

America Speaks: What Is Not on the Program

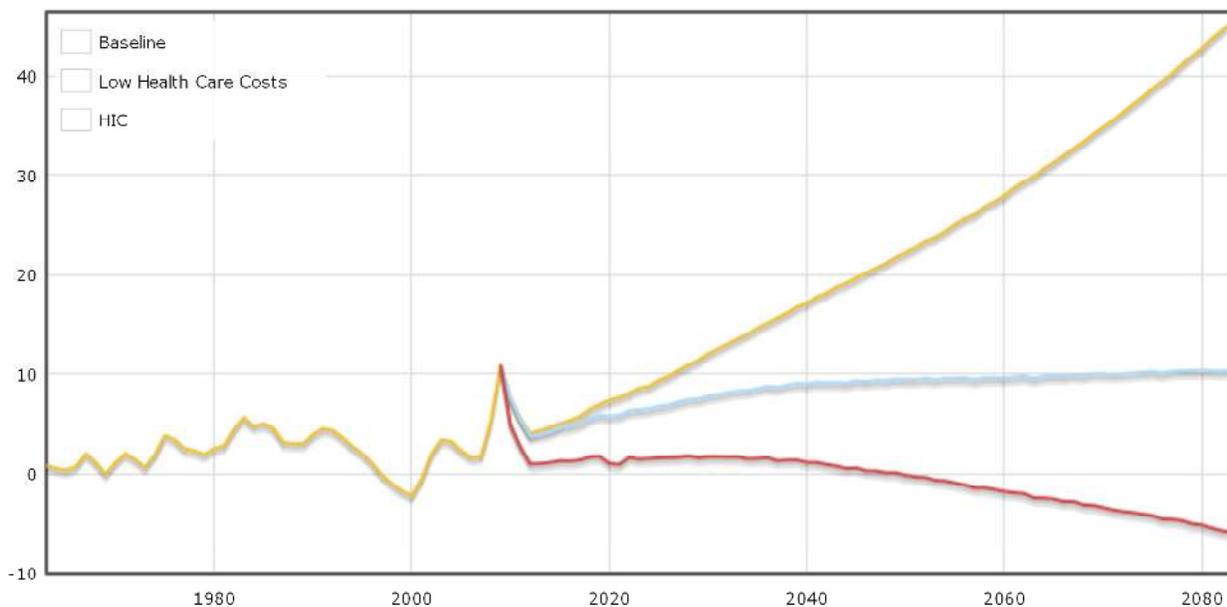
The program for America Speaks is supposed to include input from a broad range of viewpoints in order to frame an intelligent discussion of the country's long-term budget problems. It does not live up to this standard.

In terms of the framing of the budget problem, the guide for the discussion, [Options Workbook: What Are Our Options?](http://usabudgetdiscussion.org/wp-content/uploads/2010/03/Budget-Options-Workbook-Final.pdf) [http://usabudgetdiscussion.org/wp-content/uploads/2010/03/Budget-Options-Workbook-Final.pdf], does not discuss the cause of the recent explosion of the deficit, the collapse of the housing bubble. The downturn resulting from this collapse will add more than \$4 trillion to the national debt between 2007 and 2017. This debt will add substantially to the interest burden that participants in America Speaks will be told that they will face in 2025, the year for which they are to design a budget.

It would be important for participants to know that this debt (and the resulting interest burden) is not due to profligate spending or reckless tax cuts. Rather it was the result of economic mismanagement that allowed an \$8 trillion housing bubble to grow unchecked.

Also, while the workbook does note that most of the growth in future budget deficits is due health care costs and the aging of the population, it does not point out the full extent to which the long-term budget problems in the United States are the result of the inefficiency of our health care system. If our per person health care costs were the same as any for any other wealthy country, [then the U.S. would face huge surpluses](http://www.cepr.net/calculators/hc/hc-calculator.html) in the long-run rather than deficits [http://www.cepr.net/calculators/hc/hc-calculator.html]. If participants were made aware of this fact, it is likely that they would place far more emphasis on fixing the U.S. health care system.

Projected Budget Deficit as a Percent of GDP



Yellow line: Projected deficits based on baseline projections from the Congressional Budget Office (CBO).

