CONTENTS

Opening statements:
  Senator Johnson ............................................................................................... 1
  Senator Peters .................................................................................................. 4
  Senator Romney ................................................................................................ 5
  Senator Carper ................................................................................................. 22
  Senator Hassan ................................................................................................. 25
  Senator Sinema ................................................................................................. 26
Prepared statements:
  Senator Johnson ............................................................................................... 39
  Senator Peters .................................................................................................. 41

WITNESSES

TUESDAY, JANUARY 28, 2020

Douglas Holtz-Eakin, Ph.D., President, American Action Forum ....................... 7
Charles P. Blahous, Ph.D., J. Fish and Lillian F. Smith Chair and Senior Research Strategist, Mercatus Center, George Mason University .................. 8
Brian Riedl, Senior Fellow in Budget, Tax, and Economic Policy, Manhattan Institute for Policy Research ................................................................. 10
Henry J. Aaron, Ph.D., Bruce and Virginia MacLaury Senior Fellow, The Brookings Institution ......................................................................................... 12

ALPHABETICAL LIST OF WITNESSES

Aaron, Henry J. Ph.D.:
  Testimony .......................................................................................................... 12
  Prepared statement .......................................................................................... 80
Blahous, Charles P. Ph.D.:
  Testimony .......................................................................................................... 8
  Prepared statement .......................................................................................... 50
Holtz-Eakin, Douglas Ph.D.:
  Testimony ......................................................................................................... 7
  Prepared statement .......................................................................................... 43
Riedl, Brian:
  Testimony .......................................................................................................... 10
  Prepared statement .......................................................................................... 62

APPENDIX

Liabilities and Assets Chart ................................................................................... 85
30-Year Projected Deficits Chart .......................................................................... 86
Income Statement Chart ......................................................................................... 87
Tax Revenue vs. Rates Chart ................................................................................... 88
Average Interest Rate Chart ..................................................................................... 89
Progress Towards Simpson-Bowles Goals Chart ................................................ 90

Statements submitted for the Record from:
  American Federation of State, County and Municipal Employees ............... 91
  Nancy J. Altman, President, Social Security Works Chair, Strengthen Social Security Coalition .......................................................... 95
  Committee for a Responsible Federal Budget .................................................. 107
  FreedomWorks .................................................................................................... 123
  National Committee to Preserve Social Security and Medicare ................... 137

Responses to post-hearing questions for the Record:
  Mr. Blahous ..................................................................................................... 138

(III)
EXAMINING THE ROOT CAUSES OF
AMERICA'S UNSUSTAINABLE FISCAL PATH

TUESDAY, JANUARY 28, 2020

U.S. Senate,
Committee on Homeland Security
and Governmental Affairs,
Washington, DC.

The Committee met, pursuant to notice, at 9:33 a.m., in room
SD–342, Dirksen Senate Office Building, Hon. Ron Johnson, Chairman of the Committee, presiding.


OPENING STATEMENT OF CHAIRMAN JOHNSON

Chairman Johnson. Good morning. This hearing will come to order. I want to thank all of our witnesses for, first of all, your detailed testimony and your time today and your willingness to appear and provide verbal testimony and then answer our questions.

From my standpoint, this is a perfect hearing. It involves numbers. I get to use charts, which I will use shortly.

I will ask that my written statement be entered into the record,\(^1\) without objection.

I also want to thank Senator Romney. It is really his Time to Restore United States Trusts (TRUST) Act that prompted this hearing, but this hearing is really not the first because we have done this in the past, but it will be another one in a continuing series.

I was talking to Mr. Riedl a little earlier and talking to the panel. It is kind of amazing how this has sort of dropped off everybody's radar screen. Nobody really is talking about this. We are all whistling past a graveyard, basically. This is an important issue. I do not know at what point in time the debt bomb goes off, but it is not going to be pleasant. We have to start addressing these issues. And so, again, I appreciate everybody's expertise in this and your willingness to appear.

I want to just quick go through five quick charts to kind of set this thing up. Then I will turn it over to Senator Peters, and then Senator Romney would like to say a few words as well. So why don't you put up our first chart\(^2\) just to put everything in perspective.

We are always talking about the $23 trillion gross Federal debt. I want to just talk about total debt in our economy combined with

---

\(^1\)The prepared statement of Senator Johnson appear in the Appendix on page 39.

\(^2\)The chart referenced by Senator Johnson appears in the Appendix on page 85.
unfunded liabilities in terms of pensions. And when you take a look at this—and, again, all these numbers, for example, we have $21 trillion of government debt. I am sure that is probably owed to the public as opposed to gross debt. So I have not been able to, quite honestly, really take a look at all the definitions of these things, but there are all kinds of different definitions, so you have just got to sort of look at the macro issues we are dealing with.

Basically what this chart shows is between business corporate debt, government debt, household debt, and State and local government debt, we have about $82.5 trillion of outstanding debt in this country, roughly.

Then when you start taking a look at unfunded liabilities for pension and retirement plans, Medicare is about $80 trillion; Social Security is 43.2; Federal pensions—that is Federal employees plus military—about $8 trillion; State and local pensions, about 4.3. And, actually, it surprised me how small a chunk private pensions are. Actually, private companies, because we have laws, actually have to fund their pension plans, and so we do not have such a huge unfunded liability there.

I did want to just relate it to basically the private net worth of the United States. All private net assets is about $144 trillion, so that is assets minus debt owed on those assets. So it just kind of puts things in perspective. That is $218 trillion of debt and unfunded liabilities versus $144 trillion of U.S. net worth, private net worth.

The next chart,¹ I like calling this “the Johnson budget window,” but this is something that early on, when I got to the Senate, working with Congressional Budget Office (CBO) in the budget process, I got CBO to start—because we always talk about unfunded liabilities. People really do not understand net present value. You start talking about $100 trillion, $200 trillion. It is just not comprehensible. So I asked the CBO to start pulling together just a projection over 30 years. Most adults can actually conceptualize what a 30-year period is—when you get to be 64 years old, you realize how short a time span that really is, how fast it goes—and just do some measure of estimates of dollars. People do not buy hamburgers with a percent of gross domestic product (GDP). They use dollars.

So just to kind of put that in perspective, the latest 30-year projected deficit, according to CBO with their alternate fiscal scenario, $133 trillion projected deficit over the next 30 years. Again, you compare that to $144 trillion of U.S. net worth.

The next chart²—and, by the way, you all have this in front of you. I developed a one-page income statement for the Federal Government to just kind of lay this out. And so this one-page Federal income statement shows outlays, it shows revenue by categories, and then the accompanying deficit. And so of the $137 trillion projected 30-year deficit, you can see about $23 trillion is in Social Security. In other words, more benefits paid out than we bring in in terms of revenue. Medicare is about $42.6 trillion. Interest on the debt, in other words, the interest expense we are paying to our creditors, almost $60 trillion.

¹The chart referenced by Senator Johnson appears in the Appendix on page 86.
²The chart referenced by Senator Johnson appears in the Appendix on page 87.
So of the $137 trillion projected 30-year deficit, $125 trillion is in just those three categories: $23 trillion in Social Security, $43 trillion in Medicare, $60 trillion for interest on the debt. So it kind of shows you what we need to concentrate on, what Senator Romney is certainly talking about with his TRUST Act. We have to look at these long-term government-run entitlement programs.

The next chart. We will always have debates over taxes. How much do you tax success? How much do you want to kill that golden goose? I thought this was a pretty interesting chart because going back to the late 1950s, when we had a top marginal tax rate of 91 percent—now, that is punishing success—to today's current top tax rate of 37 percent, it is remarkable how consistent what our revenue generation is in comparison to GDP. It has averaged about 17.3 percent, and there is not much variation from it.

So, again, you can do everything possible to tax and punish success. The bottom line in some way, shape, or form we are only able to collect around 17.3 percent of GDP in terms of government revenue. At some point in time we ought to recognize that. My own solution? Completely simplify and rationalize the Tax Code. This obviously reflects we have a lot of complexity. There are all kinds of loopholes. I hate that crap. OK? From my standpoint, I do not even like using the term “tax reform.” I would much rather talk about tax simplification, tax rationalization. The simpler, the better. It is not exactly what we did in 2017. Maybe moving forward we will take a look at this reality and act accordingly.

The final chart I will talk about before I turn it over to Senator Peters is the average interest rate the Federal Government has paid on its debt, and this is the one that should concern us. You go back to the 1970s; average interest rate was about 4.5 percent. In the 1980s it was 6.8 percent. In the 1990s it was 4.9 percent. We have been living in an alternate universe right now with 2.7 over the first decade of this century, and only 1.5 percent over the last decade is the interest rate. Now, that interest rate gap over the average of 5.3 percent is 3.8 percent. You apply that to our current Federal gross debt of $23 trillion. I think it is $874 billion. That is off the top of my head. I did the calculation earlier. I do not have it written down, but it is a massive number if we were to return to that.

How do we return to that? Well, if the United States is no longer the world’s reserve currency and we cannot print money and global creditors start looking at the U.S. and going, kind of a credit risk, I am going to demand a higher interest payment if I am going to loan you money, that is what causes that.

I think we need to understand these realities. I am surprised that the debt bomb has not gone off already. I ran in 2010 because of this issue. We continue to be able to whistle by the graveyard. I do not know how long that is going to continue, but at some point in time the debt bomb goes off. And the bottom line is it is just not smart to be running up trillion-dollar deficits and just basically ignore all these unfunded liabilities and $23 trillion in debt which is only going to grow.

---

1 The chart referenced by Senator Johnson appears in the Appendix on page 88.
2 The chart referenced by Senator Johnson appears in the Appendix on page 89.
So, again, I thank everybody for being here. I will turn it over to Senator Peters and then Senator Romney.

OPENING STATEMENT OF SENATOR PETERS

Senator Peters. Thank you, Mr. Chairman, and certainly thanks to our expert panel of witnesses here today. We are looking forward to hearing your testimony.

I think there is no question that our Nation’s growing debts are unsustainable, and Congress has a very important responsibility to work together across party lines to reduce the national debt and to close our spending deficits.

Providing our country with a strong financial foundation is critical to ensuring that our economy can continue to grow and families in Michigan as well as all across the country can prosper.

Over the years I have been working to ensure that taxpayer dollars are used responsibly. I have been privileged to work with Members of both parties and folks on this Committee, which we do on a regular basis work together in a bipartisan way, to find some common-sense ways to cut wasteful spending and set our country on a sounder fiscal path.

Eliminating waste and fraud builds public trust, frees up funds for our Nation’s core priorities, including Social Security and Medicare.

These programs were created to ensure that every American can retire with dignity and the certainty that their essential health care needs will be met.

Medicare and Social Security are benefits that Americans have paid into through decades of hard work, and I am deeply committed to protecting Social Security and Medicare and ensuring that they are solvent for future generations.

At a time when the Government Accountability Office (GAO) estimates that 48 percent of working Americans approaching retirement have no retirement savings—I will say that again: 48 percent of working Americans approaching retirement have no retirement savings—and 29 percent of Americans over the age of 55 have no retirement or benefits plan offered by their employer, hardworking families in Michigan and across the country are counting on these programs to be there for them in the years ahead.

Congress must protect Social Security and Medicare by meeting our commitments, not by changing the rules of eligibility or slashing benefits to these folks.

There are serious challenges facing these Federal trusts, but our primary focus must be on increasing solvency without cutting benefits or changing the rules on American workers who have literally spent their whole lives working toward these programs.

We know, for example, that one of the most significant challenges facing Medicare is the rising cost of prescription drugs. Allowing Medicare to negotiate lower prescription drug prices would save tens of billions of dollars every year, according to the Congressional Budget Office.

We must also aggressively root out fraud and waste and other issues of inefficiency.

---

1 The prepared statement of Senator Peters appear in the Appendix on page 41.
And, finally, we must address workers’ limited economic mobility and stagnant wages which have both made it harder for families to save for the future but also for the trust funds to meet their commitments.

Solving this challenge is going to take bipartisan cooperation, and it is going to take also a very comprehensive approach. You need to cut costs, but you need to reform the Tax Code, and you also have to invest in economic growth.

These efforts can make our government more efficient, protecting Americans’ hard-earned benefits, and honor our commitment to keep these programs strong for our children and for our grandchildren.

I look forward to today’s discussion and to our ongoing efforts to identify commonsense, bipartisan solutions that will preserve Medicare and Social Security for all Americans for generations to come.

Thank you.

Chairman JOHNSON. Thank you, Senator Peters.

Now, Senator Romney.

**OPENING STATEMENT OF SENATOR ROMNEY**

Senator ROMNEY. Thank you, Chairman Johnson and Committee Members, for convening this hearing.

I had the occasion, as you know, of running for Senate very recently. The No. 1 issue in my State was the overspending by the Federal Government and the deficits we have and the amount of debt we have. You know the numbers. The government takes in about $3 trillion in tax revenue and spends about $4 trillion. We paid almost $300 billion in interest on the Federal debt. That number, as the Chairman has shown, is going to grow to be larger and larger and larger. And if interest rates were to rise for any host of reasons, why, it could become an overwhelming number. At some point we would be spending more in interest than we spend on our military.

As you all know, two-thirds of our spending at the Federal level is automatic. We do not vote on it in the budget—Medicare, Medicaid, Social Security, Highway Trust Fund and so forth. Last week, the GAO released a report confirming that the Highway Trust Fund will be insufficient to meet projected obligations within 2 years. The same trouble looms shortly thereafter for other major important funds. Medicare Part A in 6 years runs out of money. The Social Security Trust Fund becomes insolvent in 2034, so that is 14 years.

The question is: What are we going to do about it? A number of us—Senator Manchin, Senator Sinema, Senator Young, and I—have proposed, along with a number of other colleagues, five Republicans, five Democrats, something called the “TRUST Act.” It has been endorsed by Alan Simpson and Erskine Bowles. They made an effort and feel this is a good approach to pursue, and a number of organizations on both the right and left side of the aisle have made an effort in this regard.

The idea is to establish for each one of these trust funds individually—so for the Highway Trust Fund, for Medicare, for Social Security Disability Insurance (SSDI), for Social Security Old Age—for each one of them to establish a bipartisan, bicameral, if you will,
rescue committee and see if we cannot come up with a bipartisan approach for making sure these trust funds and these programs are made solvent.

Let me note that I know there are people on the right who feel that any give on our part is a mistake, and there are people on the left who feel that any give on their part is a mistake. Let me note this: If we do nothing then we will at some point reach a crisis where at that point we will have to raise taxes like crazy, which would clearly impact the economy, or cut benefits that would hurt our seniors. That is unacceptable. Either one of those is unacceptable.

The only other alternative is to work on a bipartisan basis, and if we just keep waiting and say we are not going to do anything until we actually run out of money in these funds—Medicare, Social Security, the Highway Trust Fund—the consequences are very severe.

So we are simply proposing that we get together, that we find a way to actually meet. We rarely have occasions to meet on a bipartisan basis in this chamber and across the Capitol with the House. So we are saying let us get the House Republicans and Democrats and Senate Republicans and Democrats together in small committees. If they can come up with a bipartisan solution, bring it to the floor in each chamber on a privilege basis for an up-or-down vote. And I believe that that is the only way we are going to prevent a circumstance where we face a crisis, a collapse in one of these funds, dramatic cuts in benefits or dramatic increases in taxes, either one of which would be unacceptable.

I am delighted to be able to hear from our experts today and hope that I will be able to get all the Members of our Committee to say, yeah, let us get together, work as a group of committees to see if we cannot solve these looming challenges.

So, with that, Mr. Chairman and Ranking Member, I appreciate your comments. I appreciate the chance to make some comments along with you in the opening here, and I hope to hear important information from our colleagues who join us on this panel.

Chairman JOHNSON. Thank you, Senator Romney. I appreciate anybody who is willing to take a look at this, highlight the issue, and start working toward some bipartisan solutions.

By the way, I did do a recalculation: $874 billion per year at our current debt level, tack that onto $300 billion, that is about $1.2 trillion of interest payments per year if we just return to a historical average interest rate. So, again, who knows what is going to happen with interest rates, but it is something we need to address.

It is the tradition of this Committee to swear in witnesses, so if you will all stand and raise your right hand? Do you swear that the testimony you will give before this Committee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. HOLTZ-EAKIN. I do.
Mr. BLAHOUS. I do.
Mr. RIEDEL. I do.
Mr. AARON. I do.
Chairman JOHNSON. Please be seated.

Our first witness is Dr. Douglas Holtz-Eakin. Dr. Holtz-Eakin is the president of the American Action Forum. From 2003 to 2005
Mr. HOLTZ-EAKIN. Mr. Chairman, Ranking Member Peters, and Members of the Committee, thank you for the privilege of being here today. I have a written statement that I have submitted.¹ Let me briefly make four points, and then I look forward to answering your questions.

There are a lot of numbers associated with the budget outlook, but all of those numbers tell the same story, which is the U.S. Federal budget is on an unsustainable trajectory with spending exceeding revenue as far as the eye can see, and how we address that I think becomes the important question.

First, sooner is better than later, for all the reasons that Senator Romney just laid out.

Second, we will need to grow as fast as possible as a Nation, and I think a priority should be placed on pro-growth policies. We will have to raise more revenue at some point, and that will be an unpleasant, I think, discussion and task. But even if we do both of those things, it is inevitable that one must take on reforms of the large mandatory spending programs. There is no way to deal with this problem without doing that.

I also think it is important to do that on behalf of the beneficiaries. Social Security, for example, was created to reduce income insecurity among the elderly. It is now the source of income insecurity among the elderly because in 14 years benefits are threatened to be slashed by 25 percent. So on behalf of the fiscal outlook but also on behalf of the beneficiaries, it is important to get to work on these programs.

There is nothing about the current low interest rate environment that should either say do not take action or defer taking action. There is a lot of talk about that right now. In my testimony I laid out some of the arguments that I think are very misleading and misplaced. This is something that is urgent and needs to be dealt with.

And then the last point I would make is that the fact that there is not a crisis does not mean there is not a problem. Often people say, “Oh, look at Japan. Japan has got a lot of debt. We do not need to worry about this.” I do not want Japan’s growth rate. I do not want the outlook for Japan. I think we can do much better than them.

It is absolutely the case that this fiscal outlook takes a toll on the United States. That toll will increase over time. It will eat away at our productive capacity, the growth rate in the standard of living; and if we borrowed this money from abroad, whatever productive capacity we have, we will owe the return to it to people who do not live here, and the standard of living will diminish as a result.

¹The prepared statement of Mr. Holtz-Eakin appear in the Appendix on page 43.
Mr. BLAHOUS. Thank you, Mr. Chairman, Ranking Member Peters, and all the Members of the Committee. It is a great honor to appear before you to discuss the leading contributors to the Federal Government’s long-term fiscal imbalance.

My remarks today will focus on the Federal Government’s largest two mandatory spending programs, Social Security and Medicare, and, obviously, these programs loom large in any discussion of Federal budgets, but they also, as Dr. Holtz-Eakin indicated, require significant reforms for their own sakes to maintain the solvency of their trust funds and to protect program participants.

Social Security and Medicare have two distinct trust funds each, or four trust funds in all, and whether these trust funds are kept financially sound is not merely an accounting issue. It is critical for program participants. Social Security and Medicare derive their unique political strengths from shared perceptions that participants’ benefits were earned through previous contributions, and this perception spares participants the frequent renegotiations of benefit levels and eligibility rules to which beneficiaries of so-called welfare programs are often subjected.

But if lawmakers ultimately prove unable to keep program revenues and benefits in balance, then Social Security and Medicare’s historical financing frameworks will have to be abandoned in favor of an alternative financing method that offers far less protection to beneficiaries.

Social Security’s long-range shortfall has grown to equal roughly 20 percent of all future benefit claims. Now, obviously, we are not about to cut benefits for retirees next year and afterward by 20 percent, and any changes we do make will almost certainly affect participants much less in the short run, necessitating even larger changes in the long run.

Those changes cannot wait until Social Security’s trust funds are nearly running dry. By that time, in the early 2030s, even completely eliminating all new benefit claims would not produce enough savings then to avert trust fund depletion. And if those trust funds are ever depleted, benefit payments must under law stop until sufficient tax revenues arrive to finance them, cutting benefits through the mechanism of delay.

1 The prepared statement of Mr. Blahous appear in the Appendix on page 50.
Medicare’s actuarial imbalance is not as large as Social Security’s, but it faces an even more immediate projected insolvency in hospital insurance in 2026. We simply do not have much time left to address Social Security or Medicare.

Now, in 1983, Social Security was rescued from insolvency at the last moment by delaying Cost of Living adjustments (COLAs) by 6 months, exposing benefits to taxation for the first time, bringing in newly hired Federal employees to contribute their taxes, increasing the full retirement age, and accelerating a previously enacted payroll tax increase, among other controversial provisions.

A Social Security solution enacted today, let alone the more difficult one that further delays would necessitate, would require far more severe measures. To preserve Social Security and Medicare finances, elected officials on opposite sides must compromise to a degree far exceeding recent political norms.

The total changes required to balance these programs’ finances is not a policy choice. The gap between their projected revenues and benefit obligations is what it is. No lawmaker who offers a solution should be attacked on the false premise that they would inflict unnecessary pain, especially when failing to act would be far more painful. Moreover, there are many potential upsides to Social Security and Medicare reforms. If it is done properly, reform can achieve more equitable treatment of different generations, lessen the risk of old age poverty from premature retirement, more efficiently target net benefits on households of greatest need, increase workforce participation and saving, all while lowering costs. Fiscal considerations are powerful reasons to pursue Social Security and Medicare reforms, but they are by no means the only ones.

Now, while restoring Social Security and Medicare finances to sound footing is critical for the programs and for their beneficiaries, it is also imperative for the larger Federal budget. As my written testimony documents, all recent and projected Federal spending growth relative to GDP in CBO’s latest long-term budget outlook from 2005 to 2033 can be accounted for by Social Security and gross Medicare spending growth alone.

Now, addressing these shortfalls requires many value judgments and tactical decisions of lawmakers. I would offer some principles for your consideration.

First, as has been said already, act as rapidly as circumstances allow. Every year that we wait means that the eventual solution imposes additional hardship on affected participants.

Second, do not make the problem worse. The only appropriate time to discuss any across-the-board increase in Social Security benefits or an expansion of Medicare is after and only after lawmakers have demonstrated, through enacted legislation, a willingness to fully fund these programs’ current-law obligations.

And, third, compromise. If, for example, one side says there cannot be any tax increases and the other side says there cannot be any deceleration of benefit growth, no solution will be possible, and program participants will suffer the consequences.

In sum, Social Security and Medicare warrant reform for their own sakes to place both programs on a sound financial footing and to better serve program participants. Prudent reforms to eliminate their shortfalls, in addition to improving the Federal fiscal outlook,
would also achieve a more equitable distribution of program benefits and financing burdens.

Thank you.

Chairman Johnson. Thank you, Dr. Blahous.

Our next witness is Brian Riedl. Mr. Riedl is a senior fellow at the Manhattan Institute focusing on budget, tax, and economic policy. He previously served as chief economist to Senator Rob Portman and as staff director of the Senate Finance Subcommittee on Fiscal Responsibility and Economic Growth. Most importantly, Mr. Riedl is a University of Wisconsin grad where he studied economics and political science before earning a master’s degree in public affairs from Princeton University. I found out before the hearing he is also from Appleton. I did not get a satisfactory answer to my question of why did you leave God’s country, but needless to say, Mr. Riedl, you are next.

TESTIMONY OF BRIAN RIEDL, SENIOR FELLOW IN BUDGET, TAX, AND ECONOMIC POLICY, MANHATTAN INSTITUTE FOR POLICY RESEARCH

Mr. Riedl. Thank you. Good morning, Chairman Johnson, Ranking Member Peters, and Members of the Committee. Thank you for inviting me to participate in today’s hearing.

My purpose is to describe the policies that are driving the historic surge in long-term deficits. I will begin by asserting that few Americans fully comprehend the fiscal avalanche that has begun. The budget deficit is on pace to surpass $1 trillion this year and is on pace to surpass $2 trillion within a decade just if we continue current policies. And if interest rates return to 1990s levels, the projected budget deficit will be $3 trillion within the next decade. This is according to data from the Congressional Budget Office.

The long-term picture is even worse. CBO projects $80 trillion in new red ink over the next 30 years, and even that assumes the tax cuts expire. That would leave the national debt at nearly 150 percent of GDP, and even that assumes peace, prosperity, and continued low interest rates.

So what is driving the red ink? We can start by looking at the $250 billion annual cost of the tax cuts and the $150 billion annual cost of the higher discretionary caps. That is $400 billion. But it is a steady $400 billion. It is not going to rise over the next decade. So it is not a contributor for the continued rise in the deficit from this point forward, and over the next decade, the definition is going to go from $900 billion to $2.2 trillion. So if the tax cuts and the discretionary caps are not driving the additional $1.3 trillion increase in the deficit, what is?

The CBO data points to Social Security and Medicare. Because payroll taxes and premiums do not fully cover the cost of benefits, Social Security and Medicare require a general revenue transfer each year to cover their shortfall. The cost of filling the Social Security and Medicare shortfall each year plus the resulting interest will rise from $440 billion in 2019 to $1.7 trillion a decade from now. That $1.25 trillion annual cost increase of filling the Social Security and Medicare shortfall drives more than 90 percent of the
projected increase in the budget deficit over the next decade, according to the current policy baseline.

So if you just take a look at the total decade figures, basically within the next decade Social Security will require a total of $2.5 trillion in general revenue transfers. Medicare will require $5.9 trillion in general revenue transfers. When you add $1.8 trillion in interest costs directly associated with those two transfers, you get $10 trillion of the deficit over the next decade that is directly attributable to general revenue transfers for Social Security and Medicare.

The long-term figures are even more dire. Remember I said earlier that CBO projects $80 trillion in red ink over the next 30 years? CBO data shows that if you break that down, the Social Security and Medicare systems will run a $103 trillion cash shortfall over the next 30 years, and the rest of the budget will run a $23 trillion surplus.

Specifically, Social Security will run a $19 trillion cash deficit, Medicare will run a $44 trillion cash deficit, and the interest costs of financing these shortfalls will add $40 trillion more.

Again, let me dig a little deeper into those numbers. Over the next 30 years, Medicare will take in $17 trillion and spend $61 trillion. Social Security will take in $56 trillion and spend $75 trillion. And, again, you get an additional $40 trillion in interest. That is how you get $103 trillion shortfall in Social Security and Medicare and a $23 trillion surplus for the rest of the budget.

This cost is not steady. It is growing rapidly. This year, the drag on Social Security and Medicare transfers is 2 percent of GDP. Thirty years from now, it will be 12.1 percent of GDP. In other words, the Social Security and Medicare annual deficit is going to rise by 10 percent of GDP over the next 30 years. You cannot raise taxes or cut other spending enough to close the 10 percent increase in the annual general revenue transfer cost for Social Security and Medicare. And, by the way, in 2049, the rest of the budget will be running a 3.4 percent of GDP surplus.

So, simply put, we basically have a Social Security and Medicare problem. The rest of the budget is going to run surpluses, but surpluses not big enough to close the Social Security and Medicare shortfall.

I have many charts in my written testimony that dive more deeply into this, and so I hope you will take a look at those, and I am happy to take any questions.

Chairman Johnson. Thank you, Mr. Riedl. And I did appreciate your charts. It is interesting. Our numbers are slightly different. Again, that is the whole definition projection, that type of thing. But they are basically point to the same problem.

Our final witness is Dr. Henry Aaron. Dr. Aaron is currently the Bruce and Virginia MacLaury Senior Fellow in the Economic Studies Program at the Brookings Institution. Dr. Aaron is also a member and former Chair of the Social Security Advisory Board. Dr. Aaron.
TESTIMONY OF HENRY J. AARON, PH.D.,1 BRUCE AND VIRGINIA MACLAURY SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. AARON. Thank you. I know you have some other things to do a little later, so I will try to be brief.

I appreciate the invitation to appear today. I divided my testimony into several sections. The first one, I want to point out that the Nation faces other problems in addition to the fiscal ones. Among those are upgrading and restoring our infrastructure, improving scientific education and training and investment in science, increases in early childhood development to develop a more productive citizenry, finding better ways to provide and pay for the explosive increase in long-term care that the Nation is going to face, fulfilling the commitments to the elderly and people with disabilities through Social Security and Medicare that we have made as a Nation, and not least, but last, taking effective steps to curb emissions of greenhouse gases and combat global warming.

That menu together with the fiscal challenges that we face underscore that the decision to cut taxes by Congress was and remains not just unwise but foolhardy and, perforce, any further cuts would be as well. In saying that, let me stress that tax reform is needed; tax cut are not.

The second part of my testimony addresses the issue of deficit reduction. The onset of low interest rates has not eliminated but it has reduced the urgency of deficit reduction. It has created additional fiscal elbow room for the government to operate. What that means is that the Nation today is able to carry more debt than it could have done in the past without harm. Deficits do create debt, and deficits do create harm. The reduction in interest rates ameliorates that problem. So in thinking about the problem of deficit reduction, it is vital to weigh it against the additional spending that is going to be necessary to deal with the other urgent problems that this Nation faces, and the relative importance of deficit reduction has been reduced by the reduction in interest rates—not eliminated but reduced.

The third part of my statement addresses Social Security. There is really no news here about the situation on Social Security. We have known for three decades that Social Security was going to cost more than the revenues it generates. There is nothing new here. We have known that there would be enough money to pay for all benefits through the middle of the fourth decade of this century. And we have known that we could, if we wished, pay for every nickel of scheduled benefits at a cost of about 1 percent of GDP. One percent of GDP. That is a smaller additional cost than the Nation has incurred for Social Security on a number of previous occasions. So it is doable if you want to do it. I am not suggesting that it is the only way to proceed.

We have all known that it was desirable to act sooner rather than later to close the projected gap in Social Security funding, and I think it is clear Senator Romney and his sponsors deserve credit for suggesting a step that would raise the salience of that issue. In

---

1The prepared statement of Mr. Aaron appear in the Appendix on page 80.
my testimony I have some comments about the bill itself, which I will come back to.

Health care is the fourth section of my testimony, and that problem is one that is far larger than Medicare or Medicaid. The problem of rising health care spending is a general problem for those programs but also for private payers as well.

It is the case that the rise in Medicare spending and Medicaid spending is the principal source of projected increases in government budget deficits. But we should take note of the fact that much of that increase is desirable of the increased spending and that the Nation has committed to providing the elderly and disabled health care commensurate to that enjoyed by the rest of the population. I hope that is a commitment that the Nation will sustain and that no Member of Congress would urge us to back away from.

So I think that it is particularly important, as Senator Peters suggested in his opening remarks, that where there are opportunities to take steps to curb the growth of health care spending we not back away from them. That includes surprise billing, an issue now before Congress. It includes efforts to curb the growth of pharmaceuticals as well.

Finally, I have some comments on the TRUST Act. The objective of heightening attention to budget problems is worthy. I believe the way in which the TRUST Act would address the major trust fund programs would not be the best way to proceed. In the case of Social Security, as Chuck Blahous mentioned, we know that a lot of circumstances in this country have changed in the roughly 40 years since there was last major legislation. It is time to take a look at Social Security in a thorough way, not merely, not only from the standpoint of trust fund balance. Social Security is a particularly difficult program and complicated one, and a rescue committee acting under expedited procedures is not the venue in which the various considerations that need to be taking place, for example, about how to provide long-term low-wage workers with better benefits, what to do about long-term beneficiaries whose assets are depleted, what to do about the fact that life expectancy has increased for some but decreased for others, affecting people very differently. These and other issues need to be considered.

In the case of Medicare, I believe that the rescue committee would push decisionmaking in the wrong direction. What happens 75 years hence, what is assumed to happen to Medicare costs 75 years hence is a matter of speculation based on almost total ignorance. We cannot know what the State of medical science will be 75 years hence, yet we have to make assumptions about that in any long-term projection. The result of making decisions within that context would be to base decisions about current health care benefits for current retirees and those soon to retire on assumptions regarding future events. Congress has never used long-term projections to shape Medicare legislation. It has taken steps to assure that it is adequately funded for a number of years into the future; 10 to 15 has been the typical range. And I think it is very important that it do that. But to use events 50 to 75 years in the future as an influence on current benefits would be, I think, a mistake and, therefore, the venue that one needs for addressing Medi-
care’s structure, something that is badly needed, is different from the one described in this bill.

Chairman JOHNSON. Thank you, Dr. Aaron.

As long as you started talking a little bit about Medicare, I think the Urban Institute right now, one of the reasons it is so popular is that for every dollar that Americans pay into the Medicare system—and I hear it all the time. “Well, that is my money.” Well, a dollar of it is, but you are currently getting about $3 out in benefits. I think it is not too far in the future that turns into 4:1 and then 5:1. Is that roughly correct? Dr. Aaron, do you want to respond to that?

Mr. AARON. Well, people are receiving through Medicare typically more than they paid in in benefits if they are low earners. Higher earners can look forward to a future in which they will be paying for much or most of their benefits.

Chairman JOHNSON. I know there is no cap on the Medicare tax, so very high earners, you could argue, are way overpaying in terms of just a self-funded type system.

Mr. AARON. Also, they pay extra premiums under Part B.

Chairman JOHNSON. Let me lay out a couple realities here. I cannot remember which one of you in your testimony talked about the trust funds. One chart I have always shown in the past is a picture of a four-drawer file—I think it is in Parkersburg, West Virginia, or Parkersville, something like that—that holds the trust fund, and it is just U.S. Government bonds. I think it is important people realize the Federal Government did not take in those payroll tax dollars and then invest that in an asset that the Federal Government can actually make a claim on. Congress has spent that money, and in its place they just put U.S. Government bonds in that four-drawer file. And a U.S. Government bond in the hands of the Federal Government is not a valuable asset. It is just an accounting convention, as one of you pointed out in your testimony.

