Domestic Reforms: The Importance of Process

Stanford G. Ross

Three major domestic program areas are in need of basic reform: health care, particularly Medicare and Medicaid; Social Security, both old age pensions and disability; and the general revenues tax system, arguably overreliant on income as opposed to consumption taxation. The topsy-turvy nature of domestic policymaking during the last few years suggests that the underlying political and institutional conditions needed to accomplish orderly reforms simply are not present. It is clear that, if the public interest is to be served, process issues must be taken much more seriously by everyone interested in major domestic program reform.

In the past the scope, timing, and sequencing of health care, Social Security, and tax system reforms have had a lot to do with outcomes. Issues of process are seldom as intriguing to politicians and the media, much less the general public, as are issues of politics. Yet the procedural dimensions of proposed changes and the technical preparation of proposals tend to be critical to their success or failure. For example, basic tax reform would change the parameters for health care and Social Security reform. Policymakers and the public rarely understand or acknowledge the inevitable interactions among program areas and the unanticipated effects that reforming one domestic program area has on another.

The Washington political system today appears incapable of focusing on more than one major reform at a time. It is unlikely that legislators could produce tax, health care, and Social Security reforms simultaneously or even sequentially in one Congress. Part of the problem is the proliferation of interest groups. Part of the problem is the structuring of Congress into separate committees and subcommittees with limited jurisdiction. And part of the problem is simply the need for leaders to mobilize grassroots support in order to garner political support within Congress. Further, with politicians in a constant campaign mode, the tendency is to shift rapidly from issue to issue as public moods shift.

History illustrates the generally long, rocky road to tax, health care, and Social Security reforms. The ability to achieve fundamental tax reform, for example, has only been present on a few occasions. President Kennedy realized a fundamental tax system reform with the revenue acts of 1962 and 1964. But preparation for those changes began in technical studies dating 10 to 15 years before the enactments themselves. Tax reforms during the 1970s, and the 1981 tax act that greatly lowered taxes, together reduced the tax base so much that piecemeal, offsetting changes were enacted in 1982, 1983, and 1984 and, ultimately in the fundamental tax reforms of 1986. Yet the 1986 reform had a long preparation process and drew heavily on the same currents as the 1962–1964 reforms.

Since 1986 the broad-based, low-rate tax model has been seriously eroded as exceptions to the base have been incorporated and rates increased. Many view the 1986 tax reform as a
promising platform for further broadening the base and lowering rates. Indeed, this could be one of the major reform proposals taken up by the president and the 105th Congress in 1997. Yet the amount of time, preparation, and persistence that would be required to undertake even this kind of restorative initiative—which would involve incremental rather than dramatic reform—should not be underestimated. Such efforts could well occupy the first two years of a presidential term.

Health system reform has been a singularly unsuccessful venture for several administrations, starting with that of President Truman. President Carter also had a negative experience, and President Clinton and the Democrats paid dearly in the 1994 elections for their attempt at basic reform. The largest health system change—the introduction of Medicare and the allied changes in Medicaid that took place in the mid-1960s under President Johnson—represented a relatively unique occurrence. These reforms were attributable in part to Lyndon Johnson’s unusual talents with respect to domestic politics, and in part to an overwhelming Democratic majority in Congress that could enact these measures with a modicum of bipartisan support.

Incremental health care reforms also have been difficult to achieve. The changes to Medicare in the 1980s resulted from continuing pressures to attempt to restrain Medicare spending, and largely involved curtailing payments to providers. Even these incremental reforms had pernicious effects by leading to the widespread cost shifting that destabilized various private arrangements and increased the number of uninsured and underinsured. Moreover, the hike in payroll taxes initiated in the 1980s has raised beneficiaries’ expectations for Medicare benefits at a time when the overall program is in dire financial straits and requires fundamental change.

The Medicare Trust Fund is expected to be exhausted by about 2001, thus is likely to be a major problem for policymakers. Yet Medicare’s most pressing problems are likely to come in about 15 years, beginning around 2010, when the baby boom generation starts to retire. A two-step process needs to be put in place as rapidly as possible involving, first, incremental changes that will preserve the program over the next 15 years and, second, an institutionalized reform process to initiate the fundamental changes that will be necessary by 2010 and beyond.

President Bush’s belated attempt at incremental health care reform got lost in the election year of 1992. The Health Insurance Portability and Accountability Act of 1996 represents an extraordinary expenditure of political effort for modest changes that do not address the basic issues of affordability or access to coverage for the uninsured. Most importantly, the whole area of health care reform, including the interactions between government and private programs, is little understood by the public. As a consequence, any successful initiative will require massive efforts at public education.

Social Security reform has been successful when the changes were fundamental, as they were in 1972, 1977, and 1983. Government created the program in 1935, indexed the system to inflation beginning in 1972, and replenished the trust funds and took the steps needed to create a large reserve in 1977 and 1983. Social Security also grew successfully by incremental changes between 1950 and 1972. The issue is whether changes will now be incremental or fundamental. The Clinton-appointed Advisory Council on Social Security has developed three Social Security reform plans, two of which would radically change the system by introducing an individual account element, while one embraces a more traditional, incremental set of reforms.

