

What is *Really* Driving the Unsustainable National Debt

**Testimony before the
Committee on Financial Services
United States House of Representatives**

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Main Takeaways from Brian Riedl's Testimony

- I will describe the policies that are driving a historic long-term surge in budget deficits.
- The budget deficit is on pace to surpass \$1 trillion as soon as next year – on its way to \$2 trillion within a decade if current policies continue.
- If interest rates merely rise back to 1990s levels, that would push the projected annual budget deficit to \$3 trillion in ten years.
- The long-term picture is even worse. The CBO projects a staggering \$84 trillion budget deficit over the next 30 years, even assuming all recent tax cuts expire. That would leave the national debt at 150% of GDP.

Drivers of the Rising Ten-Year Deficit

- The \$250 billion annual cost of recent tax cuts, and \$150 billion annual cost of the higher discretionary spending caps are certainly contributors to the deficit. But their cost will remain steady over the decade, and thus do not explain why the budget deficit (under current policies) would rise from \$779 billion to \$2,106 billion over the next decade.
- Those future increases in red ink will come from adding 74 million baby boomers to the Social Security and Medicare systems. This is both a result of demographics, and rising health costs.
- Social Security and Medicare are not fully self-financed through premiums, payroll taxes, and other dedicated taxes. Each system requires an annual general revenue transfer to pay all promised benefits (some of these transfers are credited as interest payments to trust funds). And these transfers – as well as the interest costs of the Treasury borrowing to cover these transfers – are about to soar.
- Annual Social Security and Medicare shortfalls (and their interest costs) will jump from \$450 billion this year, to \$1.6 trillion a decade from now. These \$1.15 trillion in additional Social Security and Medicare deficits will account for nearly 90% of the \$1.3 trillion projected rise in the deficit over the next decade, according to the CBO current-policy budget baseline.
- In total, over the next decade, Social Security will require a general revenue transfer of \$2.2 trillion, and Medicare will require \$5.6 trillion. When including the \$2.0 trillion in resulting interest costs from the portion of that spending that must be borrowed, the Social Security and Medicare systems will drain \$9.8 trillion from general revenues over the next decade.

Drivers of the Surging 30-Year Deficit

- Over the next 30 years, the Social Security and Medicare systems are projected by CBO to run a \$100 trillion cash shortfall. The rest of the budget is projected to run a \$16 trillion surplus.
- Specifically, Social Security will run a \$18 trillion deficit, Medicare will run a \$41 trillion deficit, and the interest costs of financing these shortfalls will add \$41 trillion more.
- CBO projects that, between 2018 and 2048, the annual Social Security and Medicare shortfalls (and their interest costs) will leap from 2.0% of GDP to 12.6% of GDP. The rest of the budget in 2048 is projected to enjoy a 3.1% of GDP surplus – as a result of both rising revenues and falling spending across the rest of the budget.

Conclusion

- The long-term debt problem is overwhelmingly a Social Security and Medicare issue. The rest of the budget is projected by CBO to produce growing surpluses over the long-term – but cannot balance out a \$100 trillion projected shortfall within Social Security and Medicare.

Good morning Chairman Hensarling, Ranking Member Waters, and Members of the Committee. Thank you for inviting me to participate in today's hearing.

My name is Brian Riedl. I am a Senior Fellow in Budget, Tax, & Economic Policy at the Manhattan Institute for Policy Research. The views I express in this testimony are my own, and should not be construed as representing any official position of The Manhattan Institute.

Few Americans fully comprehend the fiscal avalanche that has begun. The budget deficit is on pace to surpass \$1 trillion as soon as next year – on its way to \$2 trillion within a decade if current policies continue. And if interest rates merely rise back to 1990s levels, that would push the projected annual budget deficit to \$3 trillion in ten years. This is according to data from the Congressional Budget Office.

Over the next 30 years, Social Security and Medicare face a combined \$100 trillion cash deficit, which will push the national debt to 150% of GDP. At that point, interest on that debt would consume 40% of all tax revenues or more, if interest rates rise. Unless reforms are enacted, global markets will, at some point, stop lending to the U.S. at plausible interest rates. When that event occurs, or even approaches, interest rates will soar, and the federal government will not be able to pay its bills, with dire consequences for the U.S. economy.

I. Drivers of the Rising Ten-Year Budget Deficit

The Congressional Budget Office (CBO) has projected a \$12.4 trillion budget deficit between 2019 and 2028. However, if one adjusts for the “current-policy” costs of extending the 2017 tax cuts, delayed ACA health taxes, annual tax extenders, and the 2018 increase in the discretionary spending caps, the projected ten-year deficit rises to \$15 trillion.¹

Specifically, from 2018 through 2028, the current-policy budget deficit is projected to rise from \$779 billion to \$2,106 billion (see chart 1).

A portion of the underlying deficit is driven by the \$250 billion annual cost of the recent tax cuts, and the \$150 billion annual cost of the higher discretionary spending caps. They are certainly contributors to current and future deficits. However, that combined \$400 billion cost will remain relatively steady if extended. It does not explain the \$1.3 trillion rise in projected red ink between 2018 and 2028 (chart 2).

Instead, nearly the entire surge in red ink will come from adding 74 million baby boomers to the Social Security and Medicare systems. This is both a result of demographics, and rising health costs.

Social Security and Medicare are not fully self-financed through premiums, payroll taxes, and related dedicated taxes. Each system requires an annual general revenue transfer to pay all promised benefits (some of these transfers are credited as interest payments to trust funds). And these transfers – as well as the interest costs of the Treasury borrowing to cover these transfers – are about to soar.

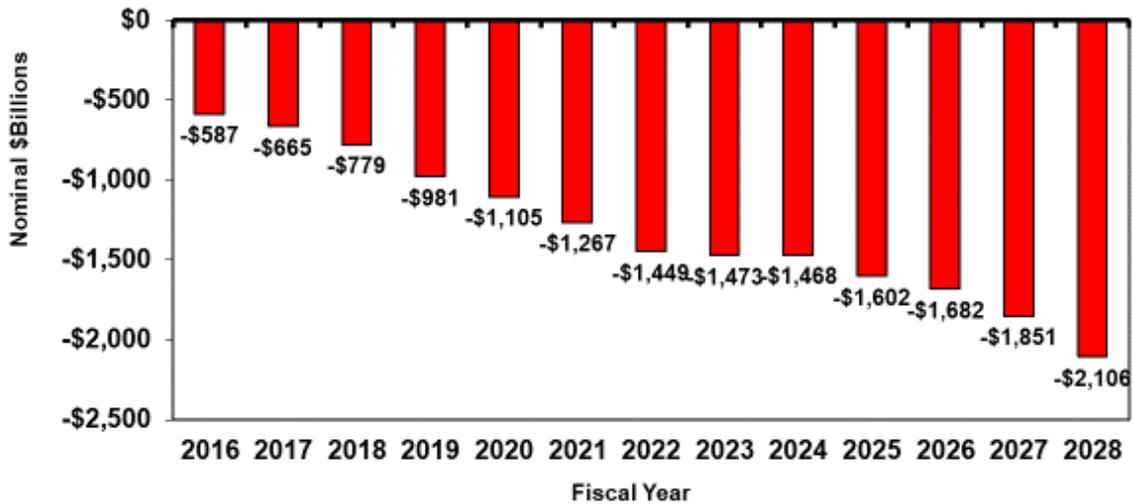
The annual Social Security and Medicare shortfalls (and their interest costs) will jump from \$450 billion this year, to \$1.6 trillion a decade from now. These \$1.15 trillion in additional Social Security and Medicare deficits will account for nearly 90% of the \$1.3 trillion projected rise in the annual deficit over the next decade, according to the CBO current-policy budget baseline.

In total, over the next ten years, Social Security will receive a general revenue transfer of \$2.2 trillion, and Medicare will receive a general revenue transfer of \$5.6 trillion. Given the percentage of federal spending that must be deficit-financed, these general revenue costs will add \$2.0 trillion in net interest costs. Thus, the Social Security and Medicare systems will drain the general revenues by \$9.8 trillion over the next decade. The rest of the budget deficit will total \$2.6 trillion (1% of GDP) under a current-law baseline, or \$5.2 trillion (2% of GDP) if current policies are extended.