Anybody want to confirm that basic reality?

Mr. HOLTZ-EAKIN. I am the guilty party. It is in my testimony.

Chairman JOHNSON. OK, good. I appreciate your pointing that out. My question is: What will happen when that accounting convention runs out? Because we already are at the point where we are paying out more benefits, so the Treasury is having to start calling on those bonds. And when those bonds run out—it is just an accounting convention—what do we think actually happens if we do nothing?

By the way, I also talk to young people and say, “What do you think you are going to get out of Social Security?” They say, “Nothing.” Well, that is not true, because you are talking about a 20 percent shortfall. So what do we think actually happens in 2035 or whenever that accounting convention runs out?

Mr. BLAHOUS. This is a subject of some debate, so I would not want to say that it is absolutely settled. I will say I think the prevailing interpretation is that the trust funds cannot spend on benefits where there are not resources in the trust funds to finance them; ergo, what would have to happen would be the benefit payments would be interrupted and effectively reduced through the process of delay until sufficient revenues came in from taxes to fi-
nance payments. So in the Social Security case, you would have a reduction in payments of about 20 percent in 2034.

Chairman JOHNSON. But you would not stop paying the benefits. You would literally just somehow—and I agree with you. Nobody really knows for sure, but the best guess would be benefits would be reduced by about 20 percent.

Mr. BLAHOUS. I think that is the prevailing interpretation.

Chairman JOHNSON. So, again, when young people are looking at that and saying, “Well, I am not going to get anything,” no, you will probably get about 80 percent if we do nothing. That is largely true.

Taking a look at those interest rates right there, is anybody knowledgeable—maybe Dr. Holtz-Eakin will be knowledgeable. To what extent are we taking advantage of these low interest rates in terms of our maturity profile? Are we refinancing our debt and locking in long-term interest rates on——

Mr. HOLTZ-EAKIN. Not in a dramatic fashion. There has been a modest increase in maturities in the past 3 years, but it is still relatively short-term debt.

Chairman JOHNSON. So why are we not doing that?

Mr. HOLTZ-EAKIN. That is a good question for the Secretary of the Treasury.

Chairman JOHNSON. I mean, is there a capacity in the marketplace to be able to lock these things? And is that one of the problems? Or when you go longer, it is going to increase interest rates, because right now they are borrowing very short term and those are really low rates versus the—what is the differential?

Mr. HOLTZ-EAKIN. So some of the other countries have moved in the past 20 years to 30 and even a 50-year maturity has been floated internationally. Those markets are not very liquid at the moment, so they are not outstanding places to borrow. But it is something that I am sure the Treasury Advisory Committee is looking at when they look at the term structure of the U.S. debt.

Chairman JOHNSON. What is the differential right now from a very short-term government bond to, let us say, a 30-year bond?

Mr. HOLTZ-EAKIN. You are looking at some of these about a percentage point.

Chairman JOHNSON. So it is not even 1 percent. So if you were—and I am not sure that you have the capacity for this, but if you were able to totally refinance it, let us say just 1 percent for easy calculation, it would cost you $230 billion a year in interest, but you have locked that in for 30 years, and you avoid that $874 billion hit per year.

Mr. HOLTZ-EAKIN. I guess the reason I have reservations about going down this path is if you take out the interest payments and just simply look at the primary deficit, the difference between spending and revenues, we have a deep fiscal problem on the fundamentals, and there will be no financial engineering that will avoid that. And I would encourage people to look at the fundamental problem.

Mr. AARON. There is another reason why the Treasury has not moved more aggressively. Were they to do so, they would be directly countering the policy of the Federal Reserve at the present time. The Federal Reserve has been trying to support low interest
rates, low long-term interest rates, and one of the ways they do it is by taking long-term bonds out of the market by buying them. If the Treasury is now dumping them back in, there is a war going on inside the government, and I think there is an awareness that there are other considerations.

Chairman JOHNSON. So you are basically sanitizing the actions of the Fed in doing that.

Mr. AARON. Yes, correct.

Chairman JOHNSON. But, again, the bottom line is if we were to do that, it would increase short-term interest payments, locking in lower long-term interest payments. To me, it still would make a lot of sense. Mr. Riedl, you are kind of shaking your head.

Mr. RIEDL. I am nodding my head because, I mean, just to put a finer point on the interest rate risk we face, for every point interest rates rise—and let us say they do not even start to rise for a decade. For every point interest rates rise, you get 16 percent of GDP in the debt in 30 years. So let us say we have rates go up by three points. You have just added 48 percent of GDP to the debt in 30 years.

Now, as bad as the interest rate risk is, I also agree with Dr. Holtz-Eakin that we do not want to assume that if we just fix interest rates, we are out of the water, because one of the—I think there have been a lot of economists who have written that interest rates are fine so we are OK. And it is important to note that even with low interest rates, we are still in deep trouble. When the underlying deficit gets so big, low interest rates will not bail you out. But rising interest rates, 16 percent of GDP gets added to the debt over 30 years for every point.

Chairman JOHNSON. Again, I completely agree with that, and my point in laying this out is we are suffering from short-term thinking. And right now government policy across the board is all dedicated to keeping interest rates low so that we are not paying the burden of our fiscal mismanagement. But that can blow up in our face, and it would be smart to take a little bit longer term view, try and take advantage of these low interest rates and change that debt maturity level. But we are not doing it because nobody wants to take the hit and have a short-term increase in interest costs. That is basically a correct statement, right? OK. Everybody is nodding their heads yes. Senator Peters.

Senator PETERS. Thank you, Mr. Chairman. Thank you again to our witnesses.

To outline the complexity of what we are dealing with, and, Mr. Holtz-Eakin, I agree with you totally that you have to look at this as a three-legged stool; and if you do not look at it as a three-legged stool, we are never going to finish this problem. We cannot grow ourselves out of it. We cannot cut our way out of it. We cannot raise revenue our way out of it. We have to be doing all three of those things. And, unfortunately, the politics that we see at this place tends to want to focus on one, maybe two, but never all three. And all three have to be done in a thoughtful way. And while we are looking at cutting costs wherever we can and raising revenue, we also cannot forget, as Dr. Aaron mentioned, we have to be investing in our economy as well, because you have to grow the econ-
omy as well. That can help us a great deal. But if you are not doing all three, we are not going to come to the end.

I want to take a look at just probably what is the most immediate problem, and it is illustrated by this wonderful chart of yours, Mr. Chairman, and that is the Medicare liabilities. If you look at where we are on health care costs around Medicare, that is a more looming problem. That is a lot quick problem than Social Security. We have to talk about Social Security, and hopefully I will have a chance to get to that and ask you. But if you are not fixing Medicare first, that is going to make it even more difficult to fix Social Security later. And that is looking at the underlying cost. It is not just putting in the money, but how are we dealing with the health care system? We are back to health care and the rising cost of health care that continues to go up at an unsustainable rate.

If you just look at what we spend in health care in this country, it is about over 17 percent of GDP, roughly. And if you look at other developed nations who oftentimes have—if you look at objective measures of health outcomes, they are equal to or surpass the United States, and they do it on average of less than 9 percent of GDP. So we are spending nearly twice as much as other countries that have equal or better outcomes when it comes to health care.

Dr. Aaron, my question to you, why are we such an outlier? How do we look at the structural problems of why we are spending so much on health care and yet getting outcomes equal to what other folks are getting at half the cost? What is happening?

Mr. AARON. That is a very complicated question.

Senator PETERS. Right. I realize that.

Mr. AARON. There are a lot of answers.

Senator PETERS. You have 4 minutes and 49 seconds to do it, to be clear. [Laughter.]

Chairman JOHNSON. So be concise.

Senator PETERS. Give me a top big factor or two.

Mr. AARON. We have a system in which there is effectively no budget constraint on expenditures for health care for most people, and that is, I think, the underlying factor.

I want to note that a lack of budget constraint is something in a way we all yearn for. We call it “insurance.” The essence of insurance is to protect us at the time of illness from being exposed to difficult financial choices. So that means if there is to be budgetary control, it needs to come from some other source. That can come in some countries from setting budgets for hospitals. That is what is done in Britain. I am not recommending this. I am just describing it. Virtually every other country has some kind of centralized negotiation for pharmaceutical prices and, therefore, pays less than we do.

I am not saying this is the solution to everything, but I am saying that these kinds of things, if you are to have lower spending than we do in the United States, these are the kinds of things that as a Nation we are going to need to consider in the future. And we are in a process, I think, of working this through. The debate about whether to have Federal policy with respect to the purchase of drugs is illustrating our efforts to find a way into this.

Senator PETERS. Can I just pick up on that?

Mr. AARON. Yes.
Senator Peters. Because Medicare cannot negotiate drug prices now, and yet the CBO has estimated that it will save $440 billion over the next decade. That is just negotiating. We let the VA negotiate for drug prices, but we do not let Medicare. That seems to me a pretty common-sense thing to be thinking about. That is not the total solution to the big problem we have, but it is the kind of meaningful steps that we should take?

Mr. Aaron. That is exactly where I was dancing around, and you—— [Laughter.]

Senator Peters. So those are the kinds of common-sense things.

Mr. Aaron. Yes.

Senator Peters. The other thing that I think is important, and to get your sense, is the way we have our health care system now, we have—the biggest expenses in the health care system long term are chronic diseases, and chronic diseases that take place over many years, diabetes, for example, which has a huge cost associated with it. And yet people who are in private insurance, let us say, in their younger years, there are things that they could be doing that would help deal with some of these chronic illnesses and reduce the cost plus make a better life for them. But there is not necessarily incentive for private insurance to do that because they figure they are going to pass these folks over to Medicare when they are old and will let Medicare worry about those chronic diseases that we probably could have been dealing with earlier. So I am thinking about treatments for pre-diabetes patients, for example, to have those kinds of things covered.

Could you talk a little bit about how we have to be thinking about this whole-life approach when it comes to health care and having a health care system—not just a sick care system but a health care system—where we invest more in preventative types of activities rather than waiting until they manifest themselves in very serious diseases? That would have a pretty significant impact on bringing costs down for Medicare, I believe. Is that accurate?

Mr. Aaron. Investing more in preventive care will make us healthier. I hate to be the skunk at the picnic on this one, but over the last three, four decades, numerous people with the best of intentions have studied the likely impact of a wide range of preventative interventions, and the conclusions have been some will save money, some will cost money; if well done, all will improve our health.

I think the way I would put it on this is preventive health care deserves a lot of attention and emphasis, but it is not going to be overall a powerful instrument for holding down long-term costs. Preventive interventions means giving people tests, which are expensive; identifying conditions that would not have been treated in the past and will now be treated, and that costs money. It also means stopping the progress of illnesses earlier so that one can save money over the long haul with particular patients.

There are all of these crisscrossing effects going on. The effects are we are better off for having it. But our wallets may or may not be better off.

Senator Peters. Thank you.

Chairman Johnson. Two quick comments. Government-paid health care, low-deductible insurance basically separates the con-
sumer of the product from the payment of the product, and we have driven as a result free market discipline competition out of the health care market, which helps restrain prices.

Second, out of a $3.7 trillion a year health care spend, it is about $500 billion on drugs. Even at a 20 percent profit rate, that is about $100 billion. If we can remove all profits, all incentives for drug innovation, we have removed $100 billion from a $3,700 billion spend. So, again, I just want to try and put things in perspective. Those things can be helpful, I suppose, but we need to be very careful that we do not remove incentives to create new drugs that are life-saving and in the end can also bring down health care costs. We have a health care financing problem, primarily, and it is totally screwed up, because we have removed the free market discipline out of it. Senator Romney.

Senator ROMNEY. Thank you, Mr. Chairman. I do agree with your comments on health care, although we are probably not going to resolve that in this Committee today. And there are a number of people who have written a lot about this and studied it, and a lot is going to go on, but it is clearly at the center of our Medicare issue and our Medicaid issue as well.

Dr. Aaron will not be surprised that I am mostly going to ask questions and direct comments to his comment. First, I would note that people in both parties are insistent that there is no change in benefits in Medicare, Medicare or Social Security for current retirees or near-retirees. There is no one—I have heard no one in either party which finds reducing benefits for current retirees or those that are nearing retiring as being acceptable. So every time there is a suggestion that we ought to look at these programs and see if we cannot get them financially solvent, the answer always comes back from the opponents: “You are going to cut benefits for seniors. You are going to throw Grandma off the cliff.” And I think that is unfortunate that that becomes the argument, rather. Second, I think you make a good point about 75 years, and, by the way, the nature of legislation is that it is discussed and debated, and so whether it is 75 years or 25 years or 50 years or what is the period of time we are looking at is certainly open for discussion and improvement.

You also note that there is a need in some of these cases, in some of these programs, for understanding how to make the programs better. And there is nothing about the TRUST Act that says that other parts of Congress cannot work on making the programs better. As a matter of fact, I very much applaud that.

I would note at the same time that the process of this place is kind of bogged down and making significant improvements to some of these programs is very difficult to do. You mentioned, for instance, surprise billing. We are all in agreement; we have to solve this problem of surprise billing. We have been going at this now for a long time, well over a year, and even though we all agree, Republicans and Democrats—this is not a divided issue on a partisan basis—we still cannot get something out. And so if you look at something where there is such division amongst our parties, why, it is almost impossible.

I would note in terms of is there a better way than the TRUST Act approach, I have not been here terribly long, but those that
have, like Senator Manchin, Senator Alexander, Senator King, Senator Warner, Senator Portman, they are saying, “Look, this is the right approach.” Simpson and Bowles who have looked at this said, “You know, this is the right approach.” Is it perfect? No. Is it a good approach? Is it a good way to have people start talking about these things and working on things? I certainly believe so.

I would note one more thing you mentioned, and that is that we are the beneficiary of low interest rates right now, and that has given us some breathing room. I think we all agree with that. And I think my own view is that we are likely to have low interest rates for a long period of time, that structurally what has happened in the world has changed and that we are not going to go back to the interest rates of the 1990s.

At the same time, I recognize that Black Swan events in the world could change that and that we are unwise as the U.S. Congress to say, well, we are going to count on nothing really bad happening. I mean, this coronavirus thing, if it became a pandemic—which I am not predicting by any means, but if we had a pandemic of some kind, that could change things quickly and dramatically. I do not need to tell you the number of things that could cause us to have an interest rate spike of some kind, and we would have a real problem if that were to be the case. And as the Chairman indicated, if we were to lose our reserve currency status, that is not going to happen anytime soon, but at some point China is going to want to replace us or find way to get around us. They do not like these sanctions we are able to put on people because of our reserve currency. So there are a number of things that could change all that.

So I would suggest it is important for us, as has been suggested, to deal with these things for two reasons: one, to protect these programs so that down the road we do not have to cause some kind of cut of 20 percent or so in benefits. I would hate for that to happen. And, by the way, I do not it ever would. I do not think politically we would ever allow that to occur. But that would mean we would have to have a dramatic increase either in debt, shooting interest rates up, or raising taxes a lot, which would have an impact on growth.

So we are now at a point where we are able to deal with these things. Hopefully we have a little breathing room given low interest rates. But we have to deal with them now. So I would look to each of you if you want to make any comments about that. I have not got a lot of time left. Yes, Mr. Riedl, please.

Mr. Riedl, I agree with your comments. I want to make one warning to those of you who are going to be voting on tough reforms at some point. You mentioned that we do not want to hit current retirees, and I think that that is a very sensible view. The warning is that nearly half of all Baby Boomers have already retired, and by the end of 2024, more than two-thirds of Baby Boomers will have already retired. And so if you want to grandfather out the Baby Boomers, you are going to have to move quickly. You are also going to grandfather them all out. And then you grandfather out the entire bulge. And so the more you want to protect current retirees, you have to move quickly, because if you wait
until they have all retired, you have grandfathered out the whole bulge. So while it is political perilous, get moving.

Senator ROMNEY. Thank you.

Mr. AARON. On the reserve currency point, it is certainly the case that having the dollar as the reserve currency is a good thing for the United States. I am not questioning that. But I would point out that interest rates are as low in Germany and the rest of the European Union as in the United States, and the euro is not the major reserve currency. Interest rates are very low in Japan, with more debt than we have, and the yen is not a reserve currency.

I think you are correct, Senator Romney, to point out that there are deeper forces at work holding down interest rates than temporary events and also correct to note that we do need to beware of surprise events which have a habit of surprising us all too often.

Senator ROMNEY. Yes, thank you. Please?

Mr. BLAHOUS. Just a couple of quick comments. One is that your point that there is not an appetite for reducing benefits for people already receiving them is absolutely true. I also think it is a constraint that people need to bear in mind as we consider when we have to act. It underscores why you cannot wait until the early 2030s. Then it is too late to hold previous recipients harmless. There just are not enough savings there.

And I cannot tell you what sort of process will work, whether it is the TRUST Act or anything else. I can tell you what will not work, and that is continuing to do what we have done in the past, waiting until we get to the brink of trust fund depletion. By the early 2030s, the income and outlay lines are going to be so far apart—the long-term deficit in Social Security might be about 1 percent of GDP now, but by then it is going to be about 1 1/2 percent of GDP——

Mr. AARON. No, it is not. The projections are 1 percent of GDP into the indefinite future.

Mr. BLAHOUS. The infinite horizon shortfall in the latest trustees' report is 1.4 percent.

Mr. AARON. When the sun cools, things may change.

Mr. BLAHOUS. But that is the projection if you wait until the 2030s. It is about 1 percent of GDP now. I am happy to have the trustees' reports checked on this point, because I just checked them before this hearing.

Mr. AARON. So did I.

Mr. BLAHOUS. But, more importantly, however, the amount of short-term—I mean, there might be some comparability in terms of the long-term change, but the short-term savings that you have to get within just a few years from the 2030s is much bigger than we have done in the past. In the early 1980s, they had to make changes equal to about 1 percent of payroll to get through the next few years, and they were already looking at surpluses in the decades that followed. So the changes they had to make, the immediate pain they had to inflict was closer to about half a percent of GDP. It was not nearly as large. So we are going in uncharted waters in the 2030s.

The last point I would associate—despite our little disagreement here, I actually would associate myself with many of Dr. Aaron's
comments about long-term forecasting and the relative certainty in Social Security versus Medicare. As a former Medicare trustee, I am painfully aware of the uncertainty bands around the Medicare cost estimates. I think the case to be made for a 75-year outlook on Social Security is much stronger. The estimates are much more certain in Social Security over long periods of time, and there are a number of reasons why you do want long-term solvency in Social Security if you can get it. You wind up with not optimal policies from a number of other perspectives if you just take the path of least resistance on Social Security 10, 20, or 30 years at a time.

So I agree that the uncertainty bands in the Medicare projections are very high. I would not let that deter you from long-term solvency on Social Security.

Chairman JOHNSON. Thank you, Senator Romney.

I hope at some point in time we can discuss obviously low inflation rates are very good for seniors; low interest rates are not real good for seniors. Senator Carper.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Dr. Aaron, take my first 30 seconds and rebut his comments. Just take 30 seconds real quick. You tried to say something? Say it. Thirty seconds.

Mr. AARON. I actually agreed generally with what Chuck just said. I think it is important to try to do long-run planning for Social Security for a couple of reasons, one of which is political. It is important to have sufficient funds to cover benefits that are going to be paid in the next few years. It is also important to have what the actuaries now call "sustainable solvency," so that as time goes by, the system does not automatically slide out of balance because of events that are now coming into the projection window as time passes. So I think it is highly desirable to do that on Social Security.

Let me inject one fact——

Senator CARPER. Very quick.

Mr. AARON. Yes, very quick, to illustrate the problem of the emergence of deficits over time. If you go back to 1983, when the last major legislation was enacted on Social Security, the system was in complete balance. It now has a projected imbalance of 2.8 percent of payroll. If every single assumption they had made was correct in doing their projections then, the imbalance today would be 2.1 percent of payroll, for purely mechanical reasons, that there were a lot of surpluses in the early years, and as time went by, you took into a projection period the bad years. The projections then were actually pretty good, and I would hope that they will be good in the future. But I would hope that when Congress acts, it assures near-term balance and takes step to assure that the system stays in balance.

Senator CARPER. Thank you. That was 30 seconds well used.

Mr. AARON. Thank you.

Senator CARPER. I was a freshman Congressman in 1983 who voted for that plan. I felt good about it then and feel good about it today.

It is interesting. We have three recovering Governors here today—Governor Romney, Governor Hassan, and myself. And I am
a recovering State treasurer. When I was elected State treasurer at 29, I had been a naval flight officer (NFO) in the Vietnam War and came back to the United States, moved to Delaware, got an Master’s of Business Administration (MBA), got to run for State treasurer when I was 29. We had the worst credit rating in the country. We could not balance our budgets for nothing. We had no trust fund for our pensions. We were a mess. It was a terrible economy and not much economic growth. And you know what happened? We elected a great Governor whose name was Pete DuPont. I am a Democrat. He is a Republican. But he is a Republican of the kind that we could use more of these days. And I learned a lot from him, and I learned a lot about leadership from him and, frankly, from Joe Biden, who was serving us as a recently elected 29-year-old Senator.

But one of the things we are not talking about: To address this problem, we need leadership. We need principled leadership, people who are not afraid to provide courage, not afraid to provide leadership, even if it looks dangerous.

I am always one of those who believes in bipartisan solutions. Rob Wallace, who is the head of the National Park System over at the Department of Commerce, he testified recently that bipartisan solutions are lasting solutions. And as we approach this issue yet again, that is what we need to focus on.

It was not that long ago we had balanced budgets. We had four in a row. We had not balanced our budget since 1968, and in the last 4 years of the Clinton Administration we ended up with balanced budgets. And Erskine Bowles was Chief of Staff at the time for Bill Clinton, I think. Sylvia Mathews Burwell was there in the mix, too. And over in the House, we had a really good Budget Committee team: a guy named John Spratt, a Democrat from South Carolina; and a guy named John Kasich, a Republican from Ohio. We were all in the same freshman class, elected in 1982 to the House of Representatives. They provided terrific leadership to get us on the right course. Those 4 years where we had balanced budgets, spending as a percentage of GDP was about 20 percent those 4 years. Revenues as a percentage of GDP was about 20 percent. Today revenue as a percentage of GDP is about 16 percent. Spending as a percentage of GDP is just a tad over 20 percent. And what we have done is we have reduced our revenue base; we have pretty much kept spending where it was in those years we had a balanced budget. And when I look at that, I am always one who—I want to go after wasteful spending. I hate wasteful spending. I am sure you do, too; my colleagues do as well. But I also think we need to raise some revenues.

I will give you a couple of quick ideas, and I want you to react to these just very briefly. We are going to run out of money in the Transportation Trust Fund sometime next year. After that, 5 years after that, we are looking at about another $100 billion hole. George Voinovich and I suggested we do something like Bowles-Simpson to restore the purchasing power of the gas and diesel tax in the near term and be prepared maybe over the next 10 years to move toward a vehicle miles traveled approach where we actually pay revenues that reflect the amount of miles we put on our vehicles, because we will have electric vehicles and hydrogen-pow-
ered vehicles. But that is the future. There needs to be a bridge to the future. And the idea that George and I suggested was raise the gas and diesel tax about 4 cents a gallon for 4 years, indexed going forward, and be prepared to transfer to a vehicle miles traveled approach.

Would you all react to that quickly? Doug, please.

Mr. HOLTZ-EAKIN. Two things. One, I like the fact that the Highway Trust Fund is included in the TRUST Act because it does not get the consideration that other trust funds do, and we have backed into a policy of general revenue transfers into the Highway Trust Fund without an explicit discussion of it.

If you do not want to do that—and I would encourage you not to—I would go to the vehicle miles traveled approach as quickly as possible.

Senator CARPER. About seven or eight States are doing a pilot right now. In our transportation reauthorization bill, we call for in the next 5 years a 50-State pilot with the idea of moving toward that. Chuck?

Mr. BLAHOUS. It is not something I have looked at. I am happy to take a look and follow up with you on it.

Senator CARPER. Thanks so much. I like to say if things are worth having, they are worth paying for, including roads, highways, and bridges.

Please, Brian.

Mr. RIEDL. I totally agree that if it is worth having, it is worth paying for. I have long advocated an approach of pushing more of it to State governments. I would rather State governments do more on this than the Federal Government to close the hole.

Senator CARPER. Thirty-one of them have raised gas and diesel taxes in the last 5 or 6 years.

Mr. RIEDL. I think States can do more. To the extent that the Federal Government is going to continue in its current role, I agree with Doug that vehicle mile taxes is a fine way to do it.

Senator CARPER. Thank you. Doctor?

Mr. AARON. If one looks at the damage done to roads by vehicles, automobiles do negligible damage. Heavy trucks do virtually all of the damage. I do not think charges based on axle weight are given sufficient weight.

One of my colleagues is a transportation expert on this and has done work over the years, and the clear implication of his work is that if what you want to do is pay for damage done to roads, you want to have an axle weight tax, and we do not to the necessary degree at this time.

Senator CARPER. Interestingly enough, the trucking industry is ready and willing to pay more money. They do not want to pay all of it, but they are ready and willing to pay some.

Mr. HOLTZ-EAKIN. I will just note that you can build that into the VMTs that I have looked at. There is no reason why that—

Senator CARPER. That is a good point. All right. My time has expired. Mr. Chairman, I could do this all day. This is a great hearing, and thanks for pulling this together.

Chairman JOHNSON. You went over time.

Senator CARPER. It did not seem like it, did it? [Laughter.]

Chairman JOHNSON. Not at all. Senator Hassan.
OPENING STATEMENT OF SENATOR HASSAN

Senator HASSAN. Senator Carper, it just flew by.

Look, I want to thank the Chairman and the Ranking Member for having this very important hearing. I want to thank Senator Romney for introducing the TRUST Act, and I know there are some cosponsors sitting here at the table, too. And I also want to thank the witnesses for your attendance and your willingness to provide such thoughtful testimony today.

Dr. Aaron, I wanted to follow up a little bit about the 2017 tax law, which provided massive tax giveaways to multinational corporations and the ultra-wealthy. Official budget estimates project that the 2017 tax law will add nearly $2 trillion to the national debt through 2028.

Dr. Aaron, you wrote in 2017 that these massive tax breaks would not pay for themselves and that there is no such thing as, to quote you, a “free lunch.” Over 2 years after the passage of this partisan tax law, does the evidence so far suggest that these giveaways indeed worsened our fiscal outlook rather than paying for themselves?

Mr. AARON. Yes.

Senator HASSAN. Thank you. By my estimate and given what your testimony is, the Federal budget deficit is projected to break $1 trillion in 2020. Can you explain to the Committee how the partisan 2017 tax giveaways worsened our fiscal outlook by how much?

Mr. AARON. The evidence is that the growth effects under various analytical models, the growth effects from the tax cut are negligible over the long haul, and that means that if you look at the actual rate changes and simply multiply them out times the tax base, that is a close approximation to the impact on the fiscal situation.

Now, let me say at this point I do think that tax reform does have the capacity to improve the efficiency with which the economy operates, and like a lot of public finance economists—and I suspect Doug is among them—we could agree on a number of changes in the tax system that would have that effect. Alas, some of them would gore particularly sensitive political oxen.

Senator HASSAN. Well, that is fair, but can I just—in terms of the way to think about this quantitatively, without the tax giveaways in the 2017 act—which I will note I support tax reform, too, but it needs to be done in a bipartisan way and a transparent way—would the 2020 deficit have stayed under $1 trillion?

Mr. AARON. Yes.

Senator HASSAN. Thank you.

I want to move on and follow up on Senator Peters’ questions about Medicare, and this is a question for Dr. Aaron as well. My colleagues and I on the Senate Finance Committee moved legislation to increase transparency of the Medicare program and provide some measure of cost controls, including capping drug prices at the rate of inflation under Medicare Part D and taking steps to control the prices of inpatient drugs under Medicare Part B.

Under current law the government has no ability to control prices of drugs or some related services provided under Medicare, so taxpayers generally pay whatever price drug companies and hospitals charge, no questions asked. While our Finance Committee
bill would start to address this issue, there is surely more that we can do to control costs, increase transparency, and leverage the purchasing power of the Federal Government in order to get a better deal for Medicare beneficiaries and taxpayers. And I appreciate as well, Dr. Aaron, that as we consider what we might do in these regards, that you focused in your testimony on our commitment to people with disabilities and with long-term chronic illness. I happen to be the mother of a 31-year-old young man who has very severe cerebral palsy. A generation or two ago, probably neither he nor I would have survived his birth. We should be celebrating the advances in medical science that allow him to be part of his community and part of our household and be a very cognizant and full participant in his community.

But that also means that for many families even earning strong middle-class incomes, the cost of even a regular procedure under our health care system without insurance or Medicaid or Medicare can simply be out of reach. It is not an elastic demand situation, I guess is one of the issues.

So can you discuss how the government could improve the efficiency and transparency of the Medicare program in ways that may lower government spending without cutting off patients from the care that they need?

Mr. Aaron. I think Congress is now in the process of debating different proposals in the House and in the Senate that hold out the promise to do just what you are saying. There is still not settled agreement. There are partisan differences as well as chamber differences in the approaches now under consideration. But I think it is essential that as a Nation we begin to inject a degree of bargaining by the public sector, aware of the issue that the Chairman raised regarding the need to preserve financial incentives for drug companies to continue to do the final stage development. But it is long overdue for some form of limitation of what have become outrageous behaviors by pharmaceutical companies.

Senator Hassan. Well, thank you very much for your testimony. I greatly appreciate it. I greatly appreciate all of you here, and I will yield the rest of my time. Thank you.

Chairman Johnson. Senator Sinema.

OPENING STATEMENT OF SENATOR SINEMA

Senator Sinema. Thank you, Chairman Johnson and Ranking Member Peters, for holding today's hearing examining the fiscal state of our Nation and bipartisan solutions.

In August 2019, the Congressional Budget Office, updated its 10-year budget and economic outlook to project that the Federal deficit would average $1.2 trillion between 2020 and 2029. The Federal debt would increase from 79 percent of GDP in 2019 to 95 percent of GDP in 2029. These numbers should alarm everyone because this picture of the United States' fiscal health is bleak.

CBO projects the Social Security Trust Fund will be exhausted by 2032 and the Medicare Trust Fund will be exhausted by 2026.

I support the TRUST Act because Congress must take action now to protect Social Security and Medicare and protect the benefits American workers and Arizona retirees have earned through a lifetime of work. The bipartisan nature of these rescue committees will
produce recommended actions to protect the benefits our seniors have earned and ensure the long-term fiscal health of these programs so that today's workers can depend on them when they retire.

Today I am also introducing the bipartisan Fiscal State of the National Resolution that requires the Comptroller General to prepare and present the Financial Report of the United States before a joint hearing of the House and Senate Budget Committees. All Members of Congress would be invited to attend in order to better understand our Nation’s financial health. Members would then be better equipped to make informed decisions on policy, relying on the most current and unbiased data.

I am joined in this effort by leaders like Senators Joni Ernst of Iowa, Senator Jacky Rosen of Nevada, and Senator Angus King of Maine, and I look forward to speaking with other interested members.

I ask that Members of this Committee and our witnesses work together to support bipartisan solutions like my Fiscal State of the Nation resolution and other proposals that have been discussed today so that Congress can get serious about fixing the fiscal State of our Nation.

I want to thank our witnesses for being here and the Committee, particularly the Chairman, for hosting this important discussion. And, Mr. Chairman, I yield back.

Senator CARPER. Before you yield back, would you yield me just 15 seconds?

Senator SINEMA. Mr. Chairman, I yield the balance of my time to Senator Carper.

Chairman JOHNSON. Well, not the whole 4½ minutes.

Senator SINEMA. Maybe just 1 minute then.

Senator CARPER. Thank you. It was not quite 4½.

Something that you said bears repeating. You talked about the Congress providing the leadership that is needed on this, and that is a big part of this. But every organization I have ever been a part of needs leadership, and States need leadership. If you have a Governor who does not care about this stuff, does not care about economic development, does not care about transportation, does not care about fiscal policy, that is a State that is in a mess. And I have seen that as a very young State treasurer. We need the same kind of leadership here from the Executive Branch, from the President.

And I will use transportation infrastructure as an example. If I have a meeting at the White House that has been reported on, he asked me what—it was like 6 or 7 months ago. “What should we do in order to help pay for transportation infrastructure improvements over the years to come?” I gave him the Bowles-Simpson idea that George Voinovich and I shared with the Bowles-Simpson Commission years ago. He cut me off right in the middle of it. He said, “That is not enough.” He said it ought to be 25 cents a gallon. It ought to be right now for gas and diesel.

Later on, a couple months later, when we were coming back to this to see what should we do to fund transportation infrastructure improvements, I reminded him of that. And basically he said he wanted us to kind of get out in front and provide the leadership.
I said, “Mr. President, that is why we get elected”—“that is what you get elected as President to do. And if you provide the leadership, we will join you.” And I expect Democrats and Republicans—we need that kind of leadership. And it may have to wait until after this year’s election, but it needs to happen really soon, hopefully sooner than that.

Thank you so much.

Chairman JOHNSON. In a side conversation Senator Carper and I had, Senator Carper said, “Let us have a hearing like this every week.” And, of course, in my opening, I said this is going to be another in a series of these. And what I have tried to do in this Committee is, no matter what the issue, whether it is immigration, whether it is the budget deficit, let us go through the problem-solving process. Let us gather the information; let us lay out the reality.

