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As boomers age, a soul-searching budget battle

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By Emily Kaiser

WASHINGTON (Reuters) - In 1983, a civil servant named Robert Ball worked a political miracle: he convinced Republican Ronald Reagan to raise taxes and Democrat Tip O'Neill to accept trims to Social Security.

That was the last time the United States made substantial changes to shore up the finances of its public pension and healthcare programs, which will cost an estimated $1.3 trillion this fiscal year and $2.3 trillion by 2021 as tens of millions of baby boomers retire.

Keeping those boomers healthy and out of poverty poses the biggest threat to long-term U.S. finances, and figuring out how to pay for it will be an epic political fight. Federal Reserve Chairman Ben Bernanke calls the fiscal problems a "near and present danger" to the U.S. economy.

Any changes to retiree benefits will require some national soul-searching and uncomfortable debate over what society owes its elderly citizens, particularly if meeting those obligations means short-changing younger people.

Back in 1983, Ball's diplomacy averted an imminent crisis. Social Security was months away from missing benefit payments, and the National Commission on Social Security Reform -- known as the Greenspan Commission -- was deadlocked.

There is no such pressing crisis today, but the longer-term fiscal problems are far more severe. Healthcare costs are rising faster than inflation, and Americans are living longer.

Even in 1983, it was obvious that Medicare, the healthcare program for seniors, would ultimately become the bigger financial burden. But the Greenspan Commission decided to focus only on Social Security.

"Trying to do both could mean we would do neither," Alan Greenspan, who chaired the 1983 commission before becoming Federal Reserve chairman, said in an emailed response to questions from Reuters.

"While the impact of the pending retiring baby boomers on Medicare was clear in 1983, we knew that policymakers had decades to address that problem. Of course, they didn't."

HISTORY REPEATS

Nearly three decades later, the battle rages on, and the arguments haven't changed much. Republicans want spending cuts and Democrats insist on tax increases, a divide that has doomed every major reform effort to failure.

Since Greenspan's group wrapped up its work, two other bipartisan presidential commissions have tried to finish the task. Erskine Bowles, the Democrat who co-chaired the latest deficit commission under President Barack Obama, called the looming fiscal mess the most predictable crisis in U.S. history.

Yet his group suffered the same fate as Greenspan's, breaking down largely along party lines. Only 11 of the 18 members voted in favor of the commission's plan, which would cut the federal deficit by $3.9 trillion over the next decade.

Unlike 1983, there is no obvious candidate to assume the shuttle diplomacy role played by Ball, who died three years ago. Obama has offered only lukewarm support for the deficit commission's findings.

Backing in Congress comes primarily from a bipartisan group of lawmakers known as the "Gang of Six." But they face stiff opposition from within their own parties and are far from mustering enough votes to pass legislation based on the commission's recommendations.

Republicans brought out their own long-term budget proposal on Tuesday, which included major changes to Medicare and Medicaid, the healthcare program for the poor. But the plan drew swift complaints from Democrats, who said it would leave the elderly and children vulnerable to rising healthcare costs.

The longer the United States waits to address the financial strains of an aging population, the tougher the choices become. But without an immediate crisis to focus the mind, there is little incentive for lawmakers to act -- particularly when the decisions are certain to anger some voters and there's always an election just around the corner.

"Fiscal policy cannot be put on a sustainable path just by eliminating waste and inefficiency," said Douglas Elmendorf, director of the Congressional Budget Office. "The policy changes that are needed will significantly affect popular programs or people's tax payments or both."

There are now 2.9 workers per Social Security beneficiary, according to the Social Security Administration. By 2035, that figure drops to 2.1 workers apiece. The CBO estimates the number of Medicare enrollees will grow to almost 60 million by 2021, from 45 million in 2010.

In 10 years' time, Medicare and Social Security spending alone will amount to 9.6 percent of U.S. gross domestic product, more than defense and other discretionary spending combined, CBO projections show.

