

**Written testimony by Jared Bernstein, Senior Fellow, Center on Budget and Policy Priorities**

**House Financial Services Committee, Dec. 11, 2018, “The National Debt: Washington, We Have a Spending Problem”**

**Let’s be honest: We also have a revenue problem.**

**Introduction**

Chairman Hensarling, Ranking Member Waters, I thank you for the opportunity to testify on the factors behind our fiscal imbalances, past, present, and future.<sup>1</sup>

With respect to the committee’s majority, the stated framework for the hearing—“Washington, We Have a Spending Problem”—is too narrow, especially in the light of the 2017 tax law that, according to CBO, added almost \$2 trillion to the nation’s debt over the next decade.<sup>2</sup> To state what should be obvious to anyone paying even scant attention to our fiscal accounts: Washington, we also have a revenue problem.

Based on Americans’ reasonable expectations about the role of government to provide social insurance and safety nets against market failures, as well as investing in public goods, and considering our aging demographics, we’re clearly going to need more revenues in coming years. Add in climate change, infrastructure, geopolitical threats, and it is clear why the revenue-reducing tax bill was so terribly misguided at this juncture in our fiscal history.

But my testimony will also stress that significant cost savings must be pursued in health care, an area where the U.S. spends far more as a share of our economy than do comparable, advanced economies.<sup>3</sup> There is no serious path to reduce the growth rate of the nation’s spending that does go through health care. However, it is essential to pursue health savings in a way that protects the living standards of low and middle-income Americans. In this regard, I emphasize ideas to significantly reduce the growth of our spending in health care without reducing benefits and access to economically vulnerable people.

**Key points:**

--To frame our fiscal outlook as solely a spending problem, thus ignoring the revenue side of the ledger, is a misguided, highly partisan analysis, one unlikely to generate the political cooperation needed to achieve fiscal sustainability. This is particularly the case when considering our near- and medium-term fiscal challenges, including aging demographics, climate change, inequality, and needed investments in public goods.

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<sup>1</sup> The author is a senior fellow at the Center on Budget and Policy Priorities. Views expressed in this testimony do not necessarily reflect the views of the Center. I thank Kathleen Bryant, Richard Kogan, and Robert Kogan for helpful input.

<sup>2</sup> John McClelland, “How the 2017 Tax Act Affects CBO’s Projections,” Congressional Budget Office, April 20, 2018, <https://www.cbo.gov/publication/53787>.

<sup>3</sup> Bradley Sawyer and Cynthia Cox, “How does health spending in the U.S. compare to other countries,” Kaiser Family Foundation, February 13, 2018, <https://www.healthsystemtracker.org/chart-collection/health-spending-u-s-compare-countries/#item-start>.

--A fiscal analysis that looks only at revenue shortfalls is similarly one-sided. My testimony argues that reducing the growth rate of the nation's health care spending must be on any serious sustainability agenda.

--I feature a recent analysis predicting that under current law, the debt-to-GDP ratio will be well north of 100 percent by 2048. Moreover, this forecast may be upbeat, as it assumes Congress will follow current laws scheduled to significantly raise tax revenues and cut spending, evincing a level of fiscal rectitude that has not been seen in recent years.

--The 2017 tax law is responsible for this year's lower-than-expected federal revenues of 16.4 percent of GDP, a level well below the historical average, especially at low unemployment. Restoring essential linkages between strong economies and higher federal revenues calls for rolling back parts of the tax cut, including the estate-tax reduction and the new passthrough loophole.

--Taking a longer view of our revenue shortfall, had we kept the Clinton-era tax code in place—meaning no George W. Bush or Trump tax cuts—but let all the spending that occurred since then proceed apace, including the military actions and the Affordable Care Act, and so on, the result would be a debt-to-GDP ratio that is 27 percentage points, or about a third, lower than it is today, about 51 percent instead of 78 percent.

--Any spending cuts must not erode the living standards or deepen the poverty of economically vulnerable Americans.

-- One of most damaging and irresponsible developments in fiscal policy has been the political weaponizing of the debt limit. I highlight three options suggested by GAO to seamlessly deal with this problem as opposed to recklessly threatening default on our sovereign debt.

--The growth of health care spending has been and can be further reduced by squeezing inefficiencies out of our over-priced system. Savings should be achieved through lowering drug costs, paying for quality over quantity, and building on the gains of the Affordable Care Act while increasing accessibility to Medicare and Medicaid.

--Spending deals don't sign themselves. This reality, in tandem with the existence of large, persistent deficits and debt, reveals that year upon year, Congressional majorities accept and add to existing spending levels. However, the current Congressional majority has not only been unwilling to raise the revenues necessary to pay for its revealed preferences. It has also significantly cut revenue inflows. The essence of our fiscal problem is thus accurately tagged as neither a revenue problem nor spending problem. Instead, it is this: Congress is unwilling to raise the resources necessary to pay for the institution's revealed spending preferences.

### ***Fiscal outlook: A quick overview***

My CBPP colleagues have recently completed their review of our long-term fiscal [situation](#).<sup>4</sup> I summarize their findings below, but I first note that their debt forecasts are lower than some [others](#), including

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<sup>4</sup> Richard Kogan, Paul Van De Water, and Yixuan Huang, "Long-Term Budget Outlook Has Improved Considerably Since 2018 But Remains Challenging," Center on Budget and Policy Priorities, November 15, 2018, [https://www.cbpp.org/research/federal-budget/long-term-budget-outlook-has-improved-considerably-since-2010-but-remains#\\_ftnref28](https://www.cbpp.org/research/federal-budget/long-term-budget-outlook-has-improved-considerably-since-2010-but-remains#_ftnref28).

CBO's.<sup>5</sup> First, CBPP uses static estimates as opposed to CBO's dynamic estimates, wherein persistent deficits lead to higher interest rates, slower growth, and higher debt/GDP levels.

