfilled administration job that receives less press attention than it should: directing the National Economic Council.

The NEC director is vital because that individual essentially has the job of facilitating all the president's economic policy decisions. This critical NEC role is generally less visible in the press than certain other roles, in part because the job is not subject to Senate confirmation and in part because the NEC interfaces with the president rather than with the public as economic policies are implemented. Cabinet-level positions such as the secretary of the Treasury and the director of the Office of Management and Budget are every bit as important as commonly portrayed, both as economic policy developers and later as implementers. But it is the NEC that actually runs the president's economic decision process, with those other advisers acting as participants. Typically, the NEC consists of a director, a deputy director, and roughly a half-dozen special assistants, each advising the president on a different portion of the economic policy portfolio.

It is important to distinguish the NEC director's role from that of the chair of the Council of Economic Advisers. CEA basically acts as the White House's internal consultancy for economic analysis; the NEC, by contrast, is the vehicle for policy development. I often explain the difference with a hypothetical example. If the president sought an analysis about why young adult males are dropping out of the labor force, that analysis would likely be authored by CEA, submitted through a process led by the NEC. If, on the other hand, the president wished to develop a policy to increase labor force participation, the NEC would lead that process with the CEA chair as one of the participants.

These distinct roles highlight the importance of finding people with the right qualifications to head up the NEC and CEA respectively. The process works best when CEA is headed by an esteemed academic economist while the NEC is headed by someone with expertise in directing economic policy process. Previous administrations have had troubles whenever there was confusion about the respective roles—for example, if the NEC is routinely disputing CEA's analyses, or CEA is attempting to control policy development.

The NEC manages the flow of information to the president to serve his economic policy decision-making. This consists of both written material and information transmitted orally in meetings. Each is important; the relative importance is determined by whether the president most readily absorbs information in writing or in oral conversation. The written part often consists of memoranda or visual presentations that the NEC compiles and condenses from information generated by the different departments and agencies. The NEC typically conducts repeat checks with all participants, to ensure the material submitted is sufficiently complete and balanced. For in-person meetings, the NEC coordinates the presentation of the principals' advice and information to the president. On both tracks, the NEC must work within the president's extremely tight time constraints, which means reading material must be succinct and oral presentations efficiently brief.

The physical structure of presidential meetings is important. Subject to the approval of the White House chief of staff, the NEC serves as arbiter of which principal advisers attend alone and which are permitted a "plus one" or additional staff. Advisers who are regarded as central to a discussion are assigned seats closer to the center, with others seated near the ends or perhaps even in separate chairs away from the table and against the wall. In my time as NEC deputy director, I felt that discussions in the White House's Roosevelt Room tended to be better structured for decision-making than those in the Oval Office. This was because the long rectangular table in the Roosevelt Room, with the president seated at the center, was more conducive to orderly discussion than the Oval Office, where the president and vice president sat on separate chairs on one side of the room and staff were distributed between two sofas and separate chairs scattered behind them.

Before any meeting, the NEC must know which departments and agencies have important information or advice to put before the president. In the George W. Bush White House, a typical meeting might begin with the NEC director sitting across from the president and saying, "Mr. President, the purpose of this meeting is to facilitate a decision on issue X. With your permission, the deputy director will summarize some critical background information about this issue for roughly five minutes. Then we would like secretary Y to present the argument for course A, and then budget director Z will present the countervailing argument for course B. In your background memorandum, we have listed a fuller range of options for your consideration, and we have also listed which of your advisers favor each one. Now, with your permission, the deputy director will begin your background briefing."

Key at all times is deferring to the president's sense of what he or she needs to make a decision. When I was the NEC deputy, Director Keith Hennessey and I spent a lot of time structuring and rehearsing our presentations to ensure maximum clarity and efficiency. Still, all bets were off once the briefing began. More than once, President Bush cut me off less than a minute into the presentation to basically say, "Wrong place. Start again. Tell me this, this, and that. Then go back to where you were." His method of reorganizing the discussion often better met his needs than what we had planned.

Other surprises can happen as well. One time I was barely into my background presentation when the president cut me off and said, "Got it. So, what do you think we should do?" As the background briefer, I had not expected to offer my opinion. I hesitated briefly and in that split second the president's eyes darted to his other advisers, who immediately filled the gap with their advice. I resolved never to make that mistake again, and I didn't.

From then on I was prepared to answer any question the president posed, whether informational or advisory.

We at the NEC always felt that, regardless of the president's decision, the meeting had gone well if the discussion had stayed on track and he had heard the information and advice he needed to decide. We were proudest of all when someone on the losing side of a decision nevertheless came up to us afterward and said, "Good meeting."

Though the NEC is not currently receiving the same level of public and press attention as other administration appointments, it is tremendously important. The quality of the president's economic policy decision-making will depend on his team getting this right.

Afterword

A writer, particularly one as unskilled as I am, can never be entirely sure how his tone comes across to others. I always have the exclusive, private advantage of knowing my own intent, which I may or may not succeed in translating into words.

Nevertheless, I hope that the preceding collection of essays reflects the approach one must adopt as staff serving, first, two senior US senators and, later, a US president. In such positions one is frequently called upon to brief top elected officials and to inform their decision-making. Those experiences inculcate certain habits.

