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ADMINISTRATION EXPECTED TO PROPOSE NEW BUDGET RULE THAT COULD ADVERSELY AFFECT SOCIAL SECURITY, MEDICARE, SSI, VETERANS' DISABILITY, AND OTHER PROGRAMS

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Overview

The Administration's forthcoming budget is likely to propose a new budget rule that would affect Social Security, Medicare, veterans' disability compensation, the Supplemental Security Income program for the elderly and disabled poor, health and retirement programs for federal civilian and military personnel, and ultimately Medicaid and some other entitlements. The new rule was proposed in the Administration's budget last year but was not considered by Congress. It is expected to be proposed again this year and may receive significant Congressional consideration this time around.

Under the new rule, OMB would issue a 75-year cost estimate for any legislation that would increase the cost of any program covered by the rule (except for Social Security, which would be treated somewhat differently, as described below). Estimated cost increases over 75 years would have to be offset by cuts in the same program or another of the programs covered by this rule, except Social Security. Offsetting cuts in programs *not* subject to this rule — as well as offsetting measures that would raise more general revenues, such as measures to close abusive tax shelters or wasteful tax loopholes — *would not be allowed*. Legislation that did not meet this test would be subject to a point of order in the House and Senate and require 60 votes to pass on the Senate floor.

For Social Security, the rule would be even more stringent. Cost increases would be projected not over 75 years but *into eternity*, and they would have to be offset into eternity by reductions in Social Security benefits or increases in taxes dedicated to Social Security. No other offsets would be permitted. Legislation not meeting this test, as well, would require 60 votes to pass in the Senate.

While the nation faces significant long-term fiscal challenges that need to be addressed, this proposal would not represent sound policy. It rests upon long-term cost estimates that would often be unreliable and arbitrary. In addition, careful examination shows the proposal to be unbalanced and highly ideological in nature; it would skew policy debates on matters such as health care in deleterious ways and tilt the playing field in favor of regressive policy approaches even when doing so would produce more costly or less efficient policy outcomes. Finally, adoption of the new rule would decrease the likelihood of a major, bi-partisan deficit reduction agreement in which all parts of the budget are on the table. As a result, approval of this rule could well turn out to do more to retard the goal of long-term fiscal responsibility than to advance it.

Departure from Traditional Pay-As-You-Go Rules

Under the proposal, any legislation that would increase the long-term costs of a program covered by the new rule would be barred, unless the legislation met one of three conditions:

- the legislation included offsetting cuts in one of the other entitlement programs covered by the new rule;
- the legislation included offsetting increases in the Medicare payroll tax (or Medicare premiums or other income dedicated to Medicare), or created a new revenue source dedicated to one of the covered programs; or
- the rule was set aside by the vote of 60 Senators and by the House of Representatives.

For the same reason, any reduction in income dedicated to Medicare would have to be offset by cuts in Medicare or in other programs subject to the rule. (As noted, Social Security would be treated separately and subject to its own set of constraints.)

This proposed rule would represent a marked departure from the pay-as-you-go rules of the 1990s, not only in the proposal's use of a 75-year cost estimating period but in other crucial ways as well.

- The pay-as-you-go rules of the 1990s required both entitlement expansions *and tax cuts* to be offset, and allowed the costs of such measures to be offset *either* by a reduction in *any* entitlement program or by raising *any* type of revenues.
- Under this new rule, by contrast, not only would tax cuts be exempt from budget discipline, and not only would measures to offset the costs of an entitlement improvement through an increase in general revenues be prohibited, but legislation that increased the long-term costs of any of the covered programs could be offset only by cuts in the same program or another of the covered programs. Even offsetting cuts in other entitlement programs would not be considered valid offsets.