Blue line: Projected deficits if health care costs in the U.S. were to rise only due to the aging of the population and stay even with per capita GDP growth, based on CBO's "Low Health Care Cost" projection.

Red line: Projected surpluses if U.S. health care costs were the same as in other High Income Countries.

Source: [CEPR's Health Care Budget Deficit Calculator](http://www.cepr.net/calculators/hc/hc-calculator.html) [http://www.cepr.net/calculators/hc/hc-calculator.html]

Remarkably, the options section essentially excludes further health care reform from the debate. For example, participants are not allowed to pick a [public option health insurance plan, which could substantially reduce annual health care costs](#) according to the Congressional Budget Office [http://www.nationaljournal.com/congressdaily/cda_20090925_6347.php]. They also are not presented with the option of [having Medicare negotiate prescription drug prices](#) [http://www.cepr.net/index.php?option=com_content&id=1519&view=article]. This would achieve substantial savings by bringing drug prices in the United States more in line with drug prices in the rest of the world.

The guide instead offers participants a menu of options that accept the structure of the existing health care system. As a result, the options mean either charging people more money for the same care or requiring that they get by with less care. The options that could hurt the profits of the insurance industry, pharmaceutical industry or other powerful special interest have been excluded from the list.

The guide also badly fails in describing the interaction of the budget and the economy. First, it never clearly notes that average incomes are rising through time. It is unlikely that most participants will realize that [the average hourly wage is projected to buy 20 percent more in 2025 than it does today](#) [<http://www.cbo.gov/ftpdocs/102xx/doc10297/AppendixA.9.2.shtml#1091396>]. This knowledge might affect how people view things like tax increases. For example, if we know that people will be on average 20 percent richer in 2025 than today, we might be less concerned if their tax rate were to rise by 1-2 percentage points. This basic fact is especially important in the context of a discussion that focuses on intergenerational equity.

The workbook also never mentions the plunge in wealth that older workers have suffered as a result of the collapse of the housing bubble and plunge in the stock market. This has left the bulk of near retirees (those in their late 40s and 50s) [facing retirement with almost nothing other than their Social Security and Medicare](#) [http://www.cepr.net/index.php?option=com_content&id=2118&view=article]. This information would be essential for people who want to make an informed choice on the cuts to Social Security and Medicare laid out in the guide.

On the other side, the guide barely notes the fact that public investment in areas like infrastructure, research and development, and education has been essential for supporting growth in the past and is likely to continue to be in the future. This point is not really in dispute. While there have been a range of estimates for the impact of public investment on economic growth, economists from across the political spectrum have done research showing that public investment has a comparable or even higher return than private investment.

Remarkably, the book repeatedly warns that raising taxes on wealthy individuals or corporations may lower economic growth. However, it includes no comparable warning that cutbacks in the investment components of government spending may also slow growth and eliminate jobs. It is hard to justify this difference in the treatment of tax cuts and public investment.

The workbook also gets some very basic economics wrong in its discussion of the problem of debt and the deficit. It tells participants that one of the problems of high deficits is that it can lead to a weaker dollar.

In fact, in standard economic models the relationship is just the opposite: the story runs that budget deficits can jack up interest rates, leading to a stronger dollar. This is how a budget

deficit can be tied to a trade deficit – by raising the value of the dollar. A higher dollar makes U.S. exports more expensive to foreigners and imports cheaper for people living in the United States. The high dollar over the last decade has been a major cause of the record U.S. trade deficits over this period.

People who want to see our trade deficit fall want a lower dollar. Getting the value of the dollar down (not up) is one of the main reasons that economists give for smaller budget deficits. It is remarkable that America Speaks managed to turn this basic relationship on its head.

Topic-By-Topic Analysis

Baseline Projection of the Budget

The baseline seems deliberately designed to make the 2025 problem as bad as possible. It effectively assumes nothing has been done to rein in the budget between now and 2025, including items that have already been put forward by President Obama, most notably allowing the tax cuts for high-income taxpayers to expire at the end of this year.

The cumulative effect over 15 years (including interest) of allowing for the [changes to income taxes already proposed by President Obama would reduce the 2025 debt by more than \\$1 trillion](http://www.whitehouse.gov/omb/budget/fy2011/assets/tables.pdf) [http://www.whitehouse.gov/omb/budget/fy2011/assets/tables.pdf]. This implies an interest burden that it is \$40-50 billion less than what is assumed in the guide.