Second, CBPP follows the standard practice of applying a "current law baseline," meaning they assume that significant portions of the 2017 tax law will expire on schedule post-2025 (thus raising more future revenues) and that the relief provided by the 2018 Bipartisan Budget Act to previously legislated caps and "sequestration" cuts will end in 2020 and 2021, "deeply cutting defense and non-defense discretionary funding in those years." Given recent deficit-expanding actions by Congress on both the spending and revenues sides of the ledger, the current law baseline may turn out to be optimistic.<sup>6</sup>

Even so, CBPP's forecast still shows that we need to address current and future imbalances.

--Under the assumptions just noted, the debt-to-GDP ratio will grow from 78 percent today to 94 percent by 2028 to 113 percent by 2048 (note that this is debt held by the public, widely agreed to be the most relevant metric when evaluating the impact of our fiscal balance on economic growth and fiscal sustainability).

--The 2017 tax law is responsible for the lower-than-expected FY 2018 federal revenues of 16.4 percent of GDP, "well below the 17.4 percent average over the last 40 years, and even further below the 18.4 percent average in years when the economy was operating at or near its full capacity." Extending the provisions of the 2017 tax law that are currently scheduled to expire would add 19 percentage points of GDP to the 2048 debt ratio.

--Two factors that have significantly improved our fiscal outlook in recent years include unexpectedly low interest rates and slower-than-expected health care inflation. Low interest rates are a double-edged-sword, as they've largely been a function of slower real growth. But reducing the above-average pace of health care inflation is an essential goal of fiscal sustainability. This insight is underscored by the Figure 1 below, which compares CBPP's 2010 health-care spending projection to its most recent version. The current 2048 endpoint projection is more than 4 percentage points below the 2010 projection.<sup>7</sup> What's so remarkable about that result is that the higher 2010 [trajectory](#) "preceded the enactment of the ACA, with its coverage expansions, but the cost of those expansions is more than offset by a combination of factors that have slowed health cost growth. These factors are (1) the ACA's short- and long-term reductions in Medicare payment rates to health care providers; (2) the changes in health care payment and delivery systems initiated by the ACA and the 2015 Medicare Access and CHIP Reauthorization Act; and (3) the growing effects of a health cost slowdown in the public and private sectors that commenced before the ACA."

### Figure 1

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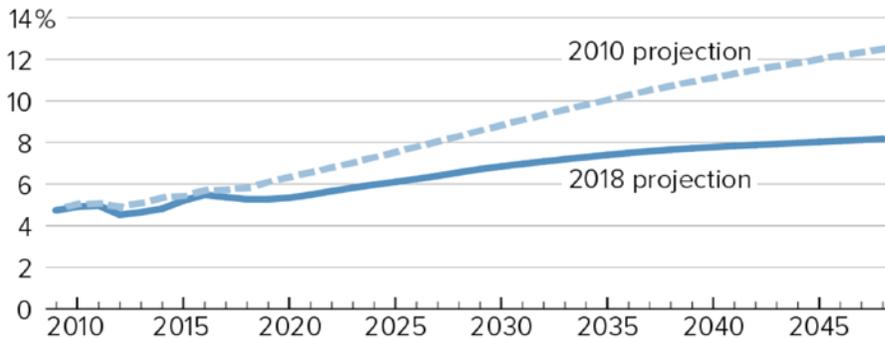
<sup>5</sup> The Committee for a Responsible Federal Budget, "The 75-Year Budget Outlook," October 25, 2018, <http://www.crfb.org/papers/75-year-budget-outlook>.

<sup>6</sup> CBPP also assumes that post-2028, discretionary spending grows at the rates of inflation and population growth. This leads to slower growth relative to CBO's assumption that such spending remains a constant share of GDP.

<sup>7</sup> Ibid.

## Projected Costs of Major Health Programs Have Fallen Significantly

2010 projection vs. 2018 projection, as a percent of gross domestic product



Note: The 2010 projection encompasses Medicare and Medicaid; the 2018 projection encompasses Medicare, Medicaid, the Children's Health Insurance Program, and the subsidies for coverage through the Affordable Care Act marketplaces.

Source: CBPP based on Congressional Budget Office and Medicare trustees data from 2009 (for the 2010 projection) and 2018 (for the 2018 projection)

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### ***Washington, we have a revenue problem***

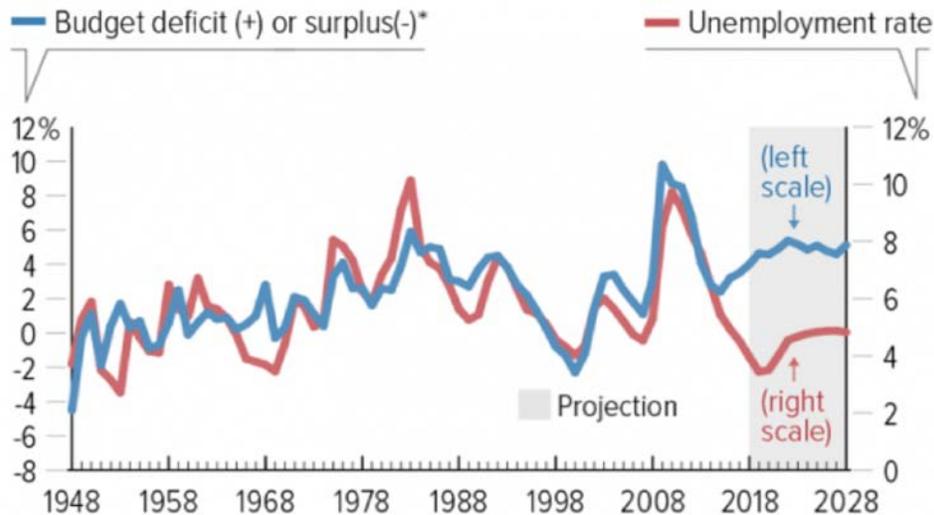
The above observations show the “spending-problem-only” framework to be clearly misguided. In fact, one of my biggest concerns about the impacts of the Republican tax plan is the extent to which it has broken a critical linkage in public finance: that between a full-capacity economy and lower deficits and debt through higher revenue flows. (Because it so heavily favors wealthy households, the other major concern is the extent to which the tax law exacerbates after-tax income inequality.)