This proposal would have large effects. Consider, for example, the need to address a significant problem in the Supplemental Security Income (SSI) program for poor elderly individuals and poor people with disabilities. The program's asset limit is set at only $2,000 for an elderly or disabled individual, has not been adjusted in 16 years and is slated under current law to remain at $2,000 indefinitely. Under the proposal, a measure simply to adjust the SSI asset limit for inflation would need to be accompanied by a measure that offset the cost of such an improvement over the next 75 years by making cuts elsewhere in SSI, unless cuts could be secured from another entitlement program subject to this rule. Since the other entitlements that would be subject to this rule all have more potent constituencies than SSI, the offsetting cuts likely would have to come from SSI itself. Yet SSI already has income limits that are well below the poverty line, and the benefit that it provides to impoverished elderly or disabled individuals with little or no other income brings them up only to *three-quarters* of the poverty line. Cuts in SSI would make the elderly and disabled poor still poorer.

Transferring Authority from Congress to the White House

Under its proposal, the Administration also would have the unilateral authority to add additional entitlement programs to the list of programs that would be subject to this new rule (i.e., to the rule that any legislation raising a program's costs over the next 75 years must be offset by cuts in the same program or in other programs subject to the rule). Once the Office of Management and Budget determined it could make long-term cost estimates for an entitlement, OMB would be free to subject the program to this rule. Although OMB would consult with the Congressional Budget Office and the Budget Committees of the House and Senate, OMB alone would decide whether to make additional programs subject to this requirement. As a result, decisions on the scope of this new House and Senate budget rule would be made by OMB, not by the House and Senate.

Skewing Health Care and Other Debates

In material accompanying the formal transmittal of this proposal to Congress last April, OMB emphasized its intention to add Medicaid as soon as possible to the list of programs that would be subject to this rule. Once that was done, legislation to expand Medicaid to cover more of the uninsured would have to be offset by cuts elsewhere in Medicaid (or in one of the other entitlements subject to the rule). In contrast, legislation to provide new tax deductions or tax breaks related to health insurance (other than refundable tax credits) would not have to be offset at all, even though such proposals would necessarily be less well targeted on the uninsured population and thus almost certainly be less effective at reducing the ranks of the uninsured. As a result, the rule would favor tax cuts for health insurance costs borne by high-income taxpayers who already are insured — the group that would benefit most from tax deductions for health-related costs because they are in the top income tax brackets — over measures to extend health care coverage through Medicaid to uninsured working-poor families.

This proposal for a 75-year pay-as-you-go rule that would be narrowly applied to selected entitlements appears to have a highly ideological nature. In conjunction with a related Administration proposal to establish pay-as-you-go rules from which tax cuts would be exempt, the proposal would tilt the "playing field" so that Congress could not consider competing policy proposals in an evenhanded manner. In the example just noted, proposals to reduce the ranks of the uninsured through an expansion in a health care program would have to overcome formidable obstacles, while proposals ostensibly to address the same problem through tax cuts would not. This type of imbalance would diminish the ability of policymakers to engage in thoughtful efforts to find the most economical and effective solutions to national problems.

Reliance upon Dubious Cost Estimates

In a report issued last summer, the Congressional Budget Office advised that cost estimates for a number of these programs would be inherently unreliable. CBO warned, "The growth of costs for the government's major health care programs is also a substantial source of budgetary uncertainty. CBO includes alternative paths in its long-term projections that show, for example, total federal spending for Medicare and Medicaid in 2050 ranging from 6.4 percent of GDP to more than 21 percent..." Such a wide range of uncertainty about underlying health care costs means that estimates of the costs of new health care legislation also suffer from extreme uncertainty. CBO made the same point another way: in speaking about presenting projections of long-term health care costs in a single "present value" estimate, as the Administration's proposal would require, CBO wrote, "Such measures [i.e., present-value summaries of long-term costs], however, are particularly sensitive to assumptions about the growth of productivity, the growth of Medicare costs, and the discount rate… The assumption about cost increases for Medicare is the most critical influence. Consider an assumption that health care outlays per beneficiary will grow 1.0 percent faster than real (inflation adjusted) GDP per capita through 2080. Adjusting that rate down or up by 0.5 percent would result in a total fiscal imbalance ... that ranged from 4.3 percent of the present value of GDP to 9.4 percent."[1] In short, CBO believes that whether measured in terms of ultimate costs or in present value, the uncertainty surrounding long-term health care costs is extremely large and makes long-term estimates of health care costs unreliable.