A staff person ill serves his boss if he approaches a briefing with the objective of persuading her to pursue his favored policy. That is not the purpose of his access to the official's time and attention. The objective is to allow the elected official to decide on the best policy from the perspective of her own judgment. If a staffer approaches the job with the objective of advancing his own policy preferences, he risks omitting critical information his boss might have needed or wanted to hear.

Having been shaped by such experiences, whenever I write I try to avoid the temptation to sell my viewpoint to the reader. I don't regard it as my place to tell the reader what her subjective value judgments should be. On the other hand, if I believe many readers have likely read distorted accounts of issues in play, for example accounts that selectively withhold information, I have no qualms about filling in the parts of the picture that seem to be largely missing elsewhere.

Such a purpose departs from the apparent aim of most topical policy columns published in US media—which instead have the narrow and (to my eyes) uninteresting purpose of persuading the reader of the correctness of the author's subjective value judgments. Sadly, even so-called explanatory journalism usually just means a strong ideological slant dressed up with extra numbers and graphs. The people who are most convinced of their own objectivity tend to be most guilty of bias. I therefore try to have no illusions about my own subjective value judgments; I do, however, earnestly try to distinguish the facts from my own opinions, and also to present facts that may inform judgments counter to my own.

Working as a staffer provides a vantage point well recommended to anyone who writes about public policy and genuinely wishes to inform. If you are briefing an elected official before a critical decision, you need to be certain the official has considered all critical angles before pulling the trigger. The last thing you want to do is to steer the official toward a decision made in ignorance of vital information.

NEC staff under President George W. Bush always entered "policy time" with the president prepared to answer the following questions: What is the best argument against the action under consideration? How do we answer it? Are we still comfortable with the recommended action despite the strongest countervailing argument? Note how this contrasts with the style of argument adopted in too many opinion columns—which is to begin by citing one of the opposing side's weakest arguments, solely for the purpose of discrediting it. This might be satisfying to the writer and to some readers, but does little to broaden understanding.

The US Senate also maintains rules and norms that are instructive for the aspiring writer. One is a prohibition against impugning the motives of any senator during floor debate. These rules are appropriate and important. They are appropriate first and foremost because none of us can truly see inside another person's heart and mind to determine his or her motivations. The person who presumes to do so nearly always operates from a standpoint of ignorance. It's also counterproductive to take this route: it might be cathartic in front of an audience that already agrees with your viewpoint, but it can only anger an audience that doesn't. Further, it suggests the intellectually fatal mistake of assuming that only your own subjective value judgment can be virtuous. This usually indicates a failure of analytical and moral imagination. If substantial numbers of people disagree with your viewpoint, and if you regard the opposing position as immoral, it is far more likely that you are overlooking a critical competing consideration than that you are of superior moral character.

For such reasons, impugning motives should generally be taboo, a principle guiding not only writers but readers. When an author asserts that another individual or party advocates X because of a sinister motive, it's a good signal to quit reading and move on. Such rhetorical tactics convey that the author is comfortable asserting things he cannot possibly know to be true.

No doubt some of the material in the preceding essays falls short of these standards. But even where my own writing is imperfect, the standards are nevertheless important, and I recommend them to writers and readers alike.

One final nugget from my personal "behind the scenes" experience: contrary to what many say, federal government officials, elected and otherwise, tend to be honest, hard-working, intelligent, and dedicated to the public good. Granted, the preceding essays display a persistent skepticism about government's ability to overcome economic challenges more effectively than freely acting individuals can through market processes. However, this opinion should not be confused with a belief that government has corrupted all those who serve within it. To the contrary, counterproductive government behavior that many people assume derives from malevolence is more typically a manifestation of limited competencies, good intentions gone awry, and honest disagreement.

Some of the most impressive people I have ever encountered are those I worked with during my periods of public service, first in the Senate and later in the George W. Bush White House. Apart from my gratitude for the opportunity to work among them, there was an important lesson to be drawn from these experiences. It's that when it comes to improving the functioning of our government specifically and our economy generally, there is less to be gained from changing the caliber of people who work in government than from prudently limiting what we ask our government to do for us.

About the Author

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Blahous's media appearances range from *The Diane Rehm Show* and Fox News to C-SPAN's *Washington Journal*. He was named to *SmartMoney*'s "Power 30" list in 2005 and has written for the *Wall Street Journal*, *The Washington Post*, *Financial Times*, *Politico*, *National Review*, *Harvard Journal on Legislation*, *National Affairs*, *Journal of Chemical Physics*, and *Baseball Research Journal*, among others.

Blahous is the author of *Social Security: The Unfinished Work* and *Pension Wise: Confronting Employer Pension Underfunding and Sparing Taxpayers the Next Bailout*, as well as the influential studies *The Costs of a National Single-Payer Healthcare System* and *The Fiscal Consequences of the Affordable Care Act*.

Blahous served as a public trustee for Social Security and Medicare from 2010 through 2015. He was formerly the deputy director of President Bush's National Economic Council, special assistant to the president for economic policy, and executive director of the bipartisan President's Commission to Strengthen Social Security. He recently served on the Bipartisan Policy Center's Commission on Retirement Security and Personal Savings.

Blahous received his PhD in computational quantum chemistry from the University of California at Berkeley and his BA from Princeton University.

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