As we have laid out this reality, there are different projections. There is a dispute in terms of how we talk about this. The more we can agree on the basic facts, the basic presentation, how we lay out that reality, we are going to set ourselves up, first of all, in properly defining the problem, start identifying the root causes. You have to go through all that. Then set achievable goals. Then start designing solutions.

What I have found frustrating in Washington, DC, is everybody has their solution. It is not really directed toward an achievable goal. It is often divorced from reality. So, I will dedicate certainly my additional time in whatever capacity to keep driving this. This is why I ran.

I do want in a second round here talk about what Douglas Holtz-Eakin raised, the imperative for growth versus the imperative to raise additional revenue. Now, from my standpoint, growth, which is why I supported the tax plan—which I was not overly fond of—but I think the best, the painless way of raising revenue is through economic growth. I think what I would give this administration credit for, far from perfect policies, but, we stopped adding to the regulatory burden. That gives relief to businesses. They can concentrate on their business. It creates optimism, animal spirits. We have a more competitive tax system. Again, I argued tax simplification, tax rationalization. I have continued to reject tax reform, all change is not progress, all movement is not forward. We are going to have an opportunity, because we did not make permanent the changes, for example, to pass-through business. That is where I really objected. We are doing everything on 5 percent of the businesses, corporations, and we are going to leave behind the real engines of job creation and innovation in our economy, the pass-throughs. And I just objected to that.

My solution, by the way—again, rationalization and simplification—why not tax all business income at the ownership level at individual rates? Again, why do we have different tax rates for different forms of income? It makes no sense. It is not rational. It is not simple.

So I would love to engage this group in a conversation, a problem-solving process of a more rational tax system outside of all the interests that are going to come. Talk about drug pricing. There is the problem. You just have massive interests.
But what I tried to bring into that conversation—I realize this little tirade or this little rant is disjointed—is, yes, we can talk about drug prices, but understand it is $500 billion out of a $3.7 billion spent. Profitability is maybe $100 billion. These are rough numbers. You can wipe out the profit. Yes, you have made some progress, but you are still missing the big picture here. So I want to talk really about the big picture.

By the way, the reason I also do not think we have achieved the growth rates that I had hoped to achieve is readjustment in our trade policies. I am not in total agreement with the way this President has approached that, but I think most people agree that we have a problem with China. And if we are ever going to address that problem, if we are ever going to engage in that kind of trade war, it is better to do it when we have a strong economy and a low unemployment rate.

So these issues are incredibly complex, but I will just throw it open to the panel here in terms of you do not want to kill the golden goose. You do not want to disincentivize people from working. So that is why I have that one tax chart. Maybe you can put that thing back up. If you try and punish success, people evade it. They do not work as hard. They put income in areas that are not taxed. Let us simplify the system. I think that is a far better way of raising more revenue, if you have very low tax rates, get rid of all the deductions. I do not like either social or economic engineering through the Tax Code. The Tax Code ought to raise revenue in as simple and most rational way as possible. That is not our Tax Code. It is not what our tax reform did in 2017.

So we are going to have to have another bite at this apple in about 2025 or 2026, whenever the individual rates, whenever the pass-through rates. Let us start talking about it now.

So, again, I will just throw it open to anybody. Doug, you mentioned this. Do you want to comment on this?

Mr. Holtz-Eakin. Yes, I think you have framed this exactly right. Whether you use the word “reform” or “simplification,” the recipe has always been low rate, broad base. The 2017 act lowered corporate rates, lowered effective tax rates on pass-throughs, did very little base broadening. And if there is a need for more revenue, that is the very first place to look.

So, there is a lot of work left to make the U.S. Code more efficient and more rational. The notion of integrating the corporate and the individual side has been around for a long time, never quite gotten there. All of those things should be on the table. That is very important.

Chairman Johnson. Not to disrespect anybody, but part of the problem, that rationalization, it is like taxing unrealized gains. There are just certain things that just have not made sense to me.

Mr. Holtz-Eakin. I just want to emphasize something that Henry Aaron said, which is that every time you do that thing which I endorse, which is broaden the base, you are picking a fight with a very powerful interest. That loophole is there for a reason. It is not an accident. So, for example, I am a big fan of the expensing provisions that are in the Tax Cuts and Jobs Act (TCJA), but there is no way you should combine them with interest deductibility, like zero tax rate is enough. Negative? No. Because that is
what we have, because getting rid of the interest deduction at the corporate level is a sacred cow.

Chairman JOHNSON. And there is the lost opportunity. The time to get rid of those deductions is when you lower people’s rates. You have to trade that. We have already done the rate lowering. Now where do we go?

Again, that is why I will keep talking about let us use the words “simplification,” “rationalization,” because I agree with you, Dr. Aaron, we cannot afford tax cuts. But we are well past the time where we have to rationalize and simplify our Tax Code.

Anybody else want to make a comment on this? Dr. Blahous.

Mr. BLAHOUS. Not to sound like the proverbial carpenter who, when you have a hammer, everything looks like a nail, but—and I do tend to see the world from within the prism of Social Security and Medicare because of my experience as a trustee. But I am reminded as you are speaking, as I was reminded during Dr. Aaron’s remarks and others here, that we tend to think about mandatory program reforms as a very unpleasant business. But there are a lot of upsides to considering reforms. There are a lot of things that these programs can do better and more efficiently, more progressively, removing pockets of regressivity, improving incentives for saving, workforce participation, a lot of upsides.

But apart from that, we also have to remember that there is a range of policy priorities, some of which you have just alluded to and which were alluded to earlier, which is that no matter whether you are of the bent that we need to have a tax system where marginal rates are low and it is efficient and pro-growth or whether your policy priorities are environmental protection and investments in infrastructure and investments in education, none of that happens if we do not get mandatory spending under control. There is a shared stake from left to right that none of us are going to get our policy objectives met if we do not deal with the mandatory spending issue. And so we have a lot of common ground and a lot of common motivation.

Chairman JOHNSON. But, again, when you start talking about the structural deficit where we are spending over 20 percent and we are raising 17, you have to address that. And I guess the point of that, my one chart there—I do not think they have it up yet—is that you try and punish success, and it just does not work. So I think we have to have that—where is the sweet spot where we have as low tax rates, the most efficient and simple tax system that raises the revenue we need, without doing economic harm?

Again, I just do not want to do economic harm. Doctor?

Mr. HOLTZ-EAKIN. I just want to emphasize what Chuck just said because I think it gets lost in this. There are two related and important budget problems right now. There is the mismatch between revenue and spending. There is also the composition of spending. And what has happened over time is that as the mandatory programs have expanded, they have pushed out of annual budgets the discretionary spending that is where we do national security, basic research, infrastructure, education, all the places where you could invest in the future of this country. We have to fix the mandatorie

---

1The chart referenced by Senator Johnson appears in the Appendix on page 87.
for their own sake. Social Security should be better. We have to do it to deal with the structural mismatch, but also to allow for room in the budget for these other priorities. They are essential as well.

Mr. AARON. I would like to go back to the numbers that Senator Carper mentioned earlier. To the extent we have a deficit today, which is now in some quarters used as justification for cutting benefits to the aged and disabled, it is because we have cut taxes. There is something that strikes some of us, at least, as undesirable about using the curtailment of taxes which disproportionately benefit people who pay taxes, namely, those with relatively high incomes, as an excuse or establishing the necessary conditions for cutting benefits on people in the population who are vulnerable. There is something wrong with that. And for that reason, it seems to me the first step in this process is to recognize we have made commitments to the elderly and disabled. Those populations are increasing. The logical implication of those commitments is that spending as a share of GDP should rise, and that suggests that rather than cutting taxes, we should be talking about some increase in them as the first step, not cutting benefits on the vulnerable in our population.

Chairman JOHNSON. Senator Peters.

Senator PETERS. Thank you, Mr. Chairman. I am going to pick up on this conversation in a moment, but first a little housekeeping, if I may. I would request unanimous consent (UC) to enter the following documents into the record: first, the statement of Nancy Altman, \(^1\) president of Social Security Works and Chair of the Strengthen Social Security Coalition. I would also like to thank Ms. Altman for submitting her statement so quickly given the short notice and the Martin Luther King weekend.

And, second, a letter addressed to the Committee Members by Max Richtman, \(^2\) president and CEO of the National Committee to Preserve Social Security and Medicare.

Chairman JOHNSON. Without objection.

Senator PETERS. Thank you.

I want to pick up on what I think is an important conversation about how we are looking at revenues and looking at this in a holistic way that we talked about in the beginning, a three-legged stool. But one thing that I think I would like to get your thoughts on, all of your thoughts on, is that when we last did a major overhaul of Social Security in 1983, which I think many of you mentioned, and projected these very long rates, a lot of assumptions obviously had to be made in 1983 that did not necessarily turn out going forward.

One thing that has happened since that time is that you have seen most of the growth in income over that time has been concentrated primarily at folks, as Dr. Aaron mentioned, at the very top. We have seen a growing inequality in our country. The Social Security tax base was roughly—I think it was set at 90 percent in 1983. That tax base then has been adjusted accordingly, but what has happened with that tax base is that almost all new income increases have gone to a small slice of America. Everybody else has

---

\(^1\)The statement referenced by Senator Peters appears in the Appendix on page 95.

\(^2\)The statement referenced by Senator Peters appears in the Appendix on page 137.
been pretty stagnant over that period. So now the amount of compensation that is actually being taxed in the economy is a lot less. I think it is somewhere in the 80 percent range.

Is that something we should be looking at? Should we be looking at the assumptions that folks looked at in 1983 and said that the system should have—90 percent of compensation should be subjected to tax? They certainly did not anticipate the growing and dramatic increase of inequality over these last few years. Dr. Aaron, do you want to mention anything related to that?

Mr. AARON. I think there is a strong case for increasing the wage base in order to partially take account of the fact that the wage increases have been skewed toward higher-income Americans. This has a modest effect, doing so would have a modest effect in improving the projected long-term balance of the system for the simple reason that the benefits that will ultimately be paid to those people will be somewhat lower than the taxes that will be collected from them.

Given the fact that longevity has increased substantially among high earners, that means that under current rules they are going to be collecting Social Security for a longer period of time. So it seems to me this is not a bad trade. It is something that should be undertaken as part of a program to restore long-term balance in Social Security.

Senator PETERS. Anybody else? Yes, Dr. Blahous.

Mr. BLAHOUS. I agree with most of that. I served on a Bipartisan Policy Center commission that looked at retirement security solutions, including a Social Security solution. As bipartisan commissions often do, we wound up splitting it roughly 50–50, a little bit more on the revenue side, a little bit less on the benefit side, but mostly 50–50. That commission wound up having to include both a base increase and a rate increase in order to meet that target of a package composed of 50 percent revenue increases.

A couple of caveats that I would issue, though. One is that while it is certainly true that increasing wage inequality is one of the reasons that the percentage of earnings subject to the Social Security tax has declined since 1983, most of that increase in inequality has been in the stratosphere. It has not been just over where the current law cap is. So when you raise the cap, you are going to be taxing people more who have not necessarily participated in the enormous gains that have been made by people at the very top.

Now, what we did is, in order to try to capture more savings from the people on the highest end, we lowered the rate of accrual in the benefit formula associated with raising the tax above its current law base so that we were not inefficiently paying so much of the proceeds back out to people in the high-income end. So I think that does have to be part of the conversation. If it is done, I think it is best structured with a reduction in the benefit formula factor that benefits people on the top end.

Senator PETERS. Anybody else wish to comment?

Mr. HOLTZ-EAKIN. I will just take this opportunity to note that one of the reasons we have seen slow growth in cash wages has been the fact that there has been very rapid growth in the cost of health insurance and other untaxed fringes. The Congress recently chose to repeal the Cadillac tax, which was a truly poorly designed
tax, but they did it without replacing it with any form of tax on
the compensation provided by employer-sponsored insurance, and I
think that is a misstep, and that is something you should look at.

Senator Peters. Yes, and I think that it goes back to Medicare
and health care, where we started this hearing, too, that as impor-
tant as Social Security is as a stabilizer, we must do that. The cost
of health care in this country is driving a lot of this, more than
anything else. It is the most critical problem we have with Medi-
care, prior to Social Security, the cost of health care generally going
up. If we are not dealing with that, it is going to be hard to fix all
of these other problems, including the fact that you can deduct
health care insurance from the Social Security base as well, which
I think has increased—as those premiums go up, it also impacts
Social Security as well. So they are all interrelated in a pretty in-
tricate way.

In the remaining time here, Mr. Chairman, I just want to get
back to Dr. Aaron when you mentioned about preventative costs
and the impact that that may have on the bottom line. I agree with
your assessment that we do not want to incentivize somebody going
through all sorts of tests and having all of those additional costs.
But there are also some common-sense changes in there, I think,
like having nutrition therapy for folks who are in pre-diabetes.
That does not require expensive testing. Empirically, I think it is
shown to dramatically reduce the incidence of diabetes later in life.
There are things that we can definitely do that are not that expen-
sive but have a significant bottom-line impact on reducing the costs
to Medicare. We should be cherry-picking those really great things
that are good for human health, too. The patient is better off not
developing full-blown diabetes if they are in therapy when they are
younger to prevent that from happening if it is diagnosed, if you
could comment on that.

The other question is CBO currently considers a 10-year window
when scoring budgetary impacts, but we are talking about a lot
more than 10 years when you are looking at these chronic diseases
and people living longer as well. Should we be thinking about that
as well?

Mr. Aaron. On the last question, choosing the appropriate budg-
etary window is a tricky issue because whatever the window is, it
creates some perverse incentives. You just get different ones de-
pending on the length of the window. Making projections beyond 10
years about the impacts of actions taken today is very difficult, and
it just increases the arbitrary element in those projections.

With respect to your comment on preventive measures, I agree
with you absolutely. There is a whole roster of interventions such
as the ones you listed that can both improve health and help our
wallets. We should look for those first. My comments about health
improvements being what you can really count on referred to a
broad agenda of increases in preventive health interventions. Some
save money, some do not. I frankly would like to see that whole
agenda addressed because of the improvements in health. I con-
sider those the primary objectives of measures to invest in preven-
tive health.
Senator Peters. Right. We want to accomplish both, lower cost and improve health, and there are options out there. We need to aggressively seek them.

Thank you so much.

Chairman Johnson. So I do not forget, real quick, because we have experts, when Social Security was first established, what percent of wages were they targeting in terms of subjecting it to the payroll tax?

Mr. Aaron. It was about 90 then.

Chairman Johnson. 90 percent. What is it now?

Mr. Aaron. About 83.

Chairman Johnson. So, again, there is a solution that is actually targeted toward something in terms of the program design. Senator Carper.

Senator Carper. Let me say thanks again to each of you for showing up today and to our Chairman and Ranking Member for pulling this together.

It is unfortunate that more of our colleagues are not here, but I am glad they are not in a way because that way we get to ask more questions. You guys get to answer those questions.

Sometimes people ask me, “What kind of Democrat are you?” And I say, “Well, I am a Democrat who has actually read and believes in Matthew 25.” And they say, “What is that?” And I say, “It is something like this: When I was hungry, did you feed me? When I was thirsty, did you give me a drink? When I was naked, did you clothe me? When I was sick and in prison, did you visit me? When I was a stranger in your land, did you welcome me?” And I say I think that we have a moral obligation, regardless what our faith is, to the spirit of Matthew 25. But since we do not have unlimited resources, as we know, we have a fiscal imperative to meet that moral obligation in fiscally sustainable ways. That is what kind of Democrat I am.

And they say, “Well, tell me more.” And I say, “I am a Democrat who believes if you give a person a fish, you feed them for a day. If you teach a person to fish, they can feed themselves hopefully for a lifetime. That is the kind of Democrat I am.”

I think Republicans are like that, too, and somehow we have to be able to take those things where we agree and have that consensus and build policies around those core values.

I am a senior Democrat on the Environment and Public Works (EPW) Committee, and I was telling my wife and our sons the other night—we connect on the phone. One is on the West Coast, one of our sons is on the East Coast, and we connect on the phone every Sunday night and talk. One of the things I mentioned to them not long ago was one of my overriding goals for this Congress and the Congresses that lie ahead is how do we seriously address climate change, the fact that our planet is getting warmer, creating these crazy weather patterns? Not far from where we are, I was in a town where they had a 1,000-year flood in Ellicott City like every 2 years. I mean, really? Houston, the same thing. This really crazy, bizarre weather. And rather than just say, “Oh, this is terrible. Woe is me,” why do we not do something about it, and why do we not do something about it in ways that can create economic opportunity for us?
One of the elements in our surface transportation bill that we have reported unanimously out of committee, with the sponsorship of Senator Barrasso and myself and others, is 5-year reauthorization of roads, highways, and bridges, and we do so in a way that calls for some additional monies. We also believe that we have to pay for that. Those who use these roads, highways, and bridges need to find ways to pay for them.

But included for the first time ever in our surface transportation bill is a climate title. One of the provisions in the climate title is creating a corridor of charging stations and fueling stations across the country so that people who buy electric-powered vehicles or hydrogen-powered vehicles can find places to get them charged. The auto industry tells us they are coming. I am going to be at the Detroit Auto Show again this June. They moved it to summer in Detroit instead of January, thank you very much. But one of the things we will see when they open the Detroit Auto Show in June is a whole new generation of electric-powered vehicles and hydrogen-powered vehicles, hybrid-powered vehicles. We want to make sure that as they build them, they will have folks go out and actually buy them because they will be able to use them.

I want you just to think out loud, any of you, for maybe 30 seconds or 45 seconds apiece, on how do we look at this huge challenge to our planet, climate change. How do we do it in a way that we address that challenge but actually create economic opportunity? And I think there are plenty of ways to do that. Go ahead, Doug.

Mr. Holtz-Eakin. So I think there are two important considerations that go into the design. The first is that my personal opinion is that this will not be addressed without U.S. leadership. The United States will, in fact, not have the luxury of waiting. It will have to move first and bring other people along with it. That suggests that whatever is done should have as little economic threat to the United States as possible because people will not endorse it if it does.

Second is you want to harness the creative capacity of the private sector. Capitalism will solve this problem. Nothing else will. And to me that says that you want to have something that looks like an upstream carbon tax and get the regulatory State out of point source emissions of greenhouse gases. That to me is a fairly straightforward policy design. It is a tough political thing to get done.

Senator Carper. All right. Chuck?

Mr. Blahous. This question is just outside my expertise.

Senator Carper. That does not stop us. [Laughter.]

We will give you a pass. All right. Brian.

Mr. Riedl. I do not pretend to be a deep expert on this, but my understanding of the issue reflects a lot of what Dr. Holtz-Eakin said, which is that I think one of the first things you need is the United States has to have global leadership. The United States cannot stop global warming by itself, especially when you have emissions that are growing so quickly from China and India. So you really need global leadership by America, but you need a lot of cooperation of other countries. I think some of that has been a challenge.
And I also believe that innovation is ultimately what will solve this. I think carbon taxes are a workable solution. I read a carbon tax would reduce temperatures in the year 2100 by about one one-hundredth of 1 percent Celsius. You need a lot more innovation to get out of this. And so I think that has to be a lot of the thrust of it. So I think there is kind of an all-of-the-above strategy.

Senator CARPER. One of the easier ways we can reduce the threat of climate change is something called hydrofluorocarbons (HFCs). We use them in air conditioners or as refrigerants and so forth. If we would phase them out with a follow-on product over the next 15 years, we can reduce the increase in Celsius by about half a degree. Just one thing we need to do. I would invite the cosponsorship of our colleagues on this Committee to do that. It is actually led by a Republican from Louisiana.

Mr. AARON. A carbon tax. You want innovation? That is the way to encourage it. It will become profitable to develop alternatives to using fossil fuels.

You want to reduce the degree to which you need to rely on regulations? A carbon tax will create the incentives for people to move in that direction. I understand the political controversies involved, but——

Senator CARPER. How can we somehow tamp those down a little bit by the way we use the monies——

Mr. AARON. To some degree, you are going to end up spending some of the revenue to protect those who will be injured, and there will be those injured by a carbon tax. But the nice thing about this is there is an emerging consensus, at least among economists, for what that is worth, that cuts right across party lines. Republican and Democrat alike, if you talk to economists, they start with carbon taxes, and we can argue about the rest. The bills founder on the uses of the revenues, and that is where the real problems arise.

Senator CARPER. All right. Thank you. That might be an interesting hearing. Maybe we can do a joint hearing with EPW and this Committee.

Can I just have another minute, Mr. Chairman? I know there are people waiting with bated breath to close, but if I could.

I used to hold about every year—in one of my townhall meetings, we would have a session where we would do a budget exercise, and we would ask people—you have probably done these before. But we actually have just regular ordinary people come in and help us balance the budget. That was when the deficits were under $100 billion. And I remember one of these budget workshops, I said to the folks who were there, I said, “Spending is part of it. Entitlements, making sure we do not harm people, but spending is part of it. But revenues are part of it as well.”

I will never forget this one lady in the room, Mr. Chairman, she said, “I do not mind paying more taxes. I just do not want you to waste my money.” That is what she said: “I do not mind paying more taxes.” I do not like to waste money either. The Chrysler Town & Country minivan that I drove to work this morning in Delaware to catch a train has 522,000 miles on it, so I do not waste my own money. And I do not like to waste taxpayers’ money either. And as it turns out, GAO is right here ready to help us, and every
2 years, what do they come up with? Their High-Risk List. We got one 12 months ago. We will get another one 12 months from now.

One of the items they highlight every year on the High-Risk List is improper payments, and we just got an update on improper payments not that long ago, which was about $40 or $50 billion, I think. Brian, what is the latest number what it is going to be? $151 billion in improper payments. We have passed legislation, the Chairman and I are, I think, prime cosponsors of the legislation. It is over in the House. I met with Chairman Maloney who is the Chairman of the oversight committee there. I explained what we are doing to seek her cooperation, and I think we are going to get that.

Mr. AARON. Would you please add some revenues to that bill so that you can hire more people at the Internal Revenue Service (IRS) to do tax audits as well?

Senator CARPER. That is on of the High-Risk List. I am on the Finance Committee, too, and roughly for every dollar we provide the IRS for compliance, they generate about $10 more, something like that. It is a huge payoff. And I second that emotion.

All right. Mr. Chairman, I do one of these every week. Just save my seat, OK? Thank you.

Chairman JOHNSON. Thank you, Senator Carper. Again, what was going through my mind throughout this hearing are hearings we can hold in the future. I fear no hearing. Just laying out the reality and taking a look at what the different options are. So I am happy to take a look at the tax structure, consider all kinds of alternatives, what makes sense. What is the most efficient system to raise the revenue we need?

I thought it was interesting you pointed out the $100 billion deficits. I remember, I am old enough to remember when the public was outraged by a deficit that was a couple hundred billion dollars. Now we are a trillion dollars, and nobody is even talking about it, which is why we held this hearing today.

One thing I would love to hold a hearing on is something I developed in another one of my charts, which was just a solution menu for Social Security. You hear all the time, "Oh, just increase the age by 3 years," the retirement age. That does not solve the problem. But we need to have the facts. If you start means-testing, what does that mean? If we try and capture 90 percent of wages, what does that mean?

So I would love to work with this panel. I think this is a fabulous expert panel, a pretty broad spectrum of opinion. To the extent that you want to be deputized and offer your hard-earned labor and ideas, I would love to tap into those. It does not always have to be in a hearing setting. We can do it in roundtables. We can do it in private meetings. But we need to develop the reality. One of the hearings was on income inequality. A very thoughtful piece written by Senator Phil Gramm where he was talking about, OK, you can see that it is something like a 60:1 differential when you just look at income. But if you then reduce the top income by taxes and increase the bottom income by benefits received, all of a sudden I think it is a 3:1 differential.

So, again, you have to look at the entire reality. I am happy to use this Committee to do that. We will do that. And I certainly
want to tap into this panel's expertise. I do note that we are not in a Hart hearing room to accommodate the oversized crowd, the overflow crowd. We did not even fill this hearing room. So in some way, shape, or form, maybe the TRUST Act will help generate some of the interest in starting to focus on these significant issues. But, again, thank you all for your participation now and hopefully in the future as well.

The hearing record will remain open for 15 days until February 2nd at 5 o'clock p.m. for the submission of statements and questions for the record. This hearing is adjourned.

[Whereupon, at 11:30 a.m., the Committee was adjourned.]
APPENDIX

Opening Statement of Chairman Ron Johnson
"Examining the Root Causes of America’s Unsustainable Fiscal Path"
Tuesday, January 28, 2020

As prepared for delivery:

Good morning and welcome.

In 2010, former Chairman of the Joint Chiefs of Staff Mike Mullen warned that the most significant threat to U.S. national security is our national debt. I agree. As we begin this new decade, Congress and the Administration simply cannot continue to ignore the national and economic security threats caused by growing debt and deficits.

Since Admiral Mullen’s warning, America’s fiscal situation has only worsened. Without significant reforms, the programs that many Americans depend on - and have planned their retirements around - will experience severe financial shortfalls. According to CBO’s 2019 Long Term Budget Outlook, the 30 year deficit of program taxes and trust funds to program outlays will be $16 trillion for Social Security and $44 trillion for Medicare. The projected interest cost to finance these 30 year deficits is $40 trillion. That’s a combined total 30 year deficit for Social Security and Medicare of $100 trillion.

What does this mean for most Americans? For starters, in 2026, Medicare’s hospital insurance fund will likely be unable to compensate providers for care, which could result in a reduction of services or an increased financial burden for Medicare patients. By 2033, Social Security recipients could receive a 20 percent reduction in their benefits. These benefit reductions would affect hundreds of millions of Americans that have planned their lives around these programs.

The fiscal problems with these programs are not new. When Medicare was created in 1965, the federal government estimated that it would cost about $12 billion by 1990. In reality, Medicare cost the federal government $90 billion in 1990 and $750 billion in 2018. The Congressional Budget Office projects that Medicare spending will increase to $1.3 trillion by 2029. Over the next decade, Medicare is projected to pay out trillions of dollars more in benefits than it takes in through payroll tax revenue. According to the Urban Institute, this means that beneficiaries are receiving three dollars of benefits for every dollar paid into Medicare.

In short, past Congresses and Administrations have made promises that future Congresses and Administrations will find very difficult, if not impossible, to keep. What continues to amaze me, is that the public and most elected officials seem content to ignore this reality - our nation is collectively whistling past this fiscal graveyard.
Elected officials regularly tell you that Social Security is financially solvent until 2035, and not to worry because the Social Security Trust Funds hold Treasury bonds backed by the full faith and credit of the U.S. government. But what these politicians are unwilling to tell you is that Treasury bonds have a net financial value to the federal government of exactly zero.

What will happen when the rubber meets the road, and the federal government is forced to decide how we fund these programs without raising taxes, cutting benefits or going deeper into debt? The American people need to understand that the federal government is in dire financial straits, and the root cause of this is Washington's insatiable desire to spend money, and the public's willingness to accept benefits with little concern over the resulting debt and deficits.

Look no further than our fiscal history over the past five decades. Between 1970 and 2019, federal outlays averaged 20.4 percent, and federal revenues averaged 17.4 percent. In other words, Washington has a spending problem and an inability to live within its means. This fiscal situation will only get worse as programs like Medicare and Social Security consume more of the federal budget than the 45 percent of the non-interest Federal program expenditures they accounted for in 2018.

Today's hearing is the first in what I intend will be a series of hearings and round tables that will methodically lay out the details of our country's unsustainable fiscal condition. I hope we will have a thoughtful discussion that can open up a dialogue to help find areas of agreement and potential solutions. I want to thank our witnesses for their written testimony and for being here today. I also want to thank Senator Romney for helping to drive this discussion with his TRUST Act. I look forward to discussing and evaluating that legislation as well.
U.S. Senate Committee on Homeland Security and Governmental Affairs
“Examining the Root Causes of America's Unsustainable Fiscal Path”

OPENING STATEMENT OF RANKING MEMBER GARY C. PETERS
January 28, 2020
AS PREPARED FOR DELIVERY

Thank you, Mr. Chairman, and thank you to our panel of expert witnesses for joining us today.

Our nation’s growing debts are unsustainable and Congress has a responsibility to work together across party lines to reduce the national debt and close our spending deficits.

Providing our country with a strong fiscal foundation is critical to ensuring our economy can continue to grow and families in Michigan and across the country can prosper.

I am proud of my record of fighting to ensure that taxpayer dollars are used responsibly. I have been privileged to work with members of both parties on this committee to find commonsense ways to cut wasteful spending and set our country on a sounder fiscal path.

Eliminating waste, fraud, and abuse builds public trust and frees up funds for our nation’s core priorities, including Social Security and Medicare.

These programs were created to ensure that every American can retire with dignity and the certainty that their essential health care needs will be met.

Medicare and Social Security are benefits that Americans have paid into through decades of hard work. I am deeply committed to protecting Social Security and Medicare and ensuring they are solvent for future generations.

At a time when the Government Accountability Office estimates that 48% of working Americans approaching retirement age have no retirement savings and 29% of Americans over the age of 55 have no retirement or benefits plan offered by their employer, hardworking families in Michigan and across the country are counting on these programs to be there for them in the years ahead.

Congress must protect Social Security and Medicare by meeting our commitments, not by changing the rules of eligibility or slashing benefits.

There are serious challenges facing these federal trusts but our primary focus must be on increasing solvency without cutting benefits or changing the rules on American workers who have spent their lives contributing to these programs.

We know, for example, that one of the most significant challenges facing Medicare is the rising cost of prescription drugs. Allowing Medicare to negotiate lower prescription drug prices would save tens of billions of dollars every year according to the Congressional Budget Office.

We must also aggressively root out fraud, waste, and abuse.

Finally, we must address workers’ limited economic mobility and stagnant wages which have both made it harder for families to save for the future and for the trust funds to meet their commitments.
Solving this challenge will take bipartisan cooperation and a comprehensive approach: cutting costs, reforming the tax code, and investing in economic growth.

These efforts can make our government more efficient, protect Americans' hard earned benefits, and honor our commitment to keep these programs strong for our children and grandchildren.

I look forward to today's discussion and to our ongoing efforts to identify the commonsense, bipartisan solutions that will preserve Medicare and Social Security for all Americans for generations to come.
The Unsustainable Fiscal Outlook

United States Senate
Committee on Homeland Security and Governmental Affairs

Douglas Holtz-Eakin, President
American Action Forum*

January 28, 2020

* The views expressed here are my own and not those of the American Action Forum.
Chairman Johnson, Ranking Member Peters, and members of the Committee, thank you for convening this hearing and providing me with the opportunity to address one of the preeminent risks to the U.S. economy: the federal fiscal outlook. In this short testimony I wish to make four basic points:

- The federal budget is on an unsustainable trajectory that cannot be fixed by tax increases or faster growth alone;
- Trust funds are budget management tools; their projected exhaustion is a symptom of the problem and not the problem itself;
- Recent commentary to the contrary, the low-interest-rate environment does not alter the basic need to address the fiscal outlook; and
- The absence of a financial crisis does not mean that excessive debt is harmless.

Let me discuss these in turn.

**The Budgetary Outlook Is Unsustainable**

The federal government faces enormous budgetary difficulties, largely due to long-term pension, health, and other spending promises coupled with recent programmatic expansions. The core, long-term issue has been outlined in successive versions of the Congressional Budget Office’s (CBO’s) *Long-Term Budget Outlook*. In broad terms, the inexorable dynamics of current law will raise federal outlays from an historic norm of about 20 percent of gross domestic product (GDP) to nearly 30 percent of GDP. Spending at this level will far outstrip revenue, even with receipts projected to exceed historic norms, and generate an unmanageable federal debt spiral.

This depiction of the federal budgetary future and its diagnosis and prescription has remained unchanged for at least a decade. Despite this, meaningful action (in the right direction) has yet to be seen, as the most recent budgetary projections demonstrate.

In August 2019, CBO released its updated budget and economic outlook for 2020-2029. (At 2:00 p.m. today, CBO will release the outlook for 2021-2030.) The basic picture from CBO is as follows: tax revenues eventually return to pre-recession norms, while spending progressively grows over and above currently elevated numbers. The net effect is an upward debt trajectory on top of an already large debt portfolio.
Figure 1: The Budget Outlook by the Numbers

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
<th>2026</th>
<th>2027</th>
<th>2028</th>
<th>2029</th>
<th>2030</th>
</tr>
</thead>
<tbody>
<tr>
<td>% GDP</td>
<td>16.4</td>
<td>16.6</td>
<td>16.7</td>
<td>16.8</td>
<td>16.9</td>
<td>17.0</td>
<td>17.1</td>
<td>17.2</td>
<td>17.3</td>
<td>17.4</td>
<td>17.5</td>
</tr>
<tr>
<td><strong>Outlays</strong></td>
<td>$4,928</td>
<td>$4,829</td>
<td>$4,730</td>
<td>$4,643</td>
<td>$4,554</td>
<td>$4,465</td>
<td>$4,373</td>
<td>$4,284</td>
<td>$4,195</td>
<td>$4,088</td>
<td>$3,982</td>
</tr>
<tr>
<td>% GDP</td>
<td>21.0</td>
<td>21.1</td>
<td>21.2</td>
<td>21.3</td>
<td>21.4</td>
<td>21.5</td>
<td>21.6</td>
<td>21.7</td>
<td>21.8</td>
<td>21.9</td>
<td>22.0</td>
</tr>
<tr>
<td><strong>Deficit</strong></td>
<td>$1,038</td>
<td>$1,034</td>
<td>$1,159</td>
<td>$1,181</td>
<td>$1,201</td>
<td>$1,221</td>
<td>$1,241</td>
<td>$1,261</td>
<td>$1,281</td>
<td>$1,301</td>
<td>$1,321</td>
</tr>
<tr>
<td>% GDP</td>
<td>-4.6</td>
<td>-4.5</td>
<td>-4.4</td>
<td>-4.3</td>
<td>-4.2</td>
<td>-4.1</td>
<td>-4.0</td>
<td>-3.9</td>
<td>-3.8</td>
<td>-3.6</td>
<td>-3.4</td>
</tr>
<tr>
<td><strong>Debt</strong></td>
<td>$17,159</td>
<td>$19,861</td>
<td>$20,562</td>
<td>$21,258</td>
<td>$22,045</td>
<td>$22,897</td>
<td>$23,764</td>
<td>$24,612</td>
<td>$25,433</td>
<td>$26,228</td>
<td>$27,003</td>
</tr>
<tr>
<td>% GDP</td>
<td>85.7</td>
<td>89.4</td>
<td>91.5</td>
<td>92.6</td>
<td>93.6</td>
<td>94.6</td>
<td>95.5</td>
<td>96.2</td>
<td>96.9</td>
<td>97.5</td>
<td>98.1</td>
</tr>
</tbody>
</table>

According to CBO, tax revenue will average 17.4 percent of GDP over the next 10 years, on par with the average level of taxation over the past 50 years. The federal government is projected to spend nearly $50 trillion over 10 years, maintaining spending levels about 2 percentage points above historical levels. Mandatory spending, which comprised 28 percent of the federal budget in 1968, will reach 64 percent in 2029. Interest payments on the debt comprised 6 percent of the budget in 1968 and 6 percent in 2016. These payments will rise to 11.5 percent of the budget. Debt service payments will reach 2.6 percent of GDP by 2029 – well in excess of the 50-year average of 2.0 percent.