TIMING IS EVERYTHING

The aging of the 76 million-strong boomer generation, born in the years following World War Two, comes as no surprise.

What was unexpected was that the retirement wave would crest so soon after the worst financial crisis and recession in the boomers' lifetime, one that drove unemployment to a 28-year high and wiped out trillions of dollars in household wealth.

The recession -- and the hundreds of billions of dollars the government spent to prevent it from becoming a depression -- worsened an already grim budget picture.

Judging from this year's battle in Congress over cutting a relatively modest $61 billion in discretionary spending, the looming fight over trillion-dollar programs will be bloody.

Congress sets one-year budgets and spins through two-year election cycles, but the needed fiscal fixes will span decades. That makes it difficult to separate today's political considerations from tomorrow's economic imperatives.

"We're going crazy about $61 billion, 'Oh my God, it will devastate the country!'" said Michael Tanner, a senior fellow at the libertarian Cato Institute. "How are we going to make the big cuts?"

TOUCHING THE THIRD RAIL

Polls show Social Security and Medicare remain two of the most popular public programs, even among self-described Tea Party supporters who demand deep budget cuts.

To this day, many politicians view proposing cuts to Social Security and Medicare as a deadly "third rail," which makes it all the more difficult to fix the long-term fiscal problems.

The Greenspan Commission was born in part as a way to push the Social Security discussion beyond the 1982 midterm elections. It was slated to complete its work in January 1983.

Obama's bipartisan commission was supposed to come up with a fix that would solve the short-term funding crisis and assure the program's long-term sustainability.

Not surprisingly, Democrats on the commission wanted tax increases; Republicans preferred spending cuts. Hours before the commission was set to expire, Ball brokered an 11th hour deal that included roughly equal measures of both.

Ball spent more than 30 years working for the Social Security Administration. Although he was appointed to the Greenspan Commission as a Democrat, his vast knowledge of the program earned him respect from both sides.

"He was an honest broker who could go back and forth, allowing both parties to have safe conversations... to explore the middle ground," said Jack Lew, who is Obama's budget director and served on O'Neill's staff during the Greenspan Commission.

"Everyone gives Alan Greenspan the credit, but Robert Ball was a great public servant and deserves much of the credit," Lew told Reuters in an interview. "He's one of my heroes."

BATTLE OF THE CONDIMENTS

In his memoir, Ball recalls some cloak-and-dagger moments when the press got wind of his behind-the-scenes negotiations and suspected that a deal was imminent.

With reporters camped out in his front yard, he sent his wife outside as a decoy while he sneaked out the back door and scrambled down a snowy hill to a parkway where a White House car was waiting to whisk him away to a secret meeting with top Reagan staffers.

The deal he struck included moving up scheduled tax increases, delaying payment of cost-of-living adjustments, and increasing the amount paid by the self-employed.

Neither Reagan nor O'Neill was entirely thrilled with the outcome, but they both issued identical statements "proclaiming their equal support for the compromise solution we had worked out," Ball wrote in his memoir.

To put that in a modern context, it would be like Obama and Republican House Speaker John Boehner fully endorsing the December 2010 report of the deficit commission.

The Greenspan Commission's recommendations were largely adopted in Congress, with one major addition: lawmakers voted to gradually raise the retirement age for full benefits to 67 from 65.

That was tacked on after a heated debate on the House floor between Representatives J.J. Pickle and Claude Pepper that became known as the "battle of the condiments". Pickle advocated raising the retirement age; Pepper was adamantly opposed. Pickle prevailed.

STRANGE BEDFELLOWS

If this sounds familiar, it should. Many of these same issues are up for debate once again today. The deficit commission, for example, proposed raising the retirement age to 69 by 2075. (Pickle's proposal raised it to 67 by 2027.)

Obama's deficit commission came three votes short of the 14 it needed to bring its proposal to a vote in Congress, leaving it in a state of policy limbo.

