The Heritage Foundation
LEADERSHIP FOR AMERICA
214 Massachusetts Avenue, NE • Washington DC 20002 • (202) 546-4400 • heritage.org

CONGRESSIONAL TESTIMONY

The SAFE Commission Act (H.R. 3654) and the Long-Term Fiscal Challenge

Testimony before COMMITTEE ON THE BUDGET United States House of Representatives

June 24, 2008

Alison Acosta Fraser
Director, Roe Institute for
Economic Policy Studies
The Heritage Foundation

My name is Alison Acosta Fraser. I am Director of Economic Policy Studies at The Heritage Foundation. The views I express in this testimony are my own and should not be construed as representing any official position of The Heritage Foundation.

Thank you for the opportunity to speak to the committee on this most important issue.

Entitlement Tsunami Challenge

- Entitlements will cause the budget (without interest) to soar from 18.8 percent of GDP today, to 35.3 percent by 2082.
- With interest included spending will soar from 20 percent of GDP to 75 percent by 2082 if current tax policies are kept in place.
- Maintaining current tax policy will result in revenues rising above the post World War II average of 18.3%.
- The gap between future benefits and funding committed for Medicare is $36 trillion, Social Security nearly $7 trillion more.
- When other liabilities like the national debt are added in this is the equivalent of a $175,000 mortgage for every man, woman and child in American – only without the house to go with it.
- The SAFE Commission ACT is a bold way to build public support for change and forge bipartisan agreement for action.

Entitlement spending on Medicare, Medicaid, and Social Security is a tsunami heading toward our budgetary and economic shores. Experts across the ideological spectrum agree that entitlements threaten the nation's priorities.

Entitlements are not budgeted in the same manner as most other federal programs. Though there are strong reasons for this approach, this means that entitlement spending grows virtually unchecked from year to year. This approach to budgeting makes it exceedingly difficult to tackle entitlement spending, but it does not diminish the need to do so.

The Congressional Budget Office's latest analysis projects that spending on these three entitlements will cause the budget (without interest spending) to soar from 18.8 percent of gross domestic product to 24 percent by 2030, 28.3 percent by 2050, and 35.3 percent by 2082. Maintaining current tax policy[1] and with tax levels rising just above the

[1] Key features: maintaining the 2001 and 2003 tax cuts and indexing the alternative minimum tax (AMT).

historical average of 18.3 percent of GDP, total spending *including* interest skyrockets from 20 percent of GDP in 2007 to 75.4 percent in 2082.[2]

Clearly, this is an unsustainable budget path, and it is one that is driven by entitlement spending. Social Security and Medicare have promised $42.9 trillion more in benefits to senior and disabled workers than the programs will be able to pay, according to a new report. Social Security's long-term unfunded obligations are $6.6 trillion; Medicare's are $36.3 trillion. When other liabilities and obligations are factored in, this is the equivalent of $175,000 for every man, woman, and child in America—nearly the equivalent of a mortgage, but one without a home to go with it.

According to the CBO "Ryan letter," if entitlements are left unchecked, spending will cause huge deficits that will begin to extract a tremendous toll on the economy, causing GNP not only to stop growing, but also to contract. In out years, "project deficits would become so large and unsustainable" that CBO's models simply cannot calculate the impact on the economy. Moreover, the estimates "greatly understate the potential loss to economic growth."[3]

The spending problem is so massive that federal tax rates would have rise to stagnating—even confiscatory—levels to close the gap. CBO estimates that today's income tax rates would have to more than double:

Today's Rates percent	**Tax Rates Necessary to Pay for Entitlements** Percent
Individual	
10	25
25	63
35	88
Corporate	
35	88

This is calculated without any economic feedback. Such tax rates would come at a tremendous cost to the economy and create other problems as well. According to the CBO, revenues would likely fall materially short of their projections and thus are not feasible.[4] The U.S. Corporate tax rate is already one of the highest among the industrialized nations. In order to remain competitive in the global economy, our tax rates should be going down, not up.

Why a Commission

[2] Peter R. Orszag, letter to Honorable Paul Ryan, Ranking Member, Committee on the Budget, U.S. House of Representatives, on "The Long-Term Economic Effects of Some Alternative Budget Policies," May 19, 2008, at *http://www.cbo.gov/doc.cfm?index=9216*.
[3] *Ibid.*, p. 4.
[4] *Ibid.*, pp. 8, 9.

Representatives Jim Cooper (D–TN) and Frank Wolf's (R–VA) Safe Commission Act (H.R. 3654) would create a vehicle for action that could break the entitlement legislative logjam. This legislation would achieve both public acceptance for solutions to the entitlement tsunami and bipartisan action to put these solutions into law. Since many experts feel that entitlement spending is the greatest economic challenge facing the nation, the need to tackle it is vital.

