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CONGRESSIONAL TESTIMONY

Testimony before

The Committee on Finance
United States Senate

April 13, 2011

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Chairman Baucus, Ranking Member Hatch, Members of the Senate Finance Committee, thank for the opportunity to testify today. My name is J.D. Foster. I am the Norman B. Ture Senior Fellow in the Economics of Fiscal Policy at the Roe Institute of the Heritage Foundation.

In 2007, as the country was essentially at full employment just prior to the Great Recession, the federal government ran a budget deficit of $162 billion. In 2007, spending on the wars in Iraq and Afghanistan and related activities totaled $174 billion. In short, but for the war spending, the nation ran a balanced budget while collecting a normal share of tax revenues relative to the size of the economy.

Ten years later, under the budget President Obama submitted this past February, the country is once again assumed to be at full employment, yet the federal government is projected to run a budget deficit of nearly a trillion dollars despite an assumed substantial reduction in war outlays and a substantial tax increase pushing revenues well above historical norms. And from there, the deficit balloons as the long-awaited entitlement wave crashes upon us.

Above normal revenues and high and rising deficits can only mean one thing: Spending is the problem. Congress will take a good first step at restraining spending in the legislation finally funding the government for the balance of 2011. It certainly was not easy; nor was it enough. It is also likely we have now harvested most of the low-hanging deficit reduction fruit.

The President's budget released last February offered an exceptional garden of magic asterisks totaling some $2.2 trillion in savings. The budget is usually where the President puts forward his programmatic agenda, with details sufficient to inform the public and guide legislative action. Magic asterisks indicate an area of desired programmatic change and the expected budgetary effect, but no policy. Beyond the asterisks, the President's plan was notably silent on how we would address the near-term or the long-term deficit.

Last week, Congressman Paul Ryan, Chairman of the House Budget Committee revealed a Path to Prosperity program of expansive scope calling for sweeping change -- with real policy proposals and Congressional Budget Office scoring. To date, not one magic asterisk has been identified.

The Ryan plan is bold, and has generated both heat and light in abundance. Stepping back, what this Committee, the Congress, the nation must realize is that the changes proposed in the Ryan plan suggest the magnitude of the changes necessary to stabilize federal finances. Critique parts or all if you will, in terms of magnitude nothing less than the Ryan plan must and, however painful, will be enacted.

It is no coincidence the President only now is willing to come forward with some of his own ideas on these matters. One would have expected the budget to reflect his proposals two months ago. Clearly, in light of the credibility and sweep of the Ryan proposal the President is now compelled to say something.

I sincerely hope he engages in earnest; far better late than never. The President should present a clear direction of reform for major programs, with enough specificity to see the end product. He need not address every area of government spending, every entitlement. But he must address some of them, and especially those most pressing, such as Medicaid and Medicare. If, instead, he offers exhortation, targets, and the like, then he will have merely planted another field of asterisks alongside those he planted in the budget released two months ago.

The invigoration of spending excesses is not unique to the current or immediate past Congress. Spending discipline substantially evaporated on a bi-partisan basis at the end of the last millennium, though the degree of the inspiration along with the spending certainly grew dramatically in the past Congress. The recent budget deal cutting non-defense discretionary spending some $37.8 billion is the painful reality that follows from such inspiration. With a projected deficit for 2011 of about one and a half trillion dollars, marking the third year of extraordinary profligacy, these cuts mark an important, initial effort.

It is, however, only the undercard as they say in boxing, to the bigger events yet to come later this year. The House of Representatives will soon take up a budget for 2012, a relatively novel event in recent memory. We will then see if the Senate can do likewise. It would encourage the nation and the markets greatly for Congress to succeed.

In a very few months a fight over the debt limit will build to a crescendo. This may be the main event for deficit reduction this year. Reaching the debt limit provides a unique opportunity to restrain spending and thereby cut the deficit. Between the budget resolution and the debt limit all those in and out of Congress who decry budget deficits will have every opportunity to meet the challenge implicit in the Ryan plan and, hopefully, in the President's belated response, to put forward their own substantive alternatives. We will see who walks the walk, and who just talks the talk.

The news for the near term is not all grim. As the economy recovers, receipts will recover, as well. As many have noted including President Obama's former chief economist Larry Summers, growth is the necessary but not sufficient condition for deficit reduction. This provides all the more reason for Congress and the President to declare a cease fire in their war on prosperity. Stop threatening higher taxes and more regulations. Abandon the folly of thinking that deficit spending is somehow propping up the economy when in fact it is distorting the allocation of saving and driving up the trade deficit.

There are three key aspects to near-term deficit reduction. The first is economic growth. A stronger economy means more options, so every time Congress passes legislation that nicks the economy keep in mind the costs may be far greater than appear in a Congressional Budget Office table.

The second is the level of taxation. We have heard, and will continue to hear, that higher taxes must be part of the solution. Simply as a statement of arithmetic, this is not true. As a statement of budget policy, it is not true. Taxes need not go higher, and could go lower.

When scientists describe established, physical laws, these are statements of fact. When politicians and others assert that our fiscal policy is dangerous and unsustainable, that statement can be demonstrated rigorously as factual to the extent any projection can be.

However, when anyone asserts that taxes must go up to address the deficit, they are expressing a personal opinion, judgment, or policy preference. This is what budget making is all about – making choices based in part on personal views. In my view, taxes should not be raised. On the contrary, we should be so successful at restraining spending that taxes may be reduced.