Social Security has “earned” these deficits through all the prior surpluses that it had returned to the Treasury before 2009. And the Medicare system's deficits are by program design. Nevertheless, these rapidly rising deficits are the main moving variable driving future deficits upward. The rest of the federal budget is projected to hold steady at 13% of GDP through the next decade. Revenues are projected to dip as share of the GDP, but by 2028 return to the 17.4% of GDP that prevailed before the tax cuts.

Chart 1

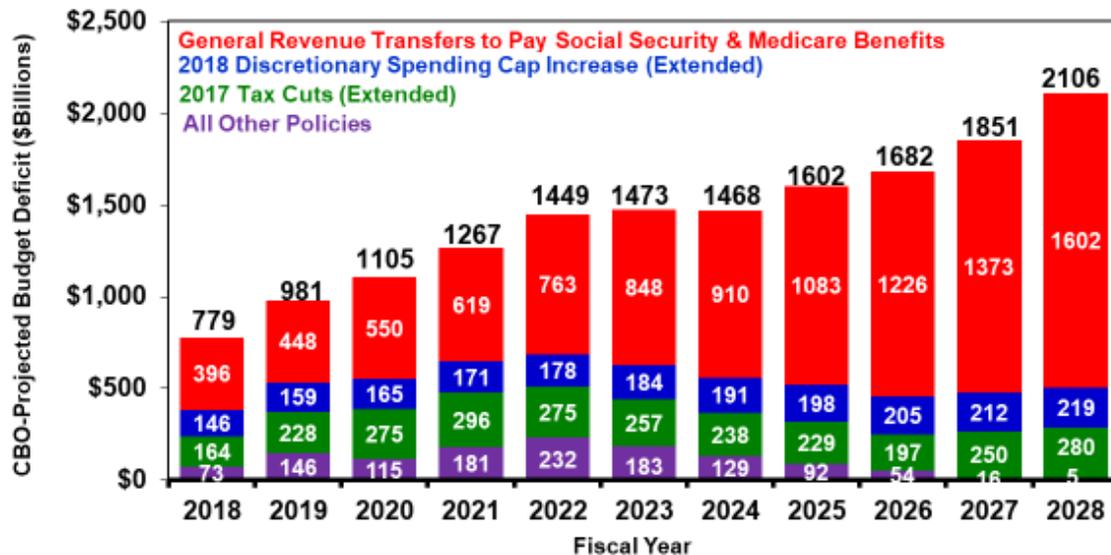
CBO Projects \$2 Trillion Budget Deficits Within a Decade, Assuming Current Policies are Extended



Source: OMB Historical Table 1.1, and April 2018 CBO (current-policy) Baseline, Table 4.5

Chart 2

Rising Social Security & Medicare Shortfalls Drive 90% of Rising Deficit Between 2018-2028



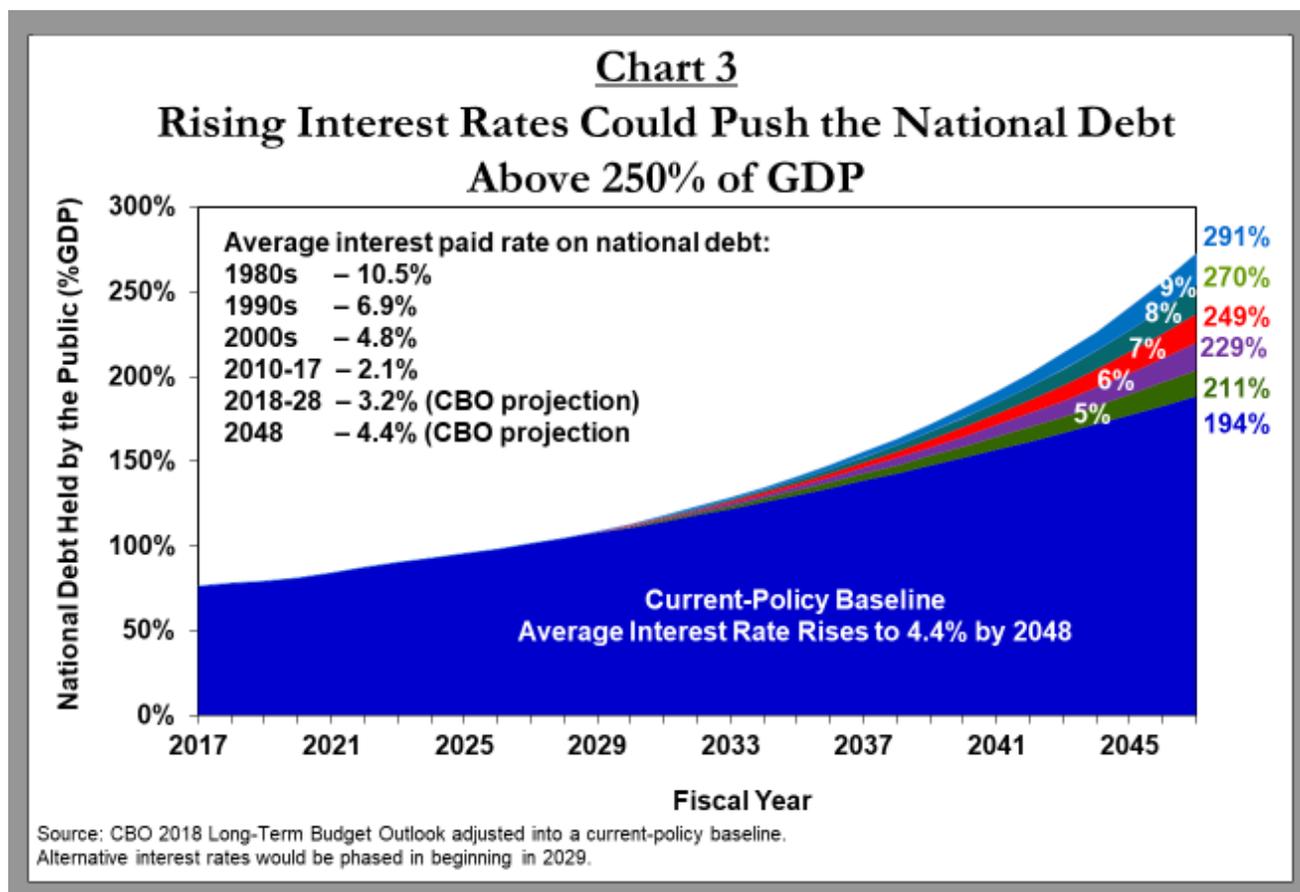
Each category includes the portion of interest on the national debt that it is responsible for. General revenue transfers include interest payments on trust funds, which are a net cost to the rest of the budget. Source: Calculated using April 2018 CBO (current-policy) Baseline and CBO 2018 Long-Term Baseline.

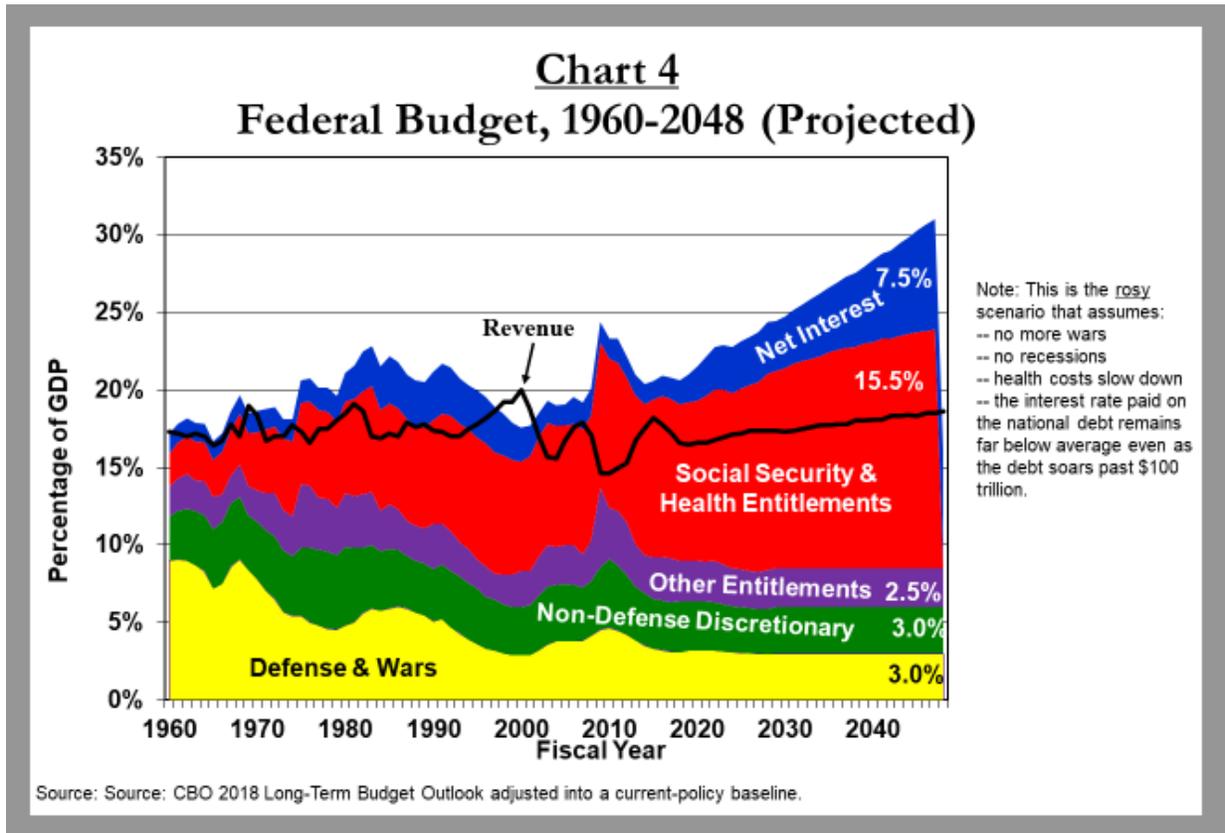
II. Why the Long-Term Debt Is Soaring

From the mid-1950s through 2008, the national debt held by the public averaged 35% of GDP.² This level of borrowing could easily be absorbed by the increasingly global financial markets, and it resulted in interest costs averaging 2% of GDP (roughly 10% of a typical federal budget). Since 2008, the great recession and the beginning of the baby-boomer retirements have more than doubled the debt, to 78% of GDP. If current policies continue, the debt is projected to reach an unprecedented 194% of GDP within 30 years.³ And if this debt brings higher interest rates (as consensus economic theory suggests),⁴ the debt could surpass 250% of GDP (chart 3) and servicing the debt could cost 7.5% of GDP—the equivalent of \$1.5 trillion in today’s economy. Americans of all incomes would face unprecedented tax increases; higher interest rates for home mortgages and car, student, and business loans; and a significant economic slowdown. Unlike Greece’s, the U.S. debt would be too large to be easily absorbed by the global economy.

What is causing the debt rise? Not inadequate tax revenues—which, since the early 1950s, have usually remained between 16.5% and 18.5% of GDP, regardless of tax policies, and which are projected to rise above historical norms, to 18.6%–19.8% of GDP, depending on the fate of various expiring tax cuts and delayed tax increases.⁵ Nor is it driven, on the spending side, by aggregate expenditures for discretionary and smaller entitlements, which are projected to continue falling as a share of the economy.

Chart 4 shows that the entire increase in long-term debt will come from surging Social Security, Medicare, and other government health-care spending. According to the Congressional Budget Office (CBO), these costs have risen from 7% to 10% of GDP since 2000 and are projected to reach 15.5% of GDP by 2048—or 21.8% of GDP when the interest cost of Social Security and Medicare’s annual deficits are included.





Why Social Security and Medicare Are Going Bankrupt

Between 2008 and 2030, 74 million Americans born between 1946 and 1964—on average, 10,000 per day—will retire and receive Social Security and Medicare benefits. Of this group, those retiring at age 66 and living to age 90 will spend one-third of their adult life receiving federal retirement benefits. The combination of more retiring baby boomers and longer life spans will expand Social Security and Medicare caseloads far beyond what current taxpayers can afford under current benefit formulas. In 1960, five workers paid the taxes to support each retiree (and, of course, Medicare did not exist). The ratio of workers to retirees has now fallen below 3–1, on its way to 2–1 by the 2030s. When today’s kindergartners are adults, each married couple will basically be responsible for the Social Security and health care of their very own retiree.

These demographic challenges are worsened by rising health-care costs and repeated benefit expansions enacted by lawmakers. Today’s typical retiring couple has paid \$140,000 into Medicare and will receive \$420,000 in benefits (in net present value), in part because Medicare’s physician and drug benefits are not pre-funded with payroll taxes, and only partially funded by retiree premiums. Most Social Security recipients also come out ahead.⁶ Thus, most seniors’ benefits greatly exceed their lifetime contributions to the Social Security and Medicare systems. By 2030, the 74 million baby boomers will have joined a retirement benefit system that runs a substantial per-person deficit.

According to CBO, between 2018 and 2048, Medicare is projected to run a \$41 trillion cash deficit, Social Security will run an \$18 trillion cash deficit, and the interest on the resulting program debt will be \$41 trillion (chart 5).⁷ (To adjust these 30-year totals for inflation, trim by one-third.) Rather than self-finance through payroll taxes and premiums, these two programs are set to add \$100 trillion to the national debt. The rest of the federal budget is projected to run a surplus over the next 30 years.

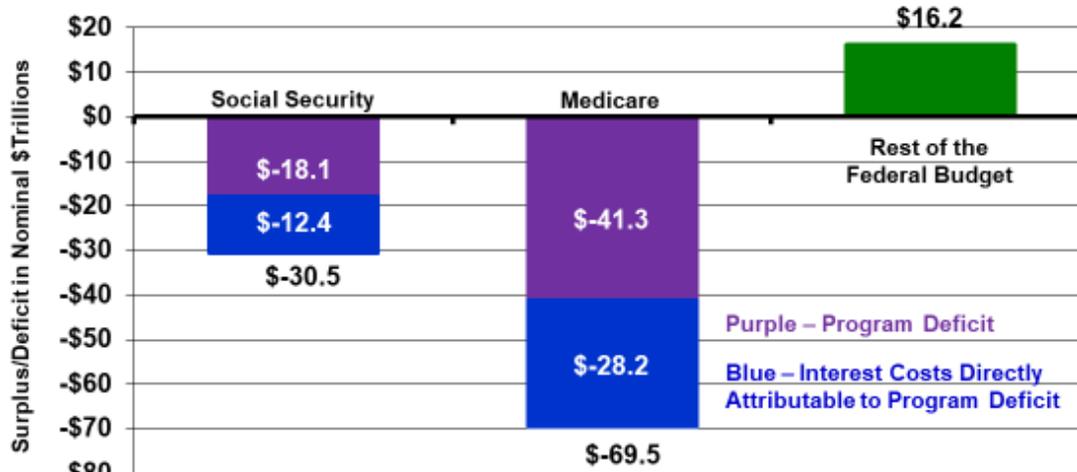
Between 2018 and 2048, the annual Social Security and Medicare deficits are projected to rise from 2.0% to 12.6% of GDP. This projected 2048 shortfall will consist of Medicare (4.5% of GDP), Social Security (1.8%), and the interest costs directly attributed to these program shortfalls (6.3%). The rest of the budget will run a 3.1% of GDP surplus, according to CBO data (see chart 6).⁸

Chart 5

What is Causing \$84 Trillion 2018-2048 Budget Deficit?