Legislation moving through Congress frequently takes steps backward, not forward to rein in the soaring costs of entitlements. It is politically difficult for most Members to talk about meaningful reform. The legislative and budget processes only aggravate that dynamic.

The entitlement tsunami is driven by huge increases in future federal spending on retirement programs for middle-class retirees: Medicare, Medicaid, and Social Security. It is not driven by falling tax levels.

The reality of today's politically deadlocked environment means that many lawmakers may insist that revenues must be considered if reductions in popular entitlements are to occur. Conservatives resist the idea of raising taxes for several reasons: Taxes are not the problem, future spending growth is; and raising taxes would threaten the economy, compounding the harm from higher levels of government spending. Moreover, increasing taxes would likely reduce the pressure on Congress to curb spending, or could even increase spending in other areas

The Cooper–Wolf bill provides a rational solution to this political quagmire. It creates a bipartisan commission with a mandate to address the "unsustainable imbalance" between federal commitments and revenues while increasing national savings and making the budget process give greater emphasis to long-term fiscal issues. While the commission could consider a range of approaches, the bill places emphasis on two:

- Reforms that would limit the growth of entitlements while strengthening the safety net, and
- Tax reforms that would make the tax system more economically efficient and improve economic growth.

Focusing on slowing the growth in entitlement spending, along with changes to strengthen assistance for the needy, the commission's proposal should appeal to those who worry that surging middle-class entitlement retiree spending will crowd out spending on other priorities. On the other hand, focusing on pro-growth tax reforms that improve economic growth (and also lead to an increase in revenues, just as the 2003 tax changes produced increases in revenues) is a critical issue for those who worry about escalating tax levels. Combining both of these areas of concern into a reform package is necessary in this polarized political environment to achieve changes that can be acceptable across the political and ideological spectrum.

Public engagement is another vital feature of this commission. This commission would not create a backroom deal and drop the results on the nation. Rather, it would hold public hearings to discuss the long-term entitlement challenge. This essential first step would consist of public "town hall"–style meetings across the nation to speak frankly about the long-term fiscal challenge and the tough options for fixing it.

Taking this first step would help to build public acceptance of the need to fix entitlements and support for ultimate plans to modernize the programs. These discussions would require balancing the worries of the young and the elderly. This up-front guidance and buy-in from Americans of all walks of life would help to guide the commission in creating detailed recommendations that would receive much broader support and understanding than proposals crafted solely inside the Beltway.

In today's political environment, it is extremely difficult and uncomfortable for many, if not most, Members of Congress to explicitly discuss the colossal fiscal challenge that entitlements present. The highly partisan environment often seeks to push discussions further and further from real action on these tough problems. The end result is that succeeding Congresses merely kick the can down the road. The Cooper–Wolf SAFE Act would change these underlying dynamics so that entitlements can be tackled and a huge economic disaster prevented.

Fiscal Wake-Up Tour

I have been a partner in the Fiscal Wake-Up Tour, sponsored by the Concord Coalition with The Heritage Foundation and the Brookings Institution and featuring former Comptroller General David Walker. The Fiscal Wake-Up Tour has traveled the nation for over two years, educating Americans on the problem and possible solutions.

Americans trust the data that are presented in the Fiscal Wake-Up Tour, and they are prepared to discuss, accept, and sometimes even demand solutions to entitlement spending that most politicians assume would be unacceptable to the public. Moreover, they view the budget crisis primarily as a moral issue, centered on the huge debt—that $175,000—facing the younger generations, often their children and grandchildren, not as just an economic crisis.

Americans are ready to have this conversation and often wonder why there is not more being done in Washington to solve the problem.

Legislative Action

The entitlement problem has been well known for years. Experts from the right and the left agree that entitlements are fiscally unsustainable and a threat to the economy, as indicated earlier. Many budget and fiscal policy experts have written extensively to warn of the entitlement problem[5]. Audiences appreciate the respectful and frank bipartisan nature of these conversations.

[5] Stuart M. Butler Ph.D., Alison Acosta Fraser and others, "Taking Back our Fiscal Future" Heritage Foundation White Paper 9999, March 31, 2008, at http://www.heritage.org/about/staff/alisonfraserpapers.cfm#2007Research

Representative Paul Ryan (R–WI) has proposed a bold legislative road map to rein in entitlements—and without raising taxes. This plan is a collection of bold, comprehensive, and sweeping reforms covering a broad spectrum of issues. He has laid out his vision for reforming entitlements and challenges others with different views to present them.[6]

Sadly, legislative action in Congress to achieve tough first steps toward solving this problem, Ryan's road map and the SAFE Commission Act notwithstanding, has not been forthcoming. Worse, efforts to rein in costs are frequently stymied even by those who view entitlements as a legitimate threat.

When tough legislation is proposed, every conceivable special-interest group—and their lobbyists—will work diligently to ensure that their particular interests are protected or receive even more favorable treatment. With programs like Medicare and Medicaid, there is an astonishing array of stakeholders: doctors, hospitals, drug companies, durable medical equipment providers, to name just a few who will want to be held harmless. The legislative result is predictable. Legislation to curb entitlements this year seems likely to meet a dismal fate.