Sources of Rising Debt

The problem facing the United States, and reflected in CBO’s budget projections, is that spending rises above any reasonable metric of taxation for the indefinite future. There is a mini-industry devoted to producing alternative numerical estimates of this mismatch, but the diagnosis of the basic problem is not complicated. The diagnosis leads as well to the prescription for action. Over the long-term, the budget problem is primarily a spending problem and correcting it requires reductions in the growth of large mandatory spending programs – particularly entitlements such as Social Security and federal health programs.

Medicare spending is projected to grow at an average annual rate of 7 percent over the next decade and is currently running a cash deficit of over $360 billion. Social Security retirement spending is projected to grow at an average rate of 6.1 percent, while currently running a cash-flow deficit of $80 billion. Medicaid and the insurance subsidies associated with the Patient Protection and Affordable Care Act (ACA) are growing at 6 percent on average every year. The economy that underpins the financing of these obligations is projected to grow at 5.2 percent annually. The growth of tax revenues is projected to average in the 4.5 percent range. The costs of the nation’s entitlements are increasingly dominating federal expenditures and are also swamp growth in projected tax revenue.

Clearly the U.S. economy is not going to grow at rates approaching 8 percent; we simply cannot “grow our way” out of the federal fiscal problem. Similarly, we cannot simply “tax our way” out of the problem. To see this, imagine that revenues grew at an 8 percent rate over the 10-year budget window. Taxes in 2029 would be $1.8 trillion higher than in the
CBO baseline and would be over 25 percent of GDP. It will be desirable to grow as fast as possible. Congress and future administrations may decide to raise more revenue. But it is inevitable that these policies will be accompanied by reforms to slow the growth of mandatory spending.

**Trust Fund Exhaustion Is Not the Problem**

The fundamental mismatch between projected spending and projected revenues is the fiscal policy problem. Some observers instead focus on Social Security and other entitlement programs “going bankrupt” when their trust funds are depleted, however. This is a symptom of the problem, but not the problem itself.

The federal government uses several trust funds; that is, accounting mechanisms to link earmarked receipts with corresponding expenditures. The federal budget has numerous such trust funds; by far the largest are the Social Security Old-Age and Survivors Insurance (OASI) Trust Fund, the funds dedicated to the government’s military and civilian personnel retirement funds, and Medicare’s Hospital Insurance (HI) Trust Fund.

The key feature of trust funds are “accounting” and “mechanism” because trust funds do not contain actual economic resources that can be used to meet the budgetary demand for expenditures. When a trust fund receives cash that is not needed to pay expenses (e.g., Social Security benefits), the trust fund swaps that cash for non-marketable Treasury securities. In this way, the cash reduces the amount that Treasury must borrow from the public to finance governmental activities. When revenues fall short of expenses, the securities are sent back to Treasury in exchange for the needed cash; this, in turn, raises the amount that the Treasury must borrow from the public.

Trust funds can be an important legal mechanism; the balance represents the amount that can be legally spent. But the balance of a trust fund at any point is simply a measure of the cumulative difference between revenues and expenses and will be held in the form of Treasury securities. While these securities are an asset to the program (e.g., Social Security), they are simultaneously a liability of the Treasury. For the federal government as a whole these net out. The only real source of capacity to redeem the trust fund securities and pay expenses is the capacity of the Treasury to tax or borrow. For this reason, the best way to evaluate the financial health of the government and its programs is to ignore trust funds and focus on the flows of revenue and spending.

**Low Interest Rates Do Not Change the Need for Action**

There has been a wave of revisionist thinking on the undesirability of federal deficits and debt. Proponents of the view that excessive debt is not harmful range from advocates of Modern Monetary Theory (MMT) on the progressive left, to recent research by Olivier Blanchard and commentary by Lawrence Summers and Jason Furman on the center-left, to the indifference of the Trump Administration toward the budgetary outlook on the populist
right. Traditionally, deficits were viewed as undesirable (except when fighting a recession necessitated them) because they competed with the private sector’s need for funds to finance productive investment or were financed by foreign capital that then had claim to the future income from U.S.-based investments. In either instance, the burden of the debt was ultimately borne by future citizens in the form of a diminished standard of living. Is it possible that there is no burden to the federal debt, or even that it makes us better off?

At the heart of the recent discussion is the reality of low interest rates, i.e., interest rates that are below the growth rate of the economy. The simple arithmetic of debt accumulation indicates that if interest rates remain low – relative to the growth of GDP – it is easier to handle federal debt.

To see this, let $D$ be the debt in the hands of the public, $Y$ be GDP, $r$ the interest rate, $g$ the growth rate of GDP, $E$ federal expenditures, and $R$ federal revenues. $P$ is the “primary deficit,” the amount by which $E$ exceeds $R$. The debt-accumulation identity is:

$$\Delta D = (1+r)\Delta D + (E-R)$$

Dividing both sides by the level of GDP gives:

$$\frac{\Delta D}{Y} = (1+r)\frac{\Delta Y}{Y} + \frac{P}{Y}$$

Since $Y_t = (1+g)Y_{t-1}$, this is:

$$\frac{\Delta D}{Y_t} = (1+r)\frac{\Delta Y_t}{(1+g)Y_{t-1}} + \frac{P_t}{Y_t}$$

Finally, using lower-case letters to denote ratios to GDP, this means:

$$d_t = (1+r)/(1+g) \frac{\Delta d_{t-1} + \Delta r}{d_{t-1}}$$

In English, the debt-to-GDP rises with interest costs but falls with growth in the economy. Of course, running primary deficits automatically demands more debt. This has the implication that if $r > g$, you need primary surpluses ($p < 0$) to keep debt from rising. That is, controlling the debt is hard fiscal work. But if $g > r$ and $p = 0$, then the debt will (eventually) shrink away (relative to GDP). Finally, if $g > r$, you can run primary deficits and still shrink the debt. Perhaps managing the debt is not such hard work after all?

An important contribution of Blanchard is to note that the current situation of low interest rates is more the rule than the exception. I was surprised by this, but my thinking was too much conditioned by the experiences of the ’70s to the ’90s, when the reverse was true. The contribution of Summers and Furman was to argue that policymakers should not try to reduce deficits – just that they should not make them worse. So, in their view, all that is needed is that if a new spending program is enacted, then new taxes should be raised, or other spending cut, to offset the new program. The position of the Trump Administration has been that growth is the key; it has made no serious attempt to address budget issues.

But in each case, one still must eventually at least stabilize debt, if not reduce it. To see how the alternatives fit together, consider that the CBO projects a primary deficit for 2029 of $571 billion. It also projects that the debt-to-GDP ratio is 95 percent ($d=0.951$). It further projects that the growth rate of (nominal) GDP is 3.9 percent ($g=0.039$) and that the interest rate is 3.1 percent ($r = 0.031$). Since $g > r$, the claim is that we can still run a
primary deficit and keep the fiscal house in order. Unfortunately, if you merely want to stabilize the ratio of debt-to-GDP (not have it decline), the primary deficit in 2029 has to be $223 billion. In the parlance of D.C., that means you would have to cut the primary deficit by roughly $350 billion – or $3.5 trillion over 10 years. That is serious fiscal work.

Worse, the calculation is very sensitive to interest rates and growth rates. 3.1 percent is the current projection for 10-year rates. If one instead uses the projected 10-year rate of 3.7 percent from January 2019, then the primary deficit has to be $56 billion to stabilize the debt. That means, for all practical purposes, balancing the primary (non-interest) budget. By recent standards of conduct, that is hard to imagine. At the other end of the spectrum, if one assumes that the economy will grow at 5 percent (the Trump Administration’s assumed 3 percent real growth with 2 percent inflation) and interest rates are 3.1 percent, then the debt will stabilize relative to GDP with a primary deficit of $530 billion – almost exactly what CBO projects. With fast growth, the administration’s budgetary indifference makes more sense.

To me the upshot is clear. There is no free pass for federal debt. Believing that there is no work to do means betting the ranch on either very low interest rates or very high growth rates, or both.

Economic Consequences of the Fiscal Outlook

Unless current law is changed, the federal debt will grow inexorably until creditors effectively refuse to continue to finance our deficits by charging ever-higher interest payments on an increasingly large debt portfolio. Unchecked accumulation of debt would precipitate a fiscal crisis that would upend world financial markets and do lasting harm to the nation’s standard of living.

In a hypothetical fiscal crisis, the policy response most readily available to lawmakers would be ill-targeted insofar as it would likely leave untouched the large drivers of the debt itself – health and retirement and entitlement programs. Such programs do not lend themselves to immediate reduction. Accordingly, a fiscal consolidation that was forced by creditors would likely take the form of tax hikes and cuts to discretionary spending. These tax hikes and discretionary spending increases would be sharp and immediately felt.

The nation would also face immediate and steep interest penalties on financing its shorter-term debt portfolio. About half of all U.S. debt held by the public is of 3 years or less in duration. All else being equal, the higher costs of rolling over this portfolio, would also have to be borrowed or absorbed through significant, additional tax increases and spending.

An immediate fiscal contraction from a debt crisis would have a deleterious effect on the economy. From a purely budgetary perspective, large and immediate tax increases and spending cuts would reduce growth, and immediately reduce the revenue collected from tax increases. Spending would also increase as certain automatic stabilizers come into force as the economy flags.
Some observers note that financial markets – bond markets in particular – appear quiescent, and that countries like Japan have had large increases in debt without facing a sovereign debt crisis. Where is the harm, they ask?

Absence of a crisis is hardly a policy success. Mechanically, federal debt issuance must come at the expense of either the private sector – traditional crowding out – or by attracting an inflow of foreign capital. In the former case, the growth in physical, intellectual and human capital is slowed, productivity growth is diminished and the standard of living is harmed. In the latter, the economy continues to grow, but the incomes it generates increasingly accrues to foreign investors, and the standard of living is harmed. In short, the unsustainable fiscal outlook will sap the vitality of the U.S. economy, and may be doing so already.

Thank you. I look forward to your questions.
Statement of Charles P. Blihous
Before the U.S. Senate Committee on Homeland Security and Government Affairs
January 28, 2020

Thank you, Chairman Johnson, Ranking Member Peters, and all of the members of the committee. It is an honor to appear before you today to discuss the leading contributors to the federal government’s long-term fiscal imbalance.

My remarks today will focus on the financial challenges associated with the federal government’s largest two mandatory spending programs, Social Security and Medicare. These two vital programs warrant emphasis in this context, first because so much of projected federal spending growth is concentrated within them, and second because, as programs financed through dedicated trust funds, they face enormous financial challenges of their own, even when considered separately from the larger federal budget context. Social Security and Medicare warrant attention and reform irrespective of whether they are viewed from a unified budget perspective or are instead evaluated narrowly, from within the confines of their own program purposes and operations.

Why Social Security and Medicare Finances Matter

First, I will present some background on trust fund financing as it operates within Social Security and Medicare. The Social Security and Medicare trustees, of which I was one from 2010-15, are charged under the Social Security Act with monitoring the financial conditions of four separate trust funds: Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) within Social Security, and Hospital Insurance (HI) and Supplementary Medical Insurance (SMI) within Medicare. The financing frameworks of Social Security OASI and DI as well as Medicare HI are qualitatively similar. For each of these three trust funds, the predominant source of revenues is a payroll tax assessed on taxable worker wages, with a relatively small fraction of program revenue coming from the income taxation of Social Security benefits. Because the trust funds’ holdings consist of U.S. Treasury securities, they all also earn interest income, paid from the federal government’s general fund.

These three trust funds are each designed such that program spending authority is limited to the assets the trust funds hold. Unless additional authority is granted in legislation, the programs cannot borrow or draw further upon the federal government’s general fund. If, hypothetically, a trust fund’s reserves were ever to be depleted, benefit payments would be postponed until sufficient

---

1 Charles P. Blihous holds the J. Fish and Lillian F. Smith Chair at the Mercatus Center at George Mason University, where he is also Senior Research Strategist.
dedicated revenues were received to finance those payments. This would effectively cut benefits through the mechanism of delay. Accordingly, one of the core responsibilities of the programs’ trustees is to monitor trust fund finances, and to alert lawmakers and the public if it is projected that future program revenues will be insufficient to finance scheduled benefits. The intended purpose of these alerts is to prompt lawmakers to enact the necessary changes to program outlays and/or revenues so that trust fund reserves are not depleted, and so that benefit payments can continue without interruptions that would cause hardship to program participants. Such warnings have been contained in all recent trustees’ reports for both Social Security and Medicare.

The fourth trust fund monitored by the trustees, Medicare SMI, operates somewhat differently. The SMI trust fund is always kept in balance by statutory construction. Roughly one-quarter of SMI spending is financed by premiums paid by or on behalf of beneficiaries; these premium assessments are automatically adjusted each year in proportion to total program spending. The other approximately three-quarters of SMI revenue is automatically appropriated from the federal government’s general fund. Because of the different way SMI is financed relative to the other three trust funds, the trustees do not produce projections of SMI shortfalls. This, however, does not mean that SMI is immune to financing strains. Instead, it means that SMI’s financial challenges are experienced differently; not in threats of program insolvency and sudden benefit cuts, but in rising premium assessments facing beneficiaries, and worsening pressure on government budgets.

It is important to understand these distinctive aspects of SMI’s financing structure for several reasons. One is that SMI, which pays for important Medicare benefits such as physician services and prescription drugs, actually represents a larger portion of total Medicare spending than does HI. This year, for example, the Congressional Budget Office (CBO) projects that SMI spending will total $471 billion, as opposed to $341 billion under HI. Consequently, when the trustees report annually on the HI trust fund’s actuarial imbalance as well as its projected insolvency date, these projections represent substantially less than half of Medicare’s total operations.

SMI’s unique financing design also reminds us that trust fund solvency, while a necessary condition for financial soundness, is not a sufficient one. SMI is always in actuarial balance by definition, but this does not necessarily mean that premium-paying beneficiaries or the federal government as a whole will find its rising costs affordable. Accordingly, ensuring the financial viability of Social Security and Medicare requires much more than simply decreasing that their trust funds will be credited with any revenues we want to spend. Instead it requires that the long-term growth of program obligations not exceed the growth in beneficiaries’ and taxpayers’ ability to pay.

Before I turn to the trustees’ latest projections for Social Security and Medicare, another point is worth especial emphasis. It is that the actuarial status of Social Security or Medicare is not a mere accounting abstraction, of interest only to government budget wonks. The concept of actuarial balance is central to the well-being of program participants, and vital to individual Americans’ economic security.
Social Security and Medicare enjoy exceptionally privileged positions in federal economic policy. Social Security has long been referred to as the third rail of American politics ("touch it, and you die"), and there is truth in the description. Participants in Medicare and especially Social Security have generally been spared the sorts of frequent, occasionally sudden reassessments of benefit levels and eligibility criteria to which beneficiaries of so-called "welfare" programs can be subjected. Indeed, the last significant changes to Social Security’s benefit structure and eligibility ages were enacted nearly four decades ago, in 1983. This stability is extremely important to program beneficiaries, whose retirement income planning would be undermined if these programs’ benefits were potentially on the chopping block every budget season.

This stability of the Social Security and Medicare programs, upon which beneficiaries rely, is no accident. It derives directly from their financing structures. President Franklin Roosevelt, whose administration spearheaded the effort to create Social Security, was adamant that it be structured as contributory insurance rather than as a welfare program. FDR’s successful implementation of this principle matters greatly even today because it underlies shared perceptions that Social Security participants are receiving benefits for which, at least in the aggregate, they have paid. In contrast, in a traditional welfare program, it is generally understood that many Americans will provide financing without ever receiving the benefits, while others will receive benefits without paying the taxes that fund them. The political dynamics of welfare programs reflect inherent tensions that force periodic reassessments of where benefit levels should be set as well as who should receive benefits. This happens far less frequently with Social Security, because of the widely shared perception that its essentially universal benefits have been earned by worker contributions, and are thus not appropriately subject to frequent renegotiation.

To be sure, Social Security’s self-financing design is not perfectly pure in practice. Individual participants may receive benefits over their lifetimes that are either far more or far less than they personally contributed. Social Security is also only required to be self-financing on average over time, not in every individual year. In some years (such as the decades immediately prior to 2010), Social Security collected more taxes than it paid out in benefits, and thus effectively subsidized other federal spending during those years as debt held by its trust funds built up. In the years since 2010 and extending indefinitely into the future, it will pay out far more in benefits than it will generate in taxes, and during these years it contributes significantly both to recent and future federal budget deficits. In addition, lawmakers have occasionally waived strict self-financing. For example, in 2011-12, a temporary payroll tax reduction took effect, which was coupled with an injection of $217 billion of general revenues into Social Security’s trust funds, a substantial subsidy from the federal government’s general budget accounts for which program participants had not paid.

Even with its imperfections, the preservation of Social Security’s self-financing framework remains important to the economic security of millions of program participants. Unless lawmakers are willing to moderate benefit growth and/or increase program taxes sufficiently to balance Social
Security's books, then its historical financing design will have to be abandoned, and with it the exceptional income security Social Security has delivered to beneficiaries for decades. In addition, unless lawmakers successfully eliminate projected financing shortfalls sufficiently far in advance of the necessary changes' implementation, today's workers will not be able to make informed plans for their own retirement years. As long as Social Security and Medicare's funding shortfalls remain uncorrected, Americans face future income losses about which they are not being told.

While restoring Social Security and Medicare finances to sound footing is critical from the perspectives of the programs and their beneficiaries, it bears mentioning that doing so is also imperative from the standpoint of the larger federal budget. CBO's latest long-term budget outlook projects, under its extended baseline scenario, that federal debt held by the public will surpass our Gross Domestic Product by the early 2030s. The principal reason for this projected debt accumulation is federal spending growth. From today through 2033, federal spending is projected to rise from 20.7% to 23.9% of GDP, far higher than historical norms. Future revenue collections are also projected to exceed historical averages as a percentage of GDP, but not by nearly as much, and thus deficits will rise. This baseline scenario assumes that full scheduled Social Security and Medicare benefits continue to be paid despite projected insolvency of certain of their trust funds. Strikingly, under CBO's baseline, the entirety of federal spending growth (relative to GDP) through 2033 can be accounted for solely by projected growth in gross Medicare spending and Social Security. See Figure 1.

Figure 1. Social Security and Medicare Spending Growth
Drive Total Federal Spending Growth

![Spending as a Percentage of GDP](image-url)
Federal spending growth to date tells a similar story. In 2005, total federal spending equaled 19.3% of GDP. This year it is projected to equal 20.7%. All federal spending growth relative to GDP over the last 15 years can be accounted for by growth in gross Medicare spending and Social Security. Our national politics have a tendency to focus on legislation in other areas of the budget affecting the fiscal outlook, especially when this focus permits opposing political parties to draw contrasts between their respective policy positions. What we find less pleasant to acknowledge is that nearly all federal spending growth, recent and projected, spanning the first four decades of the 21st century, can be explained by Social Security and Medicare spending growth alone.

Our shared failure to contain the growth of mandatory spending programs undercuts policy priorities across the political spectrum, whether they are conservative objectives of keeping federal tax burdens within historical norms, or progressive objectives of increasing investments in education, infrastructure and environmental protection. None of these objectives can realistically be met if current mandatory spending trends continue.

Budget impact aside, Social Security and Medicare warrant attention and reform for their own sakes. The next section of my testimony will summarize the financial outlooks for the two programs.

**The Trustees' Projections for Social Security and Medicare Finances**

The trustees traditionally summarize Social Security’s financial outlook with reference to the combined operations of its two trust funds, OASI and DI, although under law the balance of each trust fund must be maintained separately. Their latest report projects that these trust funds face a combined shortfall over the next 75 years equal to 2.78% of the program’s revenue base of taxable worker wages. This 2.78% figure appears deceptively small; perhaps a clearer way to understand the magnitude of the shortfall is to note that closing it by cutting projected benefit obligations across the board would require reductions of 17 percent—that is, if they are enacted immediately and if they affect not only future claimants but also everyone already receiving benefits. Alternatively, a solution consisting solely of raising the payroll tax rate would require an increase of nearly 22 percent—specifically, a 2.70 percentage point increase on top of the current 12.40% Social Security payroll tax, resulting in a Social Security tax rate of 15.10%.

Even these sobering illustrations underestimate the magnitudes of the changes that will almost certainly be required. This is because historically, lawmakers have been extremely resistant to reducing Social Security benefits for those already receiving them. Consequently, any legislated moderation of future benefit growth is likely to affect only those who have yet to claim benefits. If applied prospectively in this manner, the required reductions would need to be 20 percent rather than the 17 percent described in the previous paragraph. But again, this assumes a sudden cut effective next
year, legislative action that would likely face insurmountable political obstacles. It is far more likely that any future moderation of benefit growth would be phased in gradually, so that it affects near-term retirees far less than under these illustrations, requiring in turn much larger changes affecting later retiree cohorts.

These illustrations dramatize how large the Social Security financing challenge has already become, even if lawmakers were to act immediately to address the situation. For comparison, consider the last major Social Security financing reforms enacted in 1983 with great difficulty after several false starts. Those reforms included delaying COLAs by six months, exposing benefits to income taxation for the first time, bringing in all newly hired federal employees to contribute payroll taxes, increasing the full retirement age, and accelerating a previously-enacted payroll tax increase, among other provisions. Controversial though those changes were, today’s Social Security shortfall is much larger by any measure; not only in absolute terms, but also relative to the current program’s larger contribution base and benefit schedules. See Figure 2. We are already in a position where we need an historically exceptional degree of bipartisan cooperation and compromise to avert Social Security insolvency, and to preserve its historical financing design. Even in the best possible scenario for expeditious action, Republicans and Democrats would need to join together to overcome enormously difficult politics, to support a package of reforms that deviates markedly from either of their competing policy preferences.

Figure 2. We Face a Much Larger Soc. Sec. Shortfall Now than in 1982

Projected Soc. Sec. Surpluses/Deficits, 2013 vs. 1982 Trustees’ Reports

Data given are in increments of five years because the 1982 report did not provide long-term projections for individual years.

Other dire illustrative scenarios highlight the immense cost of continued delay in enacting corrections to Social Security’s financial imbalance. If lawmakers were to wait until the brink of combined trust fund depletion in 2035 to enact repairs, the size of the benefit reductions required to
do the job would reach 23 percent. Again, this 23 percent figure assumes that the reductions are applied to all beneficiaries regardless of age or need, even those who have been dependent on Social Security benefits for decades. And if nothing at all were done, combined trust fund depletion would cause immediate reductions of 20 percent, as shown in Figure 3, a percentage reduction that would increase to 25 percent by the end of the trustees' long-range valuation window.

Figure 3. Trustees’ Projections of Combined Soc. Sec. Income/Costs
(All Numbers Expressed as a % of US Workers’ Taxable Wages)

Again, it is not realistic to expect that lawmakers would react to impending insolvency in 2035 by immediately cutting all participants’ benefits by 23 percent. However, by then there would be a huge additional problem. By that late date, it would no longer be possible to repair system finances through prospective benefit changes alone. Even total elimination of all new benefit claims in 2035 would be insufficient to prevent the combined Social Security trust funds from being depleted. We simply do not have the luxury of waiting until trust fund depletion is imminent if we wish to maintain a realistic chance of preserving Social Security’s self-financing design. Prompt, expeditious action is required if Social Security is to function in the future as it has in the past.

The causes of Social Security’s shortfall are relatively straightforward and essentially boil down to three. The first is the rise in the number of beneficiaries relative to the number of taxable workers. This is driven primarily by population aging (the fact that we are generally leading longer, healthier lives than previous generations) and is accelerated by the movement of the historically large Baby Boomer generation from the ranks of workers onto the retirement rolls. We have failed thus far to adequately adjust Social Security law to these demographic realities. Cohort life expectancy today at age 65 is 20.3 years as compared with 13.7 years in 1940, and yet due to the subsequent introduction of early eligibility for older age benefits, the most common age of benefit
claim today is actually three years younger (62) than it was those eighty years ago (65). The resulting dramatic decline in the ratio of workers to beneficiaries (see Figure 4) not only strains Social Security finances, it undermines participants' retirement security. This occurs for the simple reason that when a fixed amount of income resources must be stretched over a larger number of retirement years, the annual income it can provide must inevitably become smaller.

![Figure 4: The Declining Worker-Collector Ratio](image)

The second primary cause of the shortfall is Social Security's predominantly pay-as-you-go financing method. Social Security is not a savings program in which each generation advances funds their own retirement benefits. Instead, since Social Security's inception, each generation's benefits have been paid primarily from the tax contributions of the following generation of workers. The finances of such a system are extremely sensitive to changes in the ratio of workers to beneficiaries. The third main cause of the shortfall is the dramatic expansion of benefits enacted in stages during the 1970s, including pegging the growth of initial benefit levels to growth in the national Average Wage Index (which generally rises faster than price inflation) and adding Cost of Living Adjustments. A consultant panel advised Congress at that time, and subsequent events have confirmed, that these benefit indexation methods result in program costs rising faster than can be financed with a stable tax rate.²

https://www.ssa.gov/history/reports/hsiaco/hsiacoChapter1.pdf
substantive consequence of combining pay-as-you-go financing, an aging population, minimal changes to eligibility ages, and real per capita benefit growth, is that program costs grow faster than our capacity to finance them.

It is important to understand that the total size of the changes required to balance Social Security’s finances is not a matter of policy discretion. Rather, the magnitude of the changes required is determined solely by the gap under current law between the program’s projected revenues and its projected benefit obligations. No lawmaker who offers a solution to this shortfall should be attacked on the false premise that they would inflict unnecessary pain. The only policy discretion lawmakers have pertains to how much of the shortfall is filled by increasing revenues vs. moderating benefit growth, and to whether continued delay forces affected participant cohorts to shoulder a disproportionate share of the necessary changes.

The younger generations who would be most adversely affected by further delays are also the ones who already stand to lose substantial net income through Social Security in the absence of reforms. Simply playing for time, allowing costs to rise, and raising taxes periodically would effectively prevent Social Security from bolstering younger Americans’ income security, because this strategy would force those generations to make tax contributions to the program that far exceed (in present value) the benefits Social Security could later pay. Under current projections, future workers would experience net income losses under Social Security equal to 3.4% of their taxable career earnings, even after accounting for all benefits that they receive. If Social Security reaches the point wherein it causes such large net income losses for entire generations, as it would if today’s participants do not make a significant contribution to solving the problem, then it will no longer function as effective social insurance.

Medicare’s finances are more complex than Social Security’s, but show similar strains. The Medicare HI trust fund faces a projected actuarial imbalance over the next 75 years equal to 0.91% of its revenue base in taxable worker wages. Again, the small-seeming 0.91% number belies the magnitude of the HI shortfall. HI’s shortfall equals 19 percent of all scheduled benefits over the next 75 years. If full HI benefit payments are made until trust fund depletion in 2026, then closing the shortfall would require cost savings equal to 20 percent of subsequent scheduled benefits. Alternatively, if the shortfall were to be eliminated by an immediate revenue increase, an increase equal to 0.91% of taxable worker wages would be required. This would be an increase of roughly 23 percent in Medicare HI’s total income rate, which would need to be roughly 26 percent if delayed until 2026.

As previously noted, HI is but one part of Medicare, and SMI is larger. SMI by definition faces no actuarial imbalance, but its costs are projected to rise dramatically as a share of overall federal spending. SMI costs are projected to rise from roughly 2.2% of GDP this year to nearly double that amount as a share of our economy, nearly 4.2% of GDP by the end of the trustees’ 75-year valuation period. For comparison, consider that SMI alone, which is just one trust fund within
Medicare, would then spend a larger share of our economy than either all defense spending or all non-defense discretionary appropriations do today.

Figure 5: Medicare Cost and Non-interest Income by Source

Medicare is buffeted by the same cost-driving forces as Social Security, notably an aging population, a declining ratio of workers to collectors, a failure to adjust eligibility criteria for demographic changes, and pay-as-you-go financing. In addition, Medicare faces the additional factor of health cost growth, which is generally faster than economic growth. These factors cause Medicare costs not only to rise faster than Social Security’s (see Figure 5, reproduced directly from the trustees’ report summary), but to be more difficult to project. Whereas the size of the Social Security shortfall has a high degree of certainty, and the depletion of its trust funds is highly unlikely to occur more than a few years earlier or later than currently projected, feasible long-range Medicare cost projections cover a wide span. The trustees’ projections for the 75-year actuarial balance of Medicare HI alone range from a deficit that is five times larger than the central projection (4.55% of taxable payroll vs. 0.91%), to no HI deficit at all. That said, the projected depletion of the HI trust fund is near enough (2026) that it is highly certain to occur in the absence of additional financing reforms.
There is a tendency to think of Social Security and Medicare financing reforms as inherently imposing pain but they also require restraint on benefit growth and/or increases in tax collections. Yet there are substantial potential upsides to Social Security and Medicare reforms. Done properly, program reforms could improve incentives for workforce participation as well as individual saving, achieve more equitable treatment of different generations, lessen the risk of old-age poverty from premature retirement, and more efficiently target income gains on households of greatest need, all while producing substantial financial savings. Fiscal considerations are powerful reasons to pursue Social Security and Medicare reforms, but they are by no means the only ones.

What Should Be Done?

Addressing the Social Security and Medicare shortfalls involves critical policy value judgments and tactical decisions that are properly in the purview of legislators rather than program trustees or former trustees. Nevertheless, pursuant to this objective, I offer the following principles for Senators’ consideration.

First: act as rapidly as circumstances allow. Every year that we wait means that the eventual solution imposes additional hardship on affected participants, either as taxpayers or as beneficiaries. It also, importantly, means that the barrier to bipartisan agreement rises higher, increasing the risk that the historical financing framework for these vital programs cannot be preserved, leading it to be abandoned in favor of another structure that offers far weaker protections to beneficiaries.

Second: don’t make the problem worse. The reason the Social Security and Medicare shortfalls are as large as they currently are is that legislators have found it substantively and politically daunting to tackle them. We do not yet know what amounts of tax increases, or what rates of benefit growth, a critical mass of voters and legislators will be willing to support in order to restore these programs to balance. It would be irresponsible in the extreme to make this daunting problem even more intractable by pursuing significant expansions of program obligations. The appropriate time to discuss any across-the-board increase in Social Security benefit obligations, or an expansion of Medicare to Americans of younger ages, is after — and only after — lawmakers have demonstrated, through enacted legislation, a willingness to fully fund these programs’ current-law obligations.

Third: compromise will be necessary. There are many who prefer to avoid any and all tax increases. There are many on the other side who prefer to avoid any deceleration in the rate of benefit growth. Neither side can get its preferred way completely. Unless one party alone controls the White House, the House of Representatives, and commands a supermajority of 60 in the Senate, a solution will need to be negotiated that lands somewhere in the middle between opposing policy perspectives. For one party or the other to hold out until they control all the branches of government almost certainly will not work. The last time the federal government was under one-
part control that included a Senate supermajority, no attempt was made to address the Social Security shortfall. This job will not get done without bipartisan cooperation.

Fourth: remember that individuals participate in Social Security and Medicare both as taxpayers and later as beneficiaries. To understand individuals’ net treatment by these programs, policy makers must take into account both sides of the equation; not only the effect of these programs on beneficiaries’ income security during retirement years, but also the effects of program costs on the standards of living of paying workers. Analyses conducted in support of any policy proposal should examine the net treatment of affected individuals over their lifetimes, with attention to how this net treatment varies according to income level, birth year, marital status, employment history, and other factors.

