How to Talk America Down From Impending Fiscal Suicide

http://www.fool.com/investing/general/2010/10/29/how-to-talk-america-down-from-impending-fiscal-sui.aspx

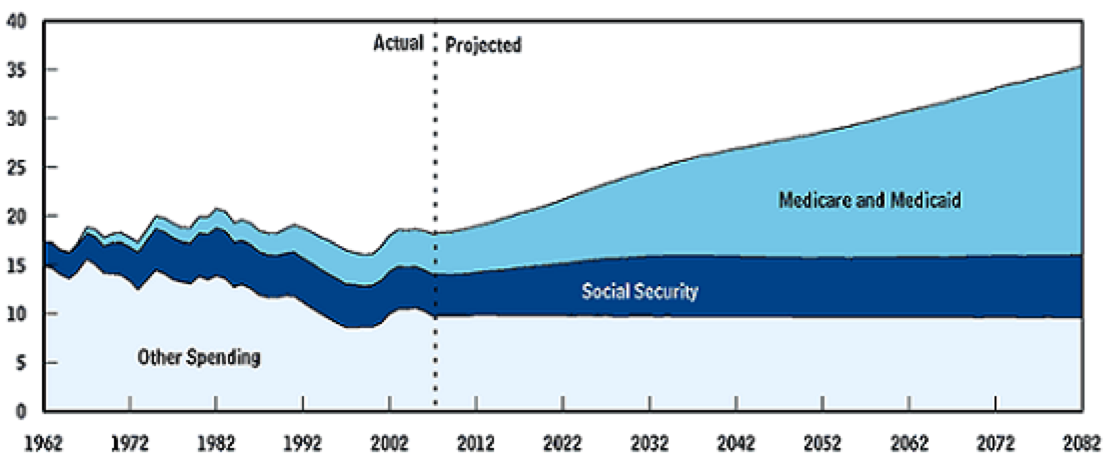
Morgan Housel
October 29, 2010

Findings like this, from the Tax Policy Center, are as terrifying as they are ironic:

> Three-quarters of Americans believe that entitlement programs such as Medicare and Social Security "will create major economic problems" over the next 25 years. But two-thirds are opposed to addressing these challenges by reducing benefits, and 56 percent are against raising taxes.

I believe the word for this is "ungovernable." Fix the deficit immediately, but don't you dare touch my entitlements -- never mind that entitlements are responsible for those deficits.

Consider this. The projected budget deficit in 2035 is $5.6 trillion. Yet even if spending on every government program except entitlements were cut to the lowest percentage of GDP since the 1940s, the deficit would still be roughly $5.4 trillion. When the topic of reining in government spending arises, the typical emotions-laced buzzwords always pop up -- pork, waste, TARP, stimulus. But these aren't even rounding errors against the 800-pound gorilla of entitlements:



Source: Congressional Budget Office. Y-axis is spending as a percentage of GDP.

The tragedy in this is that everyone is eventually eligible for entitlements, so mere talk of cutting the programs is political napalm. True fiscal responsibility means less retirement money than you -- you! -- are currently promised. Yet how many political candidates run on the "I'll-gut-*your*-retirement" platform? None. There's a reason for this. Very few of even the most hardnosed fiscal hawks are willing to part with their entitlement checks -- something that affects them directly -- in the name of a balanced budget -- more of an abstract concept.

Rolling Stone's Matt Taibbi, who has skillfully insulted everyone at least once, detailed this paradox by describing a recent austerity rally as "A hall full of elderly white people in Medicare-paid scooters, railing against government spending and imagining themselves revolutionaries." He went on: "The average Tea Partier is sincerely against government spending -- with the exception of the money spent on *them*." I want to keep this column as apolitical as possible, but the mentality Taibbi describes, which isn't unique to the Tea Party, is strongly backed up by the Tax Policy Center's poll.

Long-term spending needs to be curtailed. No one's denying that. Just don't pretend it's as easy as holding up a sign that says "stop the spending!" It's not. Look at France. It recently proposed overhauling public pensions to make them more financially viable, and the people went ballistic. They rioted. Airports were shut down. A quarter of the country's gas stations went dry. One French politician called it a "coup." People get angry when a gravy train they've grown accustomed to is taken away. Yes, France's entitlement system is more engrained than ours. But there's little doubt about it: We're going to freak out once we get around to fixing our entitlement programs. It's imaginary to think otherwise.

But how, exactly, do we fix these programs? Here are a few options.

Social Security
The Congressional Budget Office issues a report on policy options every few years with recommendations on how to keep Social Security afloat. One of the simplest recommendations is also the most effective. It boils down to this: Stop being so generous in the way initial retirement benefits are calculated.