**A Balancing Act**

Reforming any one of the big three domestic program areas will undoubtedly affect reform of the other areas. It seems entirely possible, for instance, that fundamentally reforming Medicare would not only absorb whatever payroll tax increases are possible, but would also soak up some of the reserves or payroll tax revenue now underlying the Social Security system. Such a scenario would require Social Security reforms to take into account the fewer resources available to that system.

As we contemplate the crisis in Medicare, it is clear that the possibilities for change depend on the results in the other two major areas of domestic reform. It is unlikely that Social Security reform will be taken up before Medicare, if only because the Old-Age and Survivors Trust Fund is not projected to be exhausted until about 2030, some 35 years from now. If, however, Social Security were to be reformed first, it is likely that some increase in payroll taxes and reduction of benefits would be needed to restore financial balance to the program in the long run. Yet taking these steps could curtail the possibilities for Medicare reform by reducing the ability to increase payroll taxes to sustain Medicare.

Furthermore, a decline in Social Security benefits as the result of program reforms would constrain the ability to raise the Medicare Part B premium, which gets taken out of the Social Security checks of most recipients. Indeed, long-range projections indicate that the costs of Medicare will increase so rapidly relative to Social Security that the elderly may increasingly receive large in-kind medical benefits with greatly reduced cash pensions (see table). This could give the elderly very limited choices in their way of life. The unfortunate fact is that whether this scenario takes place is more likely to be dictated by the scope and timing of reform efforts than by reasoned decisionmaking.
There could be major advantages to linking reforms in Medicare and Social Security. For example, Medicare reforms requiring larger contributions by beneficiaries through higher deductibles or copayments would present a burden for the lower income elderly. This load could be alleviated by a coordinated Social Security change that would increase the cash benefit for such persons to offset their increased Medicare contributions. This would both improve the efficiency of the Medicare changes and assure the continued level of cash benefits under Social Security.

In regard to tax reform, fundamental changes in the tax laws would dramatically alter the prospects for health care and Social Security reform. For example, a tax reform involving a shift from primary reliance on income taxes to consumption taxes would eliminate the tax deduction for employer health contributions and pensions. The present institutional arrangements in the health care area are very dependent on employer-provided health care coverage, which in turn is highly sensitive to tax treatment. Arrangements for providing health care would change dramatically if this deduction were abolished by a shift to consumption taxes.

Indeed, the entire premise of mandated employer-based health care and governmentally directed arrangements for the unemployed would be a non-starter. A move toward consumption taxes that would erode employers’ incentives to provide health benefits might increase the number of uninsured and decrease reliance on employers. This might well result in policymakers giving more serious consideration to some sort of universal health care program (such as a single-payer system) than they did in the 1993 debate.

In the pension area, employer-provided defined benefit pensions have been declining in recent years but still represent a major institutional arrangement for pension coverage. Yet, as defined contribution arrangements increase through 401(k) plans, IRAs, and similar arrangements, they also are highly dependent on being tax-favored. A shift from income to consumption taxes that eliminated these tax benefits would probably change private pension arrangements and individual saving patterns. Depending on how these patterns changed, Social Security pensions might become even more important. Thus, reform efforts designed to reduce Social Security benefits or to provide an individual account component would have to be analyzed in light of the changing institutional arrangements created by tax reform.

Achieving technically adequate reform plans in the 1990s is far more challenging. There is much less professional expertise in the executive and legislative branches than existed in prior decades. Many experienced staff persons able to supply institutional memory about the programs have left government. Considerable expertise exists outside government but can be difficult to mobilize effectively. Yet attention to developing an effective process for achieving technically adequate reform plans will be indispensable for accomplishing legislative goals.

Political preparation for reform is also more problematic than it was in the 1980s, when a few people met behind closed doors to broker reform plans. Interest groups today are stronger and the political system more fractured and divisive. It will be necessary to expend a good deal of time and effort in educating the public to build the grassroots support needed to create the political will for reform in Washington.

Many would say it is naive to expect an orderly process for domestic reforms during a period in which the political system seems to be breaking down and the body politic seems highly divided. Yet the alternative is even less likely. The kind of legislative deadlock that prevailed during the last four years may not be acceptable to the public. There appears to be momentum building for carrying out domestic reforms. The politicians who best figure out how to master the issues of process may well be those who can make their views on the substance of changes prevail.

### Social Security and Medicare Outgo as a Percentage of Gross Domestic Product, 1996–2070

<table>
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<tr>
<th>Trust Fund</th>
<th>1996</th>
<th>2020</th>
<th>2045</th>
<th>2070</th>
<th>% Increase 1996–2070</th>
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<tr>
<td>Social Security Old-Age and Survivors Insurance</td>
<td>4.08</td>
<td>4.88</td>
<td>5.46</td>
<td>5.70</td>
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<td>Social Security Disability Insurance</td>
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<td>0.86</td>
<td>0.85</td>
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<tr>
<td>Medicare Hospital Insurance</td>
<td>1.71</td>
<td>3.13</td>
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<tr>
<td>Medicare Supplementary Medical Insurance</td>
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<td>3.55</td>
<td>3.79</td>
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<tr>
<td>TOTALS</td>
<td>7.37</td>
<td>11.68</td>
<td>14.39</td>
<td>15.38</td>
<td>109</td>
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