1-1-2012

A Buffett Rule for Social Security and Medicare: Phasing Out Benefits for High Income Retirees

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A BUFFETT RULE FOR SOCIAL SECURITY AND MEDICARE: PHASING OUT BENEFITS FOR HIGH INCOME RETIREES

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I. INTRODUCTION

A. Three Deficit and Debt Proposals

The concern with the federal budget deficits[1] and the growing federal debt[2] has brought forth three principal proposals: (1) the December 2010 proposal by the bipartisan National Commission on Fiscal Responsibility and Reform (the Deficit Commission Proposal);[3] (2) the April 2011 Fiscal Year 2012 Budget Resolution, *The Path to Prosperity*, advanced by Congressman Paul Ryan, the Republican chairman of the House Committee on the Budget (the Ryan Proposal);[4] and (3) the proposal of President Obama set out in a speech he gave at George Washington University on

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* I would like to thank the following for their helpful comments on this paper: the faculty members at the Penn State Dickinson School of Law who participated in a forum on the paper; