

POLICY ANALYSIS:

How to Avert the American Spending and Debt Crisis: A Menu of Options

By Alison Acosta Winters | July 19, 2019

EXECUTIVE SUMMARY

Even as the United States enjoys a strong economy and historically robust jobs market, a fiscal shadow hangs over the country. The latest long-term forecast from the Congressional Budget Office shows the federal government on a course of overspending and record deficits that will overwhelm the agenda of pro-growth policies and sink America further and further into debt. This spiral of spending and debt imperils the current economic boom and puts at risk the prospects for prosperity.

The crisis is approaching more rapidly now, but it has been decades in the making. Both political parties shoulder plenty of blame. The mountain of debt that threatens our economy was a bipartisan creation, and it will take a bipartisan effort to find a solution.

Simplistic slogans like “taxing the rich” will not suffice. Spending projections far outpace any conceivable revenue increases, and as we approach debt-to-GDP ratios of 100 percent and worse, the only way to meet the problem will be to reform Social Security, Medicare, and Medicaid, the real drivers of overspending. Those three programs account for \$2.1 trillion in federal spending today, a figure that will rise to \$3.9 trillion in 10 years.

A range of options, many bipartisan, exist to prevent the crisis, but policymakers simply cannot address the debt crisis, deliver better health outcomes, and secure a dignified retirement for all Americans without reforming Social Security, Medicare, and Medicaid.

America is enjoying a surging economy and historically robust jobs market. But, as the newest long-term outlook from the Congressional Budget Office confirms,¹ there is brewing fiscal turmoil that imperils this bright picture.

KEY TAKE AWAYS

- Federal spending is driving up debt and is imperiling economic growth and prosperity. Without urgent action, the burden from unaffordable spending will fall on everyone from younger Americans to seniors.
- In 2018, the federal government spent over \$32,000 for every household in America, taxed \$26,000, and put \$6,000 on the credit card—which already had a tab of \$168,000.
- On top of today’s \$22 trillion national debt, the tab for the long-term unfunded promises for Social Security and Medicare benefits is stunning—\$56 trillion in net present value terms.
- Addressing the biggest drivers of spending and debt—Social Security, Medicare, and Medicaid which will account for 84 percent of all increases in program spending over the next decade—is paramount to avoid a fiscal crisis.
- The proposals included here are intended as a menu of options to improve retirement and health outcomes for Social Security, Medicare, Medicaid, and federal savings plans, and make them affordable for taxpayers.

The federal government’s current course of putting spending in overdrive and racking up record deficits and debt runs contrary to the positive agenda of pro-growth policies—such as tax and regulatory reform achieved in the past two years. There is more that can be done to further unleash the economy. But perpetually increasing spending is harmful fiscal policy that is holding back growth, opportunity, and prosperity for Americans.

The picture is deeply troubling, but this crisis has been coming for many years. Year after year, Washington has failed to address our budget challenges and opted instead to make them worse. As a result, the country is lurching ever closer to a spending and debt crisis. Both parties are to blame, making this a true bipartisan problem that will require a bipartisan solution.

The federal government has a core, positive role as laid out in the Constitution. But we have strayed far from that core role and it is costing us dearly. High government spending, taxes, and debt interfere in the free market and create harmful incentives for businesses and individuals. Costly corporate welfare policies pick winners and losers, while large, mandatory spending programs take from one group and give to another. Americans are left with fewer opportunities and less money in their pockets to provide for their families, and it is harder for them to invest for their future or save for their retirement.

Sadly, it’s true that much of this budget problem will fall on the shoulders of our younger generations. This intergenerational theft is a troubling moral concern. But without action, no group of Americans, including today’s retirees, will be spared. Continuing to wait will ultimately mean painful and disruptive changes for everyone—especially the most vulnerable. We cannot allow this to happen. We must address this problem today with the urgency it deserves.

TODAY’S FISCAL OUTLOOK

At the end of fiscal year 2018, federal spending topped \$4 trillion for the first time.² Tax revenues grew slightly to \$3.3 trillion, and the deficit of \$779 billion pushed the national debt to \$21.5 trillion, according to the Congressional Budget Office (CBO).³

Let’s put this into a more relatable context. For every household in America, last year the federal government spent over \$32,000, taxed \$26,000, and put \$6,000 on the credit card—which already had a tab of \$168,000.⁴

For every household in America, the federal government:

spent over

\$32,000

taxed

\$26,000

charged the credit card

\$6,000

1. “[The 2019 Long-Term Budget Outlook](#),” Congressional Budget Office, June 25, 2019

2. “[The Budget and Economic Outlook: 2019 to 2029](#),” January 28, 2019, Congressional Budget Office, note: This outlook was used because it is a more in-depth analysis than the May, 2019 update which did not significantly alter the results

3. [The Daily History of the Debt](#), Treasury Direct

4. CBO Budget Outlook, and author calculations based on 2018 households, Census Bureau, [Historical Household Tables](#)

This is a gloomy snapshot. The problem is, the situation only grows more dire in the future—not just over the next decade, but perpetually after that. Unfunded benefits for Social Security and Medicare are massive and over the long term total \$56 trillion in today's dollars,⁵ or \$438,000 for every household in America—on top of the debt owed.

Unfunded benefits for Social Security and Medicare:

\$56 trillion **\$438,000**
total per household

As scary as these numbers are, the debt is a symptom of the disease. Spending is the root cause of our debt. To fix the debt we must fix our spending problem, which at its core is a combination of wasteful overspending and huge, expensive programs that are not designed for the times. To solve the debt crisis, we not only need to reduce wasteful spending across the board, but we must also take on the necessary task of finding better ways to provide health care and retirement security. By modernizing Social Security and Medicare, we can reduce the debt while ensuring they work better for all Americans.

To solve the debt crisis, we not only need to reduce wasteful spending across the board, but we must also take on the necessary task of finding better ways to provide health care and retirement security.

Debt

There are actually two measures of federal debt. The first is debt held by the public, such as T-bills issued by the Treasury Department. Since this debt is bought and sold in financial markets, it matters most for the economy. Most pension plans own some of this publicly held debt, as do many mutual funds. At the end of fiscal 2018, debt held by the public was \$15.8 trillion, or 77.8 percent of gross domestic product (GDP).⁶ The historical average level of debt is 42 percent. Public debt as a share of GDP has been this high only once before, at the height of and immediately following World War II. Today's high debt levels are truly unprecedented in a time of strong economic growth and prosperity.⁷

5. "2019 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds," Centers for Medicare and Medicaid Services, April 22, 2019

6. CBO, [Budget Outlook](#)

7. "Historical Tables, Budget of the U.S. government, Fiscal Year 2020" Office of Management and Budget; in 1947 public debt was 93.9 percent of GDP and then declined to 82.4 percent in 1948. It continued to decline as a share of GDP until the mid-1980s where it increased with the Reagan-era defense buildup, briefly declined again under President Clinton, before rising again beginning in 2001.

Even worse, by 2029 publicly held debt is projected to reach \$28.7 trillion, or 92.7 percent of GDP. In just 18 years debt will reach 108 percent of GDP, surpassing its previous highest level following World War II, and will climb to 144 percent of GDP in 30 years. Over the longer term, publicly held debt will reach 144 percent of GDP—a level never seen in this country.⁸ In dollar terms, it would reach \$96 trillion, vastly outpacing the entire U.S. economy of \$66 trillion.

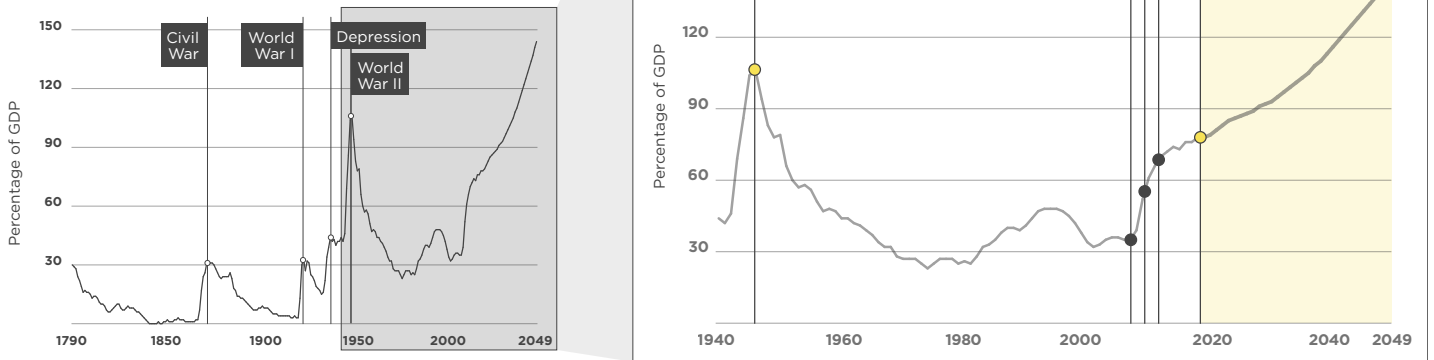
Chart 1

Publicly held debt

1790-2049

As a share of GDP

○ Projected Debt



Source: CBO Long-Term Budget Outlook

The second measure, total national debt reached \$21.5 trillion at the end of last fiscal year, or about 106 percent of GDP. In addition to debt held by the public, it includes what the government owes to itself through intergovernmental debt, including the Social Security and Medicare trust funds.

A BLEAK FISCAL FUTURE

The relentless growth in spending, particularly on the nation’s seniors and health care, will consume an ever-larger share of our economy and push debt to historic highs.

Spending will increase from \$4.4 trillion in FY 2019 to over \$7 trillion in 2029. Tax revenues will also grow—from \$3.5 trillion to \$5.7 trillion. But large, constant deficits will push debt held by the public up by \$12.1 trillion, from \$16.6 trillion to \$28.7 trillion.⁹

Another way to measure the budget is to compare it to the size of our economy (as measured by gross domestic product, or GDP). This helps show how spending is growing relative to the economy as a proxy measure for our ability to pay for it. Looking at the budget this way tells the same story of runaway spending.

8. “[The 2019 Long-Term Budget Outlook](#),” Congressional Budget Office, June 2019

9. CBO, Budget Outlook

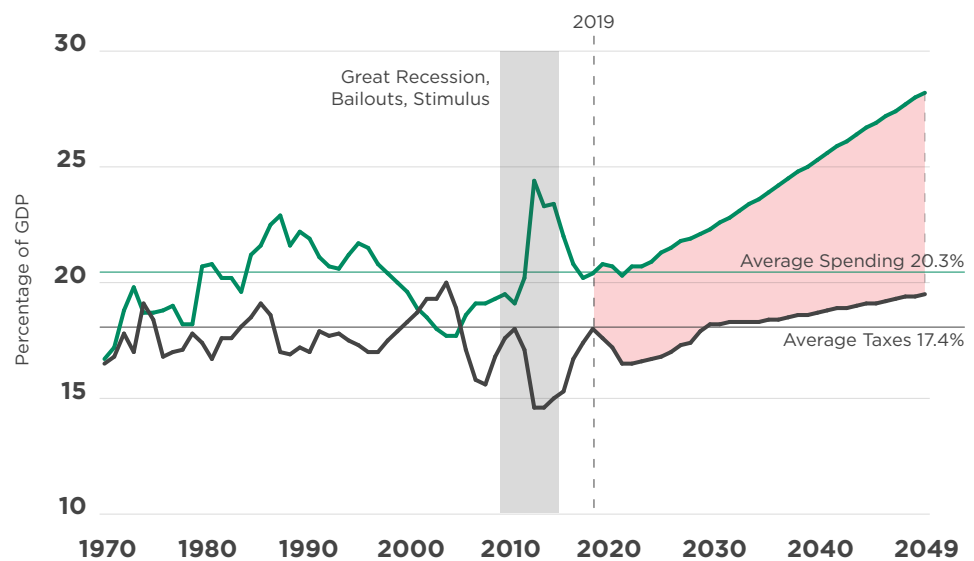
In 30 years, federal spending will be a stunning 39 percent higher than today as a share of our economy.

Over the past 50 years, federal spending has averaged 20.3 percent of GDP. FY 2018 marked the last year federal spending will be at this historical level. From this year forward, it will increase, reaching 22.7 percent of GDP in 2029. It gets even worse, reaching 28.2 percent of GDP by 2049.¹⁰ This is a stunning increase, with federal spending 39 percent higher than today as a share of our economy. This will put increasing pressure on our resources, making it harder for families, entrepreneurs, and businesses to save and invest, or to buy a car or a house, and generally diminishing our standards of living.

Tax revenues will grow too, but not nearly enough to keep pace with spending. At 16.4 percent of GDP, revenues today are low compared with the 17.4 percent historical average. But by 2025, they will reach the historical average, and by 2029 exceed it at 18.3 percent of GDP. Over the longer-term, revenues will also grow significantly, rising to 19.5 percent of GDP. Making permanent the individual income tax cuts in the Tax Cuts and Jobs Act, which are set to expire at the end of 2025, would shave that to around 17.4 percent of GDP by 2029 and 18.8 percent by 2049, still well above the historical average.¹¹

Chart 2
Spending and taxes:
 Past, present, and future
 As a share of GDP

- Spending
- Taxes
- Deficit



Source: CBO Long-Term Outlook

Some argue we have a revenue problem, particularly after the TCJA. But with taxes soon to reach and then exceed the historical average, this is clearly not the case. Unaffordable spending is driving our debt and deficits. According to the CBO, in just three years deficits will return to \$1 trillion levels.¹² But unlike those during the financial crisis, these trillion-dollar deficits will be permanent and growing, reaching \$1.4 trillion by 2029 and upward from there on out.

The chief drivers of federal spending are Social Security, Medicare, and Medicaid. Spending on these programs will rise dramatically every year, from a combined \$2.1 trillion in 2019 to \$3.9 trillion in 2029. These three programs account for 84 percent of all increases in program spending¹³ over the next decade, and 73 percent of all new debt.

10. "The 2019 Long-Term Budget Outlook," Congressional Budget Office, June 2019; long-term projections are calculated as a share of GDP

11. CBO, Budget Outlook, and CBO Long-term Outlook and author's calculations. The personal income tax cuts in the Tax Cuts and Jobs Act expire at the end of 2025.

12. CBO, Budget Outlook; OMB Historical Tables show deficits reaching \$1 trillion even sooner in FY2019

13. Total spending less net interest

Net interest will more than double to \$900 billion in 10 years, more than will be spent on either defense or Medicaid.

One result of runaway spending and deficits is higher interest costs. Net interest will more than double to \$900 billion in 10 years, more than will be spent on either defense or Medicaid. By 2045, net interest would equal and then surpass total discretionary spending as a share of the economy. This will put tremendous pressure on the budget, driving spending on all other programs—defense, veterans, homeland security, judiciary, antipoverty, and more—down as a share of GDP.

NOT JUST A BUDGET PROBLEM

This is not just a budget problem. High levels of spending and debt are bad fiscal policy. But what makes this even worse is that high government spending, and its programs and activities, actually harm society and make it harder for people to rise to their full potential and achieve success.

Unreasonable Expectations

When policymakers constantly add and expand federal programs, they create unreasonable expectations that government can and should solve every perceived problem in society. This leads to increasing demands for more government, rather than looking to broader society for solutions. These demands now run the gamut, from child care, family leave, health care, and welfare, to corporate welfare for businesses and industries. Expectations creep has led to extraordinary mission creep.

Support for Social Security ultimately led to calls for federal health care programs and the creation of Medicare and Medicaid, which have both been expanded over the years, including under the Affordable Care Act. Now there are calls to have the federal government take over health insurance entirely. These programs are already unaffordable and unsustainable. Moreover, as the Affordable Care Act clearly demonstrated, they do not deliver promised results. Just ask anyone who didn't get to keep their health care plan or their doctor, or saw their premiums going up.

Harmful Incentives and Barriers

In a similar vein, when government expands beyond its core, beneficial role, it creates harmful incentives and barriers for individuals and businesses to rely on the government rather than achieve their own success and to help others to do so. Social Security's high payroll tax makes it difficult for lower-income workers to save for their own needs and retirement, while also creating incentives to rely on Social Security and avoid saving. For example, according to the Government Accountability Office, almost half of Americans over 55 have no retirement savings.¹⁴

Crowd Out

Large government programs crowd out private solutions and civil society organizations that can provide better, local direct assistance. They also crowd out the role of free enterprise. For example, studies have shown that creating a government-funded paid family leave program for new parents would result in businesses cutting back their own existing benefits.

14. Government Accountability Office "[Retirement Security: Most Households Approaching Retirement Have Low Savings, an Update](#)," Letter to Senator Sanders, March 26, 2019

POLICY CHOICES

If we do not tackle the major programs—Social Security, Medicare, and Medicaid—there are three paths to follow: hiking taxes, cutting low-hanging fruit, or doing nothing.

A closer look at each of these reveals they are not real solutions at all.

1. Hiking Taxes

With few exceptions, policymakers have been loath to offer serious solutions to rein in spending, but some have proposed tax increases to close the spending gap, often targeting top income earners, private wealth, and businesses. This would be wrong. American taxpayers have not been under-taxed—even the top 1 percent—and they should not be asked to send more of their hard-earned income to feed the insatiable appetite of an ever-growing federal budget.

The top 1 percent of income earners in America earn 16 percent of taxable income, yet pay 42 percent of the federal income tax and nearly 27 percent of total federal taxes.¹⁵ The top 20 percent earn 53 percent of taxable income yet pay 87 percent of the federal income tax and 69 percent of total federal taxes. Some have proposed a wealth tax, but these taxes are notoriously hard to enforce, easy to avoid, and rife with cronyism, which is why most European countries have abandoned them.

Moreover, raising taxes on the rich would not raise the revenues necessary, even when setting aside the predictable and significant economic consequences of raising taxes on risk takers, entrepreneurs, and job creators, and just using simple math. For example, doubling the current tax brackets on top earners from 35 percent and 37 percent to 70 percent and 74 percent would yield just over a quarter of the revenues needed to close the budget gap.¹⁶

Hiking taxes alone would require massive, across-the-board increases that would put a crushing burden on taxpayers, hit the most vulnerable the hardest, and stifle economic progress.

Hiking taxes alone would require massive, across-the-board increases that would put a crushing burden on taxpayers, hit the most vulnerable the hardest, and stifle economic progress. This would require tax increases on the magnitude of a European-style value added tax on all purchases that would reach 17 percent in 2030 and 34 percent by 2048; or raising the combined Social Security and Medicare payroll tax from 15.3 percent to 33.5 percent.¹⁷ This would just stabilize the debt at 95 percent of GDP, and would not even close the budget gap.

What's worse, there is no guarantee that new taxes would be used to close the current spending gap. If past is prologue, it's more likely that lawmakers would spend these new taxes—even several times over.

15. "T18-0097—Share of Federal Taxes - All Tax Units, by Expanded Cash Income Percentile, 2019," Model Estimates, Tax Policy Center August 2018

16. Chris Edwards, "Why Europe Axed its Wealth Taxes," National Review Online, March 27, 2019; and Brian M. Riedl, "A Comprehensive Plan to Avert a Debt Crisis" by Brian M. Riedl, Manhattan Institute, September 2018

17. Brian Riedl, "A Comprehensive Federal Budget Plan to Avert a Debt Crisis," September, 2018, The Manhattan Institute; Note: these calculations were based off the 2018 Long-Term Outlook

2. Cutting only Low Hanging Fruit

Cutting other spending is important and necessary to constrain government to its core role and to keep the burden on taxpayers affordable. Unfortunately, that alone will not be adequate to close the growing budget gap, which this year will be nearly \$900 billion, according to the CBO.

Foreign aid is often considered a prime candidate for spending cuts because, by nearly all measures, it fails to achieve its goals and in some instances is even harmful.¹⁸ It includes programs like the Peace Corps, international military training, foreign assistance and more. Cutting wasteful and harmful foreign aid spending should happen, but total foreign aid spending is \$48 billion, just 5 percent of this year's deficit,¹⁹ so even eliminating it wouldn't close the gap. And \$10 billion of the \$48 billion is for running our embassies and administration of foreign affairs.

Chart 3
Closing
the Deficit



Source: CBO Budget Outlook and President's FY2020 Budget

Taxpayer dollars must be used efficiently and for the purposes they were intended. So rooting out waste, fraud, and abuse is important. The president's 2020 budget outlined a number of proposals to make government programs more efficient and eliminate fraud and abuse. Some of these steps would not be popular and might even be controversial. All totaled, they add up to \$300 billion over a decade, \$30 billion per year on average, or about 3 percent of the total deficit.²⁰ These are sound policies, but far, far more would be needed to close the spending gap.

Even eliminating the entire Department of Defense would close only three-quarters of the deficit with total military spending projected at \$664 billion this year.

Even eliminating the Department of Defense—the entire military and our troops at home and abroad—would close only three-quarters of the deficit with total military spending projected at \$664 billion this year. Likewise, cutting the other \$670 billion in discretionary spending, which includes programs related to agriculture, homeland security, justice, energy, roads and bridges, housing, and veterans, wouldn't close the deficit.

And because Social Security, Medicare, and Medicaid grow so much faster than the rest of the budget, even eliminating defense or other discretionary spending would only delay trillion-dollar deficits by a matter of years.

But eliminating our entire military, explicitly a constitutional function of the federal government, or all other discretionary spending programs would be a mistake. The example serves to show, however, the vastness of our mandatory spending problem and the challenge in finding cuts that are easy politically and will make a significant contribution to tackling overspending.

18. Ian Vásquez, "U.S. Foreign Aid Programs," Downsizing the Federal Government, The Cato Institute, July 20, 2017

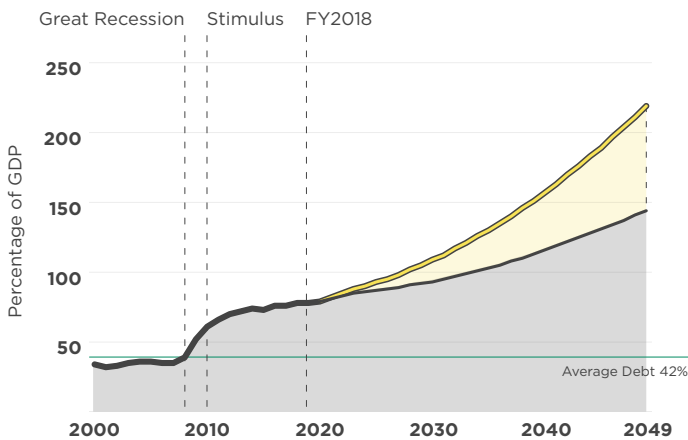
19. CBO, "Budget and Economic Data, Spending Projections by Budget Account, January 2019," all outlays in budget function 150 including all operations for the Department of State

20. "President's Budget Gets Serious About Cutting Waste, Fraud, and Abuse," Committee for a Responsible Federal Budget, May 3, 2019

Chart 4

Alternative Fiscal Scenario

Debt as a Share of GDP



Source: CBO Budget Outlook and Long-Term Budget Outlook

- Baseline
- Alternative Fiscal Scenario

3. Doing Nothing

Doing nothing is neither responsible, nor a solution. Unconstrained spending growth will push the budget ever higher to new, unaffordable and unsustainable levels. Deficits will drive the debt to levels never seen before, with rising interest costs taking up more of the federal budget.

Yet that's exactly what Congress is doing today by letting mandatory spending continue on autopilot and blowing through the Budget Control Act's discretionary spending caps (which ironically were intended to rein in spending and debt.)

This situation will become untenable at some point, likely sooner rather than later. Other countries will eventually start demanding a premium for buying our debt and interest rates could skyrocket. According to CBO, if interest rates were to rise by even just one percentage point, the debt would reach 199 percent of GDP by 2049 and surpass \$100 trillion by as soon as 2046, and top \$132 trillion!²¹

Spiking interest rates, which also raise prices and slow the economy, are one likely scenario. We could also experience a financial crisis that would make the Great Recession pale in comparison. Or we could experience some combination of these—but any outcome like this would decrease opportunity for American families, workers, and businesses.

Additionally, these numbers assume that Congress will stay within the discretionary spending caps and continue reining in this part of the budget when the caps expire. Under a more pessimistic scenario, spending and debt could be even worse, making a bleak fiscal future even bleaker. Under such a scenario, by 2049 spending could reach 33 percent of GDP (rather than 28 percent), while debt could soar to 219 percent of GDP (rather than 144).²² If interest rates increase, this would be even worse—just an increase of one-tenth of one percentage point could push the debt to 225 percent of GDP.

Increases in the debt to such massive levels would leave all Americans considerably less well-off. For example, real gross national product would be 3.6 percent lower. This is a significant loss of wealth, amounting to \$3,400 less per person, or \$13,600 for a family of four by 2049.

21.CBO Long-Term Outlook and author calculations

22.CBO 2019 Long-Term Outlook, alternative fiscal scenario which assumes discretionary spending grows with inflation and certain tax changes including making all TCJA tax cuts permanent and repeal of Obamacare taxes.

Increases in the debt to such massive levels would leave all Americans considerably less well-off. For example, real gross national product would be 3.6 percent lower. This is a significant loss of wealth, amounting to \$3,400 less per person, or \$13,600 for a family of four by 2049. These are some of the possible outcomes of taking the “do nothing” path. What we know for certain is that doing nothing will make ultimate solutions costlier, even draconian. We also know that it will result in abrupt, dramatic benefit cuts. Under current law, for example, every person on Social Security will be subjected to abrupt and painful across the board benefit cuts just 15 years from now when the trust fund runs out of money.

SOLUTIONS

The first law of holes says when you’re in one, stop digging!

On top of today’s existing \$22 trillion debt, the tab for the long-term unfunded promises for Social Security and Medicare benefits is stunning—\$14 trillion for Social Security and \$42 trillion for Medicare in net present value terms. In other words, we would need to set aside a whopping \$56 trillion in cash immediately, in a real trust fund earning interest, to pay full benefits for Social Security and Medicare over the next 75 years. That’s on top of today’s \$22 trillion debt and comes to an additional \$438,000 for every household in America.²³

Sadly, there are more proposals today that would blow the lid off the budget, including Medicare for All, tuition-free college, student-debt bailouts, paid parental leave, free child care, a new infrastructure program, and even colonizing the moon.²⁴

But before we even consider whether there is merit to any of these lofty goals, we must make the programs we already have affordable today and in the future. Otherwise, those who rely on them the most will suffer dramatically.

That means we must make substantive reforms to Social Security, Medicare, and Medicaid, which are the main drivers of spending and debt. Incremental changes would be welcome because with programs of such magnitude, especially Social Security and Medicare, changes can start slowly but compound over time to achieve significant savings. Waiting any longer to address overspending will make solutions harder on all Americans. In fact, many worry that we are at that threshold today.²⁵

Overspending is often portrayed as an issue that will affect younger taxpayers and future generations. But this is an urgent problem that will affect older Americans, too, and it will come to a head during peak retirement years for many.

Parents and grandparents want to make life better for their children and grandchildren. But if we continue on this path, the opposite will happen—we will witness the greatest transfer of wealth in history to our parents and grandparents from our kids and grandkids.

If we continue on this path, we will witness the greatest transfer of wealth in history to our parents and grandparents from our kids and grandkids.

23. “2019 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds,” Centers for Medicare and Medicaid Services, April 22, 2019

24. NASA FY2020 [budget amendment](#), May 13, 2019; “[White House wants \\$1.6 billion extra for NASA to accelerate astronaut return to the Moon](#),” The Verge, May 13, 2019

25. See Charles Blahaus, “[Four Lessons from the Latest Social Security Trustees’ Report](#),” E-21 Commentary, June 11, 2019; and “[Social Security is staring at Its First Real Shortfall in Decades. Big Cuts Could Follow](#),” New York Times, June 12, 2019

We have a moral imperative to fix these programs. They must be fair for all Americans—seniors, workers, and families alike.

Principles for Reform

- Federal spending should be sustainable and affordable, without growing deficits or massive debt.
- Spending should respect all taxpayers and not require ever-growing levels of taxation.
- The biggest drivers of spending and debt—Social Security, Medicare, and Medicaid—must be reformed without imposing harmful fiscal and economic burdens on society.
- Entitlement reforms must go hand in hand with discretionary spending reforms, including defense and foreign policy, economic development, and more.
- Reforms must improve incentives for personal responsibility, remove barriers for success, and reflect the changing economic and demographic realities of the 21st century.
- Shared state and federal programs should provide flexibility for states to tailor solutions to meet the needs of their citizens.

Below follows a brief discussion of these largest programs driving our spending and debt crisis and a menu of options to consider as first steps in preventing it. Many of these proposals have the advantage of having bipartisan support.

SOCIAL SECURITY

Social Security faces severe demographic challenges with more Americans moving into retirement, living longer in retirement, and fewer workers to pay their benefits. These challenges are driving the program's multitrillion-dollar deficits. Beyond that, there are weaknesses with the program itself. Social Security is not adequately meeting some of its original goals as an anti-poverty program or an insurance plan that protects seniors who outlive their savings: the minimum benefit is below the poverty line, and the payroll tax incentivizes workers not to save for retirement.

This is an urgent problem. The Social Security Trust Fund will be insolvent in 2034.²⁶ The trust fund is a misnomer and provides a false sense of security that Social Security's finances are just fine until then. That is wrong. Already, Social Security has been paying more in benefits than it's been taking in in payroll taxes, contributing to today's rising deficits.

The trust fund is not like a normal one that has real assets like cash or certificates of deposit. Instead it contains a special kind of note issued by the U.S. Treasury that the trust fund can cash in later, like an IOU. Soon, the Treasury will have to pay off those IOU's by borrowing more money in financial markets. In 2034, those special notes will all be spent.

That means the trust fund will be exhausted when today's 51-year-olds reach eligibility age and today's youngest retirees turn 77. At that point, all beneficiaries will face a 20 percent across-the-board benefit cut. This makes reform urgent not just for younger taxpayers, but also seniors and near retirees.

26. ["Status of Social Security and Medicare Programs, A Summary of the 2019 Annual Reports,"](#) Social Security and Medicare Boards of Trustees

Reforms should concentrate on making Social Security affordable, predictable, and sustainable, while limiting the burden it places on American workers. They should prioritize benefits for those who need them most and eliminate incentives against work and saving.

Specific Policy Options:

Increase Transparency

Americans should better understand the condition of Social Security's finances, including how much they pay in Social Security taxes.

- Congress requires employers to disclose the employee share of FICA on W-2s. It should also require disclosure of the employer share so workers know the full tax they pay.
- Under current law, benefits will be cut across the board when the Social Security trust fund runs out of money in 2034 by approximately 20 percent.
 - Congress should require the Social Security Administration to inform every worker how much their benefit will be before and after the trust fund runs out of money.

Align the Eligibility Age for Benefits with Current and Future Longevity

Americans are living much longer than when Social Security was introduced. This alone is excellent news. But they are also living longer in retirement than Social Security was designed for. The eligibility age for retirement benefits is gradually being increased to 67 for full retirement, but this hasn't kept pace with longevity increases. Congress should:

- Continue to gradually increase eligibility age (to 69 for full retirement).
- Match future increases in life expectancy by indexing it to longevity.
- Gradually increase the eligibility age for early retirement to 65 (from 62).

Correct Cost of Living Increases

The Social Security cost of living adjustment (COLA) should be improved to more accurately reflect inflation. Benefit increases now use the Bureau of Labor Statistics' Consumer Price Index (CPI), which is an older formula that overstates inflation for households. As a result, benefit increases more than offset inflation.²⁷

- Switching to Chained CPI, a more up-to-date measure, would be more consistent with household purchasing behavior as prices rise. The yearly changes would be small, but savings would be large over time.
- This would also make Social Security consistent with the inflation measure used in the tax code.

27. CBO, "[Options for Reducing the Deficit: 2019 to 2028](#)" Mandatory Spending

Prioritize Social Security Resources

Given Social Security's perilous financial situation and programmatic breakdowns, resources should be reserved for those who need them most. Refocusing benefits to protect seniors from poverty would reorient the program to its safety-net roots, while keeping it affordable for taxpayers.

Refocusing benefits to protect seniors from poverty would reorient the program to its safety-net roots, while keeping it affordable for taxpayers.

- Improve the safety net by gradually increasing the focus of benefits on lower-income seniors, away from higher-income seniors. This already occurs to some extent and so would not be setting new precedent.
 - Provide the newest, highest-earning retirees lower initial benefits.
 - Gradually increase the benefit for the lowest-income seniors to a level that will protect them from poverty.
 - Expand this gradually to lower benefits for current high-income retirees.
 - Phase out COLAs over a certain threshold of post-retirement income.
- These changes will relieve middle class families from the burden of paying taxes for upper-income retirees, while better protecting the most vulnerable from poverty.

MEDICARE

Medicare is the largest health care system in the country. Because its benefits go to retirees over 65, it faces the same demographic challenges as Social Security. But it also has the added challenge of rising health care costs. Medicare's Hospital Insurance trust fund is projected to be depleted in 2026, a mere seven years. While millions of seniors enjoy Medicare benefits, the program has a number of problems. It stifles innovation and competition, which are key to improving health care outcomes and containing costs. It also rations care by capping life-time benefits and limits certain kinds of private coverage, while private catastrophic coverage (which is not provided by Medicare) is excessively costly.

Specific Policy Options:

Gradually bring Medicare Eligibility Age in line with Social Security

The current eligibility age for Medicare is 65.

- Gradually bring the Medicare eligibility age in line with Social Security.
- This would not affect those near retirement, would allow others time to adjust, and would bring better cohesion between federal programs for seniors.

Prioritize Medicare Resources

About 50 percent of total Medicare net benefits are subsidized by taxpayers through general tax revenues. This makes sense for low-income seniors and perhaps to some degree for middle-income seniors. But it does not make sense to tax hardworking American families to pay for health care for higher-income retirees.

It does not make sense to tax hardworking American families to pay for health care for higher-income retirees.

- Gradually increase Medicare premiums and cost sharing on a sliding scale for recipients with higher incomes.
- This is not new precedent. Medicare premiums are already income-adjusted.
- Traditional Medicare has three parts—Medicare A (hospitals), B (physician and outpatient services), and D (prescription drug benefit). They each have different financing structures, which is confusing, inefficient, and costly to administer.²⁸
 - Consolidate these elements into one program and collect a single premium.

Improve Incentives for Using Health Care

Medicare does not cover all costs for medical services a senior may use and it has a lifetime benefit cap. This is intentional. Seniors are expected to share in the costs of their care. Seniors can purchase approved private Medigap insurance, which often means seniors pay no other cost besides Medigap premiums. These plans are expensive, but more problematic, they also drive up utilization and costs for all Medicare.

- Reform Medigap insurance and restructure other cost-sharing rules to ensure better incentives for seniors to manage costs and health care services such as by requiring higher Medigap deductibles.

Move Medicare toward Patient Choice

Medicare is complicated and unwieldy, with massive inefficiency, soaring costs, and fraud. It distorts the health care market with its complex rules, price setting with limited competition, and few choices for retirees. Patients have little incentive to manage costs, treatment, or health care utilization.

- Convert Medicare to a patient choice, premium support model, with seniors getting a predetermined contribution (income adjusted) to buy insurance coverage in the private market. This will give seniors incentives to manage costs, while allowing competition to drive innovation in insurance products, medical services, and health care treatments, and to drive down costs. The premium support contribution would be sufficient to afford a plan at least as generous as traditional Medicare. This model already works well for Medicare Advantage and the prescription drug program (Part D).
- Accelerate enrollment in the Medicare Advantage program (Medicare Part C). Seniors shop for their entire Medicare benefit (hospitals, physician and outpatient services, and prescription drugs) in one combined plan under Medicare Advantage, which covers about 1/3 of all Medicare recipients. Accelerating enrollment would provide better continuity, more choices for seniors, improved competition, and lower costs.
 - This will result in more competition and innovation among plan providers so seniors and insurers can capture more of the savings, even allowing plans with a narrow network that save money to give seniors a refund on their premium.

28. Medicare Advantage Program is a good model

Delink Social Security and Medicare

Social Security and Medicare are separate programs with participation voluntary and eligibility requirements clearly defined in law. However, agencies making rules for these programs decreed that participation in Medicare is a mandatory prerequisite to receiving Social Security benefits.²⁹

This is not consistent with current laws governing Medicare or Social Security and poses many problems for those wishing not to participate in Medicare for a variety of reasons, such as a desire to have private health insurance or to avoid onerous restrictions to outside care imposed by Medicare. It also forces a harsh tradeoff between a lifetime of Social Security benefits and private hospital insurance.

- Policymakers, either administratively or legislatively, should return Medicare to voluntary participation and delink it from eligibility for Social Security.

MEDICAID

Medicaid was one of the biggest health care programs in the country even before it was expanded by Obamacare. Originally intended to provide coverage to low-income children and pregnant women, Medicaid was expanded for the disabled and frail elderly, and the Affordable Care Act encouraged states to expand coverage significantly to higher income individuals and families.

Expansion and rising health care costs have resulted in Medicaid straining federal and state budgets and diverting resources away from the most vulnerable populations.

Medicaid is operated by the states, but a majority of funding comes from the federal government and is accompanied by inflexible regulations. Expansion and rising health care costs have resulted in Medicaid straining federal and state budgets and diverting resources away from the most vulnerable populations. This is despite Medicaid enrollees frequently being unable to get the care they need.³⁰ Moreover, Medicaid does not consistently improve health outcomes. Any federal funding should be concentrated on those who need it most, and states should not be encouraged to direct funds away from the least fortunate.

Specific Policy Options:

Freeze Medicaid Eligibility Immediately

Medicaid is already failing the people who truly need it and using more taxpayer dollars to expand it under the current system, which is only digging a deeper hole. Eligibility should not be expanded further, and new enrollees should not be added if they didn't qualify under pre-Obamacare standards.

29. Citizens' Council for Health Freedom, Letters to President Trump [June, 6, 2019](#) and [November 7, 2018](#)

30. Thomas P. Miller, "[The real hidden tax on increased insurance coverage](#)," American Enterprise Institute, January 25, 2018; Matt Winesett, "[What we know about Medicaid's effectiveness](#)," American Enterprise Institute, November 13, 2017; Avik Roy, "[Oregon Study: Medicaid 'Had No Significant Effect' on Health Outcomes vs Being Uninsured](#)," Forbes, May 2, 2013

Allow States to Design Innovative Medicaid Programs

The federal government should grant maximum flexibility to the states, either through a block grant or per-capita cap with broad instructions to improve health outcomes for the most disadvantaged. That means a fixed amount will be given to a state for each eligible enrollee, and the state can decide how best to improve the health outcomes of those enrollees.

SAVINGS

There are a myriad of savings plans that allow Americans to save tax-free or tax-reduced, but they have confusing and complicated rules and restrictions that reduce both usage and effectiveness. Expanded savings plans should accompany reforms to the major spending programs to allow families and individuals to save more for their short and long-term retirement, health care, and personal needs.

Expanded savings plans should accompany reforms to the major spending programs to allow families and individuals to save more for their short and long-term retirement, health care, and personal needs.

Broaden Health Savings Accounts

Health Savings Accounts should be broadened so they can be a more effective tool for patients and families to obtain better care:

- Increase contribution limits. Current limits prevent individuals with expensive health conditions from saving adequately for long-term health care needs.
- Eliminate mandates that require individuals to enroll in high-deductible health insurance before they enroll in an HSA. High-deductible plans do not adequately address the health care needs of sick patients, and mandating they purchase these plans would expose them to high out-of-pocket expenses.
- Allow individuals to spend HSA dollars on insurance premiums. This ensures individuals with HSAs shop for health insurance as cost-effectively as they shop for out-of-pocket medical care.
- Allow individuals to spend HSA dollars on direct primary care. DPC providers offer a variety of medical services in exchange for a flat monthly fee, instead of charging on a fee-for-service basis. This model is particularly effective treating patients with chronic illnesses that require ongoing routine medical care.
- Allow individuals on Medicare to contribute to their HSA.

Broaden Retirement Savings Accounts

Retirement Savings Accounts should be broadened so that more Americans save for their retirement and personal needs.

- Reduce restrictions on contributions and arbitrary drawdown schedules.³¹
- Add a broad universal savings plan with fewer restrictions than other savings plans such as IRAs, Roth IRAs, 401ks, etc., that would make it easier for more people to save—especially lower-income Americans—for a variety of reasons, including retirement. Such plans have been effective in improving savings and achieving self-sufficiency in other countries.³²

CONCLUSION

America is rushing headlong into a fiscal crisis, one that is well-known and predictable. The time for solutions—across the entire budget—is now. But addressing the biggest drivers of spending and debt—Social Security, Medicare, and Medicaid—is paramount. The imminent depletion of the Medicare and Social Security trust funds make clear the urgency in addressing these fiscal challenges while ensuring Americans are not burdened by crushing debt or taxes. In addition, modernizing them to meet our needs in the 21st century and to deliver better health and retirement outcomes, especially for the most vulnerable, is no less important.

Alison Acosta Winters is a Senior Policy Fellow at Americans for Prosperity.

31. Erica York, "[The Complicated Taxation of America's Retirement Accounts](#)," Tax Foundation, May 22, 2018

32. Ryan Bourne and Chris Edwards, "[Tax Reform and Savings: Lessons from Canada and the United Kingdom](#)," Tax and Budget Bulletin No. 77, Cato Institute, May 1, 2017; and Adam N. Michel, "[Universal Savings Accounts Can Help All Americans Build Savings](#)," Backgrounder No. 3370, The Heritage Foundation, December 4, 2018

Appendix: Potential Savings

INTRODUCTION

There are many ways to structure the policy options offered in this paper. Rather than offer very specific solutions, these options are instead intended as a menu of reform ideas to be discussed and refined so they will deliver better program outcomes, especially for those who rely on the programs most and for those who must pay for them. These details are key as different approaches result in much different fiscal and program outcomes. The longer it takes for solutions to be implemented, the more aggressive they will need to be.

Some proposals, especially in long-term generational programs such as Social Security and Medicare, yield small savings over the short term, but compound over time to significant savings. For these programs, short-term savings are important, but the key to reducing long-term deficits is to make changes that are affordable and will deliver sustained fiscal improvements over time. As the growth of spending on these programs is slowly reduced, it is also important to improve the ability of Americans to save. Even though this would reduce revenues, it would lower barriers for Americans to save for their personal, health, and retirement needs.

It is especially important for programs for the elderly to consider gradual approaches that will phase in changes to avoid turmoil and uncertainty and allow time for workers and families to adjust.

Estimates used below are to provide examples of the savings that could be achieved and might not fit exactly with the proposals included in this paper. Significantly, many of these proposals have been made before and, as noted, many enjoy some form of bipartisan support. Where possible, long-term estimates have been used, such as those for Social Security; others are presented in dollars over a 10-year window.

SOCIAL SECURITY

These proposals typically involve a long transition or gradual phase in and yield lower initial savings (or costs) that will compound into significant savings over time. One consideration is whether to phase in new policies only for the newly eligible and “grandfather” current retirees, or whether to make changes for all participants. There are trade-offs for either approach that are beyond the scope of this paper.

Another key element is not just to ensure 75-year actuarial balance, but that savings are enduring beyond the 75 year window, hence the importance of the impact on the 75th year annual deficit. The current estimated long-range Old-Age, Survivors and Disability Insurance (OASDI) Trust Fund for the Social Security program actuarial deficit is 2.78 percent of taxable payroll, while the 75th year annual deficit is 4.11 percent of payroll.³³ These proposals would reduce that long-range deficit and the 75th year annual deficit between 50 and 100 percent.

33. [“A Summary of the 2019 Annual Reports,”](#) Social Security and Medicare Boards of Trustees.

Savings

Increase normal retirement age: reduce by 0.84 percent of payroll long-range actuarial balance, 1.33 percent payroll 75th year according to the Social Security Chief Actuary.³⁴

Increase benefit for lowest income seniors: increase by 0.23 percent of taxable payroll long-range actuarial deficit, 0.41 percent 75th year—and—by 0.07 percent payroll long-range actuarial deficit, 0.07 percent payroll 75th year according to the Chief Actuary.³⁵

Switch to Chained CPI-U—and—phase out COLAs for highest-earning retirees: reduce by 1.25 percent payroll long-range actuarial deficit; 2.31 percent of payroll 75th year according to the Chief Actuary.³⁶

Prioritize Social Security resources with new, higher-earning retirees receiving lower initial benefits: reduce by 0.85 percent long-range actuarial deficit, 1.53 percent 75th year deficit according to the Chief Actuary.³⁷

MEDICARE

Like the Social Security proposals above, many of the proposals for Medicare would be phased in slowly, and conceivably these changes could hold current retirees harmless. Again, there are trade-offs to these approaches, including weighing how big the burden younger generations would shoulder to pay for them.

Savings

Bring the eligibility age in line with Social Security: Over 10 years, net savings range between \$15 billion and \$22 billion. Over the longer-term it would lower net spending on Medicare by 2.5 percent, or a net savings of 1.0 percent by 2048, according to the Congressional Budget Office (CBO).³⁸

Prioritize Medicare resources on those who need them most by gradually increasing premiums for new, higher-income seniors: Over 10 years, savings range from \$40 billion for a very minor premium increase to significantly more for farther reaching approaches.³⁹ For example, President Barack Obama's 2014 budget proposed increasing premiums, for the highest earners, which was estimated to save about \$50 billion over 10 years, according to the Office of Management and Budget.⁴⁰ More recent proposals, such as the Heritage Foundation's Blueprint for Balance, include bolder premium increases for high-income seniors that would save \$438 billion, according to their calculations.⁴¹

34. Scoring for H.R. 6489, the Social Security Reform Act of 2016, [Letter to Honorable Sam Johnson](#), Social Security Office of the Chief Actuary, December 8, 2016, provision 4; NOTE: These savings are from December, 2016 and so slightly outdated. For a more recent scoring, see "[Summary of Provisions that Would Change the Social Security Program](#)," Social Security Administration. These scores are updated annually and include a search feature as well as related links to other proposals using that same provision.

35. Ibid, provisions 8 and 12

36. Ibid, provision 5

37. Ibid, provision 1

38. "[Raise the Age of Eligibility for Medicare to 67, Options for Reducing the Deficit: 2019 to 2028](#)," Congressional Budget Office, December 13, 2018,

39. "[Increase Premiums for Parts B and D of Medicare, Options](#)" CBO

40. "[Fiscal Year 2014 Budget of the U.S. Government](#)", Office of Management and Budget, April 10, 2013.

41. "[Blueprint for Balance: A Federal Budget for Fiscal Year 2020](#)," Heritage Foundation, May, 2019

Move Medicare to a patient choice model, by slowly phasing in a premium support model: Moving to a premium support model would, over 10 years, produce a range of savings from \$21 billion (for new Medicare participants only) to \$419 billion (phasing in for all participants). Net federal spending on affected parts of Medicare for the mid-range option would be reduced by 8 percent, while premium costs for participants would be reduced by 7 percent. These savings would remain stable as a percentage (while dollar savings would increase) for an additional decade, while savings would likely occur further in the future, but could have less of an effect.⁴²

More incrementally, accelerate enrollment in the Medicare Advantage Program, which functions similarly to premium support and costs approximately 6 percent less than traditional fee-for-service Medicare plans.⁴³

Improve incentives for using health care by reforming Medigap insurance and restructuring cost-sharing rules: Over 10 years, savings would range from \$44 billion to \$116 billion, according to the CBO.⁴⁴

MEDICAID

The nature of the Medicaid program for the vast majority of enrollees, who are healthy and of working age, is far different than programs that exclusively or primarily serve seniors. While changes for these populations could still be phased in, they can be reformed more rapidly. But some changes for Medicaid populations, particularly the frail elderly and those with special health care needs should be made especially carefully and allow states flexibility to tailor approaches.

Savings

Allow states to design innovative programs, and cap spending through a fixed amount per capita or block grant. Over 10 years, net savings would range from \$162 billion to \$703 billion, according to CBO.⁴⁵ Alternatively, under either a block-grant or per-capita cap system, potential savings could be as large or small as policy makers might chose.

BROADEN SAVINGS

Broadening personal savings should accompany spending reforms and would, at least in the near term, not create savings for the federal budget. However, these are important policy companions to redesigning retirement and health care spending programs because they would allow people to use more of their earnings and become less reliant on federally funded transfer programs.

Fiscal Impact

Adopt a universal savings plan: an extremely modest USA would reduce revenues by approximately \$8.6 billion over 10 years, according to the CBO.⁴⁶

42. "A Premium Support System for Medicare: Updated Analysis of Illustrative Options," Congressional Budget Office, October 2017; for more on bipartisan premium support models see Robert E. Moffit, Ph.D. "Saving the American Dream: Comparing Medicare Reform Plans," Backgrounder No 2675 Heritage Foundation, April 4, 2012

43. James C. Capretta, "Medicare Coverage Options: Reforming the Beneficiary Choice Process to Improve Competition," Mercatus Center at George Mason University, 2017; for more on Medicare Advantage see Chris Pope, "Enhancing Medicare Advantage," Manhattan Institute, February 2019

44. "Change the Cost Sharing Rules for Medicare and Restrict Medigap Insurance, Options" CBO

45. "Establish Caps on Federal Spending for Medicaid, Options," CBO

46. "H.R. 6757 Family Savings Act of 2018," Congressional Budget Office Cost Estimate, CBO, September 21, 2018

Allowing Medicare enrollees to contribute to health savings accounts (HSAs) would reduce revenues by \$5.5 billion over 10 years and yield no changes to spending, according to the CBO.⁴⁷

The president's budget proposed farther-reaching changes, including **broadening HSA eligibility beyond high-risk plans and allowing seniors on Medicare to participate**, estimated to reduce revenues by \$27 billion over 10 years.⁴⁸

Other HSA proposals range from allowing direct primary care to be paid through an HSA (\$1.8 billion over 10 years)⁴⁹ to increasing the maximum contribution limits to meet total expenses for high-deductible health plans (\$15.3 billion over 10 years),⁵⁰ according to the CBO and Joint Committee on Taxation.

47. "[H.R. 6309 Allowing Working Seniors to Keep their Health Savings Accounts Act of 2018](#)" Congressional Budget Office Cost Estimate, CBO, July 23, 2018

48. President's Budget "[A Budget for a Better America Promises Kept. Taxpayers First.](#)" Office of Management and Budget, March 11, 2019

49. "[H.R. 6317, Primary Care Enhancement Act of 2018.](#)" Congressional Budget Office Cost Estimate, CBO, July 23, 2018

50. "[H.R. 6306 Health Care Security Act of 2018.](#)" Congressional Budget Office Cost Estimate, CBO, July 23, 2018