TESTIMONY

to
COMMITTEE ON THE BUDGET, U.S. HOUSE OF REPRESENTATIVES
on H.R. 3654
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by
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Mr. Chairman, Mr. Ryan:

Thank you for your invitation to testify today on H.R. 3654, which would establish a federal budget commission to 'reform tax policy and entitlement benefit programs and ensure a sound fiscal future.' My testimony will develop the following themes:

- *The premise of the bill is correct in part*; the United States faces daunting projected fiscal deficits. Early action to prevent them, while not urgent, is desirable.

- *The bill mischaracterizes the source of these deficits*. *They derive entirely from projected increases in national health care spending, not from problems peculiar to government health care or entitlement spending*.

- *Materially slowing the growth of Medicare and Medicaid apart from general health system reform is impossible*, unless the nation reneges on its commitment to assure the elderly, disabled, and poor health care roughly comparable to that available to the rest of the nation.

- *The specification of 'issues to address' and 'policy solutions' in section 3 of H.R. 3654 is unbalanced*. For example, the draft bill specifies as a 'policy solution' limits on entitlement spending, but does not mention as a 'policy solution' curbing in tax expenditures that putatively serve the same general objectives as direct spending, but benefit different groups.

- *The draft bill virtually invites 'game playing,' as policymakers could avoid hard choices by manipulating long-term projections with artful assumptions, scoring methods, or other tactics* for avoiding hard choices. Such practices were used extensively to subvert the Gramm-Rudman-Hollings targets in the 1980s. H.R. 3654 could actually obstruct desirable action to address projected long-term budget deficits.

- *Commissions never solve complex problems unless members of Congress are prepared to address the underlying source of those problems*.

I

The Congressional Budget Office has issued projections of long-term spending and revenues twice in recent years, under the directorship of Douglas Holtz-Eakin, who was selected by a Republican Congress, and under the directorship of Peter Orszag, who was selected by a Democratic Congress.[1] *Their projections* differ in detail, but *both foresee the emergence of excessive budget deficits* in future decades.

All deficit projections depend on the difference between two projections of much larger estimates of spending and revenues, each subject to large errors. Seemingly small differences in projection methods, assumed growth rates, or baseline conditions have huge effects on whether and when deficits emerge and on how large they will be.

- Demographic projections one or two decades into the future contain much useful information because most who will be alive are already born, and because mortality rates evolve slowly.

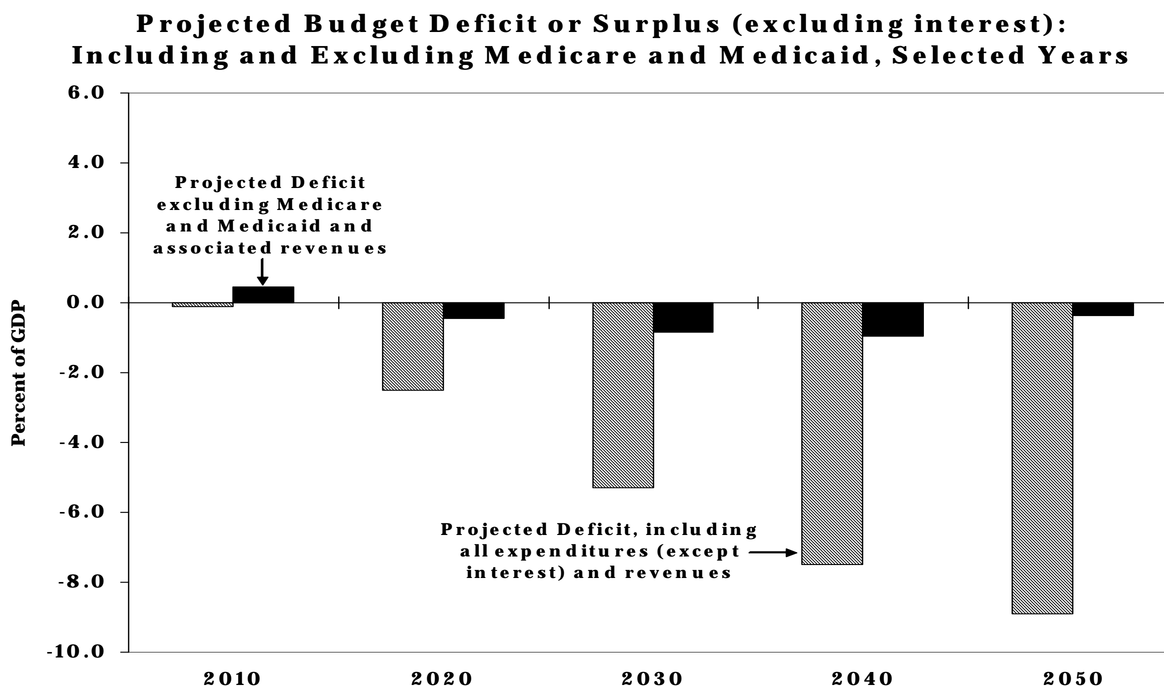
- Longer-term demographic projections and economic projections of almost any duration are subject to large errors, because birth rates and economic growth are hard to forecast.

- Long-term projections of health care spending are little better than guesses because most of the projected increase in healthcare spending arises from future discoveries, which, by definition, we currently don't know.

Past health care advances have boosted per person spending, and currently anticipated advances seem likely to do so as well. But many scientists expect medical advances eventually to reduce spending per person. Our ignorance of the directions of future health care discoveries means that projections of health care spending more than a very few decades into the future are virtually devoid of useful information. And, as I shall show, that uncertainty renders budget projections highly suspect.

Figure 1 (next page) indicates the projected size of so-called primary deficits—the gap between all government spending (other than interest on the debt) and revenues. It is based on recent CBO projections, using their 'alternative scenario' for revenues and expenditures.[2] *Deficits, shown in zebra-striped bars, are projected to grow to unmanageable size*.

This projection raises two practical questions. What causes those deficits? What can be done about them? Perhaps the shortest and most frequently heard answer to the first question is that the cause is: entitlements, which is shorthand for Social Security, Medicare, and Medicaid. This answer is misleading for three reasons.



- Entitlement (or mandatory) spending includes many programs other than the 'big three.' Collectively, the 'smaller' entitlements account for as much federal spending as Medicare and more than Medicaid.[3] As a group, entitlements other than 'the big three' will claim a declining share of gross domestic product. *In fact, the share of GDP going for Social Security and the entitlements that CBO groups as 'Other Mandatory Spending' is projected to remain roughly constant over the next decade, even as the baby-boom generation is beginning to retire*.

- Nearly *all of the projected growth of federal budget deficits is traceable to added spending on Medicare and Medicaid* in excess of earmarked revenues and general revenues as a share of GDP currently allocated to these programs. *As shown by the black bars in figure 1, CBO's long-term projections indicate that apart from the fiscal impact of Medicare and Medicaid, the federal budget will remain in approximate balance through the year 2050—and that projection includes every penny of Social Security benefits promised under current law*.[4]

- Finally spending on Medicare and Medicaid is driven mostly by forces that are outside these two programs.

  — *The most important of these forces is the projected growth of per person health care spending*. Growth of Medicare spending per person has closely tracked growth of per person spending on health care in general. That parallelism simply reflects the central

purpose of Medicare and Medicaid: to assure that the elderly, disabled, and poor receive care similar to that available to the general population. *Increases in spending per person account for about three quarters of projected increases in Medicare and Medicaid outlays*. Holding growth of per person spending on Medicare and Medicaid below that for the general population would imply the gradual abandonment of the national commitment to assure the elderly, disabled, and poor standard health care.

— *Growth in the number of Medicare and Medicaid enrollees accounts for less than a third of projected spending increases*. The only ways to offset this source of growth would be a) to increase the age of eligibility for Medicare or b) to tighten the already stringent income and asset tests for Medicaid eligibility. *Increasing the age of eligibility for Medicare has a surprisingly small* effect on outlays because the young elderly are relatively inexpensive. *My estimate is that raising the age of Medicare eligibility from age 65 to 67 would reduce spending about 2 percent; raising it to age 70 would reduce spending about 9 percent*. Furthermore, until and unless American workers can be encouraged to retire at later ages than they now do, raising the age of eligibility for Medicare would exacerbate an already serious problem—the gaps in insurance for those who lose employment-based coverage before they are old enough to qualify for Medicare.

