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THE WALL STREET JOURNAL, TUESDAY, MARCH 20, 1984

Salvaging Medicare With an IRA

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Medicare is bankrupt. At the moment, a small surplus exists in Medicare's Hospital Insurance Trust Fund. Yet by any reasonable prediction, that surplus will vanish in a few short years as expenditures quickly outpace tax revenues. The Congressional Budget Office estimates that by 1995, under current conditions, the Health Insurance Trust Fund alone will have a deficit of $200 billion to $400 billion. Fundamental reform of Medicare must be enacted now if we are to avoid the collapse of the system.

The most powerful argument for reform is a simple one: We owe it to our children. In times past, part of the incentive to have children was to be cared for in one's old age, including needed medical care. With the development of the old-age and survivors assistance and Medicare programs, some of the incentive to have children was reduced, since the government—that is, everybody's children—would be paying for upkeep and medical bills during one's retirement years. As the economic benefit of having children declined, the cost of having and educating children rose rapidly. This disincentive to have children contributed to our very low and declining birth rate. Both the old-age and survivors assistance and Medicare programs were and still are based on the assumption that the population would continue to grow rapidly and life expectancies would not increase dramatically—assumptions undermined by the Medicare and Social Security systems themselves.

An Unfair Program

No one knows exactly how many members there will be of yet-unborn generations, or what type of tax burden they will be willing to bear. What we do know is that we are putting today's children at great risk. We have no assurance that when today's children become senior citizens, the working population will be willing or able to relinquish large parts of its income to pay the benefits Medicare has promised.

In addition to safeguarding our children's future, there is another reason why Medicare must be reformed: The program, as now structured, is fundamentally unfair.

Medicare takes billions of dollars out of the pockets of some Americans and pays the medical bills of other Americans. For instance, Medicare taxes the working poor and pays the medical bills of retired millionaires.

As in the case of Social Security, under Medicare there is virtually no relationship between taxes paid into the program and benefits received. A male worker who reaches age 65 today, for example, can expect to receive $23,327 more in benefits than he paid in taxes.

By contrast, today's young workers will never receive anything like the "deal" enjoyed by today's elderly Americans, even if there is no problem collecting taxes from future generations. With no change in the current payroll tax and benefit levels, a white male, age 20, can expect to pay about $8,500 more in taxes than he will receive in benefits. However, under current law, the Medicare payroll tax rate is scheduled to rise from 2.6% to 5.08% by 1995 and real benefit levels are likely to be cut back, thus making the "deal" considerably worse.

Low-income individuals who tend to have below-average life expectancies are discriminated against. More than 14.4% of the population of taxpaying age is nonwhite—as against only 8.6% of Medicare beneficiaries.

When Medicare was first enacted, it was part of the "War on Poverty," and it is still largely viewed as a poverty program. It is not. The average household composed of people 65 years and older has slightly higher after-tax income and considerably more wealth than working-age families. Amazingly, there are 254,000 millionaires in the U.S. who either are covered by Medicare or who can be covered if they so choose.

Because eligibility is based on age, Medicare discriminates against low-income individuals who tend to have below-average life expectancies. This fact is especially true for minorities, who are over-represented among Medicare taxpayers and under-represented among Medicare beneficiaries.

- A black male at birth has a life expectancy of 64.8 years. Although he will pay Medicare taxes throughout his entire working life, he can expect to die two months before he becomes eligible for benefits.
- Currently, more than 14.4% of the population of taxpaying age is nonwhite. Yet only 8.6% of Medicare beneficiaries are nonwhite.

These facts indicate that appropriate public policy should be to expect the elderly to provide for a larger portion of the growth in their medical expenses rather than increasing the taxes of the less affluent working-age population. However, if the elderly are going to be expected to pay more of their medical-care costs, they should be provided the means by which to increase their savings during their working years.

With the help of former White House staffer Peter Ferrara and former University of Michigan economist Gerald Musgrave, we recently developed a proposal published by the National Center for Policy Analysis to privatize much of Medicare. The central feature of this proposal, the establishment of health-bank individual retirement accounts, was recommended by the congressionally mandated 1982-83 Advisory Council on Social Security for study as the long-term solution to the problem of Medicare.

Under the proposal, workers would continue to pay Medicare taxes to fund the current Medicare program. But they also would be given tax incentives to voluntarily establish health-bank IRA accounts. Funds that build up in these accounts would be available to pay for private health insurance and other medical expenses during retirement years.

Workers would be given a tax credit and/or deductions for their annual contributions to their health-bank IRAs. In effect, IRA contributions would be made with money that otherwise would have gone to Uncle Sam. Even individuals with little or no income would be able to take advantage of the IRA alternative, through an extension of the current system of low-income tax credits. These individuals would be able to direct IRS "refunds" to their health-bank IRA accounts. The health-bank IRA tax-credit deduction would reduce federal tax revenues, depending upon the amount of the allowable deduction and the utilization rate. Hence, the deficit would rise but, at the same time, private saving would increase. This increase in national saving would offset the revenue loss, thus reducing rather than increasing "crowding out."

To allow for an orderly phasing down of present-day levels of Medicare benefits coupled with an equivalent buildup of funds in health-bank IRAs, such a program would be phased in over a period of perhaps as long as 30 years. Special provisions would guarantee insurance against catastrophic illness.

Under the current pay-as-you-go Medicare system, dollars taken from today's workers are immediately spent on today's beneficiaries. Under the health-bank IRA, workers put money into interest-earning assets that grow in value over time. Each new generation of retirees would pay for an increasingly larger share of its own medical bills and thus would be less dependent on the size and charity of the next generation.

More Freedom and Flexibility

Under the health-bank IRA proposal, when elderly individuals purchase health care with their IRA funds, they are spending their own money, rather than the "government's money." The IRA accounts are part of their estates, the remainder of which will be passed on to their heirs. Thus, the elderly will have an incentive to spend their health-care dollars wisely.

The proposed system will also sharply increase worker control and choice over medical coverage. The system would be diverse and flexible, allowing workers to choose the coverage best suited to each of them individually from myriad options in the private marketplace. Workers could choose the mix of institutional coverage and personal financial responsibility they desire. They would also have increased freedom to choose when to retire, with earlier retirement allowed, and no penalties for later retirement.

Finally, the proposal provides a practical means of reaching an important social goal: that individuals can be and should be responsible for providing for their own health care during their retirement. Adherence to this principle is the best way to provide future generations of elderly citizens with the financial security they need. It is the best way to ensure that elderly citizens retain their dignity and self-esteem. And, it accomplishes these objectives in a manner that is consistent with the spirit of a free society.

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