Social Security & Medicare: \$100 Trillion Deficit

The Rest of the Budget: \$16 Trillion Surplus



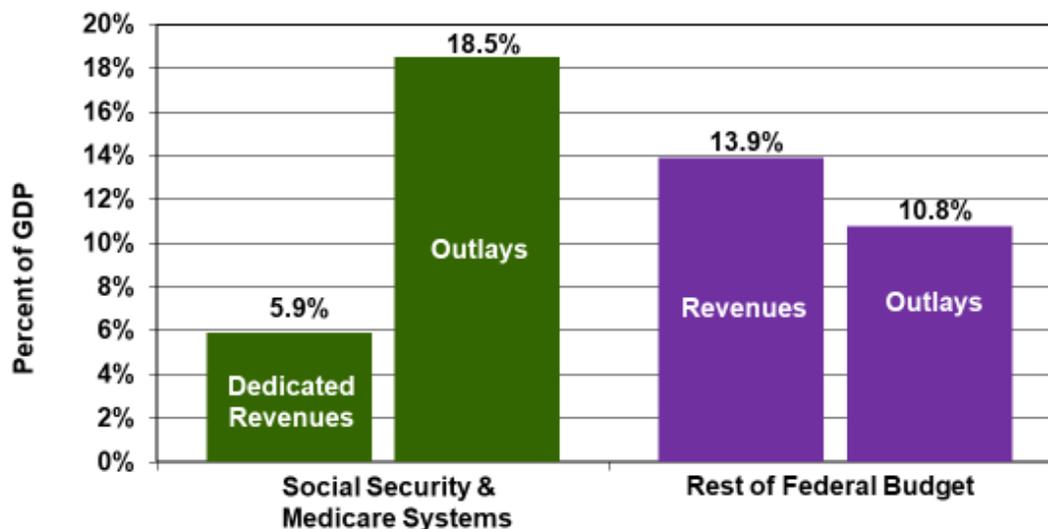
Source of \$83.7 Trillion Budget Deficit Projected over 2018-2048 Period (\$Nominal)

Source: Calculations from CBO 2018 Long-Term Budget Outlook, converted to a current-policy baseline. To inflation adjust, trim amounts by one-third.

Note: Social Security & Medicare deficits are the benefits that must be paid from general revenues because payroll taxes, premiums, and other non-interest trust fund revenues are insufficient. CBO assumes full benefits will continue even after trust fund insolvency.

Chart 6

Projected 2048 Budget Deficits are Entirely Driven by Social Security & Medicare Shortfalls



Note: 2048 is the final year of the latest CBO 30-year budget projection.

Source: CBO 2018 Long-Term Budget Outlook adjusted into a current-policy baseline. Each outlay category includes portion of national debt interest attributed to its 2018-2048 deficits.

The Fiscal Avalanche Has Already Begun

Since 2008—when the first baby boomers qualified for early retirement—Social Security and Medicare have accounted for 60% of *all* inflation-adjusted federal spending growth (with Medicaid and the Affordable Care Act responsible for an additional 31%). The majority of budgetary savings achieved by discretionary spending caps, defense cuts, and rising tax revenues have simply financed growing Social Security and Medicare costs, which will grow by another \$130 billion annually over the next decade.⁹ That is the equivalent of creating another Defense Department every five years. This will happen automatically, without any congressional votes and therefore likely with scant media coverage.

And as federal resources further shift to the elderly, Washington is beginning to run out of offsetting spending cuts. This has contributed to the deficit expanding from \$438 billion to \$666 billion through 2017, even before the recent tax cuts. CBO's current-policy baseline shows deficits rising to \$2 trillion within a decade—or \$3 trillion, if interest rates return to historical norms. Unlike the temporary, recession-driven budget deficits a decade ago, these Social Security– and Medicare-based deficits will expand permanently. Over the next 30 years, CBO projects that the national debt will grow from \$20 trillion to \$99 trillion (\$54 trillion after inflation)—or much higher, if interest rates rise from the projected 3%–4% range to the historically typical 5%–6%.

President Trump's latest budget proposal shows the impossibility of reining in deficits without Social Security and Medicare reform. By allowing these programs to nearly double over the decade, from \$1.6 trillion to \$3.0 trillion, the White House is forced to propose slashing other entitlement spending by 20% over the decade and cutting both defense and domestic discretionary spending to levels—as a percentage of GDP—unseen since the 1930s. Yet even if these implausible cuts were enacted, CBO still estimates a budget deficit topping \$1 trillion by 2028.¹⁰ This deficit would continue escalating thereafter because Social Security and Medicare costs would continue growing even after Washington would have run out of other spending to cut.

Predictably, most of the popular blame for the rising deficits is currently pinned on the 2017 Tax Cuts and Jobs Act (TCJA). TCJA will likely decrease revenues by roughly 1% of GDP indefinitely if extended past 2025, when parts of the law are currently scheduled to expire.¹¹ (This does not include additional tax revenues that will arise from economic growth that lower tax rates will induce. The congressional Joint Committee on Taxation estimates that these additional tax revenues would offset the additional *interest* costs of the tax law, though not the primary deficit-increasing impact of the tax cuts themselves.) While the government revenues forgone by TCJA will surely worsen deficits, they are a much smaller contributor than Social Security, Medicare, and Medicaid, spending on which will together rise by 2.6% of GDP over the decade and 5.4% over 30 years.¹² Even without the 2017 tax cuts, the annual deficit would still exceed \$1.7 trillion within a decade. In short, TCJA did not create the federal government's large deficits, and even repealing them would not absolve lawmakers of the need to address rising entitlement spending.

How a Crisis May Play Out

The national debt's share of the economy cannot rise forever. At a certain point, even large global savings markets will be stretched, and investor confidence in America's ability to finance its debt will evaporate. The timing of a country's debt crisis depends as much on market psychology as on economic fundamentals. But eventually, as the debt steeply escalates, investors will move from unease to panic and demand higher interest rates to finance the federal government. These higher rates will make it extremely difficult for businesses to borrow and invest, and will make auto loans, student loans, and home mortgages less affordable, while also forcing unprecedented tax increases and/or spending cuts to pay for Washington's higher interest costs. Such an outcome is highly likely if annual deficits continue growing past 10% of GDP and the debt continues to approach 200% of GDP, as projected in the current-policy baseline. On the one hand, America will have some leeway due to its reputation as a safe harbor for investment and status as the world's reserve currency. On the other hand, absorbing a debt of nearly 200%

of America's economy would be much more expensive for the global markets than absorbing, say, 200% of a smaller GDP, like that of Greece.

In the absence of fundamental reform, the more likely scenario is a series of minor investor panics (forcing up interest rates), followed by upper-income tax increases and lower-priority spending reductions that are insufficient to finance the rising entitlement and interest costs. Eventually, Washington will run out of such offsets to reduce deficits, leaving only the choice between historically large middle-class tax increases and a drastic reduction in Social Security and Medicare benefits for current retirees.

III. The Mirage of “Easy” Solutions

Real deficit reduction will involve a real burden. Yet standing in the reform is series of false claims that the problem is easily solved.

Economic Panaceas

Steep economic growth. A strong economy is necessary but far from sufficient for major deficit reduction. Growth rates will already be limited by the labor-force slowdown caused by baby-boomer retirements and declining birthrates. That leaves productivity to drive growth.

So, no problem? Let's start by disregarding CBO's 2018 projection that total U.S. factor productivity will continue growing at the 1.2% average rate of the past 30 years and instead assume the white-hot 1.8% rate that prevailed from 1992 through 2005.¹³ Most economists¹⁴ would consider this rate far too optimistic.¹⁵ Nevertheless, the resulting higher incomes and tax revenues from this productivity jet stream would seem to close at least 40% of the cumulative deficits through 2048—until one accounts for the fact that higher incomes automatically result in higher Social Security benefits when the workers who earned them retire.

Much can be done to increase real economic growth rates above CBO's long-term 1.9% annual projections. In particular, lawmakers should aim to grow the labor-force participation rate; continue to refine the tax code to encourage work, savings, and investment; and improve policies in the areas of trade, energy, job training, education, and health care. However, a refusal to address surging spending and deficits would still undermine economic growth by raising interest rates, decreasing business investment, and ultimately forcing up taxes. Lawmakers should aspire to faster growth but not simply assume it—especially if entitlement costs keep growing.

Inflate the debt away. In the short term, higher inflation can dilute some of today's \$20 trillion national debt. However, Social Security and Medicare benefits and payments are also tied to inflation, so future liabilities would expand. Additionally, Washington would have to pay much higher interest rates when borrowing to finance those benefits.

