

Putting Our House in Order

JOHN B. SHOVEN, Ph.D, Charles R. Schwab Professor of Economics at Stanford University, goes on the record to explain how the Social Security and health care systems need to change to thrive in the 21st century.

Social Security and health care reform are two of the most important economic issues of the first half of the 21st century. In our new book, *Putting Our House in Order: A Guide to Social Security and Health Care Reform*, W.W. Norton, 2008), George P. Schultz and I address these issues with solutions in mind.

These two parts of the economy are on an unsustainable financial path—Social Security is insolvent over the long haul and health care costs are out of control. The United States has never collected more than 20% of gross domestic product (GDP) in taxes. And yet if health care costs are not brought under control and if Social Security is not redesigned, Medicare and Social Security alone will cost 20% of GDP by 2050. We must start working now to avoid such an economic catastrophe.

A thriving economy

Some observers are very pessimistic. They think that the United States is in a state of economic decline. Not so. The evidence is that the U.S. economy over the past 25 years has performed admirably—in fact, it has outperformed all the other large, developed economies. We have had relatively stable prices, long booms and mild slowdowns, and a period of remarkable productivity gains. More than that, Americans are living longer and healthier lives than ever before. The long view is that the U.S. economy and society are robust and that solutions to these problems are possible.

Medicare and Social Security transfer resources from workers to retirees. They divide the economic pie. My co-author, who has served as Secretary of Labor, Treasury and State, likes to say that dividing a pie is a lot easier if you have a big pie. Social Security, Medicare and health care in general will be easier to sustain if we have policies to encourage more work and more saving. We propose a number of ideas that do just that.



ERIC MILLETTE



Fundamental changes to Social Security

One of my favorites would establish a new class of workers—those who are “paid up.” After 40 years of paying Social Security and Medicare payroll taxes, workers are deemed to have reached paid-up status. This means that from then on they are exempt from all payroll taxes. This policy alone removes a 15.3% tax on working for those eligible. We think that such long careers will become more common as many people contemplate living to 90 or even 100. (My co-author is still going strong at 87.) We have several more ideas which remove disincentives for working a long time that would at least triple the number of 65- and 66-year-olds who would choose to remain in the workforce. More workers would create more GDP and that would make these expensive programs more manageable.

In terms of Social Security, we quote a presidential address to Georgetown University undergraduates. The President talks about the crisis facing the system and the dire consequences of not addressing its long-run insolvency sooner rather than later. We use this quote to illustrate that this is a nonpartisan issue. We don't immediately tell the reader which president we are quoting. It sounds just like President George W. Bush, but it was President Bill Clinton.

In the book we lay out several fixes for Social Security's insolvency, some of which involve individual accounts and some of which don't. We think that any

of the proposals we summarize are better than doing nothing. The problems of Social Security are well understood, the menu of fixes is known and there is no excuse for letting this problem compound with interest for another 30 years. Insolvency can be addressed by very gradually raising the retirement age and by removing the increases in the promised payments over and above inflation for those who are well off. There is nothing stopping us from fixing Social Security in 2009 except a lack of political will power.

The difficult problem of health care

Coming up with a complete solution for runaway health care costs is tougher. First, the magnitude of the problem needs to be understood. Here is a hint: It's huge. Then we have to preserve what is great about our medical system, including research and development into new health solutions. While we

be part of the solution. We also think that universal coverage, or at least universal access to coverage, is an attainable goal and we present plans to accomplish it.

Ultimately, some sort of rationing of health spending will be necessary. As a society, we currently ration almost everything other than health care via the market system. Housing, food, education—you name it—are all rationed. What that means is that people choose what goods and services they want based on what they can afford. As a society, we will have to begin to address the value-for-money proposition in health care. There is widespread evidence that spending more on health care does not lead to better health outcomes.

Overall, there is a lot to admire about the American health system, but there is also an amazing amount of waste. The trick is to reduce the waste and preserve the good parts. It can be done, but it will take continuing efforts

What does FICA mean?

The payroll taxes that are collected for Social Security are considered contributions to Social Security. In 1939, these taxes were taken out of the original 1935 Social Security Act, placed under the Internal Revenue Code and renamed the “Federal Insurance Contributions Act.”

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know that the growth in health spending will have to be curtailed, George and I are against reducing federal support for basic medical research. What we are in favor of is more information for consumers about the health consequences of alternative treatments and their cost. We think an expanded role for health savings accounts could

over the next several decades. Just like Social Security, the time to start on the health cost problem is now. Federal Reserve Chairman Ben Bernanke, when asked in Congress when we should tackle these issues, said “about 10 years ago,” which is right—but “next year” might be a more operational answer. ■

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