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A Message To Friends Of Social Insurance: Wake Up!

Those who wish to preserve social insurance in the United States must face up to the affordability problem and devise realistic solutions.

by Henry J. Aaron

ABSTRACT: Theodore Marmor and Jerry Mashaw effectively present the case for social insurance as a necessary component of capitalism. They underestimate the severity of the fiscal pressures to which Social Security and Medicare will be subject. Projected cost increases are too large to be met entirely by tax increases that the American public is likely to tolerate. Those who are devoted to social insurance need to design the changes, instead of leaving the job to opponents of principles of social insurance, who will take the financial problems as an excuse to scuttle Social Security and Medicare. [Health Affairs 25 (2006): w135–w137 (published online 21 March 2006; 10.1377/hlthaff.25.w135)]

During the mid- and late twentieth century, political embrace of social insurance seemed solid and immutable. Onetime opponents of social insurance appeared to have resigned themselves to Social Security and Medicare as inescapable, if unwanted, features of political reality.

As events have shown, appearances were misleading. Resistance to the tenets of social insurance has revived. Serious libertarian political and philosophical writings and deep-pocketed and very patient financial backers of conservative writers and think tanks have produced a strong challenge to Social Security and Medicare. The conservative critique is based principally on a belief that government has come to play too prominent a role in people’s lives. But they have used projections that pension outlays will outpace earmarked payroll taxes and that health care spending will strain the federal budget to create a sense of urgency and crisis. They have argued that privatization would solve these problems, using that argument to attack the framework of social insurance.

Although slow to awake, supporters of social insurance are stirring. The essay by Theodore Marmor and Jerry Mashaw is the latest in a spate of writings restating the need for social insurance as an aid to help modern capitalism operate in a manner that is...well, yes, let’s use the term...compassionately conservative. They rightly focus on Social Security and Medicare as the two largest domestic government programs. That the alleged crisis is phony and that the arguments on behalf of privatization are specious is the main thrust of Marmor and Mashaw’s essay.

Need for social insurance. Their argument as to the need for social insurance is, in my view, clearly correct. Capitalism works well in considerable part because, on the aver-
age, markets reward people and businesses for taking risks. But not all risky acts are rewarded; if they were, they wouldn’t be risky. And not everyone can shoulder all risks equally well. Some people are myopic. Some risks, such as inflation and unemployment, are not individually insurable. People have limited capacity to make complex decisions, such as understanding the actuarial value of health insurance packages. And because even well-calculated decisions might turn out badly, social insurance helps protect the unlucky.

**Affordability.** Marmor and Mashaw also address the affordability of current social insurance commitments. On this subject, they are, I believe, not wrong but misleading. They also miss the chance to explain that not just the advocates of social insurance, but the nation as a whole, must confront some very difficult choices.

They characterize the arguments that Social Security is not affordable as “nonsense” and “silliness.” Viewed in isolation, official projections of Social Security spending support this contention. From now until 2040, well after the last baby boomer has retired, Social Security benefits are projected to increase by just 2.1 percent of gross domestic product (GDP), a smaller share than the increase during the fifteen year period 1967–1982. The tax cuts enacted since 2001 are three to five times larger than, and the cost of the 2003 Medicare prescription drug bill is nearly twice as large as, the entire projected deficit in Social Security over the next seventy-five years. No matter how you slice it, growth in the cost of Social Security pensions is not really a very big deal, the Chicken Littles of the political right notwithstanding.

**Medicare.** But then Marmor and Mashaw turn to Medicare. Here they say nothing about absolute cost, other than that health care in general is suffering from “hyperinflation” (not true, because hyperinflation is normally taken to mean price increases of at least 50 percent per month—but you get the point). They note that “fearful projections of Medicare’s fiscal future reflect a problem of U.S. medicine, not a crisis caused by Medicare’s structure” and that per capita Medicare spending is rising no faster than private spending. Well, so what if Medicare and Medicaid are no worse off than the rest of health care?

To begin with, suppose that per capita spending on Medicare and Medicaid grows no faster than other health care spending does. Assume further that per capita health care spending grows no faster than per capita income. Even then, outlays on these programs would claim an additional 2 percent of GDP by 2040. But health care spending has grown annually about 2.5 percentage points more than income. If that trend continues—and there is no obvious reason why the gap should narrow—Medicare spending as a share of GDP will quadruple from 4.2 percent in 2005 to 16.1 percent of GDP by 2040 (for comparison, total personal income tax revenue now equals 7.6 percent of GDP), and total health care spending will grow from about 16 percent of GDP today to more than 35 percent by 2040. The increase in health care outlays will claim half of all economic growth by 2022 and all of it by 2031.

That, folks, spells trouble. Yes, those projections are yet one more reason why reform of the U.S. health care system is needed. But unless Marmor and Mashaw know how to cure the tax phobia of the American public, it also means that pressure to restructure Medicare will intensify.

**What to do?** Instead of denying the problem, friends of social insurance, like Marmor and Mashaw, should face up to it. What not to do is pretty clear. We surely should not just raise the age of eligibility for Medicare. If general and Medicare per capita health care spending continues to grow 2.5
percentage points a year faster than income, it would be necessary by the year 2030 to deny Medicare to anyone under age eighty-one, to limit the growth of Medicare spending to that resulting from demography. Nor should we just cut the share of personal health care spending covered by Medicare, which would have to be cut by more than half by 2030 and more than two-thirds by 2040.

But we should also not simply wave off an affordability problem. Tax increases will have to be part of the story. But so will increased cost sharing for those Medicare beneficiaries who can afford it. Competition engendered by premium support might help some, but as Robert Reischauer and I have emphasized, viable premium support requires risk adjustment of proven efficacy and carefully regulated marketing of health insurance. We did not say, as Marmor and Mashaw suggest, that premium support would spare the nation hard choices forced by rapidly rising Medicare costs.

The more important point, however, is that if current trends continue, health care financing, in general, and Medicare spending, in particular, will necessitate fundamental changes in the way we pay for health care—all health care, not just Medicare and Medicaid. I know that both Marmor and Mashaw fully understand this challenge. But if they and the rest of us who believe that social insurance protections are vital and must be sustained don't stop denying that an affordability problem exists and design ways to cope with it, those who are itching to scuttle social insurance will be more than pleased to save us the trouble.

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