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Bush Budget Reins In Entitlement Costs

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The key feature of President Bush's fiscal year 2008 budget request is not its budget proposals for next year or even its strategy to reach a balanced budget in five years. Rather, it is the focus on entitlements that really matters. Whether the 2012 budget deficit is projected to be $50 billion or $0 is not the most vital issue of America's long-term prosperity. While balancing the budget over the next five years seems like a commonsense goal, its real importance lies in setting the stage for addressing the huge long-term fiscal challenges of entitlement spending. The impending retirement of 77 million baby boomers will trigger a $39 trillion tsunami of unfunded entitlement costs over the next 75 years.[1] The good news for the younger Americans who will pick up this tab for retiring baby boomers is that President Bush's budget begins to seriously address this challenge by proposing real reforms that could slice $8 trillion from Medicare's total unfunded liability. These reforms would be a strong first step toward reining in the enormous fiscal burden that current policies would dump on future generations.

Addressing Medicare's Insolvency. The challenge posed by long-term entitlements is daunting. Between now and 2050, Social Security, Medicare, and Medicaid costs are projected to surge from 8.7 percent of GDP to 19.0 percent.[2] Consider that an equivalently sized tax increase today—raising taxes by 10.3 percent of GDP—would amount to $13,457 per household. If lawmakers instead tried to reduce spending elsewhere in the budget, they would have to eliminate every other program—including all defense, education, homeland security, and antipoverty programs—and that still would not be enough to offset the entitlement programs' costs. And because every year of delay steeply increases the ultimate costs of reform, responsible lawmakers must address this challenge now.

Under current law, thanks to large subsidies from taxpayers, seniors enrolled in Medicare Part B and Part D typically pay premiums that total about a quarter of the programs' combined costs. Part D is the new drug benefit and Part B mainly covers physician costs for retirees. President Bush has proposed reducing these subsidies for wealthier retirees, which means they would pay more in premiums.

It is important that these Medicare reforms do not revoke any benefits that were earned with payroll taxes. Unlike Social Security and Medicare Part A, Part B, and Part D benefits are not "earned" by their recipients' payroll taxes. Rather, they are voluntary health benefits that are overwhelmingly subsidized by today's taxpayers. Currently, Part B subsidies are reduced for seniors with incomes of more than $80,000 a year ($160,000 for married couples), but the Part D drug benefit is not adjusted for income for middle- and upper-income retirees. The President's budget would introduce income-adjusted

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drug benefit premiums for these seniors and end the indexing of the income level in both parts that triggers a reduction in subsidies. Given the staggering fiscal challenges posed by Medicare, there is no reason to saddle current and future taxpayers with the cost of huge health subsidies for wealthy seniors.

Additionally, President Bush has proposed altering the "market basket" of payments for physicians and hospitals. Revising payment formulas means that payments would better reflect the cost and value of services. To be sure, Medicare will still operate under a flawed system of price controls. But until lawmakers introduce real market reforms to Medicare, such as replacing the defined benefit with a defined taxpayer contribution, these adjustments will move Medicare toward solvency.

The long-term implications of these proposals are huge and comprise the single most important element of the President's budget proposals. While the budget's short-term savings are modest in Washington terms ($66 billion over 5 years), they are steps toward serious savings in the future. The reforms would reduce the "present value" of Medicare's 75-year unfunded liabilities by over $8 trillion—$6 trillion in market basket savings and $2.4 trillion from Part B and Part D premiums. These savings mean that the long-term Medicare tab being passed to future generations would be cut by one fourth. Congress should answer the President's call to rein in the entitlements' looming costs, which otherwise pose such a great burden to future generations.

Other Budget Proposals

Farm Subsidies: Here too, the President recognizes the need to rein in spending over the short and long term. The President's budget includes his proposal to reauthorize the farm programs that expire in September. These reforms include some real improvements to the current system. The President would close a loophole that currently allows excessive marketing loan payments. Counter-cyclical payments would be slightly altered to better target low-revenue farmers.

Best of all, the President's plan would eliminate subsidies for farmers earning over $200,000 annually. Opponents of the President's proposal will now have to answer whether they believe in continuing a $25 billion farm subsidy system that distributes most spending to corporate farms with household incomes averaging $200,000.

Regrettably, while addressing these excesses, the President generally retains the bloated and economically incoherent farm subsidy programs that in 2002 replaced the innovative 1996 "freedom to farm" reforms, which had largely ended market distortions and allowed farmers to make production decisions without government interference. Farm subsidy costs have more than doubled in the past decade, and yet the President would spend only slightly less than in the past farm bill, and likely more than the Congressional Budget Office (CBO) baseline, on these programs. Anti-free market milk and sugar policies would be only slightly changed.

The President's proposal represents a modest step in the right direction. Better still would be a return to "freedom to farm" policies that would open agricultural markets and rein in long-term spending. Unfortunately, Congress appears ready to write more expensive and inefficient farm legislation like the 2002 farm bill.

Discretionary Spending: Discretionary spending excluding defense and homeland security has leaped by 41 percent since 2001 (22 percent after inflation). These programs' budgets clearly do not need yet another increase. The President claims his budget would provide an increase of just 1 percent to domestic discretionary programs (which excludes not only defense and homeland security, but also international spending). In order to bring the budget under control, any domestic discretionary spending increases should be fully offset by reductions in lower-priority programs.

Tax Cut Extenders: The President proposes making permanent the successful 2001 and 2003 tax

1. Government Accountability Office, "Fiscal Stewardship: A Critical Challenge Facing Our Nation," January 2007, at *www.gao.gov/new.items/d07362sp.pdf*.
2. Congressional Budget Office, "The Long-Term Budget Outlook," December 2005, at *www.cbo.gov/showdoc.cfm?index=6982&sequence=0*.

cuts. By increasing incentives to work, save, and invest, reduced tax rates played a key role in the expanding business investment, job growth, and the stock market gains that have powered recent years' economic growth. Furthermore, tax revenues currently stand at 18.4 percent of GDP—slightly above the historical average—and are projected by the CBO to rise to a record 22.8 percent of GDP by 2050, even with the tax cuts made permanent. Letting the tax cuts expire—or worse, repealing them—would be a major tax increase for millions of Americans. Raising tax rates would harm families and businesses, and the resulting economic slowdown would minimize any revenue increase. The federal budget's problems do not stem from Americans being undertaxed, but rather from Washington spending too much. In order to prevent one of the largest tax increases in American history, Congress should follow the President's lead by extending the current tax policies.[3]

Conclusion. The President deserves praise for beginning a long overdue examination of unsustainable entitlement costs. He makes strong proposals that take the first steps to rein in entitlement spending and set the stage for a serious discussion of these unaffordable programs. His budget proposes a credible plan to cut $8 trillion of the $39 trillion in unfunded liabilities. It is now Congress's responsibility to take up this proposal as the first step toward saving future generations from a crushing burden of debt and taxes. Any discussion of this budget must focus on these long-term solutions or it is missing the point.

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3. See Brian Riedl, "Ten Myths About the Bush Tax Cuts," Heritage Foundation *Backgrounder* No. 2001, January 29, 2007, at *www.heritage.org/Research/Taxes/bg2001.cfm*.