Figure 2 below shows that because more economic activity—lower unemployment in the figure—has historically spun off more tax revenue, as the economy has closed in on full capacity, the budget deficit has gotten smaller, and vice versa (deficits are shown as positive shares of GDP).<sup>8</sup> Outside of major wars, and before the 2017 tax law, when economic growth led to more employment and diminished labor market slack, deficits typically came down. In the fiscal year 2000, for example, the unemployment rate was 4 percent and the budget was in surplus.

### **Figure 2**

<sup>8</sup> Paul Van de Water, “2017 Tax Law Heightens Need for More Revenues,” Center on Budget and Policy Priorities, November 15, 2018, [https://www.cbpp.org/research/federal-tax/2017-tax-law-heightens-need-for-more-revenues#\\_ftnref16](https://www.cbpp.org/research/federal-tax/2017-tax-law-heightens-need-for-more-revenues#_ftnref16).

## Deficits Unusually High When Unemployment This Low



\*As a percent of gross domestic product.

Source: CBPP based on data from Bureau of Labor Statistics and Congressional Budget Office

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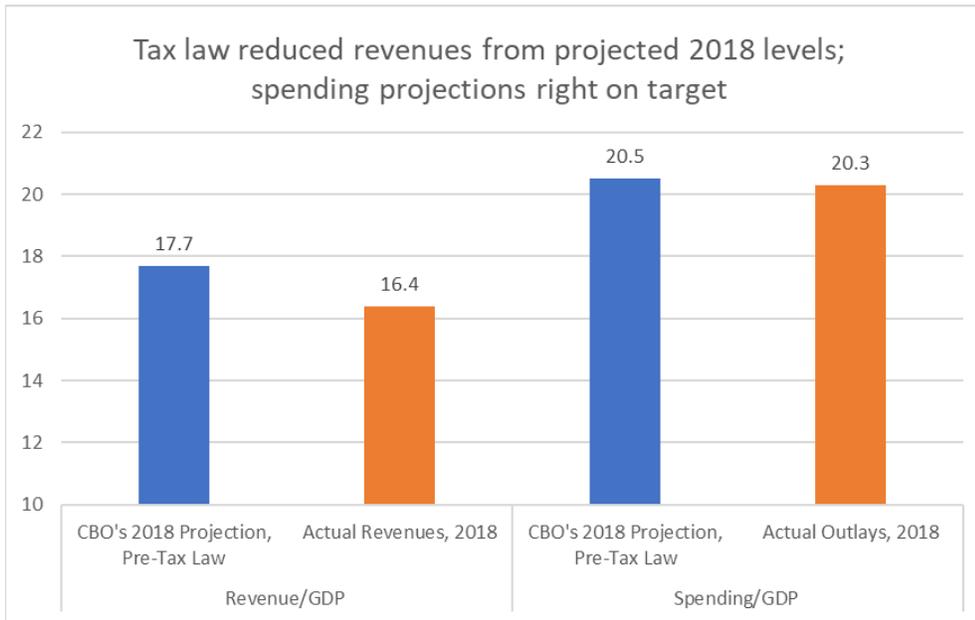
In fact, using data back to the mid-1940s, the average deficit as a share of GDP over every year that the unemployment rate was lower than or equal to 4.5 percent comes to -0.4 percent. If I take last year's and this year's deficits (-3.5 and -3.8 percent) out of that average, the result is a small surplus (0.1 percent).

The end of the figure shows just how different our fiscal stance is today and, based on CBO projections, in the future. The unemployment rate is well below 4 percent, but the deficit, also about 4 percent, is far above its average at low unemployment. In fact, a simple regression of the deficit-to-GDP ratio against unemployment predicts a deficit of about 1 percent in FY18, almost 3 percentage points below its actual value.<sup>9</sup>

Is this divergence driven by a negative shock to revenues or a positive shock to spending? CBO data reveal the answer to be a negative revenue shock. The table below shows that in the summer of 2017, before the tax cuts and spending deal, the budget office predicted that we'd spend 20.5 percent of GDP in 2018, which, as the actual spending bar shows is almost exactly the right number (20.3 percent). However, CBO also thought — remember, this is pre-tax-cut — that we'd collect 17.7 percent of GDP in revenues when the actual share was, as shown, just 16.4 percent. This diminished revenue figure is the key difference between what CBO expected then and what occurred. In fact, the spending share—20.3 percent of GDP—is precisely equal to the 50-year [average](#).

<sup>9</sup> The regression runs from 1949 to 2017 with the unemployment rate at time  $t$  and with one lag, along with a lag of the dependent variable. All coefficients other than the constant are significant at the  $p < 0.01$  level;  $R\text{-sq} = 0.81$  and  $DW = 1.77$ .