Low interest rates. CBO's 2018 Long-Term Budget Outlook assumes that the national debt can rise from 35% to 150% of GDP between 2007 and 2048, with its average interest rate peaking at just 4.4%—which is below even the levels of the 1990s (6.9%) and 2000s (4.8%). By contrast, the economic-policy community consensus is that such a large increase in federal debt would raise interest rates.¹⁶ For each percentage point that interest rates rise, Washington must pay approximately \$13 trillion more in interest costs over 30 years.¹⁷ That means an even higher national debt.

Immigration. Smart immigration policy may, on net, marginally improve the federal budget picture (and the economy). It is not a cure-all. High-skill immigrants send higher tax revenues during their working careers, but their eventual retirement into Social Security and Medicare would add new liabilities to the system. Low-skill immigrants generally increase costs to the federal government (and especially to state and local governments)—at least, in the first or second generation, because the resulting education, infrastructure, and social spending exceed the added tax revenues.¹⁸

Conservative Fantasies

Pro-growth tax policy. Economic growth is obviously important to deficit reduction—and tax legislation that depresses savings and investment must be avoided. Nevertheless, the historical record clearly shows that the vast majority of tax cuts do not increase tax revenues—especially by enough to keep pace with federal programs growing 6%–7% annually.¹⁹

Eliminating welfare and lower-priority spending. Over the past 15 years, congressional GOP blueprints have typically imposed nearly all the first decade’s cuts on antipoverty programs (Medicaid, ACA subsidies, SNAP [aka food stamps], and others) as well as nondefense discretionary spending, such as education, veterans’ health, homeland security, medical research, and infrastructure. This pot of spending—7% of GDP and declining—would have to be mostly eliminated to balance the budget a decade from now.²⁰ These cuts will never be passed by any Congress, as their advocates on Capitol Hill and in top think tanks surely know. While there are any number of failed and unnecessary programs in need of major reform, proposals to eviscerate these entire categories of spending while letting Social Security and Medicare off the hook are a politically delusional distraction.

Impossibly tight spending caps. Spending caps are a vital tool to enforce realistic spending targets. But absent any achievable underlying programmatic reforms to meet those targets, they are an empty gimmick. Nevertheless, many conservative budget blueprints simply divide the federal budget into five to eight spending categories and then assume unprecedented cuts in targeted categories, with no underlying policy proposals to achieve those targets. For instance, President Trump’s latest budget proposal assumes a 60% reduction by 2028 in total nondefense discretionary spending as a percentage of GDP. The budget proposal provides no breakdown of which specific programs would be slashed, and how they would operate once all cuts are enacted.²¹ The 2011 Budget Control Act has shown that overly tight caps will be canceled rather than force politically suicidal cuts.

Devolution to state governments. There is a strong *policy* case for allowing states to have more control over poverty relief, education, infrastructure, economic development, and law-enforcement spending. However, counting the federal savings from devolution as the centerpiece of a deficit-reduction strategy is disingenuous because it simply shifts the deficits and taxes to the state level (minus modest efficiency gains that might come from better state fiscal management). The purpose of deficit reduction is to limit government borrowing and tax increases (and to limit economic damage), not merely to change the address where the taxes are sent.

Liberal Fantasies

“Just tax the rich.” Liberal advocates often vastly overstate the degree to which upper-income tax increases can finance the ever-expanding government. In the first place, the U.S. already has the most progressive tax code in the OECD—even adjusting for differences in income inequality.²² And setting aside the moral questions that would be raised by the government seizing the vast majority of any family’s income, basic math shows that large tax increases on high-income Americans cannot close most of the long-term budget deficit.

Start with an extreme proposition: a 100% tax rate on all income over \$500,000. Result: this would raise barely more than 5% of GDP—at least for year one.²³ After that, one needs a heroic, if not absurd, projection that this tax would have no effect on working or investment. Next, try a slightly more realistic doubling of the top 35% and 37% tax brackets, to 70% and 74%. Result: this would raise only approximately 1.6% of GDP—and even that figure ignores all revenues lost to the economic effects of 85% marginal tax rates (when including state and payroll taxes) on work or investment, as well as tax avoidance and evasion.

Popular proposals to impose a 30% minimum tax on “millionaires” and to more aggressively tax banks, hedge-fund managers, and oil and gas companies would raise a *combined* 0.1% of GDP—or lose revenue if they trim the economic growth rate by even 1/20 of 1% (0.0005).²⁴ The 0.4% of GDP raised by a \$25 per metric ton carbon tax would be passed on to households through higher energy bills.

The top-earning 5% of families and pass-through businesses currently account for 30% of all income.²⁵ That means that 70% of this tax base comes from those outside the top 5%. Furthermore, that top 5% already pays 42% of all federal taxes, including 61% of all federal income taxes, which leaves less room for additional taxes.²⁶ So while some upper-income tax increases are possible, the idea that America can close an \$18 trillion Social Security shortfall and \$41 trillion Medicare shortfall—and even pay for additional spending proposals on the liberal agenda—solely by sticking it to the rich is a fantasy that finds no support in budget math.

Nor can corporate tax hikes close much of the gap. America’s total corporate tax revenues are generally in line with other developed nations. Although modest reforms may be on the table, major changes, such as a 10-point rate increase, would raise less than 0.5% of GDP while giving more companies an incentive to relocate abroad. Repealing the 2017 TCJA would not significantly raise corporate tax revenues, either, as that portion of the law was almost entirely “paid for” through a combination of tax offsets and additional revenues from projected economic growth.²⁷

An inescapable reality gets lost in this country’s intractable budget debates: *If America wants to spend like Europe, it must also tax like Europe.* This means, in addition to federal and state income taxes, a value-added tax (VAT)—essentially a national sales tax—that affects all families. Forget balancing the budget, merely stabilizing the debt at 95% of GDP (with annual deficits of 3% of GDP) without touching government spending would require either:

- Imposing a VAT that rises to 34% by 2048, or
- Raising the payroll tax from 15.3% to 33.5%.²⁸

By 2048, the Social Security and Medicare shortfalls are projected by CBO to reach 6.3% of GDP – or 12.6% of GDP including resulting interest costs. Chart 7’s menu of possible tax increases shows the extraordinary difficulty of building a 6.3% (or 12.6%) of GDP tax increase.

Chart 7

**Tax Increases Cannot Easily Close the Social Security and Medicare Shortfalls
(Which by 2048, will total 6.3% of GDP – or 12.6% including resulting interest costs)**

%GDP	Tax Proposal
	Individual Income Taxes
1.60%	Double 35% and 37% Tax Brackets to 70% and 74%
3.26%	Raise Income Tax Rates by 10% Across-the-Board*
0.68%	Raise Income Tax Rates by 10% on Incomes Over \$92k (Single) and \$153k (Married)
0.42%	Raise Income Tax Rates by 10% on Incomes Over \$400k
0.03%	30% Minimum Tax for Millionaires
0.17%	Repeal Mortgage Interest Deduction
0.21%	Repeal Charitable Giving Deduction
0.11%	Repeal State-and-Local Taxes Deduction
0.30%	Repeal Child Tax Credit Expansion in TCJA*
0.33%	Repeal Earned Income Tax Credit (EITC)*
1.59%	Repeal Tax Exclusion for Employer-Paid Health Premiums*
	Investment Taxes
0.14%	Raise Capital Gains and Dividends Taxes by 10 Percentage Points
0.01%	Tax Carried Interest as Ordinary Income
	Payroll Taxes
0.78%	Eliminate Income cap for 12.4% Social Security Tax (No Credit for Benefits)
0.30%	Raise Social Security Payroll Tax 1 Percentage Point*
0.36%	Raise Medicare Payroll Tax 1 Percentage Point*
	Excise, Estate, Sales Taxes
0.42%	Impose a Carbon Tax at \$25/Metric Ton - No Rebate for Households*
0.03%	Nearly Double Alcohol Taxes*
0.01%	Increase Cigarette Tax by 50 Cents per Pack*
0.05%	Repeal TCJA's Doubling of Estate Tax Exclusion
1.74%	Impose a 10 Percent Value-Added Tax*
	Other Business Taxes
0.01%	End Moratorium and Impose Medical Device Tax
0.22%	Repeal 20% Deduction for Pass-Through Businesses
0.45%	Increase Corporate Income Tax Rates by 10 Percentage Points
0.09%	Repeal 100% Business Expensing
0.01%	Repeal Oil and Gas Tax Preferences
0.04%	Impose "Bank Tax" on Large Financial Institutions
0.00%	Tax Corporate Moves Overseas

*Tax increase significantly includes low-income families

Notes:

- A) Policies are measured against a current-policy baseline that assumes recent tax cuts are extended.
- B) Estimates do not account for: 1) revenues lost to negative economic effect of policies, and 2) interactions between policies.
- C) The highest-income taxpayers currently pay a combined marginal tax rate (income, payroll, and state) of approximately 50%. Substantially higher tax rates would likely give back some of the new revenues due to reduced economic growth as well as tax avoidance.
- D) Sources: CBO, JCT, Social Security Office of the Actuary.

