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Promises to Keep and Deficits Before We Sleep

By John C. Goodman

THE most important domestic policy crisis this country faces was not discussed by either candidate in the 2008 presidential election. On the Democratic side, that is understandable. Democrats, after all, bear disproportionate responsibility for creating the problem. But the silence on the Republican side is puzzling, especially since any solution must involve individual empowerment, personal choice, and free-market incentives--core values of the GOP.

The problem: We have promises we are not going to be able to keep. The problem starts with the baby boomers, but it doesn't end with them. This year the boomers are signing up for early retirement under Social Security. In three years they will begin enrolling in Medicare. By the time they are through, 78 million of them will quit working, quit paying payroll taxes, quit contributing to retirement programs--and start drawing benefits instead.

Unfortunately, we're not ready for them.

Social Security is not ready. Nor is Medicare. Nor Medicaid. By "not ready," I mean we have made extensive explicit and implicit promises to this group, but we have put no funds aside to keep those promises. Worse, many of the baby boomers are in employer-based pension funds that are woefully underfunded. Although there is a federal insurance plan for employer pensions, it is seriously underfunded, too. About one-third of all employees work for an employer that has promised post-retirement health-care benefits. But virtually all of these promises are unfunded. And, as automotive workers are starting to find out, an unfunded promise is no promise at all.

State and local governments also have unfunded pension liabilities--\$1.5 trillion worth, at last count, and that was before the market crashed. These entities also have made post-retirement healthcare promises that are almost totally unfunded. We're even beginning to see local governments declare bankruptcy because of these promises--and

no baby boomer has yet reached the age of 65.

To top it off, the baby boomers have made poor investment decisions in managing their 401(k) and IRAs.

Here's the bottom line: We're looking at a huge gap--a yawning chasm--between what this generation is expecting during its retirement years and what has been set aside to make those expectations a reality. I am not aware of any occasion on which the news media have captured the full dimensions of this crisis. But you can find bits and pieces in the newspaper almost every day. And if newspapers and magazines are writing about these problems, it's presumably because their readers want to read about them. So why didn't politicians talk about them during the last election?

One reason might be that the politicians have no idea what to do about the problem. Indeed, almost every healthcare proposal from the Left that I can recall involves making Medicare and Medicaid even larger. That means more promises and greater unfunded liabilities.

On the Right, however, there are many good ideas consistent with small government and individual empowerment. Why not let employers help their early retirees obtain individually owned, personal, portable health insurance at group rates? Why not let employers pay whatever portion of the premium they deem affordable with pretax dollars (just as they do for their active employees)? Why not let the retirees pay their portion of the premium with pretax

dollars? Why not let both employers and employees save pretax dollars in anticipation of these costs?

There. I just produced four ideas that would have a great impact on baby boomers' lives without emptying the treasury. Why isn't somebody running on that platform?

The baby boomers are just the first wave of trouble. The funding problem only gets worse over time. The Social Security trustees, looking indefinitely into the future, tell us we have promised more than \$100 trillion (in present-value terms) in Social Security and Medicare benefits over and above dedicated taxes and premiums. That figure is about seven times the size of our economy. The Congressional Budget Office projects that if health-care spending trends continue, Medicare and Medicaid will crowd out every other federal program by mid-century, when today's college students reach retirement age.

Clearly this is unsustainable. We have made promises we can never keep. But what can we do about it? To answer that question, we must start by considering how we got in this mess in the first place.

There are certain economic issues that modern democracies must deal with if they are to remain viable. Significantly, these core issues have not changed in more than 100 years. They have little to do with inequality, racism, lack of diversity, poverty, or most other pet issues of the Left. The issues arise, rather, from the need to protect the middle class from risks they have

difficulty insuring against on their own. For as long as there have been human societies, people have faced:

- * The risk of growing too old and outliving their assets.
- * The risk of dying young and leaving their dependents with inadequate resources.
- * The risk of becoming disabled and unable to work and produce.
- * The risk of becoming unemployed and finding there is no market for their skills.

In the past, the main way in which people insured against such risks was through families and extended families. But as we moved through the 20th century, people had fewer children, relatives became more widely dispersed, and the family became an unreliable insurance provider. The result: People turned to government.

The new government-based substitutes almost invariably reflected the thinking of the Left. That is, they involved arbitrary redistribution from one person to the next and from one generation to the next. They reliably ignored economic realities-- including the need to head off perverse incentives, the need to save and invest today for tomorrow's benefits, and the need to allow individuals, to the greatest extent possible, to reap the rewards of their good decisions and bear the costs of bad ones.

Today there is recognition all over the world that we cannot continue with the government insurance schemes we have

created. So the political challenge is to replace political institutions that don't work with private institutions that do. More than 30 countries have completely or partially privatized their pension systems. Chile has a disability system that provides roughly the same benefits as the U.S. system at half the cost, and at one-third the cost of a typical European system. Chile has also developed a partially privatized unemployment-insurance system that should be the envy of the world.

Much less progress has been made on the health-care front, other than a growing realization that private-sector competition, choice, and markets will be central to any workable reform.

In the United States, President Bush led an unsuccessful attempt to reform Social Security. But we don't have to solve the biggest problem first. At the National Center for Policy Analysis, I have been involved with four relatively small initiatives that promise to become increasingly important over time:

- * More than 12 million families are now managing some of their own health-care dollars in Health Savings Accounts.
- * More than \$225 billion of retirement savings in Roth IRAs will never be taxed again.
- * Millions of baby-boomer retirees will be able to reach retirement age, receive their Social Security benefits, and keep supplying the economy with badly needed skills and

services--without being penalized.

* Future participation in 401(k)s will increase by one-third due to an NCPA/Brookings Institution proposal for automatic enrollment in diversified portfolios--producing higher and safer returns.

Each of these policy changes occurred on the Republican watch. Two of them were in the Contract with America. These are what Karl Rove calls "kitchen table" issues, in that they affect the lives of ordinary voters. A savvy Republican party would have campaigned by saying: "Here are four things we have done

so far; reelect us and we will do ten more things just like them." Yet how many Republican candidates said anything close to

that?

One would think that these were the types of reform most easily championed by the parties of the Right. However, in the last several decades, a number of left-of-center governments have taken power around the world and continued the process of privatization and deregulation that right-of-center governments initiated before them.

Republicans had an opportunity to make real institutional changes. To put it charitably, they blew it. Even when they did the right thing, they didn't bother to take credit for it. But despair not. I predict that if Republicans don't do the right thing, Democrats will eventually do it for them.

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