While I cannot say what process is most likely to produce the necessary bipartisan agreement, I would offer one technical suggestion with respect to the TRUST Act bill. I would recommend that in any expedited process, CBO perform the calculations of proposals’ effects on the unified federal budget, while the Social Security and Medicare trustees perform analyses of proposals’ effects on the actuarial balances of the Social Security and Medicare trust funds. The Social Security Act reflects an historical judgment by lawmakers that the trustees’ process is the preferred mechanism for monitoring the programs’ actuarial status, which is why Congressional budget points of order have historically drawn upon the trustees’ tests of long-term financial adequacy. I would further state on the basis of my personal experience that the trustees’ process is well constituted to take the long-term view of the trust funds’ financial condition that appears to be intended in the bill as introduced. Finally, I would express the hope that the Senate will soon have an opportunity to confirm a bipartisan pair of public trustees to resume critical independent oversight of the trustees’ annual projection and reporting process.

Conclusion

In the recent past as well as for the foreseeable future, the rising costs of Social Security and Medicare both contribute significantly to a worsening federal fiscal outlook. However, apart from their effects on the federal budget, both Social Security and Medicare warrant reform for their own sakes, to place both programs on sound financial footing, and to better serve program participants. Prudent reforms to eliminate the Social Security and Medicare shortfalls, in addition to improving the financial outlook, would reduce participant uncertainty in planning for retirement, and could achieve a more equitable distribution of program benefits and financing burdens.
Social Security & Medicare Shortfalls Exceed $100 Trillion Over 30 Years

Testimony before the Committee on Homeland Security and Governmental Affairs United States Senate

January 28, 2020

Brian Riedl
Senior Fellow in Budget, Tax, & Economic Policy
The Manhattan Institute for Policy Research
Main Takeaways from Brian Riedl’s Testimony

- I will describe the policies that are driving a historic long-term surge in budget deficits.
- The budget deficit is on pace to surpass $1 trillion as soon as next year — on its way to $2 trillion within a decade if current policies continue.
- If interest rates merely rise back to 1990s levels, that would push the projected annual budget deficit to $3 trillion in ten years.
- The long-term picture is even worse. The CBO projects a staggering $80 trillion budget deficit over the next 30 years, even assuming all recent tax cuts expire. That would leave the national debt at nearly 150% of GDP.

Drivers of the Rising Ten-Year Deficit

- The $250 billion annual cost of recent tax cuts, and $159 billion annual cost of the higher discretionary spending caps are certainly contributors to the deficit. But their cost will remain steady over the decade, and thus do not explain why the budget deficit (under current policies) would rise from $898 billion to $2,188 billion over the next decade.
- Those future increases in red ink will come from adding 74 million baby boomers to the Social Security and Medicare systems. This is both a result of demographics, and rising health costs.
- Social Security and Medicare are not fully self-financed through premiums, payroll taxes, and other dedicated taxes. Each system requires an annual general revenue transfer to pay all promised benefits (some of these transfers are credited as interest payments to trust funds). And these transfers — as well as the interest costs of the Treasury borrowing to cover these transfers — are about to soar.
- Annual Social Security and Medicare shortfalls (and their interest costs) will jump from $440 billion in 2019, to $1,656 billion a decade from now. These $1.2 trillion in additional Social Security and Medicare deficits will account for 90% of the $1.3 trillion projected rise in the deficit over the next decade, according to the CBO current-policy budget baseline.
- In total, over the next decade, Social Security will require a general revenue transfer of $2.5 trillion, and Medicare will require $5.9 trillion. When including the $1.8 trillion in resulting interest costs from the portion of that spending that must be borrowed, the Social Security and Medicare systems will drain $10.2 trillion from general revenues over the next decade.

Drivers of the Surging 30-Year Deficit

- Over the next 30 years, the Social Security and Medicare systems are projected by CBO to run a $103 trillion cash shortfall. The rest of the budget is projected to run a $23 trillion surplus.
- Specifically, Social Security will run a $19 trillion cash deficit, Medicare will run a $44 trillion deficit, and the interest costs of financing these shortfalls will add $40 trillion more.
- CBO projects that, between 2019 and 2049, the annual Social Security and Medicare shortfalls (and their interest costs) will leap from 2.0% of GDP to 12.1% of GDP. The rest of the budget in 2049 is projected to enjoy a 3.4% of GDP surplus — as a result of both rising revenues and falling spending across the rest of the budget.

Conclusion

- The long-term debt problem is overwhelmingly a Social Security and Medicare issue. The rest of the budget is projected by CBO to produce growing surpluses over the long-term — but cannot balance out a $103 trillion projected shortfall within Social Security and Medicare.
- The TRUST Act would provide a path for lawmakers to begin addressing these shortfalls.
Good morning Chairman Johnson, Ranking Member Peters, and Members of the Committee.

Thank you for inviting me to participate in today’s hearing.

My name is Brian Riedl. I am a Senior Fellow in Budget, Tax, & Economic Policy at the Manhattan Institute for Policy Research. The views I express in this testimony are my own, and should not be construed as representing any official position of The Manhattan Institute.

Few Americans fully comprehend the fiscal avalanche that has begun. The budget deficit should surpass $1 trillion as soon as next year — on its way to $2 trillion within a decade if current policies continue. And if interest rates merely rise back to 1990s levels, that would push the projected annual budget deficit to $3 trillion in ten years. This is according to data from the Congressional Budget Office.

Over the next 30 years, Social Security and Medicare face a combined $103 trillion cash deficit, which will push the national debt to nearly 150% of GDP. At that point, interest on that debt would consume 40% of all tax revenues or more, if interest rates rise. Unless reforms are enacted, global markets will, at some point, stop lending to the U.S. at plausible interest rates. When that event occurs, or even approaches, interest rates will soar, and the federal government will not be able to pay its bills, with dire consequences for the U.S. economy.

I. Drivers of the Rising Ten-Year Budget Deficit

CBO has projected a $1.6 trillion budget deficit between 2020 and 2029. However, if one adjusts for the “current-policy” costs of extending the 2017 tax cuts, delayed ACA health taxes, annual tax extenders, and the recent increase in the discretionary spending caps, the projected ten-year deficit rises to $1.5 trillion.1

Specifically, from 2019 through 2029, the current-policy budget deficit is projected to rise from $898 billion to $2,188 billion (see chart 1).

A portion of the underlying deficit is driven by the $250 billion annual cost of the recent tax cuts, and the $150 billion annual cost of the higher discretionary spending caps. However, that combined $400 billion to $500 billion cost will remain relatively steady if extended. It does not explain the $1.3 trillion rise in projected red ink between 2019 and 2029 (chart 2).

Instead, nearly the entire surge in red ink will come from adding 74 million baby boomers to the Social Security and Medicare systems. This is both a result of demographics, and rising health costs. Social Security and Medicare are not fully self-financed through premiums, payroll taxes, and related dedicated taxes. Each system requires an annual general revenue transfer to pay all promised benefits (some of these transfers are credited as interest payments to trust funds). And these transfers — as well as the interest costs of the Treasury borrowing to cover these transfers — are about to soar.

The annual Social Security and Medicare shortfalls (and their interest costs) will jump from $440 billion in 2019, to $1,656 billion a decade from now. These $1.2 trillion in additional Social Security and Medicare deficits will account for 90% of the $1.3 trillion projected rise in the annual deficit over the next decade, according to the CBO current-policy budget baseline.

In total, over the next ten years, Social Security will receive a general revenue transfer of $2.5 trillion, and Medicare will receive a general revenue transfer of $5.9 trillion. Given the percentage of federal spending that must be deficit-financed, these general revenue costs will add $1.8 trillion in net interest costs. Thus, the Social Security and Medicare systems will drain the general revenues by $10.2 trillion over the next decade. The rest of the budget deficit will total $1.8 trillion (1% of GDP) under a current-law baseline, or $5.3 trillion (2% of GDP) if current policies are extended.

Social Security has "earned" these deficits through all the prior surpluses that it had returned to the Treasury before 2009. And the Medicare system's deficits are by program design. Nevertheless, these rapidly rising deficits are the main moving variable driving future deficits upward. The rest of federal spending (excluding interest) is projected to steadily decline indefinitely as a share of the economy.

Revenues are projected by CBO to dip as share of the GDP, but then gradually rise past the 17.4% of GDP average that prevailed before the tax cuts (even if the tax cuts are extended).
Chart 1
CBO Projects $2 Trillion Budget Deficits
Within a Decade, Assuming Current Policies are Extended

Source: CBO Historical Table 1.1, and January 2019 CBO (current-policy) Baseline, Table 5.1

Chart 2
Rising Social Security & Medicare Shortfalls Drive
90% of Rising Deficit Between 2018-2029

Each category reflects the portion of interest on the national debt that it is responsible for.

General revenue transfers include interest payments on interest, which are a part of the rest of the budget.

II. Why the Long-Term Debt Is Soaring

From the mid-1950s through 2008, the national debt held by the public averaged 35% of GDP. This level of borrowing could easily be absorbed by the increasingly global financial markets, and it resulted in interest costs averaging 2% of GDP (roughly 10% of a typical federal budget). Since 2008, the great recession and the beginning of the baby-boomer retirements have more than doubled the debt, to 78% of GDP. If current policies continue, the debt is projected to reach an unprecedented 194% of GDP within 30 years. And if this debt brings higher interest rates (as consensus economic theory suggests), the debt could surpass 250% of GDP (chart 3) and servicing the debt could cost 7.6% of GDP—the equivalent of $1.7 trillion in today’s economy. Americans of all incomes would face unprecedented tax increases; higher interest rates for home mortgages and car, student, and business loans; and a significant economic slowdown. Unlike Greece’s, the U.S. debt would be too large to be easily absorbed by the global economy.

What is causing the debt rise? Not inadequate tax revenues—which, since the early 1950s, have usually remained between 16.5% and 18.5% of GDP, regardless of tax policies, and which are projected to rise above historical norms, to 18.1%–19.5% of GDP, depending on the rate of various expiring tax cuts and delayed tax increases. Nor is it driven, on the spending side, by aggregate expenditures for discretionary and smaller entitlements, which are projected to continue falling as a share of the economy.

Chart 4 shows that the entire increase in long-term debt will come from surging Social Security, Medicare, and other government health-care spending. According to the Congressional Budget Office (CBO), these costs have risen from 7% to 10% of GDP since 2000 and are projected to reach 15.5% of GDP by 2049—or 21.2% of GDP when the interest cost of Social Security and Medicare’s annual deficits are included.
Why Social Security and Medicare Are Going Bankrupt

Between 2008 and 2030, 74 million Americans born between 1946 and 1964—on average, 10,000 per day—will retire and receive Social Security and Medicare benefits. Of this group, those retiring at age 66 and living to age 90 will spend one-third of their adult life receiving federal retirement benefits. The combination of more retiring baby boomers and longer life spans will expand Social Security and Medicare caseloads far beyond what current taxpayers can afford under current benefit formulas. In 1960, five workers paid the taxes to support each retiree (and, of course, Medicare did not exist). The ratio of workers to retirees has now fallen below 3–1, on its way to 2–1 by the 2030s. When today’s kindergartners are adults, each married couple will basically be responsible for the Social Security and health care of their very own retiree.

These demographic challenges are worsened by rising health-care costs and repeated benefit expansions enacted by lawmakers. Today’s typical retiring couple has paid $161,000 into Medicare and will receive $498,000 in benefits (in net present value), in part because Medicare’s physician and drug benefits are not pre-funded with payroll taxes, and only partially funded by retiree premiums. Most Social Security recipients also come out ahead. Thus, most seniors’ benefits greatly exceed their lifetime contributions to the Social Security and Medicare systems. By 2030, the 74 million baby boomers will have joined a retirement benefit system that runs a substantial per-person deficit.

According to CBO, between 2019 and 2049, Medicare is projected to run a $44 trillion cash deficit. Social Security will run an $19 trillion cash deficit, and the interest on the resulting program debt will be $40 trillion (chart 3). (To adjust these 30-year totals for inflation, trim by one-third.) Rather than self-finance through payroll taxes and premiums, these two programs are set to add $103 trillion to the national debt. The rest of the federal budget is projected to run a surplus over the next 30 years.

Between 2019 and 2049, the annual Social Security and Medicare deficits are projected to rise from 2.0% to 12.1% of GDP. This projected 2049 shortfall will consist of Medicare (4.6% of GDP), Social Security (1.8%), and the interest costs directly attributed to these program shortfalls (5.7%). The rest of the budget will run a 3.4% of GDP surplus, according to CBO data (see chart 4).
The Fiscal Avalanche Has Already Begun

Since 2008—when the first baby boomers qualified for early retirement—Social Security and Medicare have accounted for 60% of all inflation-adjusted federal spending growth (with Medicaid and the Affordable Care Act responsible for an additional 31%). The majority of budgetary savings achieved by discretionary spending caps, defense cuts, and rising tax revenues have simply financed growing Social Security and Medicare costs, which will grow by another $130 billion annually over the next decade. That is the equivalent of creating another Defense Department every five years. This will happen automatically, without any congressional votes and therefore likely with scant media coverage.

And as federal resources further shift to the elderly, Washington is beginning to run out of offsetting spending cuts. This has contributed to the deficit expanding from $438 billion to $666 billion through 2017, even before the recent tax cuts. CBO’s current-policy baseline shows deficits rising to $2 trillion within a decade—or $3 trillion, if interest rates return to historical norms. Unlike the temporary, recession-driven budget deficits a decade ago, these Social Security- and Medicare-based deficits will expand permanently. Over the next 30 years, CBO projects that the national debt will grow from $22 trillion to $103 trillion ($26 trillion after inflation)—or much higher, if interest rates rise from the projected 3%–4% range to the historically typical 5%–6%.

Predictably, most of the popular blame for the rising deficits is currently pinned on the 2017 Tax Cuts and Jobs Act (TCJA). TCJA will likely decrease revenues by roughly 1% of GDP indefinitely if extended past 2025, when parts of the law are currently scheduled to expire. (This does not include additional tax revenues that will arise from economic growth that lower tax rates will induce. The congressional Joint Committee on Taxation estimates that these additional tax revenues would offset the additional interest costs of the tax law, though not the primary deficit-increasing impact of the tax cuts themselves.) While the government revenues forgone by TCJA will surely worsen deficits, they are a much smaller contributor than Social Security, Medicare, and Medicaid, spending on which will together rise by 2.6% of GDP over the decade and 5.7% over 30 years. Even without the 2017 tax cuts, the annual deficit would still exceed $1.9 trillion within a decade. In short, TCJA did not create the federal government’s large deficits, and even repealing them would not absolve lawmakers of the need to address rising entitlement spending.

III. The Mirage of “Easy” Solutions

Real deficit reduction will involve a real burden. Yet standing in the reform is series of false claims that the problem is easily solved.

Economic Panaceas

Steep economic growth. A strong economy is necessary but far from sufficient for major deficit reduction. Growth rates will already be limited by the labor-force slowdown caused by baby-boomer retirements and declining birthrates. That leaves productivity to drive growth.

So, no problem? Let’s start by disregarding CBO’s 2019 projection that total U.S. factor productivity will continue growing at the 1.1% average rate of the past 30 years and instead assume the white-hot 1.8% rate that prevailed from 1992 through 2005. Most economists would consider this rate far too optimistic. Nevertheless, the resulting higher incomes and tax revenues from this productivity jet stream would seem to close at least 40% of the cumulative deficits through 2049—until one accounts for the fact that higher incomes automatically result in higher Social Security benefits when the workers who earned them retire.

Much can be done to increase real economic growth rates above CBO’s long-term 1.9% annual projections. In particular, lawmakers should aim to grow the labor-force participation rate; continue to refine the tax code to encourage work, savings, and investment; and improve policies in the areas of trade, energy, job training, education, and health care. However, a refusal to address surging spending and
deficits would still undermine economic growth by raising interest rates, decreasing business investment, and ultimately forcing up taxes. Lawmakers should aspire to faster growth but not simply assume it—especially if entitlement costs keep growing.

Inflate the debt away. In the short term, higher inflation can dilute some of today’s $22 trillion national debt. However, Social Security and Medicare benefits and payments are also tied to inflation, so future liabilities would expand. Additionally, Washington would have to pay much higher interest rates when borrowing to finance those benefits.

Low interest rates. CBO’s 2019 Long-Term Budget Outlook assumes that the national debt can rise from 35% to 144% of GDP between 2007 and 2049, with its average interest rate peaking at just 4.2%—which is below even the levels of the 1990s (6.9%) and 2000s (4.8%). By contrast, the economic-policy community consensus is that such a large increase in federal debt would raise interest rates. For each percentage point that interest rates rise, Washington must pay approximately $11 trillion more in interest costs over 30 years. That means an even higher national debt.

Immigration. Smart immigration policy may, on net, marginally improve the federal budget picture (and the economy). It is not a cure-all. High-skill immigrants send higher tax revenues during their working careers, but their eventual retirement into Social Security and Medicare would add new liabilities to the system. Low-skill immigrants generally increase costs to the federal government (and especially to state and local governments)—at least, in the first or second generation, because the resulting education, infrastructure, and social spending exceed the added tax revenues.

Conservative Fantasies

Pro-growth tax policy. Economic growth is obviously important to deficit reduction—and tax legislation that depresses savings and investment must be avoided. Nevertheless, the historical record clearly shows that the vast majority of tax cuts do not increase tax revenues—especially by enough to keep pace with federal programs growing 6%–7% annually.

Eliminating welfare and lower-priority spending. Over the past 15 years, congressional GOP blueprints have typically imposed nearly all the first decade’s cuts on antipoverty programs (Medicaid, ACA subsidies, SNAP [aka food stamps], and others) as well as nondefense discretionary spending, such as education, veterans’ health, homeland security, medical research, and infrastructure. This pot of spending—7% of GDP and declining—would have to be mostly eliminated to balance the budget a decade from now. These cuts will never be passed by any Congress, as their advocates on Capitol Hill and in top think tanks surely know. While there are any number of failed and unnecessary programs in need of major reform, proposals to eviscerate these entire categories of spending while letting Social Security and Medicare off the hook are a politically delusional distraction.

Impossibly tight spending caps. Spending caps are a vital tool to enforce realistic spending targets. But absent any achievable underlying programmatic reforms to meet those targets, they are an empty gimmick. Nevertheless, many conservative budget blueprints simply divide the federal budget into five to eight spending categories and then assume unprecedented cuts in targeted categories, with no underlying policy proposals to achieve those targets. For instance, President Trump’s budgets have assumed a 60% reduction in total nondefense discretionary spending as a percentage of GDP over the decade without specifying which specific programs would be slashed, and how they would operate once all cuts are enacted. The 2011 Budget Control Act has shown that overly tight caps will be canceled rather than force politically suicidal cuts.
Devolution to state governments. There is a strong policy case for allowing states to have more control over poverty relief, education, infrastructure, economic development, and law-enforcement spending. However, counting the federal savings from devolution as the centerpiece of a deficit-reduction strategy is disingenuous because it simply shifts the deficits and taxes to the state level (minus modest efficiency gains that might come from better state fiscal management). The purpose of deficit reduction is to limit government borrowing and tax increases (and to limit economic damage), not merely to change the address where the taxes are sent.

Liberal Fantasies

“Just tax the rich.” Liberal advocates often vastly overstate the degree to which upper-income tax increases can finance the ever-expanding government. In the first place, the U.S. already has the most progressive tax code in the OECD—even adjusting for differences in income inequality.24 And setting aside the moral questions that would be raised by the government seizing the vast majority of any family’s income, basic math shows that large tax increases on high-income Americans cannot close most of the long-term budget deficit.

How much revenue is needed? Forget balancing the budget, simply stabilizing the debt at 95% of GDP (with annual deficits of 3% of GDP) would require a combination of tax increases and spending cuts that eventually adds up to 6% of GDP. Chart 7 shows the difficulty of building a tax increase of this size. Even a 100% tax rate on all income over $500,000 would raise just 4.7% of GDP (until those affected stop working and investing).25 Alternatively, doubling the top 35% and 37% tax brackets, to 70% and 74% would raise only approximately 1.7% of GDP—and even that figure ignores all revenues lost to the economic effects of 85% marginal tax rates (when including state and payroll taxes) on work or investment, as well as tax avoidance and evasion. A 6% wealth tax—far exceeding the mostly-abandoned rates of Europe—would raise less than 1% of GDP.

If America wants to spend like Europe, it must also tax like Europe. This means, in addition to federal and state income taxes, a European value-added tax (VAT)—essentially a national sales tax—that affects all families. The most realistic way to raise 6% of GDP in revenues is by either:

- Imposing a VAT that rises to 36% or
- Raising the payroll tax from 15.3% to 32.0%26

Deep defense cuts. Since the 1980s, the Pentagon budget has fallen from 6% to 3% of GDP—not far above Europe’s target of 2%. Cutting U.S. defense spending to the levels pledged by European members of NATO would save 1% of GDP, or roughly one-seventh of the Social Security and Medicare long-term shortfall. And Europe’s target level is possible only because its leaders can count on protection from a larger superpower—a luxury that the U.S. would not enjoy. A healthy portion of America’s higher defense budget comes from spending $100,000 per troop in compensation (salary, pension, housing, health care, and other benefits), which lawmakers are not eager to cut.27 Some long-term budget savings are possible, though it should be noted that President Obama did not propose reducing the Pentagon budget to anywhere near the levels of France or the U.K.

Single-payer health care. When confronted with rising Medicare and Medicaid costs driving federal deficits, a popular response on the left is to propose single-payer health care. The theory here is that a fully socialized health plan would drastically slash costs to families and the federal budget.

The budgetary impact of single-payer health care has been widely debated over the past two years. However, it is important to emphasize that the estimated $30 trillion to $40 trillion federal cost of single-payer refers only to the federal cost of bringing those under 65 into the Medicare program (and expanding benefits for the elderly). It does not include the cost of closing the existing $44 trillion shortfall for those age 65 and older. In other words, even a “fully-funded” single-payer program would finance only the federal expansion, not the Medicare system’s baseline shortfall of $44 trillion. Perhaps lawmakers should figure out how to pay for the current Medicare system before pledging $30 trillion to expand it.
# Chart 7

**Tax Increases Cannot Easily Close the Social Security and Medicare Shortfalls**  
*(Which by 2049, will total 6.4% of GDF – or 12.1% including resulting interest costs)*

<table>
<thead>
<tr>
<th>Tax Proposal</th>
<th>10-yr $Billions</th>
<th>Long-Term %GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Income Taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$4,504 Double 35% and 37% Tax Brackets to 70% and 74%</td>
<td></td>
<td>1.70%</td>
</tr>
<tr>
<td>$9,654 Raise Income Tax Rates by 10% Across-the-Board*</td>
<td></td>
<td>3.30%</td>
</tr>
<tr>
<td>$2,130 Raise Income Tax Rates by 10% on Incomes Over $84k (Single) and $168k (Married)</td>
<td></td>
<td>0.74%</td>
</tr>
<tr>
<td>$1,234 Raise Income Tax Rates by 10% on Incomes Over 200k (single) /400k (married)</td>
<td></td>
<td>0.17%</td>
</tr>
<tr>
<td>$292 Impose a 70% Income Tax Rate over $10 Million</td>
<td></td>
<td>0.11%</td>
</tr>
<tr>
<td>$66 Impose a 30% Minimum Tax for Millionaires</td>
<td></td>
<td>0.03%</td>
</tr>
<tr>
<td>$1,312 Repeat All Itemized Tax Deductions</td>
<td></td>
<td>0.99%</td>
</tr>
<tr>
<td>$744 Repeat Child Tax Credit Expansion in TCJA*</td>
<td></td>
<td>0.28%</td>
</tr>
<tr>
<td>$732 Repeat Earned Income Tax Credit (EITC)*</td>
<td></td>
<td>0.26%</td>
</tr>
<tr>
<td>$3,962 Repeat Exclusion for Employer-Paid Health Premium*</td>
<td></td>
<td>1.64%</td>
</tr>
<tr>
<td>Investment &amp; Wealth Taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$548 Raise Capital Gains and Dividends Taxes by 10 Percentage Points</td>
<td></td>
<td>0.14%</td>
</tr>
<tr>
<td>$1,000 Impose Mark-to-Market Capital Gains Taxes</td>
<td></td>
<td>0.28%</td>
</tr>
<tr>
<td>$520 Tax Capped Interest on Ordinary Income</td>
<td></td>
<td>0.01%</td>
</tr>
<tr>
<td>$2,500 Sen. Warren Wealth Tax of 0%</td>
<td></td>
<td>0.07%</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$1,895 Eliminate Income Gap for 12.4% Social Security Tax (No Credit for Benefits)</td>
<td></td>
<td>0.85%</td>
</tr>
<tr>
<td>$710 Raise Social Security Payroll Tax 1 Percentage Point*</td>
<td></td>
<td>0.29%</td>
</tr>
<tr>
<td>$898 Raise Medicare Payroll Tax 1 Percentage Point*</td>
<td></td>
<td>0.36%</td>
</tr>
<tr>
<td>Excise, Estate, Sales Taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$1,099 Impose a Carbon Tax at $25/Metric Ton - No Rebate for Households*</td>
<td></td>
<td>0.43%</td>
</tr>
<tr>
<td>$69 Nearly Double Alcohol Taxes*</td>
<td></td>
<td>0.00%</td>
</tr>
<tr>
<td>$41 Increase Cigarette Tax by 50 Cents per Pack*</td>
<td></td>
<td>0.01%</td>
</tr>
<tr>
<td>$111 Repeat TCJA’s Doubling of Estate Tax Exclusion</td>
<td></td>
<td>0.05%</td>
</tr>
<tr>
<td>$211 Sen. Sanders’ Estate Tax Rate of 77%</td>
<td></td>
<td>0.08%</td>
</tr>
<tr>
<td>$3,840 Impose a 10 Percent Value-Added Tax*</td>
<td></td>
<td>1.67%</td>
</tr>
<tr>
<td>Other Business Taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$433 Repeat TCJA Corporate and International Reforms</td>
<td></td>
<td>0.26%</td>
</tr>
<tr>
<td>$566 Repeat 20% Deduction for Pass-Through Businesses</td>
<td></td>
<td>0.24%</td>
</tr>
<tr>
<td>$963 Increase Corporate Income Tax Rates by 10 Percentage Points</td>
<td></td>
<td>0.44%</td>
</tr>
<tr>
<td>$476 Sen. Warren “Fair Corp. Profits Tax”</td>
<td></td>
<td>0.18%</td>
</tr>
<tr>
<td>$9 Repeat Oil and Gas Tax Preferences</td>
<td></td>
<td>0.00%</td>
</tr>
<tr>
<td>$103 Impose 0.15% “Bank Tax” on Large Financial Institutions</td>
<td></td>
<td>0.03%</td>
</tr>
<tr>
<td>$777 Financial Transactions Tax of 0.1%</td>
<td></td>
<td>0.37%</td>
</tr>
<tr>
<td>Cross-Cutting Taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$1,712 Repeat Entire TCJA (Current Policy Baseline)*</td>
<td></td>
<td>0.70%</td>
</tr>
<tr>
<td>$898 Repeat Entire TCJA (Current Law Baseline)*</td>
<td></td>
<td>0.32%</td>
</tr>
</tbody>
</table>

*Tax increase significantly includes low-income families  
Note:  
A) Estimates do not account for: 1) revenues lost to negative economic effect of policies, and 2) interactions between policies.  
B) The highest-income taxpayers currently pay a combined marginal tax rate (income, payroll, and state) of approximately 50%. Substantially higher tax rates would likely give back some of the new revenues due to reduced economic growth as well as tax avoidance.  
C) Sources: CBO, IJC, Social Security Office of the Actuary, Tax Foundation
Cross-Party Fantasies

Social Security trust fund to the rescue. Some suggest that redeeming the $3 trillion in assets held by the Social Security trust fund will shield taxpayers from the cost of Social Security’s deficits. In the first place, this $3 trillion accounts for a small fraction of the system’s $19 trillion cash deficit over 30 years. More important, the trust fund contains no economic resources with which to pay benefits—it consists of a pile of IOUs in a filing cabinet in Parkersburg, West Virginia. This $3 trillion in Social Security assets reflects a $3 trillion liability for the taxpayers, who must repay the bonds with interest over the next 16 years. All future Social Security benefits will be financed by future taxes and borrowing.

Long-term budget projections are just theory. Americans otherwise inclined to be skeptical of 30-year projections should nevertheless take these seriously. Future inflation rates are indeed anyone’s guess, but the 74 million baby boomers retiring into Social Security and Medicare are an actuarial and demographic reality. These present and future retirees exist, and the payment formulas have already been set. Furthermore, any future uncertainties are an argument for caution and prudence.

There is no hurry. Some assert that lawmakers can wait 10 or 15 years to address this challenge. Unfortunately, every year of delay raises the eventual cost of a budget fix because: 1) on average, 4 million more baby boomers retire into Social Security and Medicare, and lawmakers have generally avoided reducing benefits for those already receiving them; 2) benefit levels rise further above an affordable level; and 3) the larger national debt looks in permanently higher interest costs. The longer the reforms are delayed, the larger and more painful they must ultimately be.

Let the kids deal with the problem. The final argument against reform asserts that Social Security and Medicare benefits represent an unbreakable, unamendable promise to the elderly, consequences be damned. In reality, retirement benefits have been repeatedly expanded far beyond what current retirees were promised while they were working. For example, President George W. Bush and Congress decided in 2003 that current taxpayers would pay 75% of the prescription-drug costs of the current typical senior. This benefit was never “earned” through payroll taxes. And today’s teenagers never signed up for this budget-busting deal.

Conclusion

For decades, economists and policy experts warned that a budgetary and economic tsunami would come when the 74 million baby boomers retire into Social Security and Medicare. Nevertheless, nothing significant has been done to avert the crisis. To the contrary, both parties added a new Medicare drug entitlement in 2003, after which the Affordable Care Act further expanded federal health obligations for Medicaid and new subsidized health-insurance exchanges.

Today, one-third of the baby boomers have already retired, and another one-third will retire over the next six years. Annual budget deficits will soon pass $1 trillion on the way to $2 trillion and possibly $3 trillion in 10–15 years. Overall, the Social Security and Medicare systems face an unfathomable $103 trillion cash deficit over 30 years.

Without reform, runaway deficits will add to a debt crisis that will profoundly damage the country’s economic and social order. There is still time to avoid that crisis, but it will require the nation’s political leaders to leave their respective comfort zones and compromise.
Appendix

Rising Spending - Not Falling Revenues - Drives the Long-Term Deficit

Composition of Federal Spending, 1962-2019

Source: CBO 2018 Long-Term Budget Outlook, adjusted into current-policy baseline

Source: CNI Historical Tables 3.2, 8.5, and 10.1
Social Security’s Cash Shortfalls are Driven by Retiring Baby Boomer Costs and Resulting Interest Costs

Source: Calculated using CBO 2019 Long-Term Baseline. Revenues do not include local and interest transfers. Interest costs are those directly attributable to Social Security’s annual deficits over the period.

Medicare’s Cash Shortfalls are Driven by Soaring Benefit Costs and Resulting Interest Costs

Source: Calculated using CBO 2019 Long-Term Baseline. Outlays are net of premiums paid. Interest costs are those directly attributable to Medicare’s annual deficits over the period.
Social Security Faces a $31 Trillion Shortfall over 30 Years - $28 Trillion if Including the Trust Fund

Source: Calculated using the CBO 2018 Long-Term Budget Outlook. Interest costs reflect those directly attributable to 2019-2049 Social Security shortfalls.

Medicare Faces a $72 Trillion Cash Shortfall Over the Next 30 years

Source: Calculated using the CBO 2018 Long-Term Budget Outlook. Benefits are net of senior premiums. Interest costs reflect those directly attributable to 2019-2049 Medicare shortfalls.
The Typical Retiring Couple Will Receive $3 in Medicare Benefits for Every $1 Paid into the System — and Also Come Out Ahead in Social Security

![Graph showing Social Security and Medicare benefits comparison]


Even 100% Tax Rates on Small Businesses and Upper-Income Families Could Not Come Close to Balancing the Long-Term Budget

![Graph showing projected budget deficit by income group]

Source: CBO 2019 Long-Term Budget Outlook adjusted into current-policy baseline and analysis of IRS 2017 (latest year) income tables
1 All figures in this section were calculated by the author using the CBO’s 10-year baseline, “The Budget and Economic Outlook: 2019 to 2029,” Jan. 28, 2019, and the 30-year baseline at “The 2019 Long-Term Budget Outlook,” June 25, 2019 with the supplemental tables at https://www.cbo.gov/publication/51115. Calculations available upon request.

2 The debt held by the public generally refers to debt funded by borrowing from the public. It does not include intragovernmental debt, such as the Social Security trust fund.

3 See note 1.


5 See note 1.


7 See note 1.

8 See note 1.

9 See note 1.

10 See note 1.

11 For an overview of the research on realistic productivity rates, see Committee for a Responsible Federal Budget, “How Fast Can America Grow?” May 18, 2017.

12 Adding 0.6% to the annual economic growth rate would produce an additional $135 trillion in cumulative GDP for 2020-49, which translates to roughly $27 trillion in tax revenues and $9 trillion in interest savings on the national debt.

13 See note 4.

14 A much-hyped CBO report (“S. 744 Border Security, Economic Opportunity, and Immigration Modernization Act,” June 18, 2013) showed overwhelmingly positive budgetary effects of immigration legislation that would both increase immigration levels and provide legal status to a large number of unauthorized immigrants. The score limited most of its analysis of federal taxes and spending over 20 years. It ignored significant state and local government costs as well as longer-term Social Security and Medicare costs.

15 See note 1.

16 In 2019, antipoverty spending equals 3.9% of GDP, while nondefense discretionary spending is 3.2%.

17 The spending function tables accompanying Trump’s FY 2020 budget proposal employ what is essentially an enormous “cuts to be determined” line item to meet its proposed discretionary spending caps. See Office of Management and Budget (OMB), “Budget of the United States Government, Fiscal Year 2020,” “Table 1.1, Budget Authority and Outlays by Function, Category, and Program,” row 1153, February 2019.