Of course it is virtually certain that other changes will be made between now and 2025 that will prevent the deficit from growing as large as projected in the guide. However, the expiration of the Bush tax cuts for high earners is already in current law and is explicitly supported by the President and the congressional leadership. There seems no obvious reason for assuming that these tax cuts will be extended, as the guide does.

Health Care

Page 6: Medicare Tax Rate on High-Income Households

Readers are told that health care reform was financed in part by raising the Medicare tax from 2.9 percent to 3.8 percent for individuals with incomes over \$200,000 and couples with incomes over \$250,000. It would have been helpful to note that this is a marginal tax, which means that they only pay this tax on income above these cutoffs.

This means, for example, that a single individual with an income of \$210,000 would pay an additional \$90 a year as a result of this tax. The higher tax rate is only paid on the \$10,000 in income above \$200,000, not on the full \$210,000. It is likely that many readers will not realize that this is the way the tax is structured.

Page 8: Controlling Health Care Costs

Readers are told: “at the moment, the nation does not seem prepared to consider fundamental reform of the kind suggested in the first two approaches above – premium

support or single payer. As a result, the options outlined below would enable you to achieve savings through changes within the existing system.”¹

This structuring of the debate is striking for two reasons. First, it is not clear how America Speaks made its assessment of public opinion at present. Numerous polls indicated considerable support for giving people the option to buy into a public Medicare-type plan. It is even less clear how they feel competent to assess what public opinion will be toward this issue in 2025.

The second reason why this structuring of the debate is striking is that it requires participants to either cut services or require larger payments in order to achieve savings on public sector health care spending. In a context where per person health care spending in the United States is more than twice the average in other wealthy countries America Speaks has entirely ruled out of consideration any measures that could increase efficiency. It does not even allow anything as simple as [having Medicare negotiate prescription drug prices](#), as does the Veterans’ Administration and other governments around the world [http://www.cepr.net/index.php?option=com_content&id=1519&view=article].

Other options not included in the workbook that could save billions of dollars per year include having the government [pay for the clinical testing of drugs directly](#) [http://www.cepr.net/index.php/publications/reports/the-benefits-and-savings-of-publicly-funded-clinical-trials-of-prescription-drugs/] and then allowing new drugs to be sold as generics as well as allowing Medicare beneficiaries the option to [buy into the more efficient health care systems of other countries and share the savings with the government](#) [http://www.cepr.net/index.php?option=com_content&view=article&id=2492].

Page 9: Medicare and Medicaid Reductions

In addition to excluding any consideration of major health care reform from the agenda, when the guide does list specific proposals it does a poor job of informing readers of their implications. For example, the first proposal suggests raising Medicare premiums on higher-income beneficiaries, who are defined as single filers with incomes of more than \$85,000 and joint filers with incomes of more than \$170,000. There are currently close to 1 million people in this income category, the vast majority near the lower cutoffs. If we raised Medicare premiums for these people by an average of \$3,000 each (remember, many have incomes just above the cutoffs), this will generate savings of \$3 billion or less than 0.3 percent of its savings target of \$1.2 trillion. It would have been useful to include some estimate of the savings from this and the other specific policies listed.

It is striking that the discussion of this sort of means-testing of benefits never mentions the negative incentive effects. Means-testing of Medicare benefits will both discourage people from saving for retirement and encourage them to find creative ways to hide

¹ It is worth noting that the discussion of a single payer option told readers that under single payer “health care would be “paid for entirely by the federal government,” and that “Federal policymakers would make the major decisions about the health care services that Americas [sic] would receive and how those services are distributed among people of different ages, incomes, and so on.” Actually, all of the countries that have single-payer type systems also have separate private systems where people have the option to pay for services that are not covered under the government plan.

income so that they are not subject to the means-test. However, this issue of incentives is discussed repeatedly in the context of the various proposed tax increases.