Deep defense cuts. Since the 1980s, the Pentagon budget has fallen from 6% to 3% of GDP—not far above Europe’s target of 2%. Cutting U.S. defense spending to the levels pledged by European members of NATO would save 1% of GDP, or roughly one-seventh of the Social Security and Medicare

long-term shortfall. And Europe's target level is possible only because its leaders can count on protection from a larger superpower—a luxury that the U.S. would not enjoy. A healthy portion of America's higher defense budget comes from spending \$100,000 per troop in compensation (salary, pension, housing, health care, and other benefits), which lawmakers are not eager to cut.²⁹ Some long-term budget savings are possible, though it should be noted that President Obama did not propose reducing the Pentagon budget to anywhere near the levels of France or the U.K.

Single-payer health care. When confronted with rising Medicare and Medicaid costs driving federal deficits, a popular response on the left is to propose single-payer health care. The theory here is that a fully socialized health plan would drastically slash costs to families and the federal budget.

There is some debate over whether single-payer would slightly increase or decrease total national health expenditures. The most generous analysis of Senator Bernie Sanders's "Medicare-for-All Act," performed by the Mercatus Center, shows a 3% reduction in projected national health expenditures.³⁰ Although those savings charitably rely on the bill's assumption that private health insurance can be nationalized with reimbursement rates for its health providers cut by approximately 40%—a massive reduction that even the Mercatus Center report concedes is wildly implausible. Analyses that assume more realistic payment rates, such as those performed by the politically liberal Urban Institute, show a notable increase in national health spending under single-payer health care.³¹

Regardless of whether total nationwide health spending would slightly rise or fall, it is obvious that transferring the entire health-care system to the federal government would substantially increase federal spending. Thus, virtually all analyses of single-payer health care—from the politically liberal Urban Institute to the conservative Mercatus Center—have estimated a first-decade cost of \$24 trillion–\$29 trillion to the federal government.³² That is on top of current federal health spending that is already growing at unsustainable rates. And if the large provider payment rate reductions prove to be unrealistic, the cost will rise by trillions of dollars.

Some suggest that these new federal costs would be fully "paid for" by the health savings to families, businesses, and state governments.³³ This response leaves unanswered the rather large question of how to convert every dollar of current private-sector and state-government health spending into a nearly \$30 trillion "single-payer tax." Single-payer advocates have still not provided a tax proposal that covers more than half of the exorbitant federal cost. The most likely option, a payroll tax, would need to be set at 30%, on top of the current 15.3% rate.³⁴ There is no indication that Americans would accept tax increases this large, even if no longer paying premiums for health insurance.

Furthermore, these new taxes would finance only the *added federal costs* of the new single-payer system—not the underlying cost of current federal health spending. In other words, "Medicare for All" would not address Medicare's projected \$41 trillion cash shortfall over the next three decades. It would simply make Medicare more generous, and then expand it to everyone under age 65. Perhaps lawmakers should figure out how to pay for the current Medicare system before pledging nearly \$30 trillion per decade to expand it.³⁵

Cross-Partisan Fantasies

Social Security trust fund to the rescue. Some suggest that redeeming the \$3 trillion in assets held by the Social Security trust fund will shield taxpayers from the cost of Social Security's deficits. In the first place, this \$3 trillion accounts for a small fraction of the system's \$18 trillion cash deficit over 30 years. More important, the trust fund contains no economic resources with which to pay benefits—it consists of a pile of IOUs in a filing cabinet in Parkersburg, West Virginia. This \$3 trillion in Social Security assets reflects a \$3 trillion liability for the taxpayers, who must repay the bonds with interest over the next 16 years. All future Social Security benefits will be financed by future taxes and borrowing.

Long-term budget projections are just theory. Americans otherwise inclined to be skeptical of 30-year projections should nevertheless take these seriously. Future inflation rates are indeed anyone's guess, but the 74 million baby boomers retiring into Social Security and Medicare are an actuarial and demographic reality. These present and future retirees exist, and the payment formulas have already been set. Furthermore, any future uncertainties are an argument for caution and prudence.

There is no hurry. Some assert that lawmakers can wait 10 or 15 years to address this challenge.³⁶ Unfortunately, every year of delay raises the eventual cost of a budget fix because: 1) on average, 4 million more baby boomers retire into Social Security and Medicare, and lawmakers have generally avoided reducing benefits for those already receiving them; 2) benefit levels rise further above an affordable level; and 3) the larger national debt locks in permanently higher interest costs. The longer the reforms are delayed, the larger and more painful they must ultimately be.

Let the kids deal with the problem. The final argument against reform asserts that Social Security and Medicare benefits represent an unbreakable, unamendable promise to the elderly, consequences be damned. In reality, retirement benefits have been repeatedly expanded far beyond what current retirees were promised while they were working. For example, President George W. Bush and Congress decided in 2003 that current taxpayers would pay 75% of the prescription-drug costs of the current typical senior. This benefit was never "earned" through payroll taxes. And today's teenagers never signed up for this budget-busting deal.

Conclusion

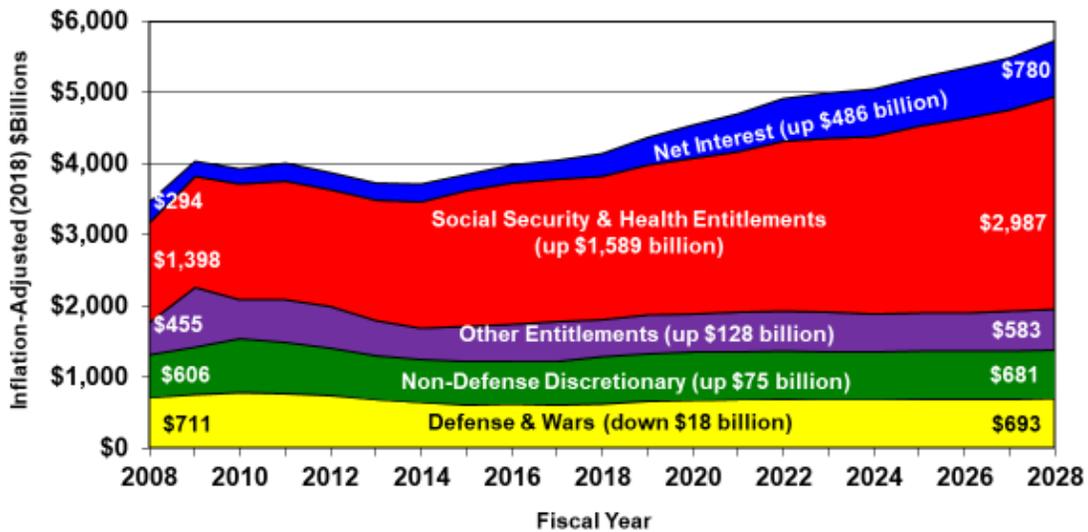
For decades, economists and policy experts warned that a budgetary and economic tsunami would come when the 74 million baby boomers retire into Social Security and Medicare. Nevertheless, nothing significant has been done to avert the crisis. To the contrary, both parties added a new Medicare drug entitlement in 2003, after which the Affordable Care Act further expanded federal health obligations for Medicaid and new subsidized health-insurance exchanges.