**Figure 3**

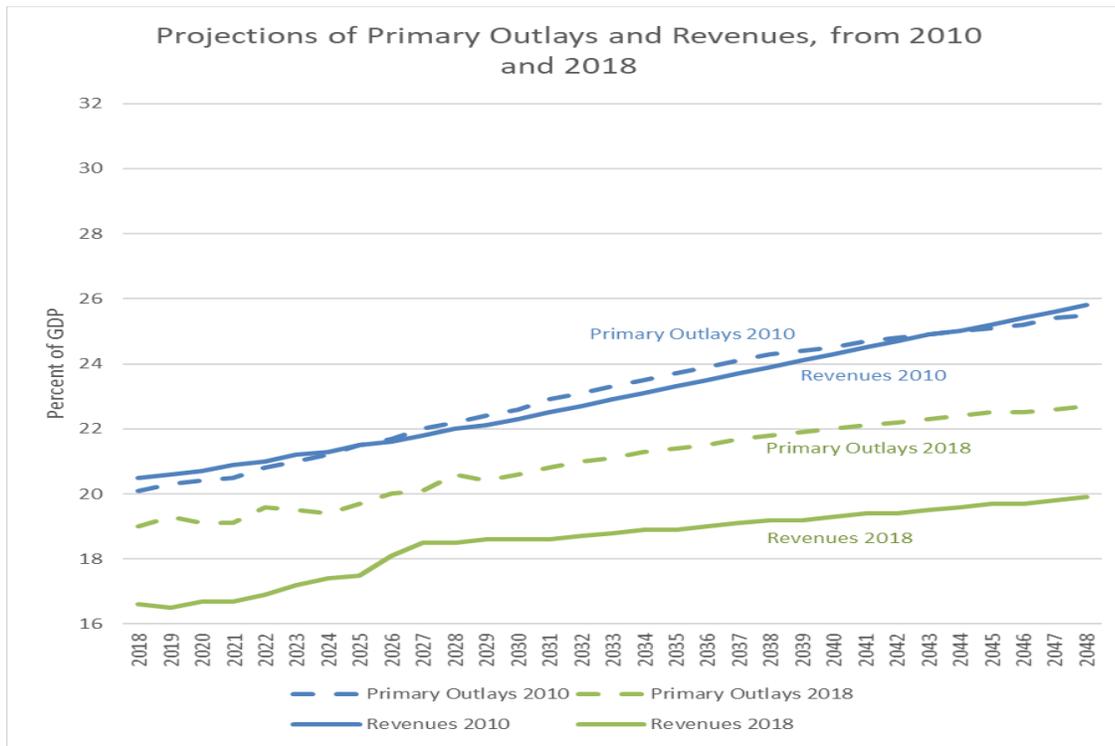


To be clear, the point of this comparison is not to argue that our current spending of about 20 percent of GDP is optimal. Instead, it shows that the jump in the 2018 deficit was a function of the tax cuts leading to diminished revenue collection, an outcome that is especially disappointing given the near-full-capacity economy.

A comparison of CBO long-term projections further underscores the revenue shortfall point. Figure 4 shows CBO's forecasts for primary outlays (outlays other than interest payments<sup>10</sup>) and revenues from two different vintages of their long-term budget outlook, one from 2010 and the most recent, from 2018. The logic of the "spending problem" case implies projected outlays accounting for a higher share of GDP in the 2018 projection, with the projected revenue share either higher or similar to that of the earlier forecast. That is, the "spending problem" scenario should show fiscal gaps being driven by more spending, not less revenues.

<sup>10</sup> Primary outlays are an appropriate choice here because the "spending problem" refers to programmatic spending. Consider a revenue increase with unchanged program spending. Thanks to the higher revenues, deficits and debt service would fall, even with no spending cuts. However, for completeness, I show the same figure with total outlays in an appendix.

Figure 4



Source: CBO

In fact, the opposite is the case. Not only are primary outlays *lower* in the 2018 than the 2010 forecast—by 2 percentage points of GDP, on average, over the forecast period—but revenues in the 2018 budget outlook are *much lower* than in 2010’s outlook—by 4.5 points, on average. And they would be even lower were Congress to extend the Trump tax cuts. In other words, current law in 2010 (not all of which was followed, to be clear; i.e., the George W. Bush tax cuts did not fully sunset) called for both higher spending and higher revenues than today’s current law. And given that the revenue decline between these two forecasts has been more than twice that, on average, as the primary spending decline, the “spending problem” framework is awfully hard to defend.

These are forecasts, but a longer-term [analysis](#) of the actual path of revenues and outlays by Robert Kogan of the Senate Budget Committee staff makes a similar point. Had we kept the Clinton-era tax code in place—meaning no George W. Bush or Trump tax cuts—but let all the spending that occurred since then proceed apace, including the military actions and the Affordable Care Act, and so on, the result would be a debt-to-GDP ratio that is 27 percentage points, or about a third, below where it stands today, about 51 percent instead of 78 percent.<sup>11</sup>

### Any spending reductions must protect vulnerable Americans

<sup>11</sup> [https://www.washingtonpost.com/news/posteverything/wp/2018/05/29/my-attempt-to-cut-through-the-fog-of-our-fiscal-debate/?utm\\_term=.52481a56ae76](https://www.washingtonpost.com/news/posteverything/wp/2018/05/29/my-attempt-to-cut-through-the-fog-of-our-fiscal-debate/?utm_term=.52481a56ae76)

While recognizing our revenue shortfalls, we must also examine our federal spending priorities and magnitudes. But in so doing, let's not kid ourselves: almost no matter what happens, spending is going to rise as a share of GDP at least over the next decade. Our aging demographics—over the next decade, the share of the over-65 population is expected to grow from 15.5 to 19 percent—mean more spending will be required simply to maintain current services on our public insurance programs to ensure health and income security in retirement.<sup>12</sup> Both Social Security and Medicare outlays are expected to grow by about 1 percentage point of GDP over the next decade, and population aging “accounts for all of the projected increase in Social Security spending, two-thirds of the increase in Medicare, and about five-sixths of the combined increase in spending for the two programs as a percent of GDP between 2018 and 2028.”<sup>13</sup>

Though slower health inflation has helped in recent years (see Figure 1), rising health costs still place upward pressure on spending, and interest payments on our debt comprise a non-negotiable, rising share of our spending obligations (up 1.4 percentage points over the next decade).<sup>14</sup>

Add in climate change and its increasing impact on the ferocity of storms and thus property/infrastructure damage, geopolitical threats, increased inequality and its implications for a robust safety net, needed investment in physical and human capital, and the ability to offset market failures (recessions, sectoral crises), and the idea that we can cut our way out our fiscal constraints sounds a lot more like wishful thinking than reasoned analysis.

Importantly, the cost pressures induced by aging are not a function of over-generous benefits, which, as budget expert Paul Van de Water recently [argued](#), “are relatively modest.”<sup>15</sup>

The average Social Security retired worker benefit is about \$1,417 a month, or \$17,000 a year, and Social Security benefits will replace a smaller portion of pre-retirement earnings in the future as Social Security's full retirement age increases to 67. In Medicare, benefits are less comprehensive than those offered by a typical employer-sponsored health plan: traditional Medicare doesn't cover most hearing, dental, and vision care and places no limit on the total amount of out-of-pocket expenditures that a beneficiary can incur each year. Medicare beneficiary households spend more than \$5,000 a year on out-of-pocket health care costs, on average, which represents 14 percent of their budgets — over twice the average for non-Medicare households.