18 See Scott Hodge, “News to Obama: The OECD Says the United States Has the Most Progressive Tax System,” Tax Foundation, Oct. 29, 2008. Even those figures underestimate this country’s current tax progressivity advantage because they do include the 2013 upper-income tax increases and, more important, do not include the large value-added taxes that make European tax systems even less progressive.

19 Calculated using IRS, “SOI Tax State—Individual Statistical Tables by Size of Adjusted Gross Income,” table 1.4. In 2017, the amount of income earned over the $300,000 threshold approximated 7.0% of GDP. An estimated 2.3% of GDP was paid in federal and state taxes on this income, leaving 4.7% of GDP in available take-home pay.

20 Calculated using tax estimates in chart 7.


22 This argument is most commonly associated with the talking point that Social Security is “fully funded” through 2034. Yet it is fully funded only because taxpayers will be repaying trillions to the Social Security trust fund over that period. These general revenue transfers will burden taxpayers and force up budget deficits each year.
Chairman Johnson, Ranking Member Peters:

Thank you for your invitation to appear today on this important topic. Projected fiscal shortfalls pose an important long-term challenge to U.S. policy makers. Important though debt and deficits may be, the best current economic analysis suggests that the problem of fiscal imbalance is not as urgent as it appeared to be in the past. Furthermore, this problem must take its place among the many challenges that require immediate and urgent attention. That list includes:

- restoring and upgrading the nation’s infrastructure;
- increasing resources devoted to scientific research and training;
- increasing investments in early childhood education to create a better educated and more productive citizenry;
- establishing better ways to provide and pay for the explosive increase in long-term care that will be necessary as the baby-boom ages;
- fulfilling current commitments to the elderly and people with disabilities through Social Security and Medicare and improving the structure and adequacy of these programs to help offset the consequences of rampant growth in economic inequality; and
- taking effective steps to curb emissions of greenhouse gasses and combat global warming.

Given the importance and prospective costs of meeting these challenges, the first and most important implication is that cutting taxes was, and remains, not just unwise but foolhardy.

Let me be clear, in making that statement I am not defending the current design of the U.S. personal or corporate tax system. It is riddled with perverse incentives and

---

1 Bruce and Virginia MacLaury Senior Fellow, the Brookings Institution. The views expressed here are my own and do not necessarily reflect those of the trustees, officers, or other staff of the Brookings Institution.
inequities. *Tax reform is needed. Tax cuts are not.* More revenue, not less, will be needed if the United States is to address the menu of challenges it faces today.

It is worth noting that a *tax on carbon, supported by economists aligned with both major parties, is one of those rare policy instruments that would help solve one problem and provide revenue to help pay for solutions to others.* It would encourage private sector investors and consumers to reduce greenhouse gas emissions even as it narrows the prospective gap between spending and revenues.

**Deficit Reduction**

Simple arithmetic tells us that when the budget deficit, measured as a percent of gross domestic product (GDP), exceeds the growth of GDP, the ratio of debt to GDP increases. Doug Holtz-Eakin kindly presents this arithmetic in his testimony. Doug also refers to the analysis of distinguished economist Olivier Blanchard, who pointed out in his presidential address to the American Economic Association that nominal interest rates are now below, and are expected for many years to remain below, the annual growth of nominal GDP. *Low interest rates create fiscal elbow room and reduce the threat that deficits and debt will create economic problems.*

Blanchard did not argue – and I am certainly not arguing – that low interest rates render harmless any amount of debt, however massive. What Blanchard said, and what I am saying, is that *low interest rates enable the nation to carry more debt without harm than it could if interest rates were high.* And that means that worries about growing debt should shrink in comparison to worry about the harms from failing, out of a fear of deficits, to address other urgent problems.

*The point at which deficits or debt become imprudently large is a matter of judgment. We are clearly nowhere near such a point.* Financial markets, which are not infallible but are the best source of information about future prospects, confirm that the United States is expected to remain a safe and low-risk place in which to invest. Interest rates reflect expectations about inflation and default risks. Rates on thirty-year bonds are low and differ little from those for short term assets.

If you believe, as I do,

– that the problems I listed at the start of my testimony are urgent,

– that solving them will be costly,

– that other nations, with far fewer resources than the United States, have carried debt much larger than our own, and

– that low interest rates have reduced the risks that deficits and debt pose,
then I believe you should conclude that efforts drastically to lower deficits now reflect misplaced priorities. Not further increasing deficits through pay-go rules is desirable. So is narrowing the primary budget deficit (that is, the deficit excluding interest payments), and there are ways to do so consistent with addressing the nation’s most urgent problems. But reducing the debt/GDP ratio is tomorrow’s goal.

Social Security

For at least three decades we have known that accumulated reserves and current revenues dedicated to Social Security will be sufficient to pay all scheduled benefits until sometime during the fourth decade of this century. We have also known that when reserves are depleted, balance can be restored by increasing revenues, reducing benefits, or some of both by about 1 percent of GDP. That change is not large by historical standards—we have boosted spending and revenues on Social Security by more than 1 percent of GDP on two previous occasions over periods much shorter than the interval now before us. From an economic standpoint, establishing sustainable solvency in Social Security is not a heavy lift.

The story is rather different from a political standpoint. Although most analysts—including, I suspect, all of us here today—have long thought that early action to assure sustainable balance is desirable, it has been the revealed preference of elected officials to leave to their successors that task of either raising taxes or cutting benefits.

The clear purpose of the TRUST Act (S. 2733) is to nudge Congress into action. Senators Romney and cosponsors deserve credit for trying to encourage attention to long-term gaps in major trust-funded programs. I shall comment in a moment on the TRUST Act. My purpose now is simply to point out that the fiscal challenge posed by Social Security is not large. The United States can easily afford to pay scheduled Social Security benefits—and larger benefits, as well, if the American public wants them.

Health Care

Health care spending poses more serious problems for two reasons. First, there is general agreement that Americans now spend more than they need to for the services that they receive. This problem afflicts both public and private budgets. Indeed, it is a bigger problem for private than for public budgets, as Medicare and Medicaid have done a better job of controlling spending per person than have private payers.

Second, projected increases in public health care spending is the principal cause of the growing gap between government expenditures and revenues. Projected growth of public spending on health care dwarfs that on Social Security. Increased Social Security spending is traceable entirely to a growth in the number of beneficiaries. But
the growth of spending on Medicare and Medicaid is traceable also to an increase in expenditures per person.

Much of this increase is desirable. *The nation has committed to providing the elderly and the disabled health care commensurate to that enjoyed by the rest of the population.* I hope that this commitment is unbreakable and that no member of Congress disagrees. Furthermore, much of the projected increase in health care spending will go for medical advances that all of us will celebrate.

While the overall rise in health care spending has generated enormous benefits, too much of current and projected future health care spending goes to pay for over-priced drugs and medical equipment and for services that provide little or no benefit to patients. This hearing is not the place to try to diagnose the myriad features of the U.S. health care system that cause this over-spending.

But it is the place to note that *when Congress has the chance to make some progress in curbing over-pricing, as it does in this session with respect to drug prices, it should act to do so.* The indefensible behavior of some drug companies in jacking up prices on old drugs and in pricing new drugs at astronomical levels has created a political opportunity to enact legislation that, according to estimates of the Congressional Budget Office, could save as much as half a trillion dollars over the next decade. One can only hope that Congress will not fail to act.

**The TRUST Act**

Early action to put the major ‘trust-funded’ programs on sustainable long-term footing is desirable. The beneficiaries of the major social insurance programs deserve the assurance that commitments now being made will be honored. Other things equal, it is better to act soon than to delay in addressing projected imbalances in these programs.

*These programs merit attention for reasons in addition to the looming depletion of the trust funds.* For example, over the past four decades, since Social Security was last the subject of major legislation, economic inequality in the United States has skyrocketed. The relative economic position of men and women has changed. The population of the very old, many of whom have exhausted their savings, has risen. The proportion of Americans claiming disability benefits first rose gradually and is now falling precipitously for reasons that are poorly understood. It is long past time to consider what changes in these programs should be made.

- Should long-term, low-wage workers be provided with more generous benefits than Social Security now provides? If so, how?

- Should long-term beneficiaries be provided some protection against the likely erosion of other assets?
• Should Social Security benefits be modified because life-expectancy of high earners has risen but life-expectancy of low earners has stagnated or fallen?

• In light of the growing recognition of the importance of early childhood development, should Social Security provide some credit to parents of young children who remain at home?

Modifying Social Security in light of these changes is not just a matter of trust fund balance. Issues such as these should be considered along with trust fund balance and in a venue that will encourage their consideration. The rescue committee envisioned in the TRUST Act is not such a venue.

_The committee envisioned in the TRUST Act, in my view, is a particularly poor venue for designing changes in Medicare._ A large part of the projected growth of Medicare spending depends on the progress of medical science. Anticipating the state of medical science seventy-five, or even twenty-five years, in the future is a proper subject for science fiction, not legislators. No one can reliably forecast the medical interventions that will be available fifty or seventy-five years from now. It would be indefensible to determine the medical services available now to the elderly or people with disabilities based on assumptions that can be little more than guesses about the medical technology that will be available decades in the future and what it will cost. But that is just what the committee that would be created under the TRUST Act would be asked to do ... and under expedited legislative procedures.

To be sure, the Medicare actuaries now make seventy-five-year projections and publish estimates of trust fund balance over that period. But Congress has had the good sense not to let these projections govern Medicare legislation. Congress has taken care to assure that Hospital Insurance is adequately funded, typically for ten to fifteen years, sometimes a bit more or less. When imbalance has moved uncomfortably close, Congress has taken action to maintain program integrity. _Wisely, Congress has never legislated to achieve actuarial balance based on a long-term projection that, despite the best efforts of capable professionals, contains little of informational value._ And, I very much hope that it never will.
U.S. PUBLIC AND PRIVATE LIABILITIES AND ASSETS

- Federal pensions: $8t
- Social Security: $43.2t
- Medicare: $80.3t
- State, local govt.: $8.4t
- Households: $16.4t
- Federal govt.: $21t
- Businesses: $36.7t

$144t All private net assets (U.S. private net worth)
$218 trillion total

Federal Reserve, Treasury, Social Security and Medicare trustees
30-YEAR PROJECTED DEFICITS
FOLLOWING CBO ALTERNATE ASSUMPTIONS

TRILLIONS OF DOLLARS

0 20 40 60 80 100 120 140

2020-29 2030-39 2040-49 30 years

$12t $38t $82t $133t $144t

All private net assets

Congressional Budget Office, Office of Management and Budget, Federal Reserve
## INCOME STATEMENT for the federal government: FY2020 to FY2049

Congressional Budget Office's baseline + alternate fiscal assumptions

<table>
<thead>
<tr>
<th></th>
<th>Outlays</th>
<th>Revenue</th>
<th>Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$73,479</td>
<td>$60,030</td>
<td>$13,479</td>
</tr>
<tr>
<td>Social Security</td>
<td>6.1%</td>
<td>5.0%</td>
<td>11.0%</td>
</tr>
<tr>
<td>Medicare</td>
<td>21.4%</td>
<td>17.5%</td>
<td>38.9%</td>
</tr>
<tr>
<td>Medicaid/Omamacare</td>
<td>9.5%</td>
<td>8.2%</td>
<td>9.3%</td>
</tr>
<tr>
<td>Mandatory other</td>
<td>48.9%</td>
<td>32.1%</td>
<td>31.1%</td>
</tr>
<tr>
<td>Interest expense</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

### Outlays:
- Defense: 40,025 (3.5%, 12.4%)
- Nondefense mandatory: 4,908 (3.4%, 11.9%)
- Medicaid/Omamacare: 34,084 (2.9%, 18.1%)
- Mandatory other: 33,909 (2.7%, 9.9%)
- Interest expense: 98,068 (0.8%, 17.1%)

### Revenues:
- Individual income tax: 112,414 (5.3%, 52.4%)
- Corporate tax: 12,412 (1.2%, 5.9%)
- Excise taxes: 4,907 (0.3%, 1.9%)
- Estate and gift tax: 3,967 (0.2%, 1.0%)
- Custom fees, duties: 3,964 (0.3%, 1.6%)
- Miscellaneous rev: 2,389 (0.3%, 2.0%)

### Total rev, outlays, deficit:
- 343,479 (26.4%, 100.0%)
- 210,038 (17.4%, 100.0%)
- 133,441 (11.5%, 100.0%)

30yr GDP: 1,290,067

*Note: All percentages are rounded to the nearest tenth. Deficit is calculated as the difference between revenue and outlays. The budget balance and GDP are measured in chained 2012 dollars, and natural rates of unemployment are based on the Congressional Budget Office's alternative fiscal assumptions.*
AVERAGE INTEREST RATE
BY DECADE

1970 to 1999 average: 5.3%

Rate gap 3.8%

Office of Management and Budget
Progress toward **Simpson-Bowles goals**

Figures are savings or revenue increases over 2012-20 relative to Simpson-Bowles "plausible baseline."

*Figures are in billions.*

<table>
<thead>
<tr>
<th>Original Simpson-Bowles</th>
<th>By 2014, we had enacted 81% of Simpson-Bowles</th>
<th>Today, we’ve backtracked to 42% of Simpson-Bowles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue increase</td>
<td>996</td>
<td>700</td>
</tr>
<tr>
<td>Discretion savings</td>
<td>1,661</td>
<td>2,100</td>
</tr>
<tr>
<td>Health care savings</td>
<td>342</td>
<td>1,742</td>
</tr>
<tr>
<td>Mandate savings</td>
<td>215</td>
<td>(255)</td>
</tr>
<tr>
<td>Social Security</td>
<td>238</td>
<td>301</td>
</tr>
<tr>
<td></td>
<td>3,452</td>
<td>2,800</td>
</tr>
<tr>
<td>Interest savings</td>
<td>673</td>
<td>545</td>
</tr>
<tr>
<td></td>
<td><strong>4,125</strong></td>
<td><strong>3,345</strong></td>
</tr>
</tbody>
</table>

Statement for the Record
by the
American Federation of State, County and Municipal Employees (AFSCME)
on
“Examining the Root Causes of America’s Un sustainable Fiscal Path”
Before the Committee on
Homeland Security and Governmental Affairs
of the United States Senate
on
January 28, 2020

The American Federation of State, County and Municipal Employees (AFSCME) is pleased to submit this statement for the record on “Examining the Root Causes of America’s Unsustainable Fiscal Path.” AFSCME is the nation’s largest and fastest growing public services employee union. AFSCME’s 1.4 million members provide the vital services that make America happen. We are nurses, corrections officers, child care providers, EMTs, sanitation workers and more. With working members in hundreds of different occupations and retirees across the country, AFSCME advocates for fairness in the workplace, excellence in public services and prosperity and opportunity for all working families.

AFSCME has a vital interest in the fiscal sustainability of the nation and is keenly focused on the ability to finance public services at all levels of government. Efforts to blame essential safety net programs, like Social Security, Medicare, and Medicaid programs, and other services are misguided. These hugely successful programs do not contribute to an unsustainable fiscal path. On the contrary, they very much contribute to fiscal stability in the country for millions of Americans and they help drive the economy for working families. Instead of cutting these and other domestic services, they must be guaranteed and expanded for future generations. Any discussion of fiscal sustainability must start with sound investments in proven services, which people depend upon and that strengthen the economy. The discussion must also focus on needed revenues to sustain these programs, as well as an equitable tax code, where everyone pays their fair share.

No Benefit Cuts to Social Security, Medicare and Medicaid

Social Security, Medicare and Medicaid are all critical federal programs that promote income stability and health care coverage among tens of millions of U.S. families. As important as these programs are for the U.S. economy, they are even more important for individuals and families in need, especially the elderly, orphans, homeless, and people with life changing disabilities or terminal illnesses. Rather than falsely blaming these programs and then proposing deep cuts, as some advocate, AFSCME believes they must be maintained and even expanded. For this reason, we strongly oppose any fast-tracked federal budgetary process that is designed to cut these benefits under the guise of reducing the national deficit.

For over 83 years, Americans have relied on Social Security to provide efficient and reliable wage insurance to tens of millions of retirees, surviving spouses and children, and individuals with disabilities. It is one of the most successful programs in history. Without Social Security benefits, about 4 in 10 Americans aged 65 and older would have incomes below the
poverty line according to official estimates based on the 2018 Current Population Survey. Social Security benefits lift more than 15 million elderly Americans out of poverty and annually adds over $1 trillion in stimulus to the U.S. economy. Social Security recipients typically spend their benefits on goods and services pumping it back into the economy. This spending helps businesses that produce the goods and services, creates jobs for their workers, and even generates tax revenues back to the government. This creates a powerful multiplier effect that benefits the economy, businesses and workers.

Equally, for more than half a century the guaranteed health coverage through Medicare and Medicaid has helped Americans visit a doctor and get hospital care. Medicare and Medicaid together provide millions of families with the peace of mind that comes with knowing you have health coverage. Both are success stories that have improved health across generations and reduced poverty. Unfortunately, some misguided advocates want to turn back the clock, so they constantly and incorrectly criticize Medicare and Medicaid and attempt to reduce benefits and coverage.

Medicaid covers one in five low-income Americans, including many with complex and costly needs. Medicaid helps one in five Medicare enrollees, with their Medicare premiums and cost-sharing. Medicaid, not Medicare, provides long-term services. In addition, Medicaid spending is particularly sensitive to economic downturns as it provides health benefits to those hit the hardest by an economic downturn in a state. Federal support of Medicaid helps spur economic growth, preserves health services, and reduces pressures to cut other services and aid to local governments.

Despite the success of these programs, there are clear threats from proposals before this committee, like the TRUST Act (S. 2733). The TRUST Act and other similar proposals are poorly designed ways to weaken and discredit the integrity of these sound programs. There are already comprehensive procedures in place to address solvency and other potential concerns. For example, Trustees and agency actuaries already annually review and report on solvency and related issues. Currently, there is no need to go beyond the current legislative protections safeguarding current and future beneficiaries. Furthermore, there is no reason to create a new structure within Congress – given that the current committees of jurisdiction already have oversight power and legislative authority in this policy arena. Consequently, AFSCME strongly opposes the TRUST Act and similar measures.

**Federal Investments are Necessary to Meet Our Most Urgent Needs**

In many ways the American economy is not working for working people. Years into a strong economic recovery, its corporations and the 1% are doing well, while incomes for ordinary Americans have stagnated. When many citizens must rely on public services more than ever, these services have been systematically cut and are now so grossly underfunded, they struggle to meet the challenges our communities face. To make the economy work for all Americans, Congress must increase investments in public programs to lift families out of poverty, feed hungry children, provide vital job training, expand access to affordable college, rebuild schools and so much more. This investment will lead to increased wages and greater economic equality. Many of these programs are also drivers of the economy.
Any fiscal policy must reverse these trends and must start with reinvesting, not just in the American economy broadly, but in American workers and the public services they rely on. To help create an economy that works for all of us, AFSCME believes we must:

- Restore and strengthen the rights of workers to negotiate better wages, benefits and working conditions.
- Support working families by increasing support for child care, early childhood and higher education, job training, ensuring workers can take paid sick and family leave, and ending pay and employment discrimination against women and people of color.
- Expand retirement security by protecting public pension systems, protecting and expanding Social Security, and increasing opportunities for retirement savings without having to pay exorbitant fees.
- Reinvest in public services by restoring funding to the neglected public workforce, institutions and infrastructure.
- Create a tax system where everybody pays their fair share.

**Adequate Revenues Needed to Invest in America and Ensure Everyone Pays Fair Share**

One major cause of America’s fiscal problems is that our rigged and broken federal tax system is riddled with loopholes that allow large profitable corporations and the wealthiest one percent to avoid paying their fair share of taxes, which raises the tax burden on working families and deprives Americans of revenues needed to invest in health care, education, job training, and other vital public services. Our federal tax system should be much more progressive. It should raise needed revenues to support and create high road jobs and to make the necessary investments that assist children, families, seniors and our communities. At the very least, Congress should make profitable corporations and the wealthy pay a minimum tax so we can invest in and develop an economy that works for all Americans.

Congress can and should raise significant new progressive revenues by closing tax loopholes, increasing marginal tax rates on top earners and the wealthy, taxing investment income the same as wages, raising the corporate tax rate, eliminating tax incentives that encourage firms to send jobs and profits overseas, and repealing tax giveaways for millionaires in the Trump-Congressional Republican tax plan of 2017 (TCJA). To address the root causes of America’s current fiscal imbalance, AFSCME believe we must reduce income and wealth inequality, and end the tax system rigged against working families. In addition, Congress must ensure the wealthiest and largest, profitable corporations pay their fair share.

**Conclusion**

Thank you for the opportunity to submit testimony on this important set of fundamental fiscal and economic issues. AFSCME strongly believes we must begin to create an economy that works for all Americans and not just for big corporations and the wealthy few. Now is the time for
budget and tax fairness that meets the needs of ordinary Americans and ensures quality public services for all. We must do this with new investments and significant new revenues to pay for common good services and benefits, like education, health care, public safety, road and bridges and so much more. Our nation's fiscal and economic policy must prioritize human needs.
Statement of Nancy J. Altman\(^1\), J.D.
President, Social Security Works
Chair, Strengthen Social Security Coalition

HEARING ON EXAMINING THE ROOT CAUSES OF AMERICA'S UNSUSTAINABLE FISCAL PATH

Committee on Homeland Security and Governmental Affairs
January 28, 2020

Chairman Johnson, Ranking Member Peters, and Members of the Committee:

Thank you for holding today’s hearing on the root causes of the federal government’s current and projected fiscal path. This statement will focus first on the financial position of our Social Security system and its Old Age, Survivors’, and Disability Insurance Trust Funds. It will next discuss, in turn, Medicare the Highway Trust Fund and the federal government’s general operating fund. The statement will conclude with a discussion of reconciliation and other fast-tracked processes for addressing these various programs and funds.

Social Security’s Strong Financial Status

Several dozen actuaries employed at the Social Security Administration have the job of projecting Social Security’s income, outgo, and reserves over an infinite time horizon. This long valuation period is in sharp contrast to most federal spending, which is projected out just five or ten years.

Every year, Social Security’s Board of Trustees reports the actuaries’ projections to Congress. The most recent report to Congress, transmitted last April 22, shows that Social Security’s financial position is strong.

According to that 2019 report, Social Security is 100 percent funded for the next decade and a half, 93 percent funded for the next quarter century, 87 percent funded for the next half century, and 84 percent funded for the next three quarters of a century.

For context, it is instructive to note that when Congress enacted the Pension Protection Act of 2006, it established three categories of multiemployer plans, based on the strength of their funding and ability to pay promised benefits. Plans that are deemed in critical condition are said to be in the red zone; plans that are “endangered,” in the yellow zone; and healthy plans, in the green zone. By these criteria, Social Security is in the green zone.

---

\(^1\) I have a forty-five-year background in the area of Social Security. I am president of Social Security Works and chair of the Strengthen Social Security Coalition, comprised of over 300 national and state organizations representing 50 million Americans, including seniors, workers, women, people with disabilities, veterans, children, young adults, people of color, communities of faith, and others. From 1983 to 1989, I was on the faculty of Harvard University’s Kennedy School of Government and taught courses on private pensions and Social Security at the Harvard Law School. In 1982, I was Alan Greenspan’s assistant in his position as chair of the bipartisan commission that developed the 1983 Social Security amendments. From 1977 to 1981, I was a legislative assistant to Senator John C. Danforth (R-Mo.) and advised him regarding Social Security. From 1974 to 1977, I was a tax lawyer with Covington & Burling, where I handled a variety of private pension matters. I have authored or co-authored three books on Social Security as well as numerous articles.
As the following chart illustrates, Social Security’s costs, as a percentage of Gross Domestic Product (GDP) is essentially a straight horizontal line for the foreseeable future.

Social Security’s benefit levels are extremely modest by virtually any measure. In absolute terms, the average monthly Social Security benefit in November 2019 was $1,358.82, or $16,305.84, on an annualized basis. That is below the 2019 official federal poverty level for a two-person household, and substantially below the amount needed to satisfy the Elder Economic Security Standard Index, a sophisticated measure of the income necessary to meet bare necessities. Social Security’s benefits are also extremely low compared to the retirement benefits of other industrialized nations, as the following chart reveals. (The bars designating U.S. benefits are highlighted with arrows.)

Most importantly, Social Security does not come close to providing sufficient income to meet the goal of maintaining standards of living in retirement. Workers earning around $50,000, who retired at age 62 in 2018, received only 32 percent of their pay or about $16,000 a year. Lower-income workers, earning around $22,500, received 43.2 percent of their pay, but that is only
about $9,700 a year. Workers earning around $80,000, who retired at age 62 in 2018, received only 26.6 percent of their pay or about $21,000 a year. Those already low replacement rates will be even lower in the future, as cuts past Congresses enacted are fully phased in.

Moreover, the latest trustees report projects that Social Security’s administrative costs are impressively low. Less than a penny of every Social Security dollar is spent on administration. The rest — more than 99 cents of every dollar — is paid in benefits. That extremely low administrative expense is unachievable by employer-sponsored retirement plans or private insurance.

According to the most recent trustees report, Social Security is calculated to cost just 6.07 percent of GDP at the end of the 21st century, in 2095. That is a lower percentage of GDP than many other industrialized countries spend on their counterpart programs today, as the following chart shows.

The increase of just over one percent of GDP between now and the end of the century should not be difficult to absorb. To put that projected increase in perspective, military spending after the 9/11 terrorist attack increased by 1.3 percent of GDP between 2001 and 2005, as a result of the Iraq and Afghanistan wars—and that increase was the result of a surprise attack, with no advance warning. Similarly, spending on public education nationwide increased by 2.8 percent of GDP between 1950 and 1975, when the baby boom generation showed up as schoolchildren, without much advance warning.

Moreover, our nation is projected to be much wealthier at the end of the 21st century, just as we are wealthier now than we were seventy-five years ago, before computers, smartphones, and other technological advances. That means that the 6 percent of GDP will be easier to afford in the future, just as an individual earning $100,000 can more easily afford a 6 percent expenditure (despite it being a larger dollar amount) than an individual earning $10,000. In one case, $94,000 remains; in the other, just $9,400.
The Law Precludes Social Security From Adding to the Federal Debt

Senators, members of Congress and Democratic presidential candidates have championed detailed proposals to eliminate the modest shortfall, still more than a decade away and just 16 percent of overall projected costs over the remainder of the century. A number of the proposals have been carefully analyzed by the Social Security Administration’s Office of the Actuary. The analyses, available on the Office of the Chief Actuary website, finds that these proposals restore Social Security to long-range balance over varying valuation periods.

One bill, the Social Security 2100 Act, so named because it restores Social Security to balance through the year 2100 and beyond, has over 200 cosponsors in the House of Representatives and has had a number of hearings before both the Full Ways and Means Committee and its Social Security Subcommittee. In the Senate, three bills that extend Social Security’s solvency have been sponsored or cosponsored by eleven members. Moreover, in 2015, a Senate resolution to expand Social Security and restore it to long range actuarial balance received the support of every Democratic Senator but two.

To date, no Republican members have sponsored or cosponsored legislation in the current Congress that extends Social Security’s solvency and no Republicans voted for the 2015 Senate resolution. Nevertheless, there appears to be a growing interest among Democratic presidential candidates to make Social Security a campaign issue, and growing interest among Democratic members of the House of Representatives to move on substantive Social Security legislation.

Even if Congress were to take no action whatsoever to restore Social Security to long range balance, though, Social Security would not add a penny to the federal debt.

- The Law Precludes Social Security from Deficit Spending

By law, Social Security cannot add a penny to the federal debt subject to limit, nor to the annual deficits which comprise that debt. Social Security can only pay benefits if it has sufficient revenue to cover all the costs. Its dedicated revenue must equal or exceed its outgo to pay benefits, and it has no borrowing authority, so it cannot simply borrow the funds to make up the shortfall. Social Security lacks the legal authority to deficit-spend, and so, cannot run a deficit. Because it cannot run a deficit, it cannot add to the federal deficit or debt.

Indeed, not only is Social Security not a contributor to the federal debt subject to limit, it is a creditor. Currently, the federal debt subject to limit is over $23 trillion. Approximately $2.8 trillion of that $23 trillion is owed to Social Security. This notion of Social Security as a creditor of the United States is an important concept which has been misunderstood over the history of Social Security. Indeed, to clear up misunderstandings, the staff of the 1957-59 Social Security Advisory Council on Social Security Financing wrote a lengthy memorandum, entitled “Misunderstandings of Social Security Financing.” In it, the staff explained, “The purchase of

2 Although economists use different definitions when speaking of the nation’s annual deficit, the straightforward, common understanding is that the annual deficit is simply the portion of the accumulated federal debt incurred in any particular year, which in how it is used here.
Federal obligations by the trust funds does not increase the total Federal debt. If there were no trust funds, the Treasury would still borrow just as much, all of it from other investors.”

- **Current Law Contains an Automatic Cap on Social Security Spending**

If Social Security were ever to lack sufficient revenue to cover the cost of scheduled benefits, the law provides that those benefits be reduced or delayed automatically. The law specifies that benefits are only as large as Social Security’s dedicated revenue allows. Therefore, though Social Security can project a shortfall, it is incapable of running short of money. That is why the Social Security actuaries project that, if Congress were to take no action whatsoever, Social Security’s outgo would automatically be reduced or delayed, starting in 2035, to match the incoming revenue.

**Medicare’s Financial Status is a Symptom of Rising Health Costs, Private as well as Public**

In contrast to Social Security’s modest and level costs, Medicare is projecting costs that constitute a growing percentage of GDP. However, these growing costs are symptoms of unsustainable health care costs, private as well as public.

As the following CBO chart reveals, if health care costs—private and public—were to continue to rise over the foreseeable future as they did historically, those costs would consume a whopping 99 percent of GDP in seventy-five years. Obviously, not even a country as wealthy as the United States can spend 99 percent of its GDP on health care.
O produced that chart in 2007, prior to the enactment of the Affordable Care Act, which sed health care costs to slow. The next chart, also produced by CBO, uses more recent data projects out fewer years, but the basic trend is the same.

![Projected Health Care Spending, Especially in Private Sector, Is the Problem](image)


At these figures make clear is that the rising costs of Medicare and Medicaid are symptoms of inefficient and overly expensive health care system, not causes. Indeed, Medicare’s administrative costs are lower than those in the private sector. According to the most recent "Stee Report," Medicare spent just 1.3 pennies of every dollar on administrative costs in 2018. Other nearly 99 cents were spent on health care. In contrast, the administrative costs private health insurance are generally more than 12 percent. Indeed, it took the Affordable Act to limit insurance companies to spending no more on administrative costs than 20 percent of patient premiums.

Noteworthy that Medicare covers seniors and people with disabilities. These are people who, on average, the most expensive and chronic medical conditions and therefore require the most numbers of doctor and hospital visits. Accordingly, they have the largest number of health care claims. Yet, Medicare is significantly more efficient than commercial health.
Even more striking, Medicaid, which has the complicated administrative burden of means-testing those it covers, also has much lower administrative costs than private insurance—just five percent or less.

If the United States had the same per capita health care cost as other industrialized countries, our nation would project long-term federal budget surpluses for the foreseeable future. Indeed, the Center for Economic Policy Research has an online calculator that allows you to see the budget surpluses that would accrue if the United States had the same per capita health care costs of other industrialized nations, all of whose residents have longer life expectancies than Americans.

When the cause of Medicare’s rising costs is clearly seen, the solution becomes clear as well. Unlike Social Security, where the United States spends a lower percentage of GDP than the rest of the industrialized world, the nation spends a much higher percentage of GDP on health care, without universal coverage and with inferior health outcomes, because our patchwork system is so inefficient. This is true for health care costs overall and for prescription medications, for which Americans pay the highest prices in the world.

Within the Democratic Party, there is an active debate about whether to build on the Affordable Care Act or improve Medicare and extend it from those age 65 all the way to birth. Both approaches will dramatically lower prices and save substantial sums. Moreover, policymakers in both Parties are exploring proposals that lower drug prices and save significant monies, as well.

The Highway Trust Fund is a Small Percentage of Federal Spending

The Highway Trust Fund is running a significant deficit that is projected to continue. While this should be addressed, it is an insignificant contributor to the nation’s fiscal path. The difference between Highway Trust Fund outlays in 2019 and that year’s dedicated revenue amounted to about one-quarter of one percent of total federal expenditures. Consequently, the Highway Trust Fund is contributing a tiny amount to the nearly $1 trillion deficit the government is currently running.

The General Fund is the Major Cause of the Nation’s Current and Projected Fiscal Path

As stated above, Social Security does not add a penny to the federal debt. Indeed, Social Security has always maintained an accumulated surplus. In stark contrast, the government’s general fund, over the last half century and longer, has run a deficit every year but two.

The enormous increase in defense spending since the terrorist attacks of 9/11, coupled with the substantial tax cuts since the attack, are the major reasons that the nation is today running large and growing deficits. According to the Costs of War Project at Brown University, the United States has appropriated or obligated $5.9 trillion, in inflation adjusted dollars, on the War on Terror from the terrorist attack on 9/11 through the end of fiscal year 2019. During that same period, federal receipts went from 19.75 percent of GDP in 2000 to 16.17 percent of GDP in 2018.
Reconciliation is the Way to Restore Fiscal Balance

The federal budgetary process includes reconciliation to reduce the nation’s deficits in the federal general fund, as well as Medicare, and can raise the gas tax or other revenue for the Highway Trust Fund. Reconciliation specifies a fast-tracked process that limits debate in the Senate and forces action.