In addition, the American Academy of Actuaries, the nation's leading professional organization of actuaries, has sternly warned against using estimates of Social Security costs into eternity. The Academy has said such projections are so problematic that they should not be used even in general policy debates, let alone for legislative purposes, as the Administration's proposal would require.[2] With regard to Social Security projections made into eternity, technically referred to as "infinite horizon" projections, the Academy has said that "the results of the 75-year statutory valuation are themselves subject to extreme uncertainty. …Given the uncertainty of projections 75 years into the future, extending the projections into the infinite future can only increase the uncertainty, rendering the results of limited value to policymakers…"

The Academy also has warned that Social Security projections made over an infinite-horizon "provide little if any useful information about the program's long-term finances and indeed are likely to mislead anyone lacking technical expertise in the demographic, economic, and actuarial aspects of the program's finances into believing that the program is in far worse financial shape than is actually indicated." Indeed, the Academy concluded that projections made over an infinite horizon are so problematic they should not even be printed in the Social Security Trustees' annual report. Including such projections in the report, the Academy has said, would be "a detriment to the Trustees' charge to provide a meaningful and balanced presentation of the financial status of the program."

The rest of this analysis examines the Administration's expected proposal in greater detail.

[1] Congressional Budget Office, *Measures of the U.S. Government's Fiscal Position Under Current Law*, August 2004.

[2] Social Insurance Committee of the American Academy of Actuaries, Letter to the Trustees of the Social Security System, December 19, 2003.

How the Proposal Would Affect Programs Other than Social Security

When legislation affecting any of a specified group of entitlement programs other than Social Security was considered, the Office of Management and Budget and the Congressional Budget Office would produce an estimate of the effect of the legislation on the "unfunded obligations" of those programs over the next 75 years. A program's "unfunded obligation" would be defined as the program's cost minus any "dedicated" revenue that goes to the program, such as payroll taxes. For programs that are funded entirely by general revenue and have no dedicated funding sources, the "unfunded obligation" would simply be the program's cost.[3]

Legislation that would increase the long-term "unfunded obligation" of any of the specified entitlement programs by more than a small amount — more than 0.01 percent of the Gross Domestic Product over the 75-year period or more than one percent of the program's expenditures over that period, whichever is lower[4] — would have to be paid for through offsetting cuts in the same program or in another one of the programs that would be subject to this rule (or through offsetting increases in dedicated receipts for the program or another of the covered programs, such as an increase in Medicare payroll taxes). If legislation did not comply with this rule, it would need 60 votes to pass the Senate.

This essentially is a highly restrictive version of the traditional pay-as-you-go rule; it uses a 75-year measuring period (rather than a 10-year period), and it mandates that the only permissible "pay-fors" are cuts within the same program or another one of the programs subject to this requirement, or new or increased dedicated revenues for these programs, such as the Medicare payroll tax. Cuts in entitlements outside the group would not be considered acceptable offsets. Neither would increases in general revenues.

The affected programs would include:

- Medicare Part A (which provides hospital insurance), Medicare Part B (which covers physician and outpatient services), and Medicare Part D (which covers prescription drugs).

- Veterans' disability compensation,

- Supplemental Security Income for poor people who are elderly or have serious disabilities,

- Civil service retirement and disability programs (CSRS and FERS),

- Military retirement,

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[3] Each calculation would be made on a "present-value" basis, to account for the effect of interest earnings or interest costs over long periods of time.

[4] This rule also would apply to legislation whose 75-year cost is *below* both of these thresholds but whose cost in the *final year* of the 75-year period (i.e., in the 75th year) exceeds 0.01 percent of projected GDP or one percent of projected program costs for that year. In addition, in the case of Medicare, this rule also would apply to legislation projected to increase costs by more than 0.02 percent of taxable payroll over 75 years or in the 75th year.

- Health benefits for federal civilian employees and military retirees, and
- Railroad retirement.

The Director of OMB would have unilateral authority to add other entitlement programs to the list once the Director determined that OMB could make long-term cost estimates for those programs. In documents accompanying the proposed legislation, OMB stated that it would add Medicaid to this list of programs in the near future.