As I stress below, there are important and significant cost savings to be realized in our health care system. But broad cuts in benefits (cuts large enough to achieve fiscal sustainability without new revenues) can only “fix” these programs by “breaking them,” i.e., by undermining their fundamental purposes.

***Non-defense discretionary spending:*** So-called discretionary (annually appropriated) spending in defense and non-defense (NDD) has been the target of both legislated budget caps and sequestration rules, though Congress has, to varying degrees, waived these constraints in recent budget agreements. Even so, as Figure 5 below [reveals](#), NDD spending as a share of the economy is already close to historical

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<sup>12</sup> Van de Water, 2018.

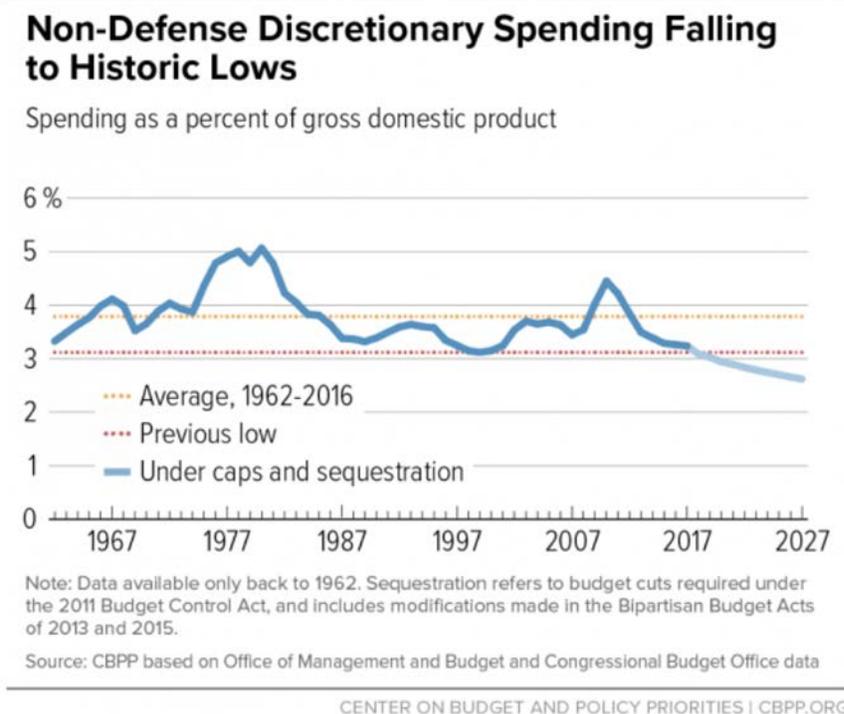
<sup>13</sup> Kogan, Van de Water, and Huang, 2018; Van de Water, 2018.

<sup>14</sup> Kogan, Van de Water, and Huang, 2018.

<sup>15</sup> Van de Water, 2018.

lows and scheduled to head lower, leading to unmet needs in key areas.<sup>16</sup> NDD resources support transportation infrastructure, including highways, air traffic control, and the Coast Guard. They support child care, education and training, and housing assistance. One fifth of NDD spending goes to health care and about half of that provides hospital and medical care for veterans; some of the rest supports research, such as that done by the National Institutes of Health.

Figure 5



As members of this committee well know, it’s one thing to talk abstractly about the pressure from debt-to-GDP ratios. It’s quite another to tell a mother who wants to join the labor market to help pull her family out of poverty that her child care assistance will no longer be forthcoming (in fact, only one in six low-income, working families that are eligible for child care assistance receives it). Or to tell a cancer patient that the trial that was giving them hope is discontinued due to spending cuts.

Perhaps it was precisely these sorts of sympathetic realizations, often prompted by constituents themselves (or their advocates), that led majorities in Congress to raise the budget caps and not enforce sequestration. If so, such responsiveness to need is admirable, in my view, but it is inconsistent with arguing that “Washington has a spending problem,” full-stop, and calling for cuts in aggregate, faceless numbers. The spending behind the “problem” meets many needs that will not be met by the market, a reality that policy makers often recognize when we discuss individual programs as opposed to more abstract aggregates.

<sup>16</sup> David Reich and Chloe Cho, “Unmet Needs and the Squeeze on Appropriations,” Center on Budget and Policy Priorities, May 19, 2017, <https://www.cbpp.org/research/federal-budget/unmet-needs-and-the-squeeze-on-appropriations>.

That said, both President Trump and House Republicans have submitted budget plans that propose deep cuts to NDD and safety-net spending. Though Republican candidates closely embraced aspects of the Affordable Care Act during the midterm campaign, their latest budget that would have caused [23 million people](#) to lose health coverage by 2026; the President’s budget included benefit and eligibility cuts that would have eliminated access to SNAP (food stamp) benefits for at least [4 million people](#).<sup>17</sup> Moreover, outside of health care, where I advocate for cost-saving changes, based on their relative magnitudes and the extent to which they meet pressing economic needs, spending on low-income programs are a misguided target for deficit reduction. Overall spending as a share of GDP on low-income programs outside of health stands at its historical average of 2 percent and is projected to fall over another half percentage point over the next [decade](#).

**Defense:** As I am not an expert in this part of the discretionary budget (defense accounts for about half of discretionary spending), I will only suggest to the committee that a recent, extensive [audit](#) of the Defense Department underscored the point that defense spending cannot be off the table when looking for ways to more efficiently and responsibly spend taxpayer dollars on this crucial function. The audit found “...systemic deficiencies in financial management systems prevent the DoD from collecting and reporting financial and performance information that is accurate, reliable and timely.”<sup>18</sup>

Because of these reporting deficiencies, one [summary](#) of the audit concluded that “the auditors couldn’t account for where all the money went because of flaws in information technology systems.” The auditors did, however, document improper payments “which lacked sufficient or appropriate documentation or approvals — of \$957 million in 2017 and \$1.2 billion in 2018.”<sup>19</sup> These are, of course, tiny shares of the \$700 billion budget, including both DoD and war spending, but they are still examples of the problem exposed by the audit.