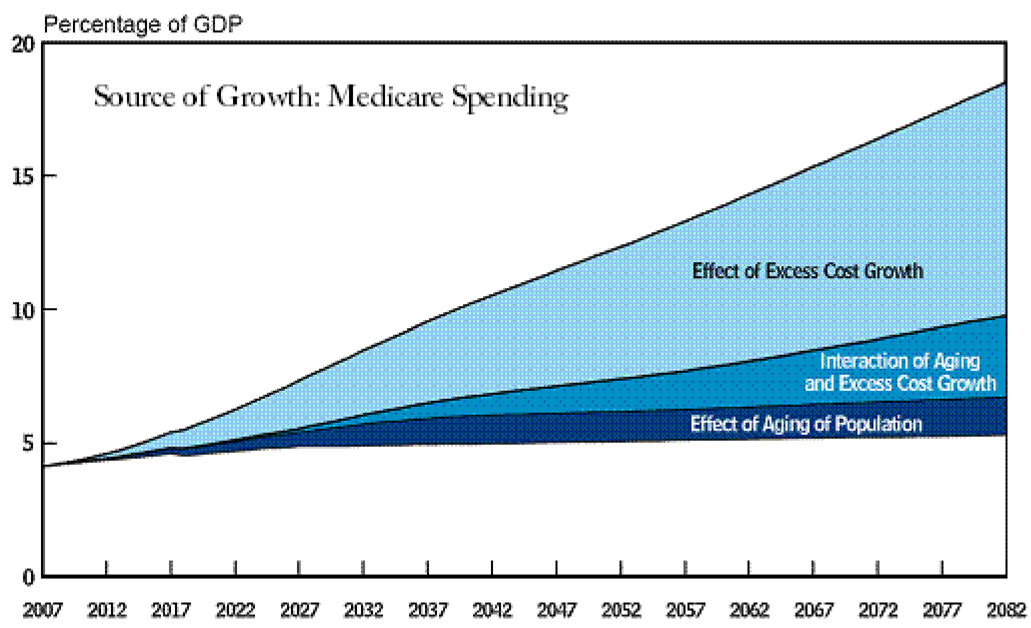
Currently, initial Social Security benefits are determined with a calculation that considers how much you earned in the past adjusted for real wage growth. They call it wage indexing.

If Social Security switched to price indexing -- a process where initial benefits are calculated by adjusting past wages only for inflation, not real wage growth -- the Social Security trust fund would never become exhausted. Ever. The program becomes permanently viable.

What would the change mean for you? Your initial benefits would give you less credit for your early working years than currently promised (wages grow slightly faster than inflation over time). In English, it's a wage reduction. But it's a very reasonable reduction. About as reasonable as it gets.

Medicare
Medicare is a far uglier story.

Social Security's projected spending growth is the result of an aging population. But nearly all of Medicare's surge is due to explosive health-care costs:



There are dozens of reasons why curtailing these runaway costs is difficult. Longevity. Sue-happy patients. Better technology. But if you really want to nail it down in one sentence, I'd offer this: With Medicare spending -- a price-setter as major chunk of the overall health-care market -- we've pointlessly bedeviled the word "rationing."

That the word "rationing" became as feared as the word "communism" (death panels!) during the health-care-reform circus last year shows how deep a hole of denial we're in. Rationing comes from the Latin word for "reason," and it's easy to see how the absence of the former precludes the latter.

When you pay for medical care out of pocket, you ration. You weigh the costs against the benefits. Then you decide what's worth it, and what isn't. When private health insurers foot the bill, they ration. Procedures with little evidence of effectiveness are declined.

Medicare is different. It doesn't ration enough. All too often it simply pays for whatever is asked of it. *What procedure do you want that has little evidence of working or preventing illness? Because we'll pay for it.* This is music to **Pfizer**'s (NYSE: PFE) and **Medtronic**'s (NYSE: MDT) ears, but it bleeds taxpayers dry and does a number to ensure medical costs spiral higher. Former Comptroller General David Walker once discussed what makes Canada's public health-care system more viable than Medicare. "Canada doesn't give blank checks for their medical programs," he said. "No other countries do, in fact. Only us. Canada uses evidence-based medicine, without paying for heroic procedures that don't work."

As my colleague Seth Jayson put it, "It's not the death panel you need to fear, but the 'everything-if-that's-what-you-want' panel that already exists in government." He continued: "The solution is rationing. It has always been rationing. That's what the private insurers do already, and it's what any public insurer will have to do. Everyone can't have everything. It's that simple."

David Leonhardt of *The New York Times* has detailed Medicare's whatever-you-want culture better than anyone. He recently profiled a $50,000 Medicare-covered prostate cancer treatment that has no evidence of being more effective than a less-complicated $10,000 treatment, among several other examples. "Genentech has not shown that its expensive vision-loss drug is better than a cheaper alternative," Leonhardt says, "but taxpayers still pay the bill." Seth has profiled other instances of the government's we'll-pay-for-it-even-if-it-doesn't-work mentality.

Leonhardt offered a solution to this waste: Give new treatments a set period of time, say three to five years, to prove their effectiveness over alternatives. If no evidence arises, Medicare would stop paying beyond the cost of proven alternatives -- even when that means halting funding altogether for some issues. "The blank checks would not go on forever," Leonhardt says.

This is what private markets already do. They ration. Medicare needs to do more of the same. It's getting the market to work better than it does now. And it's part of how we'll get Medicare costs under control.

I don't pretend any of this will be easy. But I'm absolutely certain it's necessary. If not, there's an instructive path for where we're headed: Greece.

Check back every Tuesday and Friday for Morgan Housel's columns on finance and economics.

Previous Page