Its best hope for survival rests with the Gang of Six, which brings together unlikely allies in liberal Democratic Senator Richard Durbin and conservative Republican Senator Tom Coburn. They want the deficit commission's recommendations -- known as the Simpson-Bowles report after leaders Alan Simpson and Erskine Bowles -- to form the basis of broad-ranging deficit legislation.

If the Gang of Six is to succeed, it will have to subdue intense opposition from both parties.

The disagreements go to the very heart of the left-right divide over the size and role of government. Republicans paint Democrats' support for entitlements as a slide toward nanny-state socialism. Democrats suspect Republicans are whipping up deficit fears as an excuse to dismantle the social safety net and shrink the government.

Both sides are digging in for a long fight.

THE RHETORIC

Thanks in large part to Ball's efforts, Social Security is on much firmer footing than it was 30 years ago. The Social Security Trust Fund, which was in danger of missing benefit payments in 1983, now has enough resources to pay full benefits through 2037, and about 75 percent of obligations after that.

Yet some Republicans insist the program is broke.

"There is no trust fund," Senator Mike Johanns declared in a March hearing with Federal Reserve Chairman Ben Bernanke. "It's just paper. If we're not able to borrow more money, we can't even pay current beneficiaries."

That "paper" is actually special issues of U.S. government bonds that can be redeemed at any time at face value. By law, the trust funds must be invested in securities guaranteed by the federal government.

Social Security is funded by payroll taxes, which amount to 6.2 percent out of the first $106,800 of workers' paychecks and another 6.2 percent paid by employers. (The rate paid by employees was temporarily cut by 2 percentage points this year as part of a tax deal struck in December.)

Johanns's assertion is accurate to a degree because the government is running a deficit and must therefore borrow money to meet any obligations that exceed revenues. That includes paying interest on, and redeeming, debt.

But take his "just paper" argument to its logical conclusion and it calls into question the value of every Treasury bond held by every pension fund, bank or foreign government, said Eric Kingson, a professor at Syracuse University who served as staff on the Greenspan Commission.

"Does he want to tell that to China?" he asked, referring to the largest foreign holder of U.S. government debt.

Failing to honor the bonds held by the Social Security trust would be "a selective default," said Nancy Altman, who was Greenspan's assistant on the social security commission.

Altman and Kingson are co-directors of Social Security Works, an advocacy group that opposes privatizing the program, raising the retirement age further or reducing benefits.

They see comments like Johanns's as a not-so-subtle attempt to paint Social Security as part of an insurmountable long-term deficit problem -- and therefore ripe for reforms that will gut benefits and erode public support.

AN 11-LETTER FOUR-LETTER WORD

Kingson traces Republican claims of Social Security's impending doom back to yet another commission -- President Bill Clinton's 1994 Commission on Entitlement and Tax Reform.

"The commission purposely worked to turn an 11-letter word -- entitlement -- into a four-letter word," said Kingson, who also served as an adviser for that commission.

"They were fundamentally moving toward trying to create a sense of crisis around entitlements as a way of cutting the federal deficit. The strategy was to lump Social Security, Medicare and Medicaid into the word 'entitlements'," he said.

The term "entitlements" has certainly seeped deeply into the Washington vernacular. Obama uses it. So does Boehner.

One group that most certainly does not like that word is AARP, the lobby group for those ages 50 and older.

"We kind of hate the word 'entitlements' because it lumps all these (programs) together that are very different," said David Certner, AARP's legislative policy director.

"We're hoping that Social Security doesn't get tangled up in the debate over the budget," he added.

Carol Godsey, a 65-year-old living in Bella Vista, Arkansas, isn't a big fan of that word either.

"I don't think that's an entitlement. I paid for it," Godsey said. "We've been paying into Social Security for 45 years and the government has used it for something else."

TAXATION WITHOUT REPRESENTATION

Kingson, Altman and other proponents of Social Security argue all that is required to ensure long-run sustainability is lifting the $106,800 cap on earnings subject to tax.