Two of the other options listed for health care savings also suffer from insufficient explanations. One option is raising the age of Medicare eligibility from 65 to 67. This would imply that people ages 65 and 66 would have to buy their own health care. Even with the health reform program in place people, in these age groups would be faced with premiums of more than \$10,000 a year for a single individual and \$20,000 for a couple. The vast majority of people in this age group are retired and will be relying on Social Security for the bulk of their income.

The next option is replacing Medicare with a voucher system where the voucher will only be sufficient to cover lower-cost plans. In addition to making it likely that beneficiaries will end up with lower-quality care, this creates an enormous problem of adverse selection. Insurers will try hard to avoid insuring the 10 percent of beneficiaries who account for the bulk of expenditures, since they would lose an enormous amount of money covering these people. It is possible that government bureaucrats will be able to prevent the private sector from gaming this system, but there is no easy way to prevent this sort of gaming. The workbook should have informed participants of this problem, which has been well-known to economists for several decades.

Pages 10-11: Options to Reduce Federal Health Care Spending

When the guide does list savings from health care spending it is simply listed in percentages (0%, 5%, 10%, or 15%). The savings are not tied to any specific policy or set of policies.

Social Security

The discussion of Social Security includes no background discussion on the financial situation of older Americans. It says nothing about the collapse of the defined benefit pension system, the low level of other retirement savings, nor the massive loss of home equity associated with the collapse of the housing bubble. It is difficult to understand how participants can make informed choices about Social Security (or Medicare) without this information.

The guide also never discusses the design of the program, pointing out that payroll taxes were increased in 1983 with the explicit purpose of partially pre-funding the retirement of the baby boomers. Nor are participants informed that the most recent projections from the Congressional Budget Office show that [the program will be able to pay full benefits through the year 2044 with no changes whatsoever](http://www.cbo.gov/doc.cfm?index=10457) [http://www.cbo.gov/doc.cfm?index=10457]. It is likely that knowing that benefits have already been paid for from Social Security taxes would influence many participants' views of potential cuts in the program.

Page 15: Life Expectancies

When presenting the argument for cuts, the workbook notes that life expectancies have increased by 5 years since 1940. While the guide does point out that the normal retirement age has already been raised by 2 years, it would have been useful to also point out that the Social Security tax rate is far higher today than it was in 1940. In other words, workers are paying much more out of their wages in their working years precisely so that they can enjoy more years of retirement.

The discussion of an altered indexation formula (progressive indexation) could have pointed out that it would result in a very low rate of return on Social Security for even very moderate wage earners (e.g. \$40,000 a year). This could seriously undermine political support for the program if middle-income people saw themselves as getting very little back from it.

Page 19: Raising the Cap on Taxable Wages

The discussion of raising the cap on taxable wages tells readers that: “those who earn higher-incomes are the most likely to make investments that will create jobs. Increasing taxes on these individuals will reduce their ability to make these investments and hurt job growth.”

In fact, under almost any reasonable set of assumptions, higher taxes on these individuals will lead to higher national savings and (by the economic assumptions used in the guide) therefore higher growth. It is difficult to see how this assertion is not just complete nonsense.

Page 20: Partially Replacing Social Security with Private Accounts

The discussion of replacing a portion of Social Security with private accounts never mentions the higher administrative costs of private accounts. Even in an optimistic set of assumptions, the administrative cost of handling private accounts would be more than 5 percent of the money paid out each year. By contrast, the administrative costs of the old age portion of the Social Security program is [about 0.5 percent of the money paid out each year](#) [http://www.socialsecurity.gov/OACT/TR/2009/III_cyoper.html#84548]. This means that if \$300 billion a year were paid out to beneficiaries through private accounts rather than the traditional Social Security program, there would be \$13.5 billion paid out in additional administrative expenses. The beneficiaries in this case would be firms in the financial industry.

Non-Defense Discretionary Spending

As noted before, there is no explicit discussion of the contribution that spending in areas like infrastructure or medical research contributes to growth. The workbook also never notes the fact that many experts think it is important to spend more money in this area of the budget.

Defense Spending

This discussion is heavily tilted towards those who want to maintain or increase defense spending. The last paragraph of the first page on the topic (p. 28) presents at length the views of “some experts” that the country should be spending more on defense. Only the last sentence notes that “other experts” believe that defense spending can be cut substantially without compromising national security.