Today, one-third of the baby boomers have already retired, and another one-third will retire over the next six years. Annual budget deficits will soon pass \$1 trillion on the way to \$2 trillion and possibly \$3 trillion in 10–15 years. Overall, the Social Security and Medicare systems face an unfathomable \$100 trillion cash deficit over 30 years.

Without reform, runaway deficits will all but guarantee a debt crisis that will profoundly damage the country's economic and social order. There is still time to avoid that crisis, but it will require the nation's political leaders to leave their respective comfort zones and compromise.

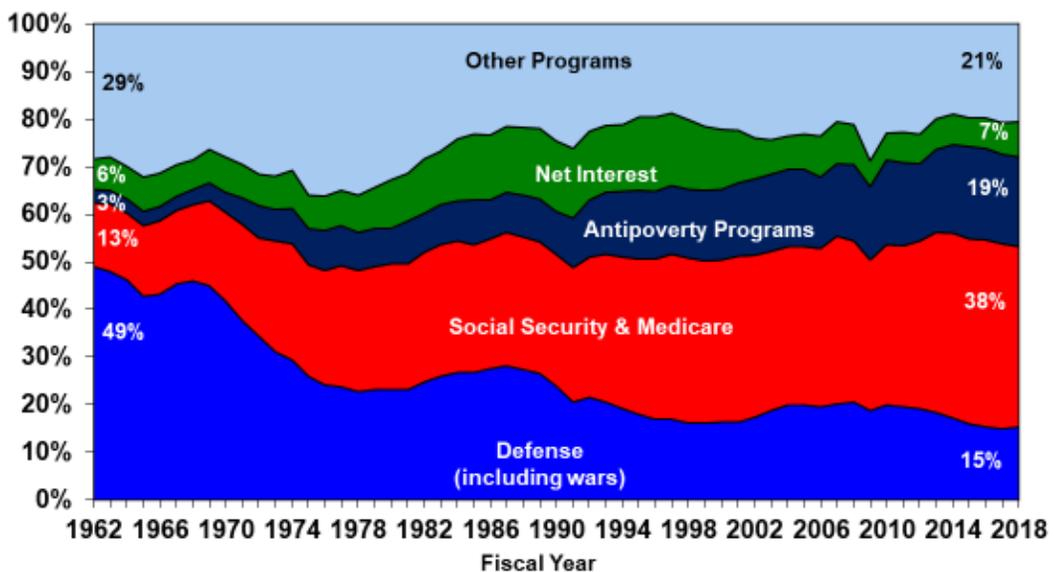
Appendix

Social Security, Health Entitlements, & Interest Costs are Driving 91% of the 2008-2028 Spending Hikes



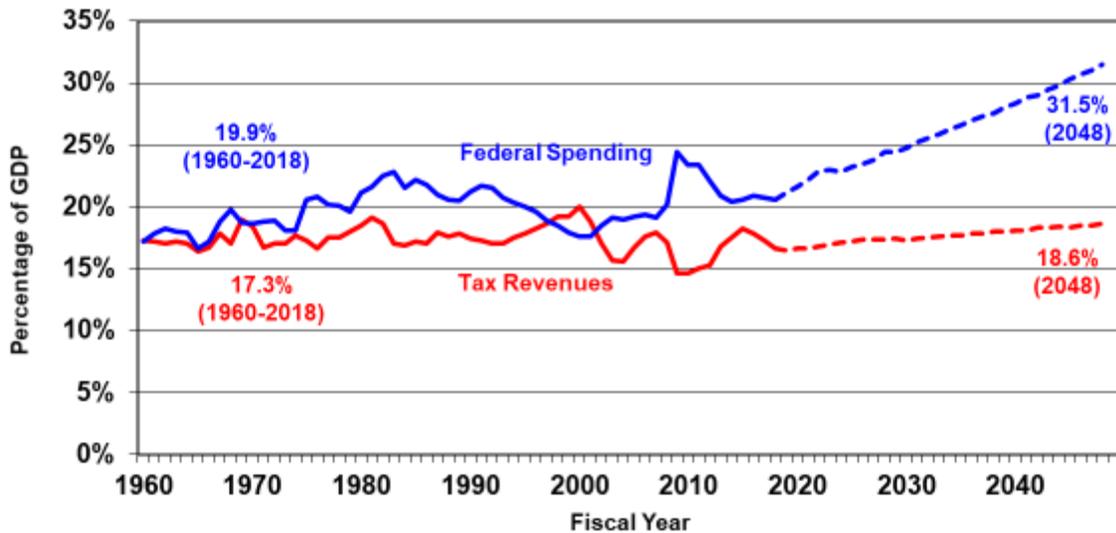
Source: April 2018 CBO (current-policy) Baseline and historical data, adjusted for inflation

Composition of Federal Spending, 1962-2018



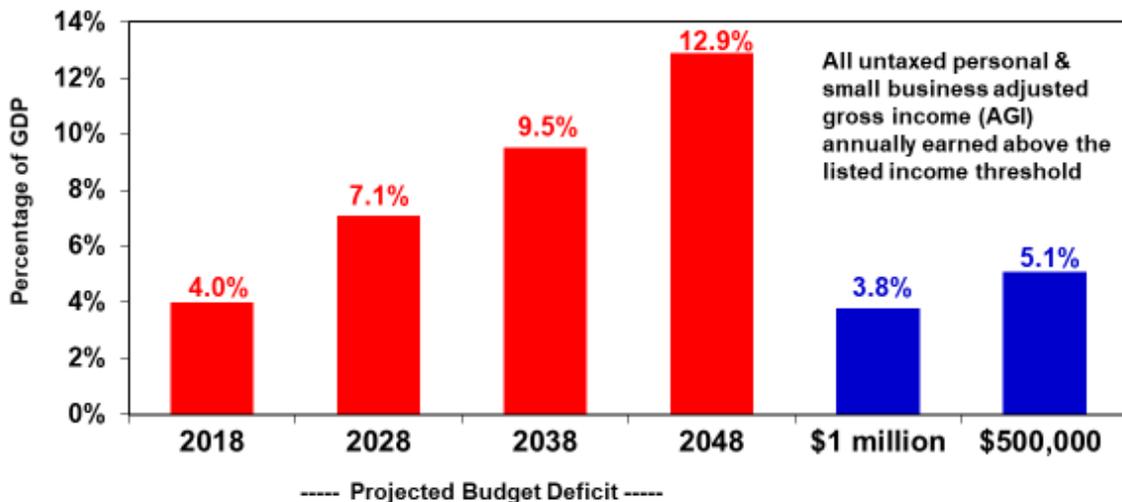
Source: OMB Historical Tables 3.2, 8.5, and 10.1

Rising Spending – Not Falling Revenues – Drives the Long-Term Deficit



Source: CBO 2018 Long-Term Budget Outlook, adjusted into current-policy baseline

Even 100% Tax Rates on Small Businesses and Upper-Income Families Could Not Come Close to Balancing the Long-Term Budget



Source: CBO 2018 Long-Term Budget Outlook adjusted into current-policy baseline and analysis of IRS 2016 (latest year) income tables

¹ All figures in this section were calculated by the author using the CBO’s 10-year baseline, “[The Budget and Economic Outlook: 2018 to 2028](#),” Apr. 9, 2018, and the 30-year baseline, “[The 2018 Long-Term Budget Outlook](#),” June 26, 2018, with [supplemental](#) tables at <https://www.cbo.gov/sites/default/files/recurringdata/51119-2018-06-ltbo.xlsx>.

² The debt held by the public generally refers to debt funded by borrowing from the public. It does not include intragovernmental debt, such as the Social Security trust fund.

³ Baseline estimates come from CBO’s 10-year baseline, “[The Budget and Economic Outlook: 2018 to 2028](#),” Apr. 9, 2018, and the 30-year baseline, “[The 2018 Long-Term Budget Outlook](#),” June 26, 2018, with [supplemental](#) tables at <https://www.cbo.gov/sites/default/files/recurringdata/51119-2018-06-ltbo.xlsx>.