For AARP's members, any changes to Social Security payouts would be particularly painful because they are near or already in retirement and would not have time to prepare for the hit.

That is one reason why even some proponents of cutting Social Security argue that changes ought to be phased in slowly, as they were in the Greenspan Commission's proposal.

Tanner, from the Cato Institute, said it was naive to think U.S. fiscal problems could be solved without paring both Social Security and Medicare.

Instead of a blanket pledge to provide Social Security to virtually all private sector and federal workers, Tanner thinks benefits should be need-based.

"There is some sort of social obligation on the welfare front to ensure seniors don't fall into poverty," he said. "But I don't think there is any societal obligation to provide simple retirement benefits. That's something that the private sector is fully capable of providing."

THE $93,000 PROSTATE VACCINE

Peter Peterson, a well-known deficit hawk whose eponymous foundation focuses on raising awareness about looming fiscal problems, said "we can sit around this table in 45 minutes and come up with a plan" to fix Social Security, but when it comes to Medicare no one seems to have a convincing plan.

Even the Simpson-Bowles report, which Peterson praised, was "pretty vague" about how exactly to address the problem of rising medical costs.

Cutting Medicare coverage will spawn heart-wrenching stories of Medicare leaving seniors to die to save a buck. Indeed, the program already faces such accusations each time it decides whether to cover a costly new drug or treatment.

Raising taxes will spark complaints from conservatives who already fear the tax burden is hurting economic growth and entrepreneurship.

The recent debate over whether Medicare should cover the $93,000 prostate vaccine Provenge showed how difficult the debate will be. Under current law, Medicare and its advisers can consider only whether use of a vaccine is "reasonable and necessary," not whether it is cost-effective.

Even under the current rules, however, the money question comes up. Thair Phillips, president and CEO of advocacy group Retire Safe, spoke at hearings in November on whether Medicare should cover Provenge.

"The real core of this discussion is price, and price is the very thing that should not be a point of discussion," he said at the hearing. "If the government is willing to break its own rule and precedent in reviewing Provenge because of its cost, we have started down the road to rationed health care."

ADULT CONVERSATION

If there is common ground between liberals and conservatives, it is that healthcare costs must be contained, somehow. Yet proposals aimed at accomplishing precisely that are sometimes distorted into powerful political weapons.

Austan Goolsbee, one of Obama's top economic advisers, complained about one such instance when the Obama administration proposed paying for end-of-life counseling to help seniors understand their options, a measure that can reduce costs.

"That was transformed into, 'The President wants to kill your grandma'," Goolsbee said in a presentation to business economists in March, referring to Sarah Palin's infamous tweet about "death panels."

"In an environment like that, we are not having an adult conversation about the aging of the population and the acceleration of healthcare costs," Goolsbee said.

Tanner, from the Cato Institute, said he was not optimistic that Washington would succeed in solving the long-term deficit problem. Lawmakers have no incentive to act when the message from voters is don't touch retiree benefits.

"You look at the polls that say, well, we don't have to cut Medicare and Social Security. We just get rid of foreign aid and illegal immigration and we're fine," Tanner said.

WHAT WOULD BALL SAY?

So what would Ball have made of the deficit commission? His son, Jonathan, said judging from his last published article, an opinion piece in the Washington Post, he would not have approved of its format or its recommendations to curb benefits.

"What was right in 1983 -- a balanced package of benefit cuts and tax increases as part, roughly half, of the final agreement -- would be wrong today," Ball wrote in his commentary, published on October 29, 2007, just a few months before he died.

In his memoir, Ball insisted the Greenspan Commission should not be held up as an example of bipartisan success because the committee itself failed to come up with an agreement. A few key players sealed the deal, and then took it back to the committee for full endorsement.

"We should not allow ourselves to fall into the trap of expecting miracles from another Greenspan Commission by deluding ourselves into believing, mistakenly, that the first one was a great success," he wrote.