Problems with the Proposal for Programs Other than Social Security

The proposal would unduly restrict Congress' ability to make decisions about budget priorities and to shift funds across a broader array of entitlements in response to changes in need. As noted, offsets would not be considered valid unless they came from the same program or another of the entitlements subject to this rule.

The proposal also would distort policy debates. Policymakers wishing to examine options to reduce the ranks of the uninsured, for example, would face a tilted "playing field." Once Medicaid was added to the list of programs subject to this rule, proposals to reduce the ranks of the uninsured by broadening Medicaid coverage, such as by extending coverage to low-income working parents, would have to be paid for with cuts made elsewhere in Medicaid itself, unless a cut could be instituted in another entitlement within the group of entitlements that would be subject to this requirement. That would likely foreclose consideration of such a Medicaid improvement. But proposals to reduce the ranks of the uninsured by writing more tax breaks related to health insurance into the tax code would not have to be offset at all; they would be "free" for policymakers, even though they would add to deficits just as unpaid-for entitlement expansions would. The new budget rules would confer an enormous advantage on tax-based approaches to health insurance regardless of their relative efficiency and effectiveness.

Another significant problem is that 75-year cost estimates in Medicare and Medicaid are far too speculative to be used for a purpose such as this. Cost estimates in Medicare and Medicaid over a 75-year period are much more uncertain than 75-year estimates in Social Security. Long-term cost estimates for Medicare and Medicaid are dependent not only upon projections of future birth and death rates, as long-term Social Security projections are, but also upon projections of future trends in health care costs. Health care costs in coming decades will be heavily influenced by medical breakthroughs and advances in medical technology that are impossible to predict today. Long-term cost projections in Medicare and Medicaid are subject to a much wider range of uncertainty than long-term cost projections in Social Security are.

Federal Reserve Chairman Alan Greenspan made this point in Congressional testimony last year. He emphasized that long-term Medicare cost projections are much more uncertain than long-range Social Security projections. "We don't have such confidence on Medicare [cost projections]," he stated. "We do not understand the processes that will evolve over time, we cannot anticipate the processes that are going to occur in medical technology and in medical application which gives us any reasonable way to come at what the costs are going to be."[5]

[5] Testimony of Alan Greenspan before the Joint Economic Committee, April 21, 2004.

In short, 75-year cost estimates in Medicare and Medicaid are not sound enough to use as a basis for such a far-reaching budget rule.

A final problem is that the proposal would likely have harsh effects on vulnerable people. This can be seen by examining the effect of applying the proposal to the Supplemental Security Income program, the nation's basic cash assistance program for the elderly and disabled poor. SSI is a parsimonious program; it is largely limited to elderly people and people with disabilities who live in poverty, and the maximum federal SSI benefit for an elderly or disabled individual equals only 76 percent of the poverty line.

As noted above, the SSI program has very low asset limits. When the program was established in 1974, based on a proposal from President Nixon, the asset limits for the program were set at $1,500 for an individual and $2,250 for a couple. They were raised modestly in the 1980s, to their current levels of $2,000 for an individual and $3,000 for a couple, and have not been raised since. Thus, the limits have not been adjusted for the past 16 years, and as a result, have been eroded heavily by inflation. Had the asset limits Congress established in the early 1970s kept pace with inflation, the limits would now be $5,885 for an individual and $8,828 for a couple.

Under the Administration's proposed budget legislation, these asset limits likely would remain stuck at $2,000 and $3,000 for the next 75 years, with the result that fewer impoverished elderly people and people with disabilities would be able to qualify over time. Any attempt to address this matter — and to try to keep these severe asset limits from falling even further behind inflation — would be subject to a requirement that the cost of such an adjustment over the next 75 years be offset by cuts made elsewhere in SSI, unless sufficient cuts to offset the cost could be made in another entitlement program subject to this rule, which would be unlikely. The probable result would be either that nothing would ever be done to address this problem, and over time fewer and fewer impoverished elderly and disabled people would qualify for SSI, or that the asset limits would be adjusted but SSI benefit levels and eligibility limits would be pushed further below the poverty line to produce the requisite savings.