To state the obvious, none of these findings discredit the courageous sacrifices made by our top-flight military personnel. To the contrary, policy makers owe it to our troops and their families to gain a much better understanding of the how our defense resources are spent, with an eye toward squeezing out improper payments and wasteful purchasing standards, sub-optimal weapons systems, inefficient facilities, and any other inefficiencies.

**Spending and “revealed preferences:”** My point in these NDD and defense discussions is that Congress’s “revealed preferences” suggest our deficits are born of an unwillingness to raise the revenue we need to meet the spending we believe is warranted. To label that a “spending problem” is fundamentally inaccurate.

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<sup>17</sup> Joel Friedman and Richard Kogan, “House GOP Budget Retains Tax Cuts for the Wealthy, Proposes Deep Program Cuts for Millions of Americans,” Center on Budget and Policy Priorities, June 28, 2018, <https://www.cbpp.org/research/federal-budget/house-gop-budget-retains-tax-cuts-for-the-wealthy-proposes-deep-program-cuts>; Sharon Parrott, Aviva Aron-Dine, Dottie Rosenbaum, Douglas Rice, Ife Floyd, and Kathleen Romig, “Trump Budget Deeply Cuts Health, Housing, Other Assistance for Low- and Moderate- Income Families,” Center on Budget and Policy Priorities, February 14, 2018, <https://www.cbpp.org/research/federal-budget/trump-budget-deeply-cuts-health-housing-other-assistance-for-low-and>.

<sup>18</sup> United States Department of Defense, “Agency Financial Report, Fiscal Year 2018,” November 14, 2018, [https://comptroller.defense.gov/Portals/45/Documents/afr/fy2018/DoD\\_FY18\\_Agency\\_Financial\\_Report.pdf](https://comptroller.defense.gov/Portals/45/Documents/afr/fy2018/DoD_FY18_Agency_Financial_Report.pdf).

<sup>19</sup> New York Times Editorial Board, “The Pentagon Doesn’t Know Where Its Money Goes,” December 1, 2018, <https://www.nytimes.com/2018/12/01/opinion/sunday/pentagon-spending-audit-failed.html>.

While hearings like this show we can have substantive disagreements on the extent of those needs and spending levels, spending deals don't sign themselves. This reality, in tandem with the existence of large, persistent deficits and debt, reveals that year upon year, Congressional majorities accept existing spending levels. However, the current Congressional majority has not only been unwilling to raise the revenues necessary to pay for its revealed preferences, it has significantly cut its revenue inflows.

The essence of our *fiscal* problem is thus accurately tagged as a neither revenue problem nor a spending problem. Instead, it is this: Congress has long been unwilling to raise the resources necessary to pay for the institution's revealed preferences. Given that framing of the problem, policy makers must either reduce Americans' expectations about the role of government in our economy and their lives or, over the long-term, raise the revenues necessary to meet those expectations.

To be clear, this does not imply a budget that is always in balance. There are times when we need budget deficits to expand, say to support countercyclical policies in economic downturns. But it does imply that in strong economies, like the present, our fiscal gap should be closing rather than widening, and we should be making progress towards primary balance (revenues equal to programmatic outlays, net of interest payments).

### **Reducing health care cost growth: An essential target for restoring fiscal health**

Though my testimony largely emphasizes tax-cut-induced revenue shortfalls, there is one way Congress could and should significantly lower the growth rate of federal spending: through more efficient spending in public health care. Moreover, because the costs of health coverage grow more slowly in public sector, the nation (public plus private) could save significant resources if more people were covered by public coverage, say, by lowering the eligibility age for Medicare coverage ("Medicare for More") and extending the ACA's Medicaid eligibility expansion to states that have yet to sign on.

Health economists suggest several changes that would likely reduce wasteful spending:

**--Get private insurance payments in line with Medicare.** Like many other large sectors in recent years, health care, and hospitals in particular, have become more concentrated and thus more powerful in some parts of the country to the point where their market power enables them to distort prices, at least relative to comparable systems in other countries. In some places, the major cost driver is price, not utilization. Papanicolas et al [find](#), for example, that the "United States spent approximately twice as much as other high-income countries on medical care, yet utilization rates in the United States were largely similar to those in other nations. Prices of labor and goods, including pharmaceuticals, and administrative costs appeared to be the major drivers of the difference in overall cost between the United States and other high-income countries." <sup>20</sup>

Thus, cost controls of the type common in other countries' health systems are required. One recent [study](#) finds that capping private insurance claim rates at 125% of Medicare rates for inpatient care

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<sup>20</sup> Irene Papanicolas, Liana R. Woskie, and Ashish K. Jha, "Health Care Spending in the United States and Other High-Income Countries," *Journal of the American Medical Association*, (March 2018):1024-1039.

would significantly reduce not just private health spending but net federal outlays as well by between 0.15 and 0.30 percent of GDP.<sup>21</sup>

--**Cutting spending on pharmaceuticals:** A recent analysis [shows](#) U.S. drug spending to be well above that of other advanced economies, and here again, the difference is more price than utilization. As health economist Austin Frakt summarizes the problem, “Prices are a lot higher for brand-name drugs in the United States because we lack the widespread policies to limit drug prices that many other countries have.”<sup>22</sup> That is, patients in these comparably advanced economies enjoy more affordable prescriptions because their public health systems engage in more cost controls.

Suggesting some room for bipartisan cooperation in generating savings in this space, President Trump himself has emphasized the drug-cost problem, suggesting, for example, the Medicare should be allowed use its market power to negotiate lower drug prices. Other cost-saving ideas in this space include allowing Medicare Part D beneficiaries access to Medicaid discounts, and economist Dean Baker’s [agenda](#) on reducing the extremely expensive impact of patents of American drug prices.<sup>23</sup>

--Congress’s delay in implementing the “**Cadillac Tax**,” has contributed to deficits by forgoing an incentive to nudge employers toward more efficient providers, losing tax revenue, and increasing health care costs. Most health economists agree that the unlimited exclusion of employer-financed health insurance from income and payroll taxes is [both](#) “inefficient and regressive.”<sup>24</sup> The tax is a 40 percent excise tax on employer plans with premiums in 2022 greater than about \$11,000 for individuals and \$30,000 for families in 2022.