⁴ One of the more influential studies is Thomas Laubach, “[New Evidence on the Interest Rate Effects of Budget Deficits and Debt](#),” Board of Governors of the Federal Reserve System, May 2003.

⁵ CBO, “[The 2018 Long-Term Budget Outlook](#),” June 26, 2018, with [supplemental](#) tables at <https://www.cbo.gov/sites/default/files/recurringdata/51119-2018-06-ltbo.xlsx>.

⁶ C. Eugene Steuerle and Caleb Quakenbush, “[Social Security and Medicare Lifetime Benefits and Taxes](#),” Urban Institute, Sept. 16, 2015. Figures in the text reflect Steuerle and Quakenbush’s table 15 for a married couple with two average earners (\$95,600 in 2015 dollars).

⁷ See note 2.

⁸ CBO, “[The 2018 Long-Term Budget Outlook](#),” June 26, 2018, with [supplemental](#) tables at <https://www.cbo.gov/sites/default/files/recurringdata/51119-2018-06-ltbo.xlsx>.

⁹ CBO, “[The Budget and Economic Outlook: 2018 to 2028](#).”

¹⁰ CBO, “[An Analysis of the President’s 2019 Budget](#),” May 24, 2018.

¹¹ Calculated from CBO, “[The Budget and Economic Outlook: 2018 to 2028](#).”

¹² CBO, “[The Budget and Economic Outlook: 2018 to 2028](#)”; idem, “[The 2018 Long-Term Budget Outlook](#).”

¹³ CBO, “[The Budget and Economic Outlook: 2018 to 2028](#).”

¹⁴ For an overview of the research on realistic productivity rates, see Committee for a Responsible Federal Budget, “[How Fast Can America Grow?](#)” May 18, 2017.

¹⁵ Adding 0.6% to the annual economic growth rate would produce an additional \$132 trillion in cumulative GDP for 2018–48, which translates to roughly \$26 trillion in tax revenues and \$9 trillion in interest savings on the national debt.

¹⁶ One of the more influential studies is Laubach, “[New Evidence on the Interest Rate Effects of Budget Deficits and Debt](#).”

¹⁷ Calculated using CBO, “[The 2018 Long-Term Budget Outlook](#),” June 26, 2018, and [supplemental](#) tables at <https://www.cbo.gov/sites/default/files/recurringdata/51119-2018-06-ltbo.xlsx>, and adjusting into a current-policy baseline.

¹⁸ A much-hyped CBO report (“[S. 744 Border Security, Economic Opportunity, and Immigration Modernization Act](#),” June 18, 2013) showed overwhelmingly positive budgetary effects of immigration legislation that would both increase immigration levels and provide legal status to a large number of unauthorized immigrants. The score limited most of its analysis of federal taxes and spending over 20 years. It ignored significant state and local government costs as well as longer-term Social Security and Medicare costs.

¹⁹ CBO, “[The Budget and Economic Outlook: 2018 to 2028](#).”

²⁰ In 2018, antipoverity spending equals 4.0% of GDP, while nondefense discretionary spending is 3.3%.

²¹ The spending function tables accompanying Trump’s FY 2019 budget proposal employ what is essentially an enormous “cuts to be determined” line item to meet its proposed discretionary spending caps. See Office of Management and Budget (OMB), “[Budget of the United States Government, Fiscal Year 2019](#),” [table 26-1: Net Budget Authority by Function, Category, and Program](#),” row 1163, February 2018.

²² See Scott Hodge, “[News to Obama: The OECD Says the United States Has the Most Progressive Tax System](#),” Tax Foundation, Oct. 29, 2008. Even those figures underestimate this country’s current tax progressivity advantage because they do not include the 2013 upper-income tax increases and, more important, do not include the large value-added taxes that make European tax systems even less progressive.

²³ Calculated using IRS, “[SOI Tax Stats—Individual Statistical Tables by Size of Adjusted Gross Income](#),” table 1.4. In 2015, the amount of income earned over the \$500,000 threshold approximated 7.8% of GDP. An estimated 2.7% of GDP was paid in federal and state taxes on this income, leaving 5.1% of GDP in available take-home pay.

²⁴ See Chart 7 for the revenue estimates of several popular tax proposals. CBO estimates that these proposals would raise \$23.3 billion annually by 2026, on a static basis. However, budget sensitivity tables estimate that a sustained 1-percentage-point decline in real economic growth would cost the federal budget \$472 billion annually by 2026. Thus, if these new taxes reduce economic growth by even 1/20 of 1%, revenues would fall by \$23.6 billion—enough to negate the tax-increase revenues. See OMB, [An American Budget: Analytical Perspectives](#), “[Economic Assumptions and Interactions with the Budget](#),” [table 2-4: Sensitivity of the Budget to Economic Assumptions](#), February 2018.

²⁵ CBO, “[The Distribution of Household Income, 2014](#),” Mar. 19, 2018. [Supplemental data](#) are at <https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53597-supplementaldata.xlsx>.

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- ²⁶ CBO, “[The Distribution of Household Income and Federal Taxes, 2013](#),” June 8, 2016. [Supplemental data](#) are at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51361-supplementaldata-2.xlsx>.
- ²⁷ The Joint Committee on Taxation (JCT) scored Title II (business tax reform) and Title III (international tax reform) of TCJA as costing \$329 billion over the decade. However, JCT separately shows that the tax bill would provide \$385 billion in total growth revenues. The economic consensus assumes that most of this growth comes from the bill’s corporate reforms, rather than the individual reforms. Thus, the corporate tax cuts in TCJA are almost entirely “paid for” with offsets such as reduced deductions (such as those for interest paid) and growth revenues. See JCT, “Estimated Budget Effects of the Conference Agreement for H.R. 1, the Tax Cuts and Jobs Act, Fiscal Years 2018–27,” [Publication JCX-67-17](#), Dec. 18, 2017; JCT, “Macroeconomic Analysis of the Conference Agreement for H.R. 1, The ‘Tax Cuts and Jobs Act,’ ” [Publication JCX-69-17](#), Dec. 22, 2017.
- ²⁸ Calculated using tax estimates in chart 7.
- ²⁹ CBO, “[Costs of Military Pay and Benefits in the Defense Budget](#),” November 2012, p. 2.
- ³⁰ Charles Blahous, “[The Costs of a National Single-Payer Healthcare System](#),” Mercatus Working Paper, Mercatus Center at George Mason University, July 2018.
- ³¹ John Holahan et al., “[The Sanders Single-Payer Health Care Plan: The Effect on National Health Expenditures and Federal and Private Spending](#),” Urban Institute, May 9, 2016.
- ³² Charles Blahous, “[Questions and Answers About Medicare for All’s Costs](#),” Economics21, Aug. 21, 2018.
- ³³ For an example of this argument, see Dylan Scott, “[Bernie Sanders’s \\$32 trillion Medicare-for-All Plan Is Actually Kind of a Bargain](#),” Vox.com, July 30, 2018.
- ³⁴ Brian Riedl, “[No, ‘Medicare for All’ Is Still Not Plausible](#),” Economics21, Aug. 10, 2018.
- ³⁵ For more on the unworkability of a single-payer system in the U.S., see Sally Pipes, *The False Promise of Single-Payer Health Care* (New York: Encounter, 2018); Richard A. Epstein, “[Why a Single Payer Health Care System Is a Really Bad Idea](#),” Newsweek, July 18, 2017; Brian Riedl, “[America Needs Health-Care Reform, and Single-Payer Will Be No Part of It](#),” National Review Online, Aug. 15, 2017; Riedl, “[No, ‘Medicare for All’ Is Still Not Plausible](#)”; Chris Pope, “[Bernie’s Bad Medicine](#),” National Review Online, Oct. 16, 2017.
- ³⁶ This argument is most commonly associated with the talking point that Social Security is “fully funded” through 2034. Yet it is fully funded only because taxpayers will be repaying trillions to the Social Security trust fund over that period. These general revenue transfers will burden taxpayers and force up budget deficits each year.