Such an outcome would be much less likely under the pay-as-you-go rules of the 1990s (or the pay-as-you-go provision included in the Senate budget resolution last year, which would have resurrected the rule in effect in the 1990s). Under those rules, the resources to pay for an adjustment in the SSI asset limits would *not* have to come from within the SSI program itself or from a narrow group of entitlements that each have strong constituencies protecting them. Under the pay-as-you-go rules of the 1990s, offsetting savings could be secured from *any* entitlement other than Social Security or from *any* revenue-raising measure other than the Social Security payroll tax, such as a measure to close abusive tax shelters or to scale back modestly the recent capital gains and dividend tax cuts, which are conferring lavish tax breaks on the wealthiest of the elderly while doing nothing for elderly and disabled people living in poverty. The proposal in question appears designed to preclude such options from even being considered.

More broadly, the proposal would have regressive effects. General revenues, which are raised primarily through progressive taxes, are currently used to finance 48 percent of all entitlement expenditures and 76 percent of entitlement expenditures outside Social Security. Nevertheless, this proposal would demand that any future improvements in the affected entitlements be financed solely through entitlement cuts or increases in regressive taxes such as dedicated payroll taxes.

The notion that entitlement programs ought to be funded with regressive taxes, rather than progressive income taxes, is underscored by the use of the term "unfunded obligations" in the proposed rule. In the case of Social Security and the Medicare Hospital Insurance program (Medicare Part A), the rule would appropriately define an unfunded obligation as being the difference between the program's receipts and the program's expenditures; the rule would prohibit legislation that would either increase future expenditures or decrease future receipts dedicated to these programs. But for the other programs that would be covered by the new rule, the *entire cost* of the programs would be defined as "unfunded obligations," and the general-fund receipts that these programs receive would be entirely ignored. Programs such as veterans' disability compensation and the Supplemental Security Income program would be treated as though these programs are slated to receive *no tax revenue at all* and the entire program is one large unfunded obligation. Such treatment is fundamentally inconsistent with the laws that govern the financing of these programs. (To be sure, general-fund receipts will be insufficient over the long term to cover all general-fund expenditures. But that does not mean these programs will receive *no* general-fund revenue. General-fund receipts are projected to be adequate over the long term to cover the solid majority of general-fund costs.)

Furthermore, if the Administration's were to be logically consistent, the rule would bar any increase in the cost of SSI, veterans benefits, or other such covered programs *or any decrease in general revenues* — since either type of legislation would increase the future mismatch between general-fund costs and general-fund revenues. Yet the proposed rule would not do so. In effect, the rule would presume that reductions in *dedicated* receipts are problematic but that reductions in *general revenues,* including reductions in individual and corporate income taxes, do not contribute to future fiscal problems.

This warped perspective makes clear the highly ideological nature of this proposal. It also suggests that one of the underlying goals of this proposal is *not* to bar any legislation that would increase future deficits (since unlimited tax cuts, outside of the payroll tax, would remain subject to no discipline), but rather to protect the Administration's tax cuts and to shield the progressive individual income tax and the corporate income tax from pressures to provide some added revenues to help address the nation's long-term fiscal problems. Indeed, the proposed rule would create pressure to shift more of the burden of financing government to regressive revenue-raising mechanisms that place more of the burden on the middle class and the working poor, such as payroll taxes and increases in premiums and co-payments for the use of health care and other benefits and services.

Social Security Provision Also is Problematic

The proposal also would bar legislation that would increase long-term unfunded obligations in Social Security. This aspect of the proposal differs in two respects from the part of the proposal that would apply to Medicare, SSI, and other specified entitlements. First, the costs of Social Security legislation (other than costs defrayed by increases in dedicated revenues) would be estimated not over 75 years but into eternity (i.e., "over an infinite horizon"), and the projected costs into eternity would have to be offset. Second, the offsets would have to come from Social Security itself; they could not come from any other entitlement.

Given Social Security's long-term financing shortfall, the idea of erecting a barrier against legislation that would increase the program's long-term unfunded obligations and requiring that offsets for such legislation come from Social Security itself has merit. Unlike programs such as veterans disability compensation, SSI, or Medicaid — which are funded by general revenues rather than dedicated revenue streams and to which the concept of "unfunded obligations" is no more applicable than it is to the defense or education budgets — Social Security does have unfunded obligations, and they are sizeable. Moreover, the use of 75-year cost estimates in Social Security is well established and is not subject to as much uncertainty as 75-year cost estimates are for health care programs. Indeed, a point of order already exists in the House against legislation that would increase Social Security imbalances over 75 years.