- **The Medicare trigger law** in the Medicare Modernization Act of 2003 (MMA) requires the President to submit legislation to the Congress for consideration when Medicare's general revenue funding becomes excessive. That trigger was pulled this spring and is an important step for Congress in addressing Medicare's perilous spending.[7] The deadline for the House to act is June 30, yet no positive action to bring Medicare spending under the trigger level is being planned as of this writing.

- A moratorium to prohibit the Administration from increasing the integrity of **Medicaid's federal matching rules** is included in the current war supplemental funding legislation. The need to overhaul federal matching fund rules has been noted for decades, including a strong critique from the Government Accountability Office. These administrative changes would make it more difficult for states to use inappropriate or questionable techniques to maximize their federal matching rate, but this moratorium would eliminate a good first step toward reining in Medicaid's soaring costs.[8]

- The MMA also authorized Health and Human Services, which runs Medicare, to require **direct competition for durable medical goods** by the companies that

[6] J.D. Foster, "Courageous Reforms in Ryan's Entitlements Road Map: Where Is the Democratic Response?" Heritage Foundation *WebMemo* No. 1958, June 19, 2008, at *http://www.heritage.org/Research/SocialSecurity/wm1958.cfm*.

[7] Robert E. Moffit, Ph.D., and Alison Acosta Fraser, "Washington Must Pull the Trigger to Contain Medicare Spending" Heritage Foundation *WebMemo* No. 1796, February 4, 2008, at *http://www.heritage.org/Research/Budget/wm1796.cfm*.

[8] Nina Owcharenko, "The Medicaid Regulations: Stopping the Abuse of Taxpayers' Dollars," Heritage Foundation *WebMemo* No. 1911, May 2, 2008, at *http://www.heritage.org/Research/HealthCare/wm1911.cfm*.

> provide them. If the program is allowed to grow, savings could be as high as $1 billion a year. This would also directly translate to savings for Medicare retirees since they typically make a 20 percent co-payment on this equipment. But these steps sadly are being sidelined by legislation pending in Congress.[9]

Despite a series of warnings about the economic and intergenerational harm from the entitlement tsunami, action from Congress seems increasingly difficult and unlikely without bold changes in the legislative dynamics, as these three examples show. The SAFE Commission Act would transcend this type of legislative paralysis.

Medicare Reforms vs. Health Care Reforms

Part of Medicare's problems stem from the fact that medical spending has outpaced the economy for decades. This doesn't mean, however, that there are not real steps that should be taken to rein in Medicare costs. A major portion of Medicare's spiraling costs in the next two decades is a result of the number of beneficiaries nearly doubling. Growth in each retiree's health care costs is certainly a large part of Medicare's spending problem, even the largest, but the increasing number of retirees in the system sorely exacerbates the trajectory of spending increases, with serious economic consequences.

Since Medicare accounts for roughly 20 percent of the nation's health care bill and other federal programs account for an additional 13 percent, Congress can and should revisit Medicare's structure to determine a way to make the program more affordable for future generations while ensuring that the basic needs of older Americans continue to be met.

Conclusion

Americans understand the entitlement problem and the consequences of inaction. They are ready for a national debate and anxious for Washington to work together to find solutions. Representatives Cooper and Wolf recognize that the nation's budgeting system is ill equipped to tackle the entitlement problem and that the political environment will not lead to a sustainable, responsible long-term federal budget. This is a sound proposal that could fundamentally change those tensions to achieve actioin and lead to a better future for younger and older generations alike.

---

[9] Robert E. Moffitt, Ph.D., "Medicare: Congress Is Poised to Block Savings for Taxpayers and Seniors Alike" Heritage Foundation *WebMemo* No. 1959, June 18, 2008, at *http://www.heritage.org/Research/HealthCare/wm1959.cfm*.

****

The Heritage Foundation is a public policy, research, and educational organization operating under Section 501(C)(3). It is privately supported, and receives no funds from any government at any level, nor does it perform any government or other contract work.

The Heritage Foundation is the most broadly supported think tank in the United States. During 2007, it had nearly 330,000 individual, foundation, and corporate supporters representing every state in the U.S. Its 2007 income came from the following sources:

Individuals	46%
Foundations	22%
Corporations	3%
Investment Income	28%
Publication Sales and Other	0%

The top five corporate givers provided The Heritage Foundation with 1.8% of its 2007 income. The Heritage Foundation's books are audited annually by the national accounting firm of McGladrey & Pullen. A list of major donors is available from The Heritage Foundation upon request.

Members of The Heritage Foundation staff testify as individuals discussing their own independent research. The views expressed are their own, and do not reflect an institutional position for The Heritage Foundation or its board of trustees.