

## Suggestions for the New CBO Director

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In this article, Warshawsky suggests ways to improve the Congressional Budget Office's scoring and analysis, for the CBO to achieve more accuracy and transparency, and to more efficiently use government resources to extend the CBO's work.

On February 27 the appointment of Keith Hall as the new director of the Congressional Budget Office was announced. Although we overlapped only briefly as scholars at the Mercatus Center, I know Hall as a serious research economist, a good administrator, and a cool, fair, and open-minded analyst. His prospects for success in this new and challenging role are excellent. I extend to him my congratulations and best wishes. In this regard, I am sharing here evidence on the need for improvements in CBO scoring and analysis; constructive suggestions for ways to achieve more accuracy and transparency; and how government resources can be more effectively used and extended for the CBO's work.

### A. Three Instances of CBO Errors

The CBO produces a large volume of regular and one-time studies, reports, and cost estimates (scores), on a wide range of topics, in response to continual congressional legislative demands and interests, often on tight deadlines and in difficult political situations. That its output is nonetheless readable and perceived as balanced is therefore a great accomplishment.

However, that does not say that the work of the CBO is always correct or even necessarily well done. Of course, it would be easy to show that the CBO's annual macroeconomic forecasts are wrong — all such forecasts will be wrong soon after their publication because the global economy is so complex, and unexpected conditions and situations always arise. It is a cheap shot to criticize the CBO on that basis alone. But still it is plausible and fair to claim that particular CBO scores or analyses are in error at the time of publication because they ig-

nored relevant and available data or information; their authors did not think deeply or creatively about the context or effects of the proposed legislation; or they hued too literally to the mainstream viewpoint despite evidence pointing to contrary outcomes. Moreover, because the CBO is central to the legislative process, its work, especially the scoring of legislative proposals in critical areas, is very important — and therefore, so are the consequences of errors. It is essential to get everything right.

I myself have found three recent instances of CBO errors, not because I was looking for them, but because I was researching the relevant topics — income inequality, long-term care insurance, and employer-provided health insurance — and came across the relevant CBO analysis or score, either contemporaneously or not long after it was published. Although not completely random picks, my negative reviews are a somewhat worrisome indicator of the overall quality of CBO work. To learn whether my inference of more widespread inadequacies is correct, or in any case that an overdue external audit of the CBO is needed, I recommend that a more complete statistical sample of recent CBO scores and analyses should be examined methodically, comprehensively, and thoroughly by a committee of external experts that includes economists and accountants. This committee would include both academics and practitioners who use a wide range of methodological approaches and have different viewpoints. The installation of a new CBO director is an excellent time to embark on this comprehensive review.

**1. Income inequality.** An important CBO study on measuring and explaining trends in income inequality over the past few decades attempted to incorporate healthcare costs into its analysis of why earnings in lower-income groups have grown more slowly than in upper-income groups. In particular, could the rapid growth in employer health insurance costs — which affects all income groups fairly equally in dollar terms but is a greater proportion of earnings and compensation for lower-income groups — be an explanation of the rise in measured earnings inequality? The CBO study found a relatively small role for health insurance costs in driving income inequality. But the method and data it used were second-rate: The study indirectly estimated health benefits for employees using household survey data, which are subject to large errors,

and topped that survey data with old healthcare data sets from the 1970s. By contrast, another available data set — the National Compensation Survey from the Bureau of Labor Statistics (BLS) — is more current and collected directly from employers, providing timely and reliable data. I used that BLS data for the 1999-2006 period and found that the health insurance cost growth explanation provided a vigorous explanation for the increase in income inequality.

**2. CLASS.** In December 2009 I wrote about both the House and Senate healthcare reform bills then being debated, which would have established a new, voluntary, federal, long-term care insurance program. Called CLASS (Community Living Assistance Services and Supports Plan), the new program would have been offered to all workers through the Department of Health and Human Services. CLASS was significant in its own right and because it represented a substantial source of near-term funding for the entire healthcare reform proposal. If participation failed to meet projections or the revenue score declined, other sources of financing would have been necessary to achieve the deficit reduction goal of health reform stated by the president.

Healthcare reform was projected to cost roughly \$1 trillion over 10 years. There were many and varied proposed sources of financing in the House and Senate bills, but both would have gotten about 10 percent of their funding from the CLASS program. According to the CBO, the House version would have brought in \$102 billion over 10 years. The Senate version was projected to collect \$72 billion. The initial positive cash flows came from the five years before participants vested in their policies, when premiums were to be paid but benefits were not. The House version had larger cash flows than the Senate version, because of the House program's eligibility for nonworking spouses.

