

Discussion of
Jagadeesh Gohkale and Kent Smetters,
*Fiscal and Generational Imbalances:
New Budget Measures for New Budget Priorities*

by

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Thank you, it's a pleasure to be here.

Let me begin by complimenting Jagadeesh and Kent on their excellent paper. The Concord Coalition has long stressed the need for a more accurate and honest accounting of the federal government's long-term liabilities. The Fiscal Imbalance (FI) measure that Jagadeesh and Kent have developed makes a valuable contribution and I applaud them for their creative and careful work.

The official measures used to gauge the sustainability of current budget policies are clearly inadequate. The most commonly cited measure, the cumulative ten-year budget balance, ignores the surge in retirement and health-benefit spending that is due to occur just beyond the budget horizon.

As we all know, focus on the ten-year balance also invites lawmakers to game the numbers by shifting the timing of taxing and spending.

Seventy-five year actuarial balance, the official solvency measure of the Social Security and Medicare Trustees, is equally misleading. Actuarial balance—that is, the difference between total benefits and total taxes over the next seventy-five years—counts trillions of dollars in future tax contributions as government assets while failing to count trillions of dollars in future benefits "earned" by those contributions, but payable beyond the Trustees' time horizon, as government liabilities. It says nothing meaningful about Social Security's or Medicare's financial position, fiscal sustainability, or generational equity. The Trustees could make a major contribution to informed debate by jettisoning the measure altogether.

The open-group liability concept underlying Jagadeesh's and Kent's FI measure is clearly superior. It gives a much more accurate picture of the long-term fiscal burden than the traditional actuarial balance measure. And, since the authors decompose the FI measure into the imbalance attributable to living and future generations, it captures the generational tilt in current policy as well.

That said, I think Jagadeesh and Kent claim too much for their measure. It may be "forward looking, comprehensive, calculated in perpetuity, and based on current law." But I don't think that it "correctly indicates the impact of all policies." While the FI measure adds an important new perspective, it also has some important limitations.

One limitation is that, in and of itself, the FI measure tells us nothing about the time path of the budget. Consider a reform that makes deep reductions in Medicare benefits, but delays the reductions until 2075. that reform won't make Medicare fiscally sustainable, since it would allow Medicare's cost rate to triple before finally slashing it. But in the FI measure's present value accounting framework, it might well eliminate Medicare's fiscal imbalance. It's a bit like wading out to a sand bar. The FI measure tells you that you'll be safe and dry once you get there. The annual budget projections tell you whether you're going to drown on the way.

There are, in fact, a number of good reasons why we should keep our eye on the annual cash in cash out numbers. It is these numbers that tell us when the burden of rising entitlement costs becomes acute, and thus how

urgent reform is. And it these numbers that tell us the government's borrowing needs, and hence the budget's impact on capital markets.

In this connection, I have some concern that the FI measure may undermine safeguards against excessive indebtedness. Jagadeesh and Kent argue that one of the big advantages of the FI measure is that it removes an irrational bias against reforms that issue public debt, even when the debt will be more than offset by future budget savings. In an economist's world, that bias may seem irrational. But in the world of budget politics, it serves a vital purpose. Once public debt is incurred, it must either be paid off or permanently serviced. Future budget savings is entirely contingent on the willingness of future Congresses to inflict pain on future voters.

Incidentally, this is why the Concord Coalition has always opposed Social Security reform plans that issue recognition bonds—that is, reforms that would translate existing implicit Social Security liabilities (which have no constitutional protection) into formal Treasury debt (which does). Ever since Social Security's establishment, Congress has reserved the right to alter benefits at any time—and over the years, it has repeatedly done so as America's priorities have changed. During World War II, for instance, Congress allowed Social Security benefits to lag behind inflation. With recognition bonds, Congress would have no such options. The economy might collapse or the nation go to war. But short of default on the national debt, it could never again make any change in future benefits.

There's another limitation that's important to keep in mind. As a present value figure, the FI measure may understate the magnitude of the future tax hikes required to sustain today's benefit policies—or conversely, the magnitude of the future benefit cuts required to sustain today's tax policies. Implicitly, the FI measure assumes that near-term surpluses can be set aside to finance long-term deficits. Unfortunately, there is no budgetary rule that can compel Congress to engage in genuine savings. Certainly the historical record is not encouraging. Two years ago, many hoped that a mountainous budget surplus would pay down the national debt and finance a painless reform of Social Security. Needless to say, it hasn't work out that way.

Let me turn to a final reservation—namely, that the FI concept is much more robust when applied to some individual federal programs than to the budget as a whole. For Social Security, projections in perpetuity make sense because the program is based on promises spanning generations. True,

Social Security is a legislated entitlement, not a contract. But its contributory nature, its permanent appropriation, and its immense popularity have always given it a special protected status. No one seriously doubts that Social Security's unfunded benefit promises constitute some sort of government obligation.

Medicare's fiscal imbalance may be several times larger than Social Security's, but the obligation is considerably less certain. For one thing, Medicare is more politically vulnerable to benefit cuts, in part because the program depends on large general revenue subsidies. For another, even assuming that current law remains unchanged, projecting Medicare costs is much more difficult. While Social Security benefits are determined by formula, Medicare constitutes a largely open-ended promise to pay for a constantly evolving package of health-care services. And as Jagadeesh and Kent point out, the program's long-term cost is very sensitive to even modest changes in assumptions about the growth in real per capita spending.

Despite these caveats, Medicare clearly represents a long-term obligation. Obviously, so do federal pensions. But once we move beyond social insurance and employee pensions, the issue becomes much more problematic. Although Medicaid costs are due to rise as the population ages, the program is means-tested and so lacks a powerful electoral constituency. And while Jagadeesh's and Kent's GDP neutrality assumption for discretionary spending seems reasonable, it's worth recalling that appropriations are determined year by year. As for general revenues, no long-term projection can be taken very seriously. From Truman to Kennedy to Reagan, tax cuts have come and gone as short-term political priorities—and the fiscal environment—have changed.

Let me wrap up by offering a few suggestions. As currently constructed, the FI measure gives the same weight to budget policies that are almost certain to endure and to budget policies that are almost certain not to. I think the FI measure would be improved if it reflected the probability of different tax and spending outcomes. I'm not sure how this would be done, but it is an important and interesting issue to explore.

I also would have liked to see the paper put more emphasis on the FI measure expressed as a share of level payroll or GDP. Focusing on the dollar numbers is less informative—and, as Jagadeesh and Kent themselves point out, can be misleading. Higher productivity, for instance, results in a higher dollar imbalance in the Social Security program—and this makes it

look as if the outlook has deteriorated. In fact, just the opposite is true. The dollar imbalance may go up, but the imbalance as a share of payroll goes down. And it is the imbalance relative to pay that determines the program's burden.

Finally, the authors might consider using the Trustees' economic scenario rather than OMB's. It's not because I think the Social Security Administration's projections are more reasonable—though I do. Rather, it's that they constitute the benchmark in the Social Security and Medicare reform debate—and it is Social Security and Medicare that account for almost all the fiscal imbalance. Having to go back and forth between the various SSA and OMB liability numbers is confusing and may be unnecessary.

Once again, I think that Jagadeesh's and Kent's paper is an important contribution. I do remain a bit skeptical that they have been successful at capturing everything that matters about long-term budget policy in a single number, or rather pair of numbers, if we include the generational imbalance measure. Still, I think the FI measure is extremely informative and I would like to see it regularly calculated and reported.