Yet this component of the proposal is designed in a way that makes it seriously flawed as well. Rather than creating a 60-vote point of order in the Senate against legislation to increase Social Security's unfunded obligation over the next 75 years, the Administration is proposing a barrier against legislation that would increase Social Security's unfunded obligations into eternity. Use of Social Security cost estimates that seek to extend into eternity would run directly counter to the advice of leading experts in the field.

Making projections of Social Security costs and receipts into eternity entails making guesses about birth rates, death rates, and productivity growth rates *centuries into the future*. In December 2003, the American Academy of Actuaries, the nation's leading professional organization of actuaries, sternly warned against relying on Social Security projections made into eternity.

In a letter to the trustees of Social Security system, the American Academy of Actuaries emphasized that infinite-horizon projections in Social Security "provide little if any useful information about the program's long-range finances and indeed are likely to mislead anyone lacking technical expertise in the demographic, economic, and actuarial aspects of the program's finances into believing that the program is in far worse financial condition than is actually indicated." The Academy also stated that: "Given the uncertainty of projections 75 years into the future, extending the projections into the infinite future can only increase the uncertainty…" and the Academy cautioned that "Anomalies and incongruities inevitably arise from extending any set of long-range actuarial assumptions to infinity."[6] The Academy warned that infinite-horizon projections should *not* be used for policy purposes.

Proposal May Make Fiscal Discipline Less Likely to Be Achieved

One argument that may be used to promote the Administration's proposed rule is that at least it imposes some discipline on a portion of the budget. "Half a loaf is better than none" the argument may go.

[6] *Op. cit.*

History suggests this argument is debatable, at best. Over the past quarter century, there have been only three successful large-scale efforts to change course and reduce looming deficits. These occurred in 1982, 1990, and 1993. In each of these cases, *all* parts of the budget were "on the table" — that is, all components of the budget were subject to scrutiny, and all parts of society were asked to sacrifice something to the broader goal of deficit reduction. In each case, taxes were raised on both the middle-class and the well-off (although to widely varying degrees), "discretionary" appropriations were squeezed (with both defense and domestic programs being restrained), and entitlement programs were scaled back. In addition, in both 1990 and 1993, budget process rules were enacted or extended that put hurdles in the way of any future legislation that would either cut taxes or increase program costs.

Based on this history, it appears that major deficit reduction occurs only when all sides of the debate are required to accept fiscal discipline in their own favored areas, in return for imposing fiscal discipline on areas of the budget they care less about. The Administration's proposal, by contrast, would impose fiscal discipline only on one area of the budget — selected entitlement programs. If the proposal is adopted, those who believe that entitlement programs, or domestic programs generally, constitute the only part of the budget that ought to be constrained would have achieved their purpose; they would have no need to sacrifice any of their own preferences to secure imposition of discipline on these programs. As a result, they would have little incentive to engage in broad deficit reduction negotiations. Indeed, successful negotiations on broad-based deficit reduction could put them in worse shape (from their point of view). Far from seeking broader deficit-reduction efforts that covered all parts of the budget, including revenues, they would have additional reason to resist such efforts.

Accordingly, we conclude that enactment of OMB's proposed rule would diminish the prospects of reaching a broad-based deficit reduction agreement, and therefore could reduce rather than increase the amount of deficit reduction actually accomplished in the foreseeable future. We do not see OMB's proposal as half a loaf, but as a step in the wrong direction.

Conclusion

Action to address the projected mismatch between revenues and expenditures for Social Security and Medicare ultimately will be necessary. However, the ideological and unbalanced nature of this proposal — with its exemption of all tax cuts from budget discipline, its indiscriminate favoring of tax breaks as an approach to national problems over programmatic approaches regardless of their relative efficiency and effectiveness, its severe constraints on the types of "offsets" that would be allowed, and its reliance on cost estimates that often will be unreliable — make the proposal unsound and inequitable.