The CBO did not reveal all the details of its projection calculations. It did say, however, that it assumed that about 4 percent of the adult population (3.5 percent for the Senate version) would be enrolled by 2019 — about 6 percent of the working population. Apparently, the CBO based this assumption on the experience of some large employers with workers enrolled in group long-term care insurance, including the federal government and California. However, this analogy was highly doubtful even at the time, because those workers are generally higher paid, better educated and more risk averse and are offered superior insurance programs than the CLASS plan available to workers in the general U.S. population. Moreover, most of the general population will eventually be eligible for free Medicaid coverage of long-term care expenses;

it is reliably established by research that Medicaid crowds out voluntary, long-term care insurance purchases through the upper middle range of the wealth distribution.

Without underwriting, the central risk for any voluntary insurance program, private or public, is adverse selection — the tendency of those more likely to claim benefits, such as people with chronic conditions or disabilities, to purchase the insurance. It raises the cost of insurance and may impair its comprehensiveness. In severe cases, adverse selection triggers an insurance death cycle — lower-risk individuals do not enroll, premiums must be raised, medium-risk participants drop out, premiums are raised again, large numbers and amounts of claims are made, and the program collapses or must be bailed out.

In group long-term care insurance with guaranteed issuance, adverse selection is controlled by requiring enrollees to be full-time employees, which implies that the enrollees have at least fair to good health. Coverage for spouses is generally underwritten, and the insurer screens claims carefully. Under CLASS, however, the work requirement was much weaker, there was an allowance for penalty-free re-enrollment after a lapse of up to five years, and, with presumptive eligibility, claims will be made and paid easily. Actuaries, as expressed by their professional organizations, did not expect the overall five-year vesting period and 24-month consecutive payment period to sufficiently counter the tendency for adverse selection. The professional actuarial societies suggested several cogent design improvements to control adverse selection and encourage participation, including spending more on marketing, imposing a tighter at-work requirement and shorter periods for re-enrollment, and eliminating presumptive eligibility. These improvements were not included in any of the versions of CLASS that eventually made its way into the Affordable Care Act.

The Medicare actuary said at the time that CLASS faced a substantial risk of being unsustainable and, moreover, would not bring in as much revenue as the CBO projected. In his view, participation would be low — 2 percent of potential participants — and the average premium a high \$240 a month initially, rather than the \$123 estimated by the CBO for the Senate bill. Over 10 years, net cash flow would be only \$38 billion (\$39 billion for the House version). The actuary also believed a sizable number of individuals who already met the functional limitation requirements for benefits would enroll immediately.

The Medicare actuary expected participation to be low for a couple of reasons, including CLASS

long-term care insurance being a new and unfamiliar benefit and the availability to many of lower-priced private insurance. In addition, the Medicaid offset design would discourage low- and moderate-income workers from enrolling in CLASS without a subsidy.

In summary, it was clear at the time that the CLASS program was not sustainable, that the federal government was unlikely to be able to market an inferior benefit plan to workers, that employers would not have participated in offering the program, and therefore that the CBO score was a substantial overestimate and in error. It is a mystery why the CBO continued to assert its position in the face of the facts and criticisms it received. The error of CLASS was eventually admitted even by the administration, which declined to execute it, and Congress repealed it in 2013.

**3. Small employer health insurance tax credit.** The ACA enacted a tax credit to encourage small employers to provide subsidized health insurance coverage to their workers through Small Business Health Options Programs (SHOPs) insurance exchanges. This tax credit was expected to lead to around 4 million people gaining health insurance in 2013 and 2014, according to my interpretation of 2010 cost estimates by the CBO. Yet, only about 75,000 people were actually enrolled in state-based SHOPs as of June 2014, according to a recent Government Accountability Office report, and almost half of these were in Vermont, where the state mandates all small group plans be set up only through the SHOP exchange. That's a sizable scoring error. But what is more concerning is that the original estimate should have been known to be an order of magnitude too large at the time of its publication as part of the score of the ACA.

For small businesses to qualify for the tax credit in 2014, they must enroll their workers in the SHOP exchange and contribute 50 percent of their health insurance premiums. They can claim the full credit if they have 10 or fewer full-time equivalent (FTE) employees and the employees' average taxable wage is less than \$25,400 in 2014. The credit phases out as the size of the firm increases to 50 FTEs and the average wage rises to \$50,800.

