

## OPINION

## A Better Strategy for Faster Growth

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Washington has become a city of tactics, obsessed with finger pointing, fear mongering and political spin. These maneuvers—designed for temporary political or personal gain—have produced incoherent policies and left the nation's pressing problems unaddressed.

The country needs a long-term strategy to achieve its common goals of personal freedom, noninflationary prosperity, broad-based economic

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opportunity and mobility, and national security. With a good strategy as a foundation, sound economic policies will follow.

A good strategy must be based on principles of the free-enterprise system in which individuals are allowed to pursue their aspirations with government's role limited to protecting property rights, setting predictable and transparent marketplace rules, and providing a safety net, infrastructure, defense and other functions if the market falls short. Many current government policies are going well beyond such limits, as shown by excessive spending and taxes, growing debt, interventionist monetary policy, and burdensome regulations that have slowed economic growth and job creation.

The obvious place to begin applying strategic thinking is to the budget—the primary vehicle for setting priorities. Yet, in recent years, the budget process has completely broken down, replaced by disorderly management by crisis. This year the president has thus far failed to produce a budget.

We need to go back to an old-fashioned regular budget order. The president needs to submit a budget that contains a strategic plan and brings the budget into balance. The House and Senate then need to pass a budget resolution that sets spending in line with revenues. The congressional committees responsible for

appropriations and entitlements must then produce legislation required to achieve the budget plan, bill by bill.

Appropriations legislation should focus on the coming fiscal year and the next, not on 10-year multitrillion-dollar totals that the current Congress can't control and the public can't understand. Annual appropriations should concentrate on supporting the basic role of the federal government, leaving major support for infrastructure and education to the states. Recent promising actions by local governments to allow more choice in K-12 education should be encouraged. The defense budget must be based on a national-security strategy, not on across-the-board cuts, ad hoc formulas that simply target defense spending as a share of GDP, or continuing resolutions that put national security at risk.

Entitlement legislation should focus on humanely controlling the growth of Social Security, Medicare and Medicaid, thereby saving them from destruction. Currently, each of these programs is projected to grow much faster than national income and the revenue to fund them, and their unfunded liabilities are several times greater than the national debt.

Medicaid's growing costs, as the Ravitch-Volcker Task Force Report recently noted, have severely impaired the ability to finance essential state government functions. A sensible reform strategy enacted now would therefore help the economy grow, raise living standards, improve government services, and avoid abrupt and unpredictable changes that harm individuals and the economy.

The key to reform is recognition that real inflation-adjusted payments per recipient in these programs are projected to rise sharply. While life spans are increasing and the baby-boom generation is retiring, the main problem is this rapid growth of payments per beneficiary.

In the case of Social Security, a typical 25-year-old worker today will get a monthly benefit 50% higher after adjusting for inflation than the amount paid to today's typical retiree. To solve this problem, the indexing formula originally adopted in 1977 should be modified for future retirees so their inflation-adjusted benefits are the same as those received by today's retirees. It is absurd to claim that slowing the growth of benefits for those retiring in the distant future is somehow a cut.



For Medicare and Medicaid, the reform goal must be to reduce their immense cost growth in a humane way. The explosive trends are mainly due to improper incentives created by poor government policies. The federal government's attempts to impose price controls on hospitals, doctors and other health-care providers makes the problem worse. Price controls cause the supply of health-care providers to shrink, as these controls have done in every other market in which they have been imposed. The declining supply amid rising demand produces shortages and reduced access to health care.

Medicare and Medicaid reforms should be part of a larger effort to improve the private health-care system. The best strategy is to allow consumers to have more skin in the game, provide high-quality, readily accessible information, and permit competition among health plans and insurers.

Introducing more copayments that reflect some of the opportunity costs of health-care resources will provide the proper incentives and moderate demand. More-informed decision making will lead to lower insurance premiums and thus more disposable income for Medicare recipients, and higher wages for workers with employer-sponsored health plans.

Government can play an important role in making accurate information more widely available, both by funding its dissemination and by protecting health-care institutions

and individuals who provide it. If they are to be wise and effective consumers of health care, people need to know what works and what doesn't, who works best and who doesn't, and what prices will be.

The federal government can encourage competition in a number of ways: by making out-of-pocket health-care spending tax deductible and thereby in line with the tax treatment of health-insurance premiums; by providing insurance subsidies through which people can shop among alternative insurance programs; by expanding the availability of health savings accounts; and by permitting individuals to purchase health insurance in other states. Insurance companies and health-care provider groups long ago "captured" state legislatures and insurance regulators, creating anti-competitive barriers to entry and thousands of state mandates to provide insurance coverage and procedures.

The ideal strategy for Medicaid reform would allow states flexibility in designing and administering their programs in exchange for a level of federal funding that grows in line with population plus inflation. The federal government should take immediate steps to allow states greater discretion to reform their programs to curtail costs and maintain coverage.

Sound entitlement reform will have other beneficial effects. The work disincentives now built into our large and growing federal transfer programs impede economic growth.

These work disincentives affect all recipients: younger workers, senior citizens, healthy workers and those with disabilities. Social Security, for example, contains significant disincentives for older people to work. To reduce these disincentives, the government could introduce a "paid-up" concept so that a person continuing to work after his or her retirement age would not be subject to either employer or employee payroll taxes.

Franklin Roosevelt rightly called welfare a "subtle destroyer of the American spirit." In 2011, the latest year in which data are available, 38 million working-age households (i.e., with no member age 65 and older), representing 42% of working-age households, received benefits from at least one federal welfare-entitlement program. Among these 38 million households, the average effective tax rate on additional earnings—a rate that includes the loss of welfare benefits as earnings increase—ranges from 36% to over 50% depending on whether or not the additional income causes a family to lose Medicaid eligibility.

By discouraging work and human capital investments, these high effective tax rates on such a large segment of the American working-age population harm economic growth and reduce employment. Thus, a broad reform strategy should include a complete overhaul of the entitlement system, with reduced work disincentives and improved targeting on persons who are unable to help themselves.

At the end of World War II, strategic economic thinking enabled the United States to lead the world by encouraging free enterprise and promoting a rules-based system for trade and finance. The result was an unprecedented period of prosperity, which by the 1980s had spread across the globe, dramatically improving living standards.

Strategic thinking today will produce policies that bolster economic growth, employment and American geopolitical leadership. As other countries again emulate our economic and political system, their prosperity will be to our mutual benefit.

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