Changes to Revenues / Taxes

Pages 35-37: Impact of Tax Changes vs. Cuts in Public Investment

While there is never any explicit discussion of the impact that cuts in public investment can have on growth and jobs, this point is mentioned repeatedly with reference to a wide variety of possible tax increases or the scaling back of tax deductions (e.g. p. 35, p. 36 top, p. 36 bottom, p. 37). There is no obvious rationale for this asymmetric treatment.

Page 39: Home Mortgage Interest Deduction

The discussion of converting the home mortgage interest deduction into a tax credit lists as a negative factor that this could “lower home values for high-priced homes and would reduce home construction for those homes.” It is difficult to see why this would not be a positive factor. This means that housing would be more affordable for younger buyers (this would help our young). Also, the intention of the proposal is to shift construction from higher end homes to more middle class and moderate-income homes. That is not a negative.

It also lists as a downside that “it could reduce the rate of homeownership.” It is almost impossible to envision a scenario in which this could be an outcome. Homeownership rates are extremely high among the high income households who would see a smaller homeowner tax benefit under this proposal. Their rates of homeownership would likely be very little affected by this measure.

By contrast, low- and moderate-income families, who have far lower rates of homeownership, would get much greater tax benefits as a result of the switch to a credit. Many of these families do not even take the mortgage interest deduction at present and even if they do, it will generally only provide a small benefit compared with taking the standard deduction. The greater incentive is likely to cause far more of an increase in homeownership among this group than could possibly be offset by any plausible decline in homeownership among higher-income households.

Page 46: Home Prices

The guide again lists the possibility of a decline in home prices as a possible negative effect from a change in the tax code. As noted before, a decline in home prices is a transfer from those who currently own a home to those who want to become homeowners. From the standpoint of a group that is concerned about budget deficits ostensibly because of the harm that they could do to future generations, this sort of transfer should be viewed as a positive. It is making housing more affordable.

New Taxes

Page 47: Value-Added Tax (VAT)

While the discussion of a value-added tax does point out that a VAT would be regressive, more heavily hitting lower-income and older Americans, it overlooks an important argument against a VAT. Higher-income families often travel abroad. Insofar as these families have the option to consume in the United States or abroad, they will

have the ability to escape much of the VAT by increasing their expenditures abroad (and receiving VAT refunds for purchases made abroad). Lower-income households, who are less likely to travel outside the country, will not have this option.

Page 48: Carbon Tax

The discussion of a carbon tax asserts that it would be difficult to engineer a system that protects lower-income people from the impact of the tax. Actually, it should not be difficult to construct such a system. If a portion of the tax was rebated (say 60 percent), this could be divided on an equal per capita basis for every person in the country. Since payments of the tax would be loosely proportionate to income (higher-income people are likely to use more fuel heating and cooling their homes, drive bigger cars, and fly more frequently), a rebate that was a fixed per capita amount would fully or near completely rebate the tax paid by most lower-income people, while still imposing a tax on high income individuals.

Page 48: Securities Transaction Tax

The discussion of a securities transactions tax (also known as a financial speculation tax) hugely underestimates that potential revenue that could be collected from such a tax. The guide estimates that a securities transactions tax would yield \$30 billion a year, just over 0.1 percent of projected GDP in 2025. By comparison, the revenue from the current tax in the United Kingdom, which only applies to stock trades, is almost 0.3 percent of GDP, which would be almost \$85 billion in 2025.

Virtually everyone who proposes such a tax would have it apply to a wide range of financial instruments, such as options, futures, credit default swaps and other derivative instruments. It is difficult to see why the tax would be described here as simply a "securities transactions tax," thereby only applying to stocks. In the 1980s, a broad-based financial transactions tax in Japan raised an amount of revenue equal to 0.8 percent of GDP before it was cutback and eliminated in the 1990s. This would be equivalent to \$230 billion in 2025 given the projected size of the economy. Given the enormous growth of the financial sector over the last two decades, it is very plausible to imagine that [a broadly based financial speculation tax could raise as much as 1.0 percent of GDP, which would be close to \\$300 billion in 2025](http://www.cepr.net/index.php?option=com_content&id=2744&view=article) [http://www.cepr.net/index.php?option=com_content&id=2744&view=article].