In 2014 the full credit is 50 percent of the for-profit employer's contribution toward premiums. The credit is not refundable; that is, it is limited by the firm's actual tax liability, but it may be carried forward. For nonprofit employers, the full credit is 35 percent, paid in the form of a reduction in income and Medicare taxes withheld for workers plus the employer share of Medicare taxes paid. The credit phases out more rapidly for firm size compared with increases in average wage. For example, if the firm size remains below 10 FTEs but the

average wage increases from \$25,000 to \$45,000, the tax credit declines from 50 percent to 10 percent. But if the average wage remains at \$25,000 and firm size increases from 10 to 24 FTEs, the tax credit declines from 50 percent to 3 percent.

The tax credit is available to an employer for only two consecutive tax years, beginning with the first year that the employer offers coverage through a SHOP exchange. The employer contribution for purposes of determining the credit is calculated as the lesser of the actual premium contribution or the contribution the employer would have made if the workers had enrolled in a plan with a premium equal to the average for the small group market in the rating area for the employer. In 2013 the state average premium for single-employee coverage ranged from \$4,546 in Arkansas to \$7,961 in Alaska, with a nationwide average of \$5,400. Small firms that take the tax credit cannot also take the usual expense deduction for premiums paid.

When it scored the ACA in March 2010, the CBO projected that the small employer tax credit would cost \$6 billion in 2013 and \$5 billion in 2014. Making the somewhat heroic assumption that the average tax credit per covered individual was \$1,350 (probably on the high end because of the tax credit phaseout and the existence of tax-exempt employers) would mean that, quite roughly, 4 million people would gain health insurance because of the tax credit. Yet, as mentioned earlier, the actual take-up is a small fraction of that number.

Although we cannot explain why the CBO made this error, there are several reasons why the low take-up should have been expected. The primary one is as follows. In the ACA law, there is no "shared responsibility" penalty for firms with fewer than 50 employees for not providing affordable health insurance to their workers. But the low-wage workers that the small employer tax credit is intended to help are certainly eligible for generous cost-sharing assistance and premium subsidies to purchase health insurance on the individual exchanges. The small employer tax credit covers at most a quarter of the cost of health insurance; the other three-quarters of cost are likely to fall on the worker through lower wages and direct premium charges. Depending on the worker's income, the premium subsidies and cost-sharing assistance through the individual exchange could cover about 75 percent of the cost of health insurance. So why would any small business employer that does not already provide health insurance do so because of the existence of the small employer tax credit when the premium subsidies for individual insurance are a much better deal for its workers? This simple logic



and arithmetic should have been obvious to the CBO to see the nullity of the small employer tax credit.

### B. Scoring Macroeconomic Impact of Stimulus

This is another area of likely CBO error, but I will admit it is not as clear-cut as the ones I presented above, and moreover, my opinion goes against the mainstream or consensus viewpoint and a large professional literature. That is, successive legislative packages of government spending increases and tax cuts were proposed by both President George W. Bush and President Barack Obama and passed by Congress to fight the 2008-2009 Great Recession, with the massive stimulus legislation at the beginning of 2009 totaling nearly \$1 trillion. This stimulus was intended to get the U.S. economy quickly out of the deep recession and to start a robust recovery. It did not succeed.

The logic and economics of the 2009 stimulus package were straightforward: Combined with aggressive monetary policy, immediate and substantial fiscal stimulus of a classic Keynesian nature was needed to increase economic activity, reduce unemployment, rebuild financial confidence, and help our foreign trading partners in the face of a deep recession. When designing and sizing the package, macro econometric models were used. My understanding is the administration uses the Macroeconomic Advisers' model and that this model is also used extensively by the CBO. A key aspect of that model is its demand multiplier, defined as the total change in GDP per dollar of direct effect on demand. With accommodative monetary policy and a sharp shortfall in economic output compared with potential output, the demand multiplier in these models is large — up to 2.5, according to the CBO.