Social Security is excluded from reconciliation for important and sound reasons. As explained above, Social Security does not and, by law, cannot add to the federal debt or deficit. Moreover, also as explained above, it has an automatic reconciliation within its provisions, if its outgo were ever to exceed its annual income and accumulated reserves.

Keeping Social Security out of the reconciliation process is not only sound, but provides an important byproduct, as well. Including Social Security in a comprehensive deficit package is likely to create deep and understandable suspicion, and perhaps even anger, among the American people.

By law, workers’ Social Security contributions can only be used for benefits and associated administrative costs. That requirement is not just the operation of law; it represents the solemn, longstanding, fiduciary responsibility of the government, as the plan sponsor.

Historically, Congress has been extremely diligent and careful in executing its fiduciary responsibility with respect to Social Security’s income and assets. From the program’s origin, Congress has required Social Security’s trustees to invest all surpluses in the safest, most conservative investment possible -- interest-bearing debt instruments backed by the full faith and credit of the United States. Congress has also required those trustees to report annually -- no matter the circumstances, even during wartime and other times of national emergency -- on those contributions and those surpluses which are in reserve, available whenever the monies are needed to pay scheduled benefits.

Currently, Social Security has an accumulated reserve of more than $2.8 trillion. Diverting Social Security’s dedicated income and assets from their intended purpose is legally and morally wrong. Too many Americans believe that Congress has done just that -- stolen their Social Security contributions. Too many others are uncertain or worried that Congress will steal Social Security’s income and assets to use for other unauthorized purposes, including debt reduction.

The reason for this widely-held anxiety is easy to understand. The American people have been bombarded with irresponsible rhetoric about Social Security. For example, some policymakers have casually referred to the interest-bearing United States Treasury bonds purchased by Social Security as “just IOUs.” These policymakers fail to acknowledge that the expression could be used for all Treasury obligations backed “just” by the full faith and credit of the United States.

Similarly, some elected officials have warned ominously that Social Security’s reserves have already been spent, again not acknowledging that whenever a corporation or governmental entity issues bonds, it does so to raise needed funds, which it plans to spend; investors understand and expect that the funds will be spent and repaid out of future revenue.
All of this casual, irresponsible rhetoric is a serious disservice to the American people and explains why so many Americans believe that their contributions have been stolen. To package Social Security with legislation dealing with other federal spending programs risks reinforcing the widespread belief that Congress is improperly commingling Social Security’s dedicated monies with the government’s non-dedicated revenue.

Fast Tracking Social Security has Been Tried and has Failed

Including Social Security in a fast tracked process that is not reconciliation would have all of the flaws outlined above. Moreover, it has already been tried several times over the last decade and failed.

In late 2009, the then-Chair and Ranking Member of the Senate Budget Committee sought a commission to make recommendations about reducing the federal deficit. The proposal would have fast-tracked the recommendations explicitly to bypass the Senate’s unlimited debate and ability to amend. The proposal failed, opposed by the then-Chair of the Senate Finance Committee who asserted, “It is clear from their press release that Senators Conrad and Gregg have painted a big red target on Social Security and Medicare. That’s what this commission is all about.”

Notwithstanding the failure of the Conrad-Gregg proposal, then-President Obama, shortly after the Conrad-Gregg legislation was defeated, issued an executive order establishing a commission, chaired by Erskine Bowles and Alan Simpson, with a similar charge. Though the President could not require Congress to fast-track the recommendations, he reportedly secured the agreement of the leadership of Congress that if the commission’s recommendations secured the support of fourteen of the eighteen members, they would receive a speedy vote. The co-chairs proposed deep cuts in Social Security, among other proposals, but the recommendations failed to obtain the support needed for the recommendations to be fast tracked.

Undeterred in the effort to secure a so-called Grand Bargain, a so-called Supercommittee was established, the following summer, as part of a bipartisan agreement to raise the debt ceiling, with a similar charge to the Conrad-Gregg proposal and Bowles-Simpson Commission. This too failed to reach agreement.

There is no reason to think another fast-tracked process would be more successful now. Nor should it be tried. An expedited procedure, which limits debate and prohibits all amendments, would be unprecedented.

Throughout Social Security’s long history, advisory councils and commissions have been used frequently. Their recommendations, however, have never been fast tracked. Congress has always used the normal legislative process when considering those recommendations.

The normal legislative process was followed in 1983 when Congress considered and largely enacted the recommendations of the National Commission on Social Security Reform,
colloquially known as the Greenspan Commission, after its chair, Alan Greenspan, whom I
staffed.

The success of the Greenspan Commission was largely due to its diverse membership, which
included prominent representatives of labor, business, seniors, women, and other groups vitally
affected by Social Security. It was not an effort to avoid political accountability or force action
of unpopular proposals.

**How to Enact Social Security Legislation**

The best way to move forward on Social Security is to embrace proposals that are
overwhelmingly popular with the American people and avoid proposals that are not.
Fortunately, as polarized as the American people are over many issues, we are united in our
agreement about Social Security.

Support for Social Security benefit expansions and opposition to benefit reductions cut across
ideological divides. Poll after poll finds that an overwhelming majority of Republicans,
Independents, and Democrats share these views. They are held by self-identified Tea Partiers and
union households. All ages, genders, income levels, races, and ethnicities hold these views.

Last March, for example, the Pew Research Center released a poll showing that 74 percent
believe that Congress should make no cuts to Social Security whatsoever. The poll subdivides
that overall percentage by age, education and party affiliation. Those aged 50 to 64 represented
the highest percentage, 81 percent. College educated and those aged 18 to 29 accounted for the
lowest percentage, but even 64 percent and 65 percent of those categories respectively oppose
benefit cuts.

Moreover, even those overwhelming percentages may underestimate the desire that benefits not be
cut, because the question was poorly worded, asking respondents whether they agreed more
closely with the statement, “Social Security benefits should not be reduced in any way,” or the
statement, “Some reductions in benefits for future retirees will need to be made.” (Emphasis
added.)

The second choice reflects the widespread but mistaken belief that Social Security is
unaffordable and, therefore, needs to be cut. The chart, showing that Social Security’s cost as a
percentage of GDP is close to a straight horizontal line for the next three-quarters of a century
and beyond, makes clear that the question of whether to cut Social Security is one of values, not
affordability.

Notwithstanding the clear affordability of Social Security, some of the 25 percent of Pew poll
respondents who answered that “Some reductions in benefits for future retirees will need to be
made,” may have simply been indicating their belief that the statement was accurate, despite
their preference for no cuts.

Another poll highlighting the overwhelmingly strong opposition to benefit cuts across the
ideological spectrum surveyed supporters of the major presidential candidates still in the race in
March 2016. To the proposition, “Social Security benefits should not be reduced,” 62 percent of Kasich voters, 66 percent of Cruz voters, 71 percent of Clinton voters, 72 percent of Sanders voters, and 73 percent of Trump voters agreed. It is noteworthy that then-candidate Trump stood out as the one Republican who promised not to cut Social Security.

Americans favor expanding Social Security by similarly overwhelming percentages. In the lead-up to the 2018 midterm elections, Public Policy Polling found that two out of three respondents — 66 percent — would be more likely to vote for a candidate who “supported expanding and increasing Social Security.” Similarly, a survey conducted for the National Academy of Social Insurance in 2014 by Greenwald & Associates found that 72 percent agreed that “we should consider increasing Social Security benefits.”

There is also widespread agreement about how to pay for the expansions and the restoration of Social Security to long-range actuarial balance. The same National Academy survey found that 77 percent of respondents, including 69 percent of Republicans, supported “increasing the Social Security taxes paid by working Americans,” if needed to “preserve Social Security benefits for future generations.” Those percentages increased to 83 percent of all respondents and 71 percent of Republicans, when the question was whether “top earners” should pay more. Similarly, an AARP poll found that 61 percent agree, “It would be better to pay more into Social Security now to protect benefits for future generations.”

The bills, introduced in the current Congress, that restore Social Security to long range balance, track the views revealed by these and other polls and surveys. They expand benefits without cuts and pay for the expansions, as well as the restoration of Social Security to long-range actuarial balance, by requiring the wealthiest to pay more, and, in the case of the Social Security 2100 Act, requiring working Americans to pay more, as well.

Conclusion

To the extent Congress believes that a fast-tracked process is useful to reduce the federal deficit, reconciliation is the appropriate vehicle to use. However, in addressing legislation regarding Medicare or other federal health care programs, it is imperative to evaluate changes not just in budgetary terms but in terms of what the programs were enacted to accomplish. Moreover, they should not be viewed in a vacuum, separate and apart from the nation’s overall health care system.

With respect to Social Security, the late Robert M. Ball offered policymakers profound advice. Ball remains the longest serving commissioner in the history of Social Security. At the time of his death in 2008, at the age of 93, he was the world’s leading expert on the American Social Security system.

Ball had played a key role on the Greenspan Commission. Concerned that today’s policymakers were taking the wrong lessons from the Greenspan Commission, he wrote The Greenspan Commission: What Really Happened, published in 2010, just after the Conrad-Gregg legislation had been defeated and the Bowles-Simpson Commission had been created. In it, Ball cautions:
“...[T]o suggest that the Greenspan Commission provides a model for resolving questions about Social Security’s future would be laughable if it were not so dangerous. Democrats in Congress who believe in strengthening rather than undermining Social Security should be willing to stand up for what they believe – preferably with a strong supporter in the White House – but stand up in any case. A commission is no substitute for principled commitment.”
Statement for the Record for the Committee on Homeland Security and Government Affairs on “Examining the Root Causes of America’s Unsustainable Federal Debt”

January 28, 2020

Chairman Johnson, Ranking Member Peters, and Members of the Committee:

Thank you for the opportunity to submit this statement on the important topic of “Examining the Root Causes of America’s Unsustainable Fiscal Path.”

Our national debt is higher than it has ever been as a share of the economy, other than at the end of World War II. Under current projections it will continue to grow to unprecedented levels, stifling economic and wage growth, driving up interest payments, reducing fiscal space, and increasing the small risk of a fiscal crisis.

No single cause can fully explain this unsustainable fiscal situation. Two key factors loom large, however. First, lawmakers’ failure to abide by pay-as-you-go principles has resulted in a series of recent unpaid for tax cuts and spending increases. Roughly half of the deficit this year is the direct result of legislation enacted over the past four years (see Appendix A). In fact, we have added over $4 trillion to projected ten-year deficits since 2017 (see Appendix B).

At the same time, health and retirement spending continue to grow rapidly. Between 85 and 90 percent of projected nominal spending growth over the next decade is the result of the rising costs of Social Security, federal health care programs, and interest on the debt (Appendix C).

Fortunately, it is not too late to address these drivers. Abiding by PAYG principles on new spending and securing Social Security, Medicare Part A, and the highway trust funds – through revenue and/or spending adjustments – would go a long way toward improving our long-term debt outlooks (Appendix D). Further efforts to raise revenue and control spending – especially health care spending – will also be needed.

The Time to Restore United States Trusts (TRUST) Act, introduced by Senators Romney and Marcy and Representatives Gallagher and Case, would establish an innovative process to begin addressing these root causes (see Appendix E), and it has already earned broad support (Appendix F). Congress should support this effort, in combination with other legislation to reduce health costs, raise revenue, reform the budget process, reduce spending, and save Social Security.

We welcome your attention to fiscal responsibility and sound management.
Appendix A

Fiscal Irresponsibility Will Double Budget Deficits

The Tax Cuts and Jobs Act, Bipartisan Budget Act of 2018, and other legislation enacted since 2015 are responsible for about 83 percent of the $984 billion budget deficit in FY 2019. The tax law and this year’s spending deal (the Bipartisan Budget Act of 2019) are expected to add even more to the deficit in FY 2020 ($272 billion and $98 billion, respectively), pushing it over $1 trillion for the first time since 2012.

Recent Legislation Will Double Budget Deficits

Published as part of “Our Top Fiscal Charts of 2019”

Appendix B

President Trump has Signed $4.7 Trillion of Debt into Law
January 8, 2020

Our US Budget Watch 2020 project analyzes, estimates, and explains the fiscal implications of proposals introduced during the presidential campaigns. These proposals offer important insights on each candidate’s fiscal priorities. So too do their past records, especially the record of the candidate who has already served as President for three years – President Donald Trump.

During the 2016 campaign, we estimated then-candidate Trump’s campaign plans would add $5.3 trillion to the debt from 2017 to 2026 (assuming policies were enacted immediately). In this analysis, we show that President Trump has already signed into law $4.2 trillion of debt over a comparable budget window and $4.7 trillion from 2017 through 2029.

Our recent estimates of $4.7 trillion in new debt are higher than the $4.1 trillion we estimated in July of 2019 – with the additional debt the result of new and extended tax cuts in the December 2019 appropriations bills. Roughly half of the new debt President Trump signed into law is the result of tax cuts, and the other half of spending increases.

Legislation Will Have Added $4.7 Trillion to Debt Since 2017

Source: CRFB calculations based on Congressional Budget Office data.

CRFB.org

1900 M Street NW • Suite 850 • Washington, DC 20036 • Phone: 202-596-3597 • Fax: 202-478-0643 • www.crbf.org
The Tax Cuts and Jobs Act (TCJA) alone added a projected $1.1 trillion to the debt, including interest and dynamic effects, through 2029. Even this number assumes that the individual tax cuts under the law expire as scheduled after 2025. An additional $1 trillion could be added to the debt through 2029 if the individual tax cuts are extended.

The Bipartisan Budget Act (BBA) of 2018 and Bipartisan Budget Act of 2019 added a combined $2.2 trillion to projected debt, mainly by dramatically increasing defense and non-defense spending caps for 2017 through 2021. Since no budget caps exist after 2021, CBO assumes spending will continue to grow with inflation after 2021, so the bill will increase spending by similar amounts in future years.

Finally, the December 2019 spending deal added $800 billion of debt by taking up three taxes meant to fund the Affordable Care Act, including the Cadillac tax that economists agree would have slowed health care cost growth and significantly reduced deficits over the long term. The legislation also revived a series of temporary special-interest zombie tax breaks, most of which had been expired for two years.

Other pieces of legislation account for nearly $165 billion of debt. This includes several different bills containing disaster relief and emergency spending as well as continued delays of the three ACA taxes that were subsequently repealed in December’s spending package deal, among other small items.

Importantly, this analysis does not account for any regulatory changes and covers a 13-year period from 2017 to 2029 (though nearly all costs are from 2018-2029). Using a standard ten-year budget window, we estimate President Trump signed $4.2 trillion of debt increases into law between 2018 and 2027, or $3.9 trillion from 2020 to 2029. The slightly lower cost in the later window is driven by the individual tax cut expirations after 2025.

### Debt Added Since 2017 Over Different Periods

<table>
<thead>
<tr>
<th>Legislation</th>
<th>2016-2017 Cost</th>
<th>2020-2029 Cost</th>
<th>2017-2029 Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Cuts and Jobs Act of 2017</td>
<td>$1.9 trillion</td>
<td>$1.4 trillion</td>
<td>$1.8 trillion</td>
</tr>
<tr>
<td>Bipartisan Budget Act of 2018</td>
<td>$420 billion</td>
<td>$530 billion</td>
<td>$445 billion</td>
</tr>
<tr>
<td>Bipartisan Budget Act of 2019</td>
<td>$1.3 trillion</td>
<td>$1.7 trillion</td>
<td>$1.7 trillion</td>
</tr>
<tr>
<td>Consolidated Appropriations Act, 2020</td>
<td>$350 billion</td>
<td>$530 billion</td>
<td>$500 billion</td>
</tr>
<tr>
<td>Other Legislation</td>
<td>$150 billion</td>
<td>$100 billion</td>
<td>$165 billion</td>
</tr>
<tr>
<td>Total Increase in Debt</td>
<td>$4.2 trillion</td>
<td>$3.9 trillion</td>
<td>$4.5 trillion</td>
</tr>
</tbody>
</table>

**Average Annual Increase in Deficit**

as Share of GDP

| Increase in Debt-to-GDP in Final Year       | +14.3%         | +12.8%         | +15.1%        |

Source: CBO’s calculations based on Congressional Budget Office data. Note: Numbers may not add due to rounding.
The $4.7 trillion of debt signed into law by President Trump is on top of the current $17.2 trillion debt held by the public and the $9.2 trillion we were already expected to borrow over the next decade absent these proposals. Debt is projected to be about 97 percent of Gross Domestic Product (GDP) in 2025, compared to 82 percent if none of this debt-increasing legislation had been passed.

It is worth keeping in mind that Congress—not the President—is primarily responsible for setting the federal budget and shaping federal tax and spending policy. While it is difficult for Congress to pass legislation without the President’s signature, it is impossible for the President to sign legislation without it passing both houses of Congress. Responsibility for the $4.7 trillion in new debt should therefore be shared between the President, the House, and the Senate—with nearly two-thirds of the legislation enacted on a bipartisan basis.

In future analyses, we will estimate the cost of extending the policies President Trump signed into law as well as the fiscal impact of enacting the President’s campaign agenda. We will continue to work to bring transparency to proposals put forward by candidates in both political parties.

http://www.cfrb.org/blogs/president-trump-has-signed-4-7-trillion-debt-law
Appendix C

These 3 Parts of the Budget Explain 87% of Spending Growth

February 7, 2019

The Congressional Budget Office's (CBO) latest baseline shows that deficits and debt are rising unsustainably, driven by the failure of revenue to keep pace with a $2.6 trillion (2 percent of GDP) increase in federal spending over the next decade. Fully 87 percent of nominal spending growth under current law can be explained by just three budget areas — Social Security, federal health care programs, and interest on the debt. Even if lawmakers extend higher discretionary spending caps as in the Alternative Fiscal Scenario, those three areas of the budget account for 83 percent of nominal spending growth.

Of the $2.6 trillion projected increase in spending between 2019 and 2029 under current law, 31 percent is due to the rising costs of Social Security, 23 percent due to the rising costs of Medicare, another 12 percent due to other health care programs, and 21 percent due to rising interest costs.

Social Security, Health Care, and Interest Explain 87% of Spending Growth

These programs are projected to grow rapidly as a result of an aging population, rising health costs, and increased debt. An aging population both means that there will be a greater number of elderly people eligible for benefits and the population will have more older people, who tend to have more expensive health care needs.
Other areas of spending are growing very slowly. Non-health and non-retirement mandatory spending programs – including spending on farm subsidies, federal employee retirement, food stamps, and unemployment – will only account for 6 percent of the total projected spending increase. Meanwhile, defense will make up just 4 percent of nominal spending growth and non-defense discretionary spending – including spending on federal workers, education, environmental protection, the State Department, and many other functions – accounts for 3 percent of spending growth. The modest share of spending growth going to discretionary programs is driven in part by the scheduled expiration of recent massive discretionary cap increases and the return of the sequester-level spending caps. But even under CBO’s Alternative Fiscal Scenario, which extends the spending increases and several tax cuts, the discretionary portion of the budget would only account for 14 percent of spending growth.

As a share of the economy, health, retirement, and interest spending are even more dominant. Combined, they explain 185 percent of total spending growth. Discretionary and other mandatory spending are both projected to shrink relative to the economy.

The biggest budget challenges lie in rising interest costs and the growth of entitlement programs, largely driven by the aging of the population. That suggests policymakers should focus on making Social Security solvent, controlling health care cost growth, and identifying new revenue to keep debt – and therefore interest costs – at bay.

http://www.cfrb.org/blogs/the-3-parts-budget-explains-87-spending-growth

Note: In CBO’s January 2013 budget projections, health care, Social Security, and interest accounted for 87 percent of nominal spending growth over the decade. In CBO’s latest projections in August 2013, that number is 80 percent, due to higher projected discretionary spending as a result of the Bipartisan Budget Act of 2013 and lower projected future interest rates.
Appendix D

Saving Social Security and Medicare Could Help Fix the Debt
July 1, 2019

The Congressional Budget Office’s (CBO) Long-Term Budget Outlook shows debt rising continuously as a share of the economy over the next 30 years and rising to unprecedented levels within a dozen years if temporary tax cuts and spending increases are extended. However, if policymakers pay for all new (and extended) tax and spending changes and restore solvency to various federal trust funds, the country has a much brighter fiscal future.

Under our "TRUSTGO" scenario – where the Medicare, Social Security, and Highway trust funds are brought into balance – we estimate debt would stabilize and ultimately fall as a share of Gross Domestic Product (GDP). Rather than rising to 144 percent of GDP by 2049 under current law or 219 percent under CBO’s Alternative Fiscal Scenario, we project debt would total about 83 percent of GDP under our TRUSTGO scenario.

Five Trust Funds are Close to Insolvency

CBO projects that five federal trust funds will run out of reserves in the next 13 years: the Highway Trust Fund in 2022, the Pension Benefit Guaranty Corporation (PBGC) Multi-Employer trust fund in 2026, the Medicare Part A Hospital Insurance (HI) trust fund in 2028, the Social Security Disability Insurance (SSDI) trust fund in 2028, and the Social Security Old-Age and Survivors Insurance (OASI) trust fund in 2032.

Though 2032 may seem far off, it is actually quite soon. Today’s youngest retirees will be only 75 years old when the Social Security trust fund is depleted, according to CBO, and at that point they will face an immediate across-the-board 24 percent benefit cut to match spending with revenue. Other trust funds are even closer to insolvency. Use our interactive tool to find out how old you’d be when Social Security’s trust fund runs out.
Insolvency Dates for Major Trust Funds

<table>
<thead>
<tr>
<th>Trust Fund</th>
<th>Insolvency Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highway Trust Fund</td>
<td>2022</td>
</tr>
<tr>
<td>Pension Benefit Guaranty Corporation Multi-Employer Trust Fund</td>
<td>2025</td>
</tr>
<tr>
<td>Hospital Insurance Trust Fund</td>
<td>2026</td>
</tr>
<tr>
<td>Social Security Disability Insurance Trust Fund</td>
<td>2028</td>
</tr>
<tr>
<td>Social Security Old-Age and Survivors Insurance Trust Fund</td>
<td>2032</td>
</tr>
</tbody>
</table>

Source: Congressional Budget Office

Saving Trust Funds Can Help Fix the Debt

By law, trust funds cannot spend more than they take in once they run out of money. CBO’s baseline assumes that (other than for PBGC) spending continues, which effectively means they are assuming a debt-financed general revenue transfer. Avoiding this transfer by making trust funds solvent would significantly reduce debt compared to CBO’s baseline.

In its Long-Term Budget Outlook, CBO estimates a ‘Payable Benefits Scenario’ where Social Security benefits are cut to match revenue when the (theoretically) combined trust fund runs out in 2032. Under that scenario, debt would rise to 106 percent of GDP in 2049, as opposed to 144 percent under current law.

Our TRUSTGO scenario builds off of this by also assuming the SSDI, Medicare Part A, and Highway trust funds are made solvent with benefit and/or revenue changes when their reserves are exhausted. Under this scenario, debt would still rise from 79 percent of GDP this year to 90 percent by 2020 but would peak at 93 percent in 2033 and then decline slowly to 83 percent of GDP by 2059. This would still leave a relatively high level of debt, but it would be declining over the longer term and would be much lower than in CBO’s current law and Alternative Fiscal Scenario estimates.
Some important estimating notes: CBO's Payable Benefits Scenario assumes that not only will borrowing be lower, but due to dynamic feedback, the economy (and revenue) will be stronger. Specifically, they estimate real Gross National Product (GNP) will be 2.3 percent higher, and interest rates will be 20 basis points lower by 2019. Since some of these improvements are due to lower debt and some due to specific assumptions of how Social Security is made solvent, we conservatively use CBO's dynamic assumptions for our TRUSTGO scenario rather than assuming additional improvements from even lower debt.

In truth, there are many ways to reform Social Security, disability programs, Medicare, and the Highway Trust Fund that could include new revenue, changes to benefits, improved efficiencies, or some combination.

Most comprehensive plans to save these trust funds would improve economic growth and income. All would significantly improve our nation's fiscal situation.

As the TRUSTGO scenario shows, the first key to fixing the debt is to stop **making it worse**. The next step is to save Social Security, Medicare, and the Highway Trust Fund. That makes sense in its own right, and it can put the debt on a more sustainable path as a result.

Appendix E
Bipartisan Group Introduces TRUST Act
November 1, 2019

Earlier this week, Senators Mitt Romney (R-UT), Joe Manchin (D-WV), Todd Young (R-IN), Doug Jones (D-AL), and Risch Sinema (D-AZ), alongside Representatives Mike Gallagher (R-WI), Ed Case (D-HI), William Timmons (R-SC), Scott Peters (D-CA), and Ben McAdams (D-UT), introduced the TRUST Act, an innovative approach to addressing federal trust funds facing insolvency. The bill establishes bipartisan commissions to make recommendations on each trust fund, and those recommendations would receive a fast-tracked vote in Congress.

The Time to Rescue United States Trusts Act, or the TRUST Act (S. 2733/H.R. 4907) would establish a separate commission to prevent insolvency and improve each major, endangered federal trust fund program. It would apply to trust funds that spend more than $20 billion per year and are projected to be exhausted by 2035, resulting in deep and sudden cuts to beneficiaries and other activities.

The programs expected to be covered are Social Security, Medicare Part A (Hospital Insurance), and highway programs. According to the Congressional Budget Office (CBO), the Highway Trust Fund will be depleted by 2022, Medicare Part A by 2026, Social Security Disability Insurance (SSDI) by 2028, and Social Security Old-Age and Survivors Insurance (OASI) by 2032. The Social Security Trustees separately estimate the Social Security funds will be insolvent in 2032 and 2034, respectively.

Addressing the looming insolvency of these programs will prevent large scheduled benefit cuts for future and current beneficiaries. Under current law, a 65-year-old retiring today will face a 20 to 25 percent benefit cut before they turn 79 (see how old you'll be when Social Security's funds run out).

Restoring trust fund solvency will also improve projected debt levels, which assume spending will continue beyond trust fund depletion. Earlier this year, we estimated that restoring solvency to each of these major trust funds would reduce projected debt by about 60 percent of GDP in 2050.
### Table: Trust Fund Exhaustion and Annual Deficit

<table>
<thead>
<tr>
<th>Trust Fund</th>
<th>Exhaustion Date</th>
<th>Annual Deficit in Exhaustion Year</th>
<th>Percent Cut at Insolvency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highway Trust Fund (combined)</td>
<td>2022</td>
<td>$135 billion (0.1% of GDP)</td>
<td>29%</td>
</tr>
<tr>
<td>Medicare Hospital Insurance (HI) (Part A)</td>
<td>2026</td>
<td>$68 billion (0.2% of GDP)</td>
<td>13%</td>
</tr>
<tr>
<td>Social Security Disability Insurance (SSDI)</td>
<td>2028</td>
<td>$17 billion (0.1% of GDP)</td>
<td>8%</td>
</tr>
<tr>
<td>Social Security Old-Age and Survivors Insurance (OASI)</td>
<td>2032</td>
<td>$295 billion (1.5% of GDP)</td>
<td>27%</td>
</tr>
</tbody>
</table>

Source: Congressional Budget Office

Each commission—or “rescue committee”—would have 12 members, three of whom would be selected at the discretion of the “four corners” of Congressional leadership: Senate majority and minority leaders, the House Speaker, and the House minority leader.

Each commission would be charged with producing legislation that:
- Prevents the trust fund’s depletion
- Ensures long-term solvency
- Simplifies the underlying programs
- Makes other general improvements

Rescue committees would have broad mandates and flexibility, which are appropriate considering that each program’s trust fund could be made solvent through numerous combinations of spending and revenue options. Rescue committee members could take this opportunity to implement a wide range of program improvements.

For example, several proposals have been put forward that would restore solvency to Social Security from different angles. The Social Security 2100 Act, offered by Representative John Larson (D-CT), would enact a set of benefit expansions funded by revenue increases. On the other hand, the Social Security Reform Act of 2016, from former Representative Sam Johnson (R-TX), would take the opposite approach by cutting taxes and slowing the growth of benefits. Then there are approaches like the plan offered by the Bipartisan Policy Center’s Commission on Retirement and Personal Savings—the Conrad-Lochman plan—which seeks a middle ground by raising revenue and slowing the growth of benefits.
In reviewing programs and evaluating options, rescue committees would work closely with relevant federal agencies, CBO, the Government Accountability Office, Congressional leadership, committees of jurisdiction, other members, and each other.

Commissions could put forward a proposal with a simple majority of total members, including at least two members from each party to ensure bipartisan support. Though due the week after the 2020 election, recommendations could be put forward at any point if consensus is reached. Legislation reflecting these proposals would receive fast-track consideration in both chambers of Congress.

While the TRUST Act does not force policymakers to save the major trust funds, it does force them to work together on a bipartisan basis toward that goal. Since introduced, it has received the support of groups and individuals from across the political spectrum interested in securing these programs for current and future generations.

The looming insolvency of major trust funds creates an urgent need for lawmakers to take action soon—and the cost of waiting to close these trust fund imbalances is high. As Committee for a Responsible Federal Budget president Maya MacGuineas has said, "the TRUST Act offers renewed hope that we can address these imbalances before it is too late."

CBO estimates that the 99% trust fund will become insolvent in 2028, which would require the program for reforms under the TRUST Act. The Social Security Trust Act estimate is further away. Due to different estimating methodologies and assumptions, the Secretary of the Treasury is one of Social Security’s trustees, and under the legislation, would determine whether or not SSI is projected to be insolvent before 2018 to qualify for inclusion.

http://www.cfrb.org/blogs/bipartisan-group-introduce-trust-act
Appendix F

Support for TRUST Act Grows
January 7, 2020

The Time to Rescue United States Trusts Act, or the TRUST Act, was introduced last fall on a bipartisan basis in both chambers of Congress to establish a process for addressing the impending insolvency of the Social Security, Medicare, and Highway trust funds. The measure has garnered twelve sponsors or co-sponsors in the House and eleven in the Senate as well as the endorsement of the Blue Dog Coalition. Senators Mitt Romney (R-UT) and Joe Manchin (D-WV), alongside Representatives Mike Gallagher (R-WI) and Ed Cao (D-HI), have led the effort.

The bill (S. 2733/H.R. 4897) would create a separate bipartisan commission for each major, endangered federal trust fund program, and any recommendations would receive a fast-tracked vote in Congress. It would apply to trust funds that spend more than $20 billion per year and are projected to be exhausted by 2035, resulting in deep and sudden cuts to beneficiaries and other activities. According to the Congressional Budget Office (CBO), the Highway Trust Fund will be depleted by 2022, Medicare Part A by 2026, Social Security Disability Insurance (SSDI) by 2028, and Social Security Old Age and Survivors Insurance (OASI) by 2032 (the Social Security trustees estimate earlier dates for those two trust funds). Read more on the TRUST Act here.

Outside of Capitol Hill, support for the TRUST Act is growing. Below are some endorsements of the bill:

Maya MacGuineas, President, Committee for a Responsible Federal Budget - “Some of the federal government’s most important trust fund programs are headed toward insolvency. The TRUST Act offers renewed hope that we can address these imbalances before it is too late. Senators Romney and Manchin deserve great praise for taking on a challenge that for too many ignore, by proposing to establish a process to achieve bipartisan solutions. The commissions established under the TRUST Act would be charged with securing programs like Social Security, Medicare, and the highway fund so that they are stronger, more effective, and continue to be there for current and future generations. The bill wouldn’t force policymakers to agree, but it would force them to try to work together. That goal should have unanimous support.”

Alan Simpson and Erskine Betsy, co-chairs of the National Commission on Fiscal Responsibility and Reform - “It has been nine years since the Fiscal Commission we co-chaired released common sense comprehensive recommendations to fix the debt and to secure our major entitlement programs, those programs still remain in serious financial jeopardy. The Social Security, Medicare, and Highway Trust Funds are all predicted to be insolvent in the next 15 years, triggering deep across-the-board cuts in benefits. While most people in Washington would prefer to put – or leave – their heads in the sand, the TRUST Act would create a truly bipartisan process to save these important programs. We know from personal experience that when Democrats, Republicans, and Independents honestly work together in good faith, they can identify real and lasting solutions; the Fiscal Commission recommendations were supported by 11 of 18 commissioners. We earnestly thank Senators Romney and Manchin, Representatives
Gallagher and Case, and other co-sponsors for taking the lead on this important and vital effort. Time is running out to enact critical and thoughtful reforms to appropriately fund our infrastructure and return solvency to Social Security and Medicare.”

Robert L. Bisty, Executive Director of The Concord Coalition: “This proposal could prompt bipartisan action on key trust fund depletion dates that threaten indiscriminate across-the-board cuts to vital programs within the next 15 years. It is, in effect, a responsible call to repeal and replace the irresponsible Do Nothing Plan.”

Center Forward: “Center Forward is dedicated to bringing together thoughtful and political leaders from across the political spectrum who are working together to address our nation’s biggest challenges. At a time when government spending has continued to escalate at an astronomical rate, the sustainability of our most essential programs is being threatened. More than almost any other issue, the only way to fix this problem is for leaders on both sides of the aisle to come together.

Today, members of Congress in both parties have come together to put forward a bill, the TRUST Act, to help make many of these programs sustainable for the future. Without action by lawmakers, significant programs that rely on Trust Funds for financing like the highway fund, Medicare, and Social Security will run out of money within the next 15 years, resulting in across-the-board cuts that harm individuals, families, and businesses.

At a time when politics is all too often marked by extreme partisanship, this bill recognizes that the only kind of legislative action that is sustainable results from bipartisan policymaking. Particularly when it comes to some of our most cherished programs, workable solutions need to come from the center.”

