Entitlement Spending, Not COVID-19 Stimulus, Threatens Our Fiscal Future

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Current concern about the U.S. fiscal outlook targets recent COVID-19 stimulus legislation: the already adopted CPRSAA ($8.3 billion), FFCRA ($192 billion), CARES Act ($2.2 trillion), PPPHCEA ($484 billion), CAA ($915 billion), and ARP ($1.9 trillion); plus the proposed but not yet adopted AJP ($2.7 trillion) and AFP ($1.8 trillion). All together, these programs add (at least) $5.7 trillion to the federal debt.

That sounds huge, and it is.

But recent fiscal expansions are not the major reason for US fiscal imbalance. These measures are mainly one offs, so GDP growth will gradually make them insignificant relative to the overall economy. So long as the non-interest deficit does not grow relative to GDP, and interest rates do not spike, the U.S. can pay off even a huge spending binge, as it did after WWII when the debt to GDP ratio fell from 118 percent in 1948 to 40 percent by the mid-1960s.

The far more important fiscal issue is that pre-COVID-19 entitlement programs — chiefly Medicare and Social Security — set the U.S. on an unsustainable fiscal path long before the pandemic.

The CBO projects that Medicare spending as a percentage of GDP will double from 3.1 to 6.3 percent over the next 30 years. Social Security as a percentage of GDP will increase from 5.2 percent to 6.3 percent. Federal revenue, however, is projected to grow at just 0.49 percent per year over the same period, increasing from 16 percent to 18.5 percent of GDP, implying an ever-increasing deficit, other things equal.

This expenditure growth stems, for both programs, from significant demographic shifts in the U.S. population, particularly the aging of the Baby Boom generation and the declining birth rate. Recent Census data shows that, for the first time, the number of Americans over age 80 is greater than the number under age 5. Medicare will also grow because healthcare costs in the United States, already substantially higher than comparable countries, have outpaced GDP growth since the 1970s.

This is why CBO's projections have shown an ever-increasing debt to GDP ratio since 2009. Even the most aggressive proposals to raise taxes cannot close the gap, both because tax increases lower the deficit level but not its growth rate, and because substantially higher taxes would likely lower GDP growth, exacerbating the problem.

Nor, importantly, can reduction or elimination of most discretionary spending — including military spending — solve the problem, again because these are level rather than growth rate effects. And *growing* primary deficits are problematic *even if* interest rates remain low forever. Plus, low rates may not continue in perpetuity. In fact, if the debt to GDP ratio keeps growing, it is even more likely that rates will rise.

Thus the only policy that tames the debt is major reductions in entitlement spending. A necessary condition for any spending plan to make sense is that it be affordable. A household, for example, can spend more than it earns in a year by using past savings or new borrowing; but only up to a point. The same applies to governments.

Cutting Medicare is not a popular stance, but making it sustainable does not require draconian measures. Gradually phased in higher ages of eligibility (for Social Security and Medicare), higher deductibles and copays, and certain coverage limitations in Medicare can slow expenditure growth while simultaneously encouraging more price sensitivity in health care decisions. This is desirable independent of the debt; it is critical in light of the debt.

This is the opposite perspective from that of Democratic legislators, who want to expand Medicare. Lowering the age of eligibility and expanding the menu of services will only speed the country's fiscal decline.

Optimists might respond that CBO's projections come with substantial uncertainty. True, but forecasts can be wrong in both directions. Existing evidence suggests excess optimism is the norm, so CBO's forecasts plausibly paint an overly rosy picture. In a 2009 report, the CBO projected a debt to GDP ratio of 127 percent in 2050. A 2021 report projects the ratio to be 195.3 percent.

It is easy to attack the recent spending binge; and much of that spending may be ill advised (e.g., unemployment insurance so generous that it disincentivizes work). But recent and proposed fiscal expansions are the tip of the iceberg; Medicare and Social Security are the fundamental problems. Regardless of one's view of these programs, anything unaffordable does not make sense.

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