Robert Barro, a Harvard professor, has done research using the U.S. historical record, which casts doubts about the maintained size of the demand multiplier. In particular, he believes that it is less than one; that is, that there is a negative reaction, or pullback, from the private and foreign sectors to federal government fiscal policy. Barro believed that the 2009 stimulus package was largely ineffective. As I mentioned above, this is a controversial viewpoint. But although it is difficult to measure the impact directly and cleanly, the recent macroeconomic experience is decidedly negative on the fiscal stimulus experiment. It is not persuasive, as a matter of common sense, to argue that the U.S. economy is better off than if the package had not been in place. Indeed, such an argument is almost a tautology; it cannot be proved or contradicted. The economy was in a bad way for an extended period, and still more than five years after the official end of the recession, we have not seen vigorous economic growth. This is in contrast to past recoveries that

occurred without the help of massive stimulus packages. Indeed, I would say that this way of arguing is consistent with that of Lawrence H. Summers in his 1991 article about the science of macroeconomics.<sup>1</sup>

### C. The Need for More Transparency

The CBO claims on its website that it provides fairly full descriptions of its models and estimates in some areas. Yet this is incomplete because the complete explanations do not cover all of its scores and analyses, even significant ones, such as those for the ACA. To allow transparency, as well as comprehensive and useful external review and audit, the CBO should be required to provide an annual minimum of its scores and analyses that includes a complete explanation of its models, assumptions, data, and approaches. An increase in transparency would enhance the credibility of the CBO's work; it would also encourage higher accuracy and quality, based on external constructive criticism and review. This "minimum transparency quotient" would be in addition to, and in conjunction with, the external review committee I suggested above.

### D. The Role of Expert Panels

The CBO has two panels of paid experts to advise it on its work: the Panel of Economic Advisers and the Panel of Health Advisers. Panel members are prominent and undoubtedly quite busy people; members include chaired professors at top universities, chief economists at Goldman Sachs, Moody's Investors Service, and D.E. Shaw, the CEO of TIAA-CREF, think tank leaders, and top executives at large healthcare organizations. None are retired. It is unclear how these senior people review the CBO's work and advise it. One can imagine a largely passive role, whereby the CBO presents some of its products at one or two meetings a year and sometimes selectively asks for opinions on outstanding issues. According to the recent congressional testimony of Jonathan Gruber, a professor of economics at MIT, when he was on one of the CBO panels, he missed all the meetings over the years.

Perhaps a different approach to expert panels would be to aim for more involved and active members, perhaps with experts one tier down on the prominence scale, as well as recent retirees, who can devote more concentrated time, attention, and firmness in their review of CBO work. The CBO is now making an increased effort to avoid conflicts of interest among its panel members; perhaps aiming a bit lower on the prominence scale, with no loss in

<sup>1</sup>Summers, "The Scientific Illusion in Empirical Macroeconomics," 93 *The Scandinavian J. of Econ.* 129-148 (June 1991).

expertise, might also be helpful in that regard. Separated and retired staff from the CBO itself and other federal agencies like the Federal Reserve Board and the BLS would also seem to be good candidates for this different style of panel work.

#### E. A Resource Solution

Perhaps anticipating the suggestions for increased transparency and formal review I am making here, the CBO says the following on its website:

Nevertheless, there are limits to CBO's ability to make its analysis transparent. Much of that analysis is very technical, so explaining the models and other analytic techniques used is time-consuming. Because the pace of Congressional action often requires CBO to produce its analysis quickly, the amount of explanation that can be provided when an estimate or analytic report is released is usually limited by the time available. And because the overall demand for CBO's work is high and its resources are constrained, the agency needs to balance requests to explain more about finished analyses with requests for new analyses and with its other responsibilities, such as regularly updating its baseline budget and economic projections.

Therefore, it is incumbent on me to suggest how the CBO can get the extra resources it needs to accomplish this large jump in transparency and quality improvement. Clearly, in this time of federal budget constraints, Congress will not provide *de novo* resources, in terms of hiring either consultants

or new employees. Rather, the resources must be borrowed or reallocated by Congress from other federal government agencies.

I recommend the Federal Reserve System as the main source to increase the personnel of the CBO to do this essential work, in conjunction with existing CBO staff. Economists, analysts, and attorneys at the Federal Reserve Board and banks are recognized widely for their skills, training, and expertise. Yet, given the hundreds of such workers in the Federal Reserve System, it is hard to believe that even if a quarter of them were moved to the CBO, either temporarily or permanently, it would make monetary or regulatory policy much less effective than it is now. Many of the economic staff members at both the board and the reserve banks are engaged substantially in academic-style research, which is a questionable use of government resources, given the alternative needs of greater value.

#### F. Conclusions

Based on three cases of error in scoring and analysis, there is evidence that the accuracy and quality of CBO scores and analyses should be improved. A formal, external, and deep review of a statistically valid sample of its recent work is warranted. On an ongoing basis, the composition of the advisory panels should be rethought, a minimum transparency quotient for the regular output of the CBO implemented, and the extra personnel resources needed to accomplish these tasks should be added from the Federal Reserve System.