Bipartisan Policy Center Action: “Our debt and deficit challenges have been ignored by our national leaders for far too long. It’s good to see that some members of Congress still care about our country’s fiscal future.”

Rosa Latina, Vice President of Economic Opportunity, Americans for Prosperity: “The first step in any recovery is to admit there is a problem. The TRUST Act represents a good faith effort to start a long overdue conversation about how we secure America’s future for families, retirees, and generations to come; as many of the programs Americans have come to rely on lurk toward financial insolvency. Tackling these problems will require political courage from leaders of all stripes. We’re hopeful that the TRUST Act will help refocus both parties on the gravity of this looming crisis and the need for solutions. Americans for Prosperity, and its network of activists across the country, look forward to being a part of this important conversation in the coming months.”

Ben Ritz, Director of the Progressive Policy Institute’s Center for Funding America’s Future: “The budget debate in Washington has hit an all-time low since President Trump took office, with Congressional Republicans pushing a $2 trillion deficit-financed tax cut and some on the far left proposing tens of trillions of dollars in new spending without a plan to pay for it. The TRUST Act bucks this harmful trend and starts an important conversation about what tax increases and spending cuts will be needed to
secure the future of Social Security and Medicare, as well as fund critical public investments in our nation’s ageing infrastructure. Congress must strengthen these and other important programs for Americans of all ages.”

Kevin R. Kosar, Ph.D., Vice-President of Policy for R Street Institute - “Congress has long delayed facing this fiscal crisis. The TRUST Act is a bold and brave step toward solving the problem before it becomes a calamity for our nation.”

Bill Gale, Senior Fellow at the Brookings Institution - “The journey of a thousand miles begins with a single step. Addressing long-term federal budget shortfalls is going to take many bold actions by our political leaders and the problem is so big that it often seems unclear where even to start. Senators Romney, Manchin, Young, Jones, and Sinema, and Representatives Gallagher, Case, Timmons, and McAdams have shown how Congress can take that first step and take it in the right direction. Addressing the federal trust funds in a bipartisan manner is a promising way to make a down payment on long-term fiscal reform.”

Jason Pue, Vice President of Legislative Affairs for FreedomWorks - “Congress cannot continue kicking the can down the road. America’s fiscal situation is unsustainable, and it is time to begin treating it with the seriousness it deserves. The TRUST Act is not a silver bullet, but it does take a necessary first step toward addressing the looming fiscal crisis that taxpayers face.”

As interest in the Trust Act builds, lawmakers should consider the benefits to individuals who rely on trust fund-supported programs as well as the benefits to the nation’s overall fiscal outlook. The cost of waiting only increases when it comes to major program trust funds, and we hope to see action later this year.

http://www.crfb.org/blogs/support-trust-act-grows
Statement of Jason Pye and Josh Withrow

Vice President of Legislative Affairs and Senior Policy Analyst, FreedomWorks

U.S. Senate Committee on Homeland Security and Governmental Affairs

“Examining the Root Causes of America’s Unsustainable Fiscal Path”

Tuesday, January 28, 2020
Chairman Johnson, Ranking Member Peters, and Members of the Committee,

On behalf of FreedomWorks’ community of more than 5 million grassroots activists, thank you for holding this hearing examining the root causes of America’s unsustainable fiscal path. We welcome this discussion and hope to see more conversations on this very topic in the coming weeks and months.¹

Federal spending should be a concern for every American. Put simply, the path on which Congress has put the United States is fiscally unsustainable and reckless. We disagree, in the strongest terms, with President Donald Trump’s recent comments about federal spending, in which he reportedly said, “Who the hell cares about the budget? We’re going to have a country.”²

Budget deficits and debt impact Americans by creating a damper on the economy known as “debt drag.”³ We may already be experiencing this. However, they can impact Americans in an even more serious and tangible way should those who purchase our debt begin to lose confidence in our ability to pay it back. This will lead to higher interest rates and an increase in the cost of debt service, which will, in turn, crowd out private investment in the economy. As Kurt Coachman of the Committee for a Responsible Federal Budget explained,⁴ “For the federal government, each one percentage point increase in interest rates implies an additional $1.8 trillion increase in the budget deficit over the next decade.”

The estimate on the impact of interest rates come from the Congressional Budget Office. The agency estimates that the budget deficit would grow by $182 billion over ten years if interest rates rise by 0.1 percent.⁵ Extrapolated over ten years for a 1 percent increase in interest rates, the budget deficit would grow by $1.82 trillion.

Sadly, previous administrations, and the current administration, and Congress have ignored the growing problem with federal spending, choosing instead to increase discretionary outlays while allowing mandatory spending programs to grow on autopilot. Addressing the United States’

¹ While preparing this written statement, I learned that the Congressional Budget Office is expected to release an updated Budget and Economic Outlook during the week of January 27. For purposes of this written statement, I am relying on the Budget and Economic Outlook released on August 21, 2018.
fiscally unsustainable path must be an immediate priority, and must be done in a way that encourages economic growth to ensure that we remain internationally competitive.

Congress has tried to address federal spending before. In August 2011, lawmakers passed the Budget Control Act (BCA). The BCA was the product of bipartisan negotiations between President Barack Obama and Speaker John Boehner (R-Ohio) to reduce the budget deficit over time, while immediately increasing the debt limit by $400 billion.

Spending had grown rapidly, and the United States saw budget deficits of more than $1 trillion for four consecutive years, between fiscal years 2009 and 2012. The deficit as a percentage of gross domestic product reached a peak of 9.8 percent during this time frame.

The deficit reduction part of the Budget Control Act set defined levels for discretionary spending and created the Joint Select Committee on Deficit Reduction, also known as a “super-committee,” which was tasked under the law to develop a deficit reduction package of $1.5 trillion for FY 2012 through FY 2021. The package would receive expedited consideration in Congress.

If the Joint Select Committee on Deficit Reduction failed to agree on a deficit reduction package of at least $1.2 trillion, split evenly between defense and nondefense discretionary spending, an enforcement mechanism called sequestration would kick in to reduce defense and nondefense discretionary spending. The super-committee held five hearings but was unable to reach an agreement on a package, which triggered the enforcement mechanism that statutorily required reduced discretionary spending between fiscal years 2013 and 2021.


What has happened since this law was enacted has been a tremendous disappointment. In January 2012, Congress delayed the auto-enforcement discretionary spending cuts required by the BCA as part of the American Taxpayer Relief Act. With the passage of the Bipartisan

---

6 Public Law 112-25
Budget Act in December 2013, Congress began the often biennial process of busting the spending caps, and Republicans and Democrats alike share the blame.

Congress has also routinely used the Overseas Contingency Operations (OCO) fund to bypass the discretionary spending caps for defense. Although OCO is not off-budget spending, like Social Security or the Postal Service, the money spent through OCO does not count toward the discretionary spending caps but it does result in higher discretionary spending.

Most recently, in July 2019, for example, Congress passed another two-year discretionary spending caps deal, covering fiscal years 2020 and 2021, that busted the previous spending caps by more than $320 billion. The Congressional Budget Office (CBO) projects a return to $1 trillion budget deficits in the current fiscal year. Those $1 trillion budget deficits will remain for the foreseeable future. In fact, projections provided by the CBO likely understate the budget deficit because of Congress’s proclivity for increasing defense and nondefense discretionary spending.

As the Committee for a Responsible Federal Budget explained, the Bipartisan Budget Act of 2019 will have a $1.7 trillion impact on baseline discretionary spending that the CBO would not account for in its recurring ten-year budget and economic outlook report.

“By convention, the Congressional Budget Office (CBO) assumes that uncapped discretionary spending grows with inflation, so increasing the 2021 cap raises the level at which that spending would grow from, building in higher spending in future years as well. As a result, the two years of cap increases will actually raise spending by $1.7 trillion over ten years.”

The fifty-year average of federal spending as a percentage of gross domestic product is 20.3 percent. This range includes several higher-than-average years, such as fiscal years 2009 through 2012 when Congress attempted to spend the United States out of a lengthy recession. Outlays averaged 23.3 percent during this four-year period.

---

10 Public Law 113-67.
11 After the delay of the auto-enforcement spending cuts in January 2013 and the passage of the Bipartisan Budget Act of 2013 in December 2013, which busted the caps for the first time, Congress busts the auto-enforcement spending caps in the Bipartisan Budget Act of 2015 (Public Law 114-74). Bipartisan Budget Act of 2018 (Public Law No 115-123), and, as noted in this statement, the Bipartisan Budget Act of 2019
14 This reflects the average of federal outlays between fiscal years 1968 and 2017. The chart includes actual outlays in 2018 and the Congressional Budget Office’s projections for fiscal years 2019 through 2029.
Federal outlays are projected to rise, even without the increased baseline caused by the Bipartisan Budget Act of 2019\textsuperscript{15} factored into the equation. By fiscal year 2028, federal outlays will be 23.1 percent. Assuming the Tax Cuts and Jobs Act of 2017 is not made permanent and the individual tax changes expire at the beginning of calendar year 2026, revenues are projected to be 18.1 percent.

![Federal Outlays and Revenues as a Percentage of Gross Domestic Product](image)

The fiscal picture gets worse the further out the CBO looks. Federal spending will rise to 25.6 percent of GDP in 2039 while revenues will come in at 18.8 percent.\textsuperscript{16} The share of the national debt held by the public will be 113 percent. By 2049, federal outlays will consume 28.2 percent of GDP. Although near historically high revenues are projected, 19.5 percent of GDP, the deficit will be 8.7 percent of GDP and the share of the national debt held by the public will be 144 percent. Again, it is important to keep in mind that these projections are based on current law and does not make assumptions that current laws will be extended past their scheduled expiration.

\textsuperscript{15} Public Law 116-37
\textsuperscript{16} Congressional Budget Office, Long-Term Budget Projections, June 2019. Summary Extended Baseline (Note about the accompanying chart: There may be a slight discrepancy between the figures on the Summary Extended Baseline provided in June 2019 and the Budget and Economic Outlook provided in August 2019. The Congressional Budget Office has not yet updated its long-term projections.)
Although Congress has rarely passed up any opportunity to increase discretionary spending, this particular aspect of federal outlays represented 30.4 percent of all spending in fiscal year 2018. By 2029, based on current law, discretionary spending will represent 24.9 percent of all federal outlays. Discretionary spending should not be ignored, but spending cap battles over the past several years have avoided the larger problem with federal spending. Ultimately, the root cause of the United States’ unsustainable fiscal path is mandatory spending.

**Mandatory Deficits**

The runaway growth of mandatory spending (defined as outlays that are scheduled to occur outside of the annual Congressional budget process) is astonishing in its rapidity. In 1965, the first fiscal year of the existence of Medicare and Medicaid, net mandatory program spending and interest payments on the debt together constituted just over 34 percent of total federal outlays. For fiscal year 2019, that combined percentage was projected at over 70 percent and is expected to increase to more than 75 percent over the next ten years.

Social Security spending alone (including disability insurance) exceeded $1 trillion per year for the first time in fiscal year 2019, while Medicare is projected to do the same in fiscal year 2023. In addition to Medicare and Medicaid, which projected to clock in at $768 billion and $404 billion respectively for fiscal year 2019, the Affordable Care Act insurance premium subsidies
have reached $57 billion and the Children’s Health Insurance Program (S-CHIP) costs an additional $17 billion.

According to the GAO, the trust fund for Medicare Part A (traditional, fee-for-service hospital insurance) will be depleted by 2026, while the trust fund for Social Security pensions will be depleted by 2034. What were once alarming but distant deadlines are now looming ominously close.\(^{17}\)

In the case of Social Security, the very structure of the program has set itself up for crisis, as its sustainability was tied to always being able to pass its costs along to the younger generations of taxpayers. As demographics have shifted and the massive Baby Boomer generation nears retirement, the ratio of taxpayers to retirees whose benefits their payroll taxes fund has shrunk to fewer than 3-to-1.\(^{18}\)

More so than any of the entitlement programs, the time window is shrinking quickly to be able to fix social security in a way that doesn’t sabotage the benefits of those already enrolled in the program. Any solution to the program’s solvency is going to have to tamp down on future outlays, whether by adjusting eligibility requirements or the benefit formula.

---


\(^{18}\) Janeen Pet, “House Democrats’ Social Security Bill is an Assault on Taxpayers,” Mar. 20, 2019; [https://www.freedomworks.org/content/house-democrats-social-security-bill-assault-taxpayers](https://www.freedomworks.org/content/house-democrats-social-security-bill-assault-taxpayers)
The combined health care entitlements are also structurally biased against containing costs, and not only because their rolls are rapidly increasing. Both Medicare and Medicaid, although very different programs, contain massive structural flaws that encourage overspending and fraud. Between overpayments and outright fraud, CMS estimates that there were over $103 billion in improper payments from just those two programs alone.\footnote{CMS Fact Sheet, “2019 Estimated Improper Payment Rates for Centers for Medicare & Medicaid Services (CMS) Programs,” Nov 18, 2019 \url{https://www.cms.gov/compliance/ftp/092019/2019-estimated-improper-payment-rates-center-for-medicare-and-medicaid-services-commission}}

Medicare’s fee-for-service payment model practically begs for overuse, as it pays a set reimbursement rate per test or procedure, encouraging quantity of billable items over quality of care. Although its relatively low administrative costs are often touted as a superior feature compared to private insurance, Cato Institute scholar Michael Cannon points out that the lack of administrative overhead merely diminishes oversight over the rampant abuse of Medicare services.\footnote{Michael Cannon, “Medicare,” in The Cato Handbook for Policymakers, Ch. 38 The Cato Institute, 2017} Thus, reforming the payment model itself in a way that is less prone to abuse will be more efficient than simply policing the current system more aggressively.

Medicaid’s growth has obviously been magnified by the expansion of eligibility for enrollment under the ACA, which saw an additional 13.1 million people sign up for benefits in the states which passed the expansion.\footnote{Medicaid and CHIP Payment and Access Commission, “Medicaid Enrollment Changes Following the ACA,” Accessed Jan 23, 2020 \url{https://www.macpac.gov/sites/default/files/macpac_medicare-and-chip-entitlement-changes-following-the-aca.pdf}} This has had a disproportionate impact on federal Medicaid expenditures because under the ACA the federal matching rate for Medicaid expansion enrollees is much higher (currently at 90 percent) compared to original Medicaid patients.\footnote{Note that the average federal matching rate for Medicaid payments to a given state is just over 60% currently \url{https://files.eric.ed.gov/fulltext/ED571353.pdf}}

The design of Medicaid’s matching funds arrangement between the federal government and the states also incentivizes states to keep increasing spending under the program without any regard for misuse and outright fraud. This has combined with lax control over ineligible enrollees to result in an improper payment rate in Medicaid that may be as alarmingly high as \( \frac{1}{4} \) of total federal spending on the program.\footnote{Aaron Yelowitz and Brian Blum, “Medicaid Improper Payments are Much Worse Than Reported,” Cato at Liberty, Nov 20, 2019 \url{https://www.cato.org/blog/medicaid-improper-payments-are-much-worse-than-reported}}

As these behemoth programs continue to grow unconstrained, the deficit spending they grow increases the threat of the other giant on the mandatory spending side - interest on the national debt. These interest payments, currently projected to reach $390 billion just for fiscal year 2020, are projected to increase to over $800 billion annually by fiscal year 2029, even assuming that interest rates are not allowed to rise back to historical levels.
Tax Revenues Are Not the Problem

Overall, the economy is in generally good shape. The unemployment rate is 3.5 percent, a low rate not seen in more than 50 years. In December 2019, the unemployment rate for women was 3.5 percent, which is near a historic low. The unemployment rate for African-Americans and the Hispanic-Latino community is 5.9 percent and 4.2 percent, respectively, both of which are near record lows set in August 2019 and September 2019.

In 2018, the most recent data available, the poverty rate was 11.8 percent. As the Census Bureau noted, 2018 was the “first time in 11 years” that “the official poverty rate was significantly lower than in 2007, the year before the most recent recession.” In fact, 1.4 million fewer people were in poverty in 2018 than in 2017.

Hopefully, the passage of the United States-Mexico-Canada Implementation Act and the “phase one” deal with China will restore confidence in markets when it comes to trade, which has been one source of volatility.

---

Of course, much work remains to be done to continue to grow the economy, but it is impossible to deny the benefits of the Tax Cuts and Jobs Act of 2017. This once-in-a-generation legislation reduced income taxes across the board, nearly doubled the standard deduction, simplified the tax code, boosted pass-through businesses, and slashed the corporate income tax to make the United States more competitive internationally.

Despite the success of the tax cuts, one of the frequent complaints heard from many in the House of Representatives and the Senate is that the Tax Cuts and Jobs Act of 2017 has exploded the budget deficit. It is almost as though the budget deficit did not exist before the passage of the tax cut.

The fifty-year average of the percentage of revenues to GDP is 17.4 percent.26 Although revenues as a percentage of GDP are not as high as projected prior to the passage of the Tax Cuts and Jobs Act, the tax cut has spurred economic growth and increased tax receipts. Tax receipts, for example, were up 4 percent in fiscal year 2019 compared to fiscal year 2018. Spending, however, is growing at a faster rate, with year-over-year increase of 7.1 percent.27

---
26 This reflects the average of federal revenues between fiscal years 1964 and 2017. The chart includes actual outlays in 2018 and the Congressional Budget Office’s projections for fiscal years 2019 through 2029.
Put simply, the reason the deficit continues to grow is overwhelmingly due to federal outlays, with the primary driver being mandatory spending.

Some have complained that the higher income earners “need to pay their fair share.” In tax year 2017, the top 3 percent of income tax return filers earned 30.4 percent of adjusted gross income but paid 52 percent of all income taxes. Those same voices have even advocated for a return to 70-plus percent marginal tax rates.

Those pushing this particular view claim that the level of taxation in the 1950s did not hurt the economy. They say that this debunks the free-market view that confiscatory taxation has a severely negative impact on Americans. Of course, their view misses some important things.

First, few people actually paid a 91 percent or 92 percent tax rate. Scott Greenberg of the Tax Foundation notes this is likely due to “significant tax avoidance and lower reported income.”

There were also deductions and exemptions that allowed tax filers a way out of the highest marginal tax rate.

Overall, as Greenberg explains, citing a study by Thomas Piketty, Emmanuel Saez, and Gabriel Zucman, “the top 1 percent of taxpayers in the 1950s only paid about 42 percent of their income in taxes.” That 42 percent includes federal individual income taxes, as well as state and local taxes. “The average effective tax rate of the top 1 percent has declined slightly overall,” Greenberg writes. “In 2014, the top 1 percent of taxpayers paid an average tax rate of 36.4 percent.”

Second, the economy of the 1950s was not the boom period those who advocate for confiscatory taxation would have us believe. Americans have an odd hindsight memory of the 1950s. This nostalgia is extended to the economy of the time.

The United States economy experienced two minor recessions in the 1950s, preceded by one in 1949 and capped off by another in 1960. As Brian Domitrovic noted, “[T]here wasn’t significant economic growth in the 1950s. It only averaged 2.5 percent during the presidency of Dwight D. Eisenhower.”

---

58 Internal Revenue Service. Number of Returns, Shares of Adjusted Gross Income (AGI), Selected Income Items, Credits, Total Income Tax, AGI Floor on Percentiles, and Average Tax Rates, by Selected Expanded Descending Cumulative Percentiles of Returns Based on AGI, Tax Year 2017.
Finally, individual income tax receipts as a percentage of the economy are actually higher today than they were during any point in the 1950s. Individual income tax receipts as a percentage of GDP reached a high point in the 1950s at 7.8 percent. Individual income tax receipts came in at 8.3 percent in fiscal year 2018. It is worth nothing that individual income tax receipts are at their third-highest point since 2001 and are expected to grow to 8.6 percent in fiscal year 2025, the last fiscal year before the individual tax cuts from the Tax Cuts and Jobs Act expire.

Another potential concern is pending legislation that would increase the payroll tax to address the $13.9 trillion unfunded liability that Social Security faces. The most recent trustees report also noted that the combined trust funds will be depleted in 2035. The pending legislation, the Social Security 2100 Act, would eventually phase out the wage cap — which is outside the norm, as even Canada, Germany, Sweden, and many other countries have a wage cap — and gradually increase the payroll tax for employers and employees to 7.4 percent from 6.2 percent.

Although the payroll tax is paid by employees and employers, this still amounts to a tax on employees. As Andrew Biggs of the American Enterprise Institute noted in testimony before the House Ways and Means Committee, “Most economists, as well as both the SSA actuaries and the CBO Social Security analysts, assume that employers fund payroll tax or other employer benefit increases by holding back on employee wages. Thus, employees would bear the full cost of higher Social Security taxes.”

If Congress wants to address the budget deficit and the national debt in a meaningful way, raising tax rates, payroll taxes, or other existing taxes, or creating new taxes is not the right way to go about it. Tax increases reduce incentives to work and reduce investment. Addressing spending, which is driving budget deficits, through entitlement reform is the only way to accomplish the goal of reducing budget deficits without negatively impacting a growing economy.

We Need More Workers

Another benefit of a growing economy is that there were approximately 989,000 more available jobs than unemployed workers through November 2019. This is certainly good news, but it also highlights an area of concern in the economy that needs to be addressed.
The United States is experiencing a problem that plagues many other developed economies; declining birth rates. According to the National Vital Statistics System at the Centers for Disease Control, the birth rate declined to a record low, 1.73, below the replacement rate of 2.1.

Recently, Rep. David Schweikert (R-Ariz.), who regularly talks about the age-demographic crisis that the United States is experiencing, spoke on the floor of the House of Representatives about this concern:  

“Now, we still have a spending problem around here. We have a tremendous demographics problem. That is one of the other things we never tell the truth about is the substantial portion of our spending is actually driven by our demographics, which isn’t Republican or Democratic.”

“We are getting older very quickly as a society. But, once again, are we able to get up in front of our groups at home or fellow Members of Congress and not see the math through partisan lenses, because the math is the math.”

---

The Census Bureau recently released new population data showing population growth slowed in 2019 when compared to 2018,\(^{39}\) with the natural population increase falling to just under 1 million. Including immigration, the population grew by 1.552 million. Live births declined in 42 states and the District of Columbia. Eight states experienced an increase in live births. Deaths outnumbered live births in four states -- West Virginia, Maine, New Hampshire, and Vermont.

With an aging population and fewer available workers, this will pose problems for economic growth in the long-run, particularly if deaths outnumber live births. We need more workers, and one way to do that is through guest-worker programs and increased levels of legal immigration to fill the gaps in our economy. FreedomWorks has been supportive of an overhaul of the United States’ immigration laws to move toward a merit-based immigration system similar to those of Canada and Australia.\(^{40}\)

Rep. Schweikert is also a proponent of such an overhaul:\(^{41}\)

“So what do you do to encourage family formation? For some Republicans we are going to have to really step up and think about that. But also for immigration, you need to move to a talent-based system. The elegance of that is you don’t care about someone’s religion, their race, who they cuddle with, or where they come from. But what you do care about is what they bring to our society to maximize economic expansion. In many ways it is a much more honest and elegant system than this carve-out system that we have today.”

FreedomWorks is not wedded to a specific plan that reforms the United States’ immigration laws into a merit-based system. However, we believe that such reforms, designed to boost legal immigration and coupled with robust guest worker programs, could fill gaps in the United States’ economy and boost tax revenues without a tax increase. Obviously, the budget deficit must still be addressed through entitlement reform and restraint on discretionary spending, but this may lessen at least some of the impact of the looming debt crisis that America faces.


\(^{40}\) Adam Brandon, “Trump’s immigration plan recognizes that we urgently need workers — Here’s why it could work,” Fox News, May 18, 2019 [https://www.foxnews.com/opinion/adam-brandon-president-trump-immigration-plan-meets-the-facts]

\(^{41}\) 166 Cong. Rec. H235-H239 (2020)
January 27, 2020

Dear Senator,

On behalf of the National Committee to Preserve Social Security and Medicare's millions of members and supporters, I write to express our concerns about S. 2733, the TRUST Act, which the Senate Committee on Homeland Security and Governmental Affairs will discuss at a hearing on Tuesday morning, January 28.

S. 2733 would create so-called "Rescue Committees" that would draft legislation to address the solvency of federal trust funds, including the Social Security and Medicare funds. Once the respective Rescue Committees approve a trust fund bill, the legislation would receive expedited consideration in the House and Senate.

S. 2733 does not specify how solvency would be achieved, thus opening the Social Security and Medicare programs to whatever broad array of across-the-board cuts that the proposed committees may choose to offer. What's more, the bill fails to require the committees to consider the importance of benefit adequacy given the growing number of working and middle-class Americans who depend on Social Security for all or most of their income in retirement or how Medicare benefit cuts would undermine the health security of seniors and people with disabilities.

In addition, we object to using the proposed committees to bypass the committees of jurisdiction over Social Security and Medicare — the Senate Committee on Finance and the House Committees on Ways and Means and Energy and Commerce.

The National Committee believes that fast-track consideration of Social Security and Medicare legislation required by S. 2733 would circumvent a deliberative and regular order process, limiting the participation of Social Security and Medicare stakeholders and advocates in the debate.

The committees of jurisdiction should hold hearings, develop legislation and vote on the consensus package that they develop under the regular rules of the House and Senate. Adhering to regular order, while perhaps more challenging for legislators, would ensure that the public has an opportunity to express their overwhelming support for Social Security and Medicare and opposition to unpopular benefit cuts.

As an alternative to including Social Security in S. 2733, we urge you instead to support S. 269, the Social Security 2100 Act. S. 269 clearly represents the consensus of an overwhelming majority of Americans to close Social Security's modest funding gap and improve Social Security benefits. It strikes the right balance between the overall financial needs of the program and the specific needs that still exist for strengthening the protections that Social Security provides. That's why the National Committee urges the Senate to pass this commonsense legislation rather than embrace another commission bill that would likely result in cuts to the earned benefits of seniors, people with disabilities and survivors.

Sincerely,

Mary Richtman
President and CEO

111 K Street, NE, Suite 700 • Washington, DC 20002 • 202-216-0420 • www.ncpasm.org
1. During the hearing on January 28, you asserted that if Congress waits until the verge of trust fund depletion to address Social Security solvency, then the required changes would be closer to one and a half percent of GDP rather than one percent. Can you explain in detail why you believe the shortfall would be closer to one and a half percent of GDP, and why that may be prohibitively difficult to close?

The Social Security trustees’ most recent projections, accessible at https://www.ssa.gov/OACT/TR/2019/ir6g4.html, are that the final year in which annual program deficits will be smaller than 1 percent of GDP is 2031, after which every subsequent year will exhibit an excess of costs over revenues exceeding 1 percent of GDP. In later years, these annual deficits will generally grow larger, contributing to the finding that if action is delayed until Social Security’s combined trust funds are on the verge of depletion in 2035, then such action will need to close a deficit substantially larger than 1 percent of GDP. Social Security’s long-range (75-year) shortfall for the period starting in 2035 cannot be precisely calculated from the figures published by the trustees; however, under the extremely conservative assumption that annual operating deficits cease growing after 2095, Social Security’s 75-year shortfall would be roughly 1.3% of GDP in 2035. Under the more realistic assumption that annual deficits continue to grow after 2095 at the same rate as in the years just prior to 2095, the long-range shortfall in 2035 would be somewhat larger. Also, while the trustees estimate the 75-year shortfall over the valuation period starting in 2019 at 0.9% of GDP, their estimate of the permanent shortfall is 1.4% of GDP (see Table VI.F1 on page 200 of the 2019 trustees’ report). Importantly, the increasing deficits in the later part of the trustees’ valuation period indicate that larger changes will be needed to achieve sustainable solvency than would be needed to attain long-range (75-year) solvency. For example, the currently projected annual deficit in 2095 is 1.45% of GDP, which reasonably extrapolates to 1.6% of GDP in 2120. All of this information together indicates that achieving sustainable solvency, if actions are delayed until 2035, will require changes totaling roughly 1.4% of GDP on average over the following 75 years, under the trustees’ assumptions.

It should also be noted that the Congressional Budget Office foresees a larger actuarial imbalance than the Social Security trustees do, as well as sooner combined trust fund depletion in 2032 (per “CBO’s Long-Term Social Security Projections,” published December, 2019). Extrapolating CBO’s projection
window past 2093, the 75-year shortfall estimated under CBO assumptions starting in 2032 would be roughly 1.85% of GDP. Based on these respective views of Social Security finances, it is reasonable to conclude that the size of the shortfall lawmakers will face if reforms are delayed until the 2030s will be somewhere between 1.30%-1.85% of GDP.

Lawmakers should understand that closing a shortfall of such a magnitude would be several times more difficult than enacting the 1983 Social Security amendments was, and also that 1983’s relatively smaller changes were nevertheless substantial and required overcoming formidable political obstacles. Under the trustees’ current projections, delaying action until 2035 would require immediate, sudden improvements of more than 1.1 percent of GDP in Social Security’s annual cash flows, if solvency of the combined trust funds is to be avoided. These sudden changes would be more than twice as large as the near-term effects of the 1983 reforms, which averaged less than 0.5 percent of GDP in their first five years, yet were still intensely controversial and difficult to enact.

2. Given that Medicare projections are highly uncertain over 75 years, how would you recommend that any type of commission approach financing goals?

The enormous uncertainty surrounding long-term projections for Medicare suggests a different approach to long-term financing than is appropriate for Social Security. With Social Security, projections remain remarkably consistent over several years of projection reports, because long-term demographic trends loom larger than short-term economics in shaping the broad contours of program finances. Because individuals are born decades before they begin to collect Social Security benefits, and because benefit levels are statutorily tied to the amounts of workers’ taxable earnings prior to claiming benefits, we have considerable information, decades in advance, about any likely imbalances between revenue collections and benefit obligations. At the same time that lawmakers have access to this extensive information, workers also need accurate information about future Social Security tax and benefit schedules if they are to engage in meaningful retirement income planning. Such individual planning is impossible while Social Security faces a substantial financial imbalance that must be closed via future legislative decisions that remain unspecified. All of this indicates that lawmakers have not only the essential information required, but also a duty to participants, to align Social Security’s benefit and revenue schedules so that the program remains not only solvent for the long-term (75 years), but sustainably solvent.

As noted in your question, Medicare projections are highly uncertain over the long term; Medicare program finances could be qualitatively better, or qualitatively worse, than the trustees currently project. In the near term
Medicare’s finances, like Social Security’s, are governed largely by demographics. However, Medicare’s long-term projections are much more susceptible to changes in the rate of national health cost growth, which is much more difficult to predict.

Wherever there is greater projection uncertainty, one must be more conservative in financial planning, to provide a cushion against the significant possibility that trends may prove more unfavorable than under the central projection. As an example of such prudence, the 1981-83 Greenspan Commission conducted analyses to determine provisions’ effects on trust fund solvency not only under the trustees’ intermediate projection scenarios but also under their high-cost scenario. Prudent Medicare financing policy would similarly ensure that the program remains solvent in the near term under the trustees’ high-cost projection scenario (which currently shows the HI trust fund being depleted in 2023). Clearly, it would be imprudent for lawmakers to leave Medicare in a financial condition where it fails the trustees’ short-range (10-year) test of financial adequacy under the trustees’ high-cost projection scenario. More prudent, although also more politically difficult, would be the enactment of legislation that eliminates Medicare’s financing shortfalls over 30 years, as projected under the trustees’ high-cost scenario.

3. When you were asked about raising the cap on taxable wages, you mentioned the desirability of slowing benefit growth for higher-income participants in combination with (or perhaps as a substitute for) any increase in the cap on taxable wages. Could you provide additional detail about why it is important to focus on slowing benefit growth for high-income participants versus raising their taxes?

Social Security benefits are calculated as a function of one’s earnings subject to the Social Security payroll tax. This connection cannot be severed without destroying the contributory insurance design of Social Security, which provides the program with much of its political strength by distinguishing it from so-called welfare. This connection also means that absent changes to the benefit formula, the more earnings that are subject to tax, the greater the program’s benefit obligations will be. This in turn means that raising the cap on taxable earnings is financially very inefficient, in that a significant portion of the additional revenues collected in the near term simply result in higher benefit payments over the long term. For example, the oft-cited proposal to increase the cap on taxable wages to cover 90 percent of all national earnings would reduce Social Security’s long-term annual deficits by only 14 percent (see https://www.ssa.gov/OACT/solvency/provisions/charts/chart_run165.html). In addition, after such a change, program costs would still be growing perpetually faster than growth in our capacity to finance Social Security. This accentuates the
desirability of slowing the growth of benefit payments to high-income individuals, irrespective of whether the cap on taxable wages is increased.

In addition, there are important distributional reasons to slow the growth of benefit obligations instead of focusing primarily on increasing the taxable wage base. One is that, as detailed in my testimony, under current law Social Security treats generations just now entering the workforce less favorably than older generations. To close the financing gap solely by raising taxes shifts the financing burden to younger generations who are already being treated worst, while failing to collect significant contributions from older high-income participants who were the greatest gainers from rising income inequality over the last few decades. These high-income individuals will only make a significant contribution to Social Security solvency if changes are imposed on the benefit side rather than by taxing future wages. In addition, while it is often said that only a small percentage of Americans have earnings above the current-law payroll tax cap, this is only true on an annual basis; raising the cap would actually increase taxes for roughly one-fifth of American workers, who have earnings above the current cap in at least some of their working years. Contributions to sustaining Social Security can be more precisely targeted on the highest earners by changing the benefit formula than by increasing the tax cap. For these and many other reasons, moderating the growth of benefits for the highest earners is an appropriate policy goal regardless of whether the tax cap is increased, and is especially important in the presence of a tax cap increase.