I [recognize](#) that many recipients of these more expensive plans, especially union members, are strongly against this tax as they often traded wage gains for health benefit increases.<sup>25</sup> Moreover, for good reasons, they are not quick to accept the argument that any benefit losses will quickly and fully be made up in higher paychecks.

But because the premium thresholds are set fairly high, the tax will initially hit a small minority of plans (less than 10 percent) and apply to an even smaller share of costs (less than 5 percent). Moreover, the tax is a reliable way to lower costs and generate net federal savings (of 0.10-20 percent of GDP) through,

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<sup>21</sup> Zack Cooper, Stuart V. Craig, Martin Gaynor, and John Van Reenen, “The Price Ain’t Right? Hospital Prices and Spending on the Privately Insured,” National Bureau of Economic Research Working Paper No. 21815, 2015, <https://www.nber.org/papers/w21815>.

<sup>22</sup> Austin Frakt, “Something Happened to U.S. Drug Costs in the 1990s,” *The New York Times*, November 12, 2018, <https://www.nytimes.com/2018/11/12/upshot/why-prescription-drug-spending-higher-in-the-us.html>.

<sup>23</sup> Baker recently endorsed an interesting, new proposal by Sen. Sanders and Rep. Khanna that would “effectively end the patent monopoly for any drug where the price in the United States is above the median of the prices charged in the next seven largest wealthy countries. This is likely to mean a reduction in the price of most brand drugs by around 50 percent.” <https://truthout.org/articles/sanders-khanna-bill-would-stop-propping-up-drug-prices/>

<sup>24</sup> Paul Van de Water, “House Shouldn’t Repeal or Further Delay Cadillac Tax,” Center on Budget and Policy Priorities, July 11, 2018, <https://www.cbpp.org/blog/house-shouldnt-repeal-or-further-delay-cadillac-tax>.

<sup>25</sup> Jared Bernstein, “The Cadillac Tax, Part 2: My critics made some good points...but I still think I’m right,” *The Washington Post*, July 24, 2015, [https://www.washingtonpost.com/posteverything/wp/2015/07/24/the-cadillac-tax-part-2-my-critics-made-some-good-points-but-i-still-think-im-right/?utm\\_term=.8b0d9b3f5337](https://www.washingtonpost.com/posteverything/wp/2015/07/24/the-cadillac-tax-part-2-my-critics-made-some-good-points-but-i-still-think-im-right/?utm_term=.8b0d9b3f5337).

according to the [CBO](#), the encouragement and “dissemination of less costly ways to deliver appropriate medical services.”<sup>26</sup>

A viable alternative to the tax, one that could meet some of the objections of middle-income workers with high-end plans, would be a cap on the exclusion of employer-provided coverage for workers in high-income households.

**--Delivery system reform:** The Kaiser Family [Foundation](#) attributes some part of the slower growth in public vs. private health care spending to the types of delivery reforms discussed above, “including accountable care organizations, medical homes, bundled payments, and value-based purchasing initiatives.”<sup>27</sup> The Affordable Care Act accelerated these efforts to reduce costs by penalizing inefficiencies (e.g., avoidable hospital re-admissions) and rewarding efficiencies (paying for quality, not quantity). These included “bundled payments” (an overall fee covering all the care related to a procedure), “accountable care” models (monetary incentives to reduce spending below a set level while maintaining quality), and bonuses for savings, as in re-admission reductions.

**--Moving more people into Medicaid and Medicare:** Recent [analyses](#) of cost growth show per-capita health spending has been growing significantly more slowly in the public sector than in the private sector.<sup>28</sup> Therefore, both the ACA Medicaid expansion and greater Medicare eligibility have the potential to provide more Americans with access to affordable care and can reduce the nation’s health care bill.

To be clear, while even critical [analyses](#) of this change show that it will lower the nation’s net health care spending, it invokes more public and less private spending.<sup>29</sup> The question of how to make and finance such an ambitious transition remains open and unanswered.

It would therefore provide a useful service to the American people if the incoming House majority, many of whom favor some form of universal coverage, would quickly form an expert commission to formally report out on different policy paths to ramp up the share of Americans covered by public options. “Medicare for All” should be on the docket, but so should “Medicare for More” (a gradually implemented reduction of Medicare’s eligibility age), and a public option in the ACA exchanges. An important goal of this commission should be to quantify the tradeoffs that taxpayers will face in transitioning to more public care, specifically between higher taxes and lower private insurance premium expenses.

### **The debt limit: Options for avoiding a massive “own-goal”**

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<sup>26</sup> Congressional Budget Office, “An Analysis of Health Insurance Premiums Under the Patient Protection and Affordable Care Act,” November 30, 2009, <https://www.cbo.gov/sites/default/files/111th-congress-2009-2010/reports/11-30-premiums.pdf>.

<sup>27</sup> Juliette Cubanski and Tricia Neuman, “The Facts on Medicare Spending and Financing,” Kaiser Family Foundation, June 22, 2018, <https://www.kff.org/medicare/issue-brief/the-facts-on-medicare-spending-and-financing/>.

<sup>28</sup> Cubanski and Neuman, 2018.

<sup>29</sup> Michael Hiltzik, “How a libertarian analyst inadvertently made a good case for Bernie Sanders’ Medicare for All,” *Los Angeles Times*, July 31, 2018, <http://www.latimes.com/business/hiltzik/la-fi-hiltzik-blahous-medicare-20180730-story.html>.

One of most damaging and irresponsible developments in fiscal policy has been the political weaponizing of the debt limit (or debt “ceiling”). Former Federal Reserve Chairman Ben Bernanke put it well, when he wrote: “Refusing to raise the debt limit takes the economic well-being of the country hostage [and] ought to be unacceptable no matter what the underlying issue being contested.” As my testimony has hopefully revealed, rejection of the debt limit as serving a useful purpose is by no means an endorsement of fiscal recklessness. It is the recognition that this concept has been revealed to do far more harm than good.