This is my personal opinion, not the product of economic or budgetary analysis. Even when a highly respected economist or budget expert tells you taxes must be part of the deficit reduction or entitlement reform solution, their statement is not based on economic analysis. It cannot be. They are making a personal judgment about what ought to be. Economic training should not front for personal judgment. Being an economist does not make one's opinion less valid, but nor does it make it any more so.

It is a fact that taxes need not go up. It is an opinion to argue the contrary. It may be a judgment about what is necessary to achieve a political outcome, but it should not be confused with a statement of fact, however forcefully or artfully presented.

Spending, of course, is the third aspect of the deficit problem, especially the big three entitlements. It may surprise you to learn there's a fairly strong consensus on how to reform Social Security and Medicare to make these programs affordable while strengthening their core missions. A similar consensus is emerging in Medicaid. The problem, the hindrance, is the political environment. We should all hope the President now intends to improve that environment.

Medicaid, of course, is uniquely structured and so poses unique issues to resolve. The essential feature of Medicaid is that it demonstrates a distinct federal paternalism. Its structure suggests the federal government, that is the Congress, believes it is the only true defender of the health care for poor families and seniors. It is a statutory insult to the competence and humanity of every state government.

Medicaid imposes unaffordable burdens on the states and an increasingly unaffordable burden on the federal government. It should be turned into a block grant program combined with an appropriate minimum performance standard applicable to all states. States could then fashion programs that best fit their unique circumstances. A Medicaid program that works well for Montana is likely to look quite different that works well in New Jersey.

The basic outlines of how to reform Social Security to make it sustainable and more effective in protecting seniors from poverty are by now well-known. Changes relating to the eligibility age, indexation of benefits, cost of living adjustments, and so forth are all well-understood and would have dramatic consequences for the program, saving more than enough to ensure a more robust benefit to low-income seniors.

Some have argued that for both Social Security and Medicare, changes should not affect current retirees or those nearing normal retirement age. I agree that low- and middle-income Americans above some age nearing retirement should not be affected, nor need they be. They simply do not have enough working years left to adjust their lifestyles and finances. However, this does not apply to seniors with substantial resources. There is no reason, for example, not to apply an income-relating mechanism to Social Security benefits similar to what applies today to Medicare Parts B and D premiums. There are other approaches, as well. I am not proposing a specific approach, but rather a direction of change.

Medicare is a far more complex program, but poses only a slightly more complex problem. Some aspects of reform will follow the changes to Social Security, such as a higher eligibility age. The best solution is to pursue a premium support model similar to that in the Ryan plan or the less frugal Rivlin-Ryan proposal. Some find this a radical proposal. It is nothing of the sort. In important respects, this approach simply acknowledges that Medicare Part D offers a successful model of providing seniors financial support and allowing them to make their own health insurance decisions.

This can be further extended to achieve the necessary savings to reduce the budget deficit in the near term and assure Medicare's long-run viability by setting the premium support levels to reflect both need and available resources. Low- and middle-income seniors need more assistance than those of greater means, and wealthy seniors should carry the costs of their own health insurance.

In the premium support model one can and should continue with the traditional Medicare fee for service program as an option seniors may choose to buy with their premium support. Many current seniors for any of a number of reasons would choose to continue buying their health insurance from Medicare, with the same level of premium support they would receive if they were to choose a private plan, and they should be allowed this option.

Alternatively, if one believes it really does make sense for the federal government to run the world's largest health insurance company, then Medicare's finances can be improved immediately and adequately without fundamental changes to the program. This can be achieved by further tightening the income-relating mechanism current at work for Parts B and D, and then applying a premium for Part A along the same lines. This is a minimalist approach to Medicare reform. It leaves seniors with fewer options than the premium support model and would have relatively little effect in strengthening the market processes necessary to restrain health care costs overall. But it would be sufficient to generate the near-term savings needed to address the near-term deficit while simultaneously establishing long-run program viability.

Many seniors will counter that they paid into these programs and they are entitled to the benefits they were promised. Very true, and it should be acknowledged unequivocally at the outset.

But there are other truths that must be acknowledged. As is now well and broadly understood, benefits were promised that the nation cannot afford. This may warrant an apology to some seniors, but it does demand a fundamental change.

Another competing truth is that the longer we go making good on all these promises made in the past, the more extensive will the promise be broken for future generations. How much tax and how much government debt must our children and grandchildren and generations beyond bear to maintain our fidelity to all seniors for just a few years longer? Someone must pay more for others to get more. It is moral corruption to continue to support seniors who can support themselves at the expense of today's working families and generations to come.

Some have suggested these problems can only be addressed in a crisis. Maybe so. But if so, it is quite an indictment of our political leaders and our political system. Many politicians retort that it is easy for analysts to say these things. Analysts don't have to stand before the voters. True enough, but then why does every politician campaign on their leadership abilities and willingness to make the tough choices? Ducking is not leadership, and orating is not choosing.

The presumption by some is that a crisis will allow radical changes to be pushed through the Congress, including unnecessary and unwise tax hikes that could never survive normal public scrutiny. Thus we see intensive efforts plumbing the inner workings of a Value-Added Tax, or new taxes on financial services, or carbon taxes. Generally fearful of advancing a proposal in advance, instead proponents prepare for the day when they may be able to foist a new tax system onto the American people.

To this I say "semper paratus, semper vigilis" – ever ready, ever vigilant. That which cannot prevail in the light or the calm will not pass under cover of darkness or crisis.

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