The forgoing numbers carry three clear implications:

➢ *America does not face an entitlement crisis; it faces a health care financing problem*.

➢ *The health care financing problem is a total system problem, affecting private as well as public spending, not a problem just of government programs*.

➢ *The solution to the fiscal challenge posed by increasing health care spending hinges ultimately on overall reform of health care financing.*

II

Even though projected budget shortfalls derive almost entirely from forces that equally affect private and public health care spending, general measures to slow the growth of budget outlays or increase government revenues can defer the onset of those deficits and reduce their size. *To be regarded as fair, an examination of possible measures should include all government spending, not just entitlements. And on the sound, conservative principle that we should pay for what we buy, the search should include tax expenditures that erode the tax base and measures to boost tax rates*. I invoke fairness because entitlement programs provide basic support for low- and moderate-income households, while tax expenditures disproportionately benefit those with comparatively high incomes.

Consider the two largest tax expenditures—the exclusion of employer-financed health insurance and the mortgage interest deduction. Both flow disproportionately to upper income tax filers for two reasons. First the value of an exclusion or deduction rises with one's

marginal tax rate. Second, upper-income households typically carry larger mortgages than lower-income households do and are covered by more generous health plans. *Thus, an effort to cut Social Security benefits on the ground that they are unsustainable while ignoring tax expenditures would represent an ideologically biased agenda that favored the well-to-do in the name of fiscal responsibility*. Calling for cuts in Social Security in the name of fiscal balance while embracing extension of all of the 2001 and 2003 tax cuts is also unbalanced. The estimated seventy-five year cost of the 2001 and 2003 tax cuts just for the top 1 percent of filers with incomes of $450,000 or more exceeds the entire projected Social Security shortfall over that period.

III

The key to dealing with long term deficits is substantive agreement on legislative changes that either curb net spending or raise net revenues, or both. Actually cutting spending or raising taxes is hard work. Setting numerical goals and procedures is easy. Dealing with projected deficits by specifying procedures or numerical targets is a virtual invitation to avoid or delay the hard work and instead to fall back on easy gimmicks to comply with numerical targets.

Two elements of H.R. 3654 illustrate this problem. First, t*he draft bill would explicitly authorize three methods of estimating the cost of legislation*: the methods used by the Congressional Budget Office and two others that could have the support of fewer than one-third of the membership of the proposed Commission. Rather than forcing the Commission to agree on how to price policy changes, this provision virtually guarantees that there will be three estimates of everything. It would, thereby, divert discussion and commission attention from discussion on real policy to bickering over estimation techniques. I interpret this provision as an attempt to appeal to those who persist in believing that so-called 'dynamic scoring' will transform revenue losing tax cuts into revenue gainers. The continued belief in the transformative power reflects a tenacious faith, but is contradicted by careful studies of dynamic scoring by the Congressional Budget Office under both Dan Crippen and Douglas Holtz-Eakin and by President Bush's Department of the Treasury. These studies have shown that dynamic scoring techniques variously cause tax cuts to appear less or more costly than conventional techniques do but never make much difference.

Second, the life of the Commission would end whenever Congress enacted legislation that the Comptroller General certified that legislation would reduce the fiscal gap by 1 percent of gross domestic product measured over twenty-years and 2 percent of gross domestic product measured over fifty years as estimated by the Comptroller General.

However, *the draft bill leaves undefined what the term fiscal gap means or how it should be computed. Another point should be made here. Projections of what revenues and spending will be half a century hence are highly speculative; no one has a good idea of how complex measures undertaken today (such as national health care reform) might affect the economy, revenues, and spending fifty years hence*. How, for example, would budget

estimators in the Eisenhower Administration have estimated the impact on today's fiscal gap of the interstate highway system established during their term?[5]

Quite apart from the impossibility of intelligently estimating the impact on the fiscal gap so far in the future, this provision means that *Congress could do absolutely nothing that materially affects either spending or revenues for many years yet comply technically with these targets*. How? One way would be to shift spending responsibility to the states. A second would be to back-load tax increases or spending cuts that members would be confident that future Congresses would reverse.

