

## Dominant Budget Issue Facing the New President, The

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The dominant domestic economic issue for this year, next year, and many years to come is the transformation of the economy due to demographic forces commonly associated with the retirement of the baby boomers. Other than maintaining economic growth and employment—issues that never go away—every other domestic economic issue pales in importance.

This budgetary problem has been creeping up on us, but now it's here. Retirement and health spending have been growing as a percentage of national income, federal spending, and federal revenues for almost 50 years. In 1950 these expenditures occupied about one-tenth of federal spending; today they are about one-half. And the fraction continues to increase at a dramatic rate even today—long before the baby boomers start to retire. Moreover, once the baby boomers are fully retired, current law would continue that inexorable growth upward.

Can't we just wait a couple of presidential terms to solve these problems? Not really. First, as long as so much growth is "foreordained" out of past legislation, almost no flexibility is left in the budget for current policymakers. Certainly there is a surplus before the baby boomers retire, but that depends significantly on projected declines in discretionary spending relative to the economy.

Moreover, campaign promises would use up a significant share of whatever surplus is available for the next 10 years. Even if those pledges could be fulfilled during the decade, there would be limited flexibility left for all the years after 2001 and huge deficits scheduled in later decades. More importantly, if it were desired to undertake some major reform, the resources that might be used to "buy out" some of the potential losers would not be around. And such resources, we already know, are required for social security and Medicare reform—if for no other reason than to protect the benefits of those already retired.

Sometimes the problem is defined as the social security problem, but that is misleading. Forget for the moment about the confusion over social security trust funds, or even of accounting for social security expenditures and taxes independently of the trust funds. The simple fact is that one share of the national pie cannot increase without other shares decreasing.

The public share of the national pie cannot increase without the private share decreasing and without higher tax rates. The retirement and health share of the public budget cannot increase without the non-retirement, non-health portion of the budget decreasing. Nor can the retirement and health share of total national income increase without some decrease in national income spent on some combination of other private or public goods.

Rising shares of resources spent on retirement and health, therefore, are not issues that will wait until the 2030s; they won't wait until the 2010s. Sure, it is 2015 when social security taxes first fall short of social security expenditures, but there is already significant financing of Medicare and some of social security from general revenues, and, together, it could be said that the two systems are already running deficits when their total expenditures—including Medicare, Part B—are compared to their revenues. Everything the new administration will want to do that involves more money—from education to tax cuts to reforming other parts of government—will effectively be dominated by what is done in the areas of retirement and health.

A second reason why these issues should be addressed up front is that delay dramatically reduces the types of reforms that can be undertaken. For example, if people might have to work a bit longer when they live a bit longer, then gradual increases in the early retirement age of 62 might be one of the reforms to be considered. But if one waits until social security and Medicare are running large deficits, then one cannot simply increase that early retirement age suddenly by, say, two years, so that people retiring in 2015 can retire at 62 and those retiring in 2016 can retire at 64. Gradual phase-ins of many institutional reforms could profoundly influence the long-term viability of the program but have little effect on cash flow for a number of

years.

There is one set of adjustments, on the other hand, that would have a more immediate cash flow impact; those adjustments are most likely to be applied if there is delay. Social security tax increases, for example, are much swifter in their effect on the cash flow budget. Similarly, cutbacks in the annual inflation adjustment allowed the elderly often can be implemented in ways that would have a quick cash flow impact because they affect current retirees, not just those who will retire in the future. Of course, one consequence of cutbacks in the inflationary adjustment is that the older and poorer of the elderly would be hurt the most (those just retiring are not affected at first).

In health care, a similar calculus prevails. Tax increases and price controls can save money up front, whatever their long-term costs to the health care system or the economy. Structural reforms, such as gradual conversion to a system with more choice but stricter limits on the cost of each policy, often take years to put into place. They can even cost money in the early years if options are allowed to hold onto traditional Medicare.

The bottom line? Delay reduces the chances of long-term structural reform, makes large tax increases almost unavoidable, puts the oldest and most vulnerable of the elderly at greater risk, and invites further price and quantity controls in healthcare.

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