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April 22, 2011

To Work, Ryan's Reforms Need Process Constraints

By Jagadeesh Gokhale

House Budget Committee Chairman Paul Ryan's recently released budget proposal will radically redirect the federal budget trajectory. Specifically, it will prevent the federal government from taking over one-half of the U.S. economy by the middle of this century, and it will reduce the risk of a debt crisis. If these proposals are to work long term, however, it is essential to combine them with procedural reforms that will make reversing them difficult once their goals are met.

The proposal has many elements, but it mainly targets federal Medicare and Medicaid spending. Medicare would be converted to a "premium support" system after 2022; instead of providing payments directly to doctors and hospitals for patient care on a fee-for-service basis - a system that encourages provision of services irrespective of their beneficial health effects - patients would be given a set amount of funds per year for the purchase of health insurance policies or health care services. With patients responsible for spending their funds, they are likely to be more cost conscious in deciding what type of health care or health insurance to buy.

Introducing such competition into the market has worked well in Medicare's prescription drug program,which now costs much less than earlier projections. Federal Medicaid support to states would be converted to block grants, which will allow states flexibility in designing health care programs for the poor and medically needy. The proposal would also reduce income tax rates and expand the tax base by eliminating loopholes similar to the 1986 Tax Reform Act (TRA-1986).

Under the Ryan reforms, however, government spending and debt won't ratchet down rapidly. Indeed, national debt held by the public increases to 70 percent of GDP by the early 2020s. Given the uncertainty surrounding fiscal projections, that's too high for comfort. And, according to the Congressional Budget Office, the proposal won't reduce national debt to the more comfortable recent level of 40 percent until after 2040.

What would happen without the Ryan reforms? The CBO projects what it calls an "Alternative" fiscal scenario, which is a more accurate representation of the nation's current fiscal policy. That is so because it reflects policymakers' recent behavior in consistently reversing key and costly elements of the laws governing federal spending and revenues.

For example, past Congresses and Administrations have consistently waived cuts to medical doctors, increased the limits on taxable income to prevent millions of people from being subjected to the Alternative Minimum Tax, and increased discretionary federal spending faster than inflation. Arguably, that behavior more closely reflects what might happen in the future rather than the CBO's baseline scenario that strictly follows existing laws. Under the Alternative scenario, federal spending increases to 35 percent of GDP, and debt held by the public increases to 185 percent of GDP by 2035; well beyond the 90 percent threshold thought to be the maximum debt ratio sustainable without risking an economic crisis.

The Ryan proposal correctly focuses on achieving debt reduction through spending cuts, but this very gradual debt reduction schedule is a weakness that could lead to its downfall. TRA-1986, for example, although based on sound economic principles, was undone as later Congresses granted tax exemptions to narrow interest groups.

Even more to the point is the 1990 Budget Enforcement Act (BEA). That Act controlled surging national deficits through tight caps on federal discretionary spending and pay-go financing restrictions on federal mandatory spending. The constant political pressure to reverse it was initially relieved by the "peace dividend" of reduced defense spending and base closings when the Cold War ended. When that source was exhausted, the BEA was abandoned, federal spending ratcheted upward, taxes downward, and deficits ballooned again.

Significant reforms enacted by one Congress can be modified, defunded, repealed, or simply abandoned by a subsequent Congress. As soon as the Ryan reforms generate budget surpluses, lawmakers facing vociferous lobbies for all types of subsidies, grants and benefits will inevitably begin proposing additional federal spending programs or unwarranted tax reductions. Without some constraints in place, we will be back to where we are today.

The Ryan or other similar budget proposals won't be sustained for long without constraints on the budget process to stabilize fiscal policy, and which provide the best environment for rapid economic growth. Historical precedent shows that reforms stick when they are combined with changes in infrastructure - even in just administrative mechanisms. Base closings and welfare reforms of the 1990s stuck because the former involved removal of infrastructure, and the latter changes in administrative mechanisms at the state level; both costly to reverse.

In contrast, reforms such as the TRA-1986 and the BEA-1990 involved legal constraints which were easily modified or reversed. TRA-1986 suffered death by a thousand cuts, and BEA-1990's constraints were simply not renewed. The other, more difficult, way is to combine reform measures with a procedural impediment to reversal by future Congresses. One example is the Senate's Byrd Rule which prevents budget legislation from including changes to Social Security through a simple point of order raised by a single senator, and cannot be overturned without a supermajority in the Senate.

Legislative constraints required to protect benefits - as the Byrd rule accomplishes - are fundamentally different from those required to protect a Ryan-type Medicare and Medicaid reform from erosion. The latter are required to prevent benefit expansions as the federal government's fiscal condition improves in the future. Experience with BEA-1990 suggests that constraints based on traditional deficit measures will be inadequate.

Once more sensible Medicare and Medicaid systems are adopted, along the lines suggested by Rep. Ryan, their structural integrity will likely be eroded as retirees seek to enlarge pay-go financed benefits, thereby transferring more of the younger generation's resources toward themselves. Such systems create "generational imbalances" which show up as deficits much later.

The new process constraints should seek to limit such generational imbalances as a way to sustain the improvement in federal finances. Without procedural constraints anchored on limiting the generational imbalances created by social insurance programs, we are bound to repeat the mistakes of the past.

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