One way to understand the illogic of this debate is to consider that recent debt limit arguments have amounted to various members of Congress essentially refusing to pay the bill after they’ve eaten the meal. That is, recent battles around the limit have taken place *after Congress passed bills that, because they invoked deficit-financing, required increasing the debt limit.*

Moreover, such debates have invoked totally unnecessary and counterproductive threats to the credit-worthiness of the U.S. Treasury. According to GAO’s [analysis](#) of the 2013 “debt limit impasse,” even tactically hinting at default on our sovereign debt led creditors to react: “For the affected Treasury securities, these actions resulted in both a dramatic increase in rates and a decline in liquidity in the secondary market where securities are traded among investors. In addition, there were also unusually low levels of demand at the relevant auctions and additional borrowing costs to Treasury. Treasury securities are one of the lowest cost and widely used forms of collateral for financial transactions, and because of this, disruptions to the Treasury market from the 2013 debt limit impasse extended into other markets, such as short-term financing.”

Under the assumption that Congress is not going to repeal the debt limit, GAO offers three options to avoid such “own-goal kicks,” i.e., to more seamlessly raise the limit when necessary. Their first option is to embed a higher debt limit in any budget resolution that implies the need to raise the ceiling. One challenge here is what happens in sessions when there is no such resolution yet still a need to raise the ceiling?

Better options include giving the administration the authority to increase the limit, subject to a Congressional *disapproval*. This approach worked in the Budget Control Act of 2011 and has the advantage of the increase being the default, meaning Congress would have to act to reverse the administration’s authority to raise the limit. A third option—the one that in my view most thoroughly removes default risk—is simply give the administration the authority to “borrow as necessary to fund enacted laws.” GAO notes that the approach is “used in some other countries: delegate to the administration the authority to borrow such sums as necessary to fund implementation of the laws duly enacted by Congress and the President. Since laws that affect federal spending and revenue that create the need for debt already require adoption by the Congress, Congress would still maintain control over the amount of federal borrowing.” In other words, give the diners the authority to pay for what they ordered.

## **Conclusion**

This testimony argues that “we have a spending problem” is a highly partisan, misguided way to frame our fiscal challenge. The analysis I present of our fiscal accounts, past, present, and future, show that diminished revenues are a major contributor to the problem. I thus argue that the most balanced way to achieve a sustainable fiscal outlook would be through increasing revenues and lowering health care

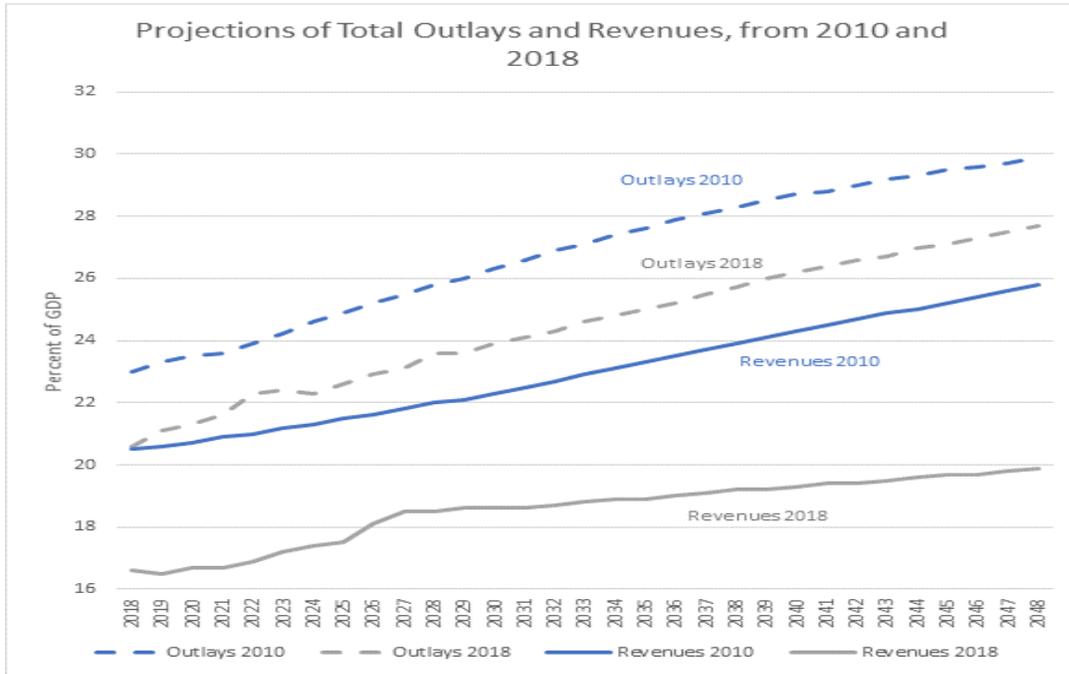
spending. Because the regressive 2017 tax law broke the linkage between strong economies and increased revenues, and exacerbated after-tax income inequality, this agenda should begin with reversing the high-end cuts and closing some of loopholes opened by that misguided package. Good places to start include raising the estate tax and closing the pass-through loophole (I'd argue against repealing the tax bill's SALT cap, as this would both lose revenue and make the code less progressive). Bold ideas like taxing capital gains as regular income and a small financial transaction tax should also be on the table. Funding the IRS must be a top fiscal priority: Every extra dollar spent on enforcing the tax code raises \$18 in new [revenue](#).<sup>30</sup>

On the spending side, I've suggested various granular ways to slow the growth of federal health care spending, as well the more sweeping idea to expand public coverage. Interest among the electorate and many Democrats to pursue universal coverage make this an exciting moment in a critical area of government policy. To follow through in a systematic way, I've suggested that the incoming House majority form a commission to, within a relatively short time period (e.g., six months), report out on a variety of options in this space, with careful attention to financing.

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<sup>30</sup> Jared Bernstein, "The art of getting rich on Daddy's deals," *The Washington Post*, October 9, 2018, [https://www.washingtonpost.com/outlook/2018/10/10/art-getting-rich-daddys-deals/?utm\\_term=.25a45557bb0a](https://www.washingtonpost.com/outlook/2018/10/10/art-getting-rich-daddys-deals/?utm_term=.25a45557bb0a).

**Appendix Figure 4 (alternate): CBO budget projections in 2010 and 2018 with total, as opposed to primary, outlays.**



Source: CBO