Those who believe that the good consciences of elected officials would deter them from such phony fiscal probity need only look back at the truly comical avoidance mechanisms adopted to comply with Gramm-Rudman-Hollings requirements of the 1980s. Or they could look at the sunset provisions of the 2001 tax legislation, which the Administration advocated with straight faces, thereby low-balling estimates of long-term revenue loss and avoiding need for a super-majority for passage in the Senate under the Byrd rule. Or they could look at the 1997 Medicare legislation, which delayed insolvency in part A by the device, entirely bogus from the standpoint of budget balance, of shifting spending to part B. Furthermore, the triggers in H.R. 3654 introduce yet a fourth possible method of estimation, as the Comptroller General would not be duty bound to use the methods employed by the Congressional Budget Office or by either of the five-member Commission factions that could under this bill insist on estimation methods of its own.

IV

Finally, the most fundamental point is that projected long-term budget deficits result from specific policies. Until such time as the Administration and Congress, with the backing of the American people, are prepared to modify the policies that generate those deficits, Commissions are an avoidance mechanism, not a solution. Some observers demur from this negative appraisal of commissions, pointing to the 1983 National Commission on Social Security Reform (known better as the 'Greenspan Commission'), which recommended a combination of tax and spending changes to prevent imminent insolvency and to restore close actuarial balance to Social Security.

In fact, the Greenspan Commission illustrates a quite different truth. Although President Reagan had inveighed against Social Security during his pre-presidential years, as president he recognized—as did Congressional leaders—that allowing exhaustion of the Social Security trust funds to force capricious benefit cuts was intolerable and that immediate action was necessary to forestall that event. All of the key leaders in Congress and in the administration, Republicans and Democrats, as well as key outside groups—including the elderly, insurance companies, organized labor, and large businesses—wanted to make sure that Social Security was sustained. The consensus was solid, and it was generally recognized that a deal would have to include both benefit cuts and tax increases. The Greenspan Commission served as political cover for action to avoid results that no one wanted but that would otherwise have occurred in a few months. No such budgetary cliff exists today. We

are not in a situation comparable to that in 1982, when President Reagan and Congressional leaders of both parties agreed to try to work out a bipartisan compromise involving both Social Security benefits and Social Security taxes, and to use a commission as the mechanism through which the White House and Congressional leaders would negotiate the deal. In the current circumstances, a commission likely would only provide an appearance of doing something. And creating that appearance could reduce the likelihood that real action would be taken.

ENDNOTES

1. Congressional Budget Office, *The Long-Term Budget Outlook*, December 2005; Congressional Budget Office, *The Long-Term Budget Outlook*, December 2007

2. The alternative revenue scenario assumes that 2007 personal income tax law remains in effect and that the AMT is indexed for inflation, that estate and gift taxes are a constant share of GDP, and that corporation income taxes, payroll taxes, and other revenues follow current law except that other revenues remain a constant share of GDP after 2017. The alternative expenditure scenario is based on the assumption that Medicaid and Social Security follow current law, that Medicare spending follows current law except that physician payments grow with the Medicare economic index, and that other spending other than interest remains a constant share of GDP.

3. The largest 'other mandatory spending' programs civilian and military retirement pay, the earned income tax credit, supplemental security income, unemployment insurance, and food stamps. All of these programs qualify as 'entitlements.'

4. If one uses CBO's 'extended baseline' projections, subtracting the impact of Medicare and Medicaid leaves large and growing projected surpluses in the rest of the budget.

5. The question is important for two reasons. First, advocates of increased spending or reduced taxes that might be classified as 'investments' or 'pro-growth' would doubtless argue that short term costs would lead to improved long-term outcomes. What looked to be deficit increasing over a few years, it could be argued, would be deficit reducing in the long run. Second, actually doing the analysis to substantiate or refute such claims is impossible to do reliably. Critics of the interstate highway system would have pointed to the unfunded liabilities for highway maintenance that would boost future deficits of the states. The road-builders of the Eisenhower years could have claimed—with considerable legitimacy as events turned out—that those unfunded liabilities would pale beside the economic innovation and growth that would result from a revolution in the transportation of goods and the associated investments. Were an analogous undertaking to be enacted to day, should the Comptroller General under H.R. 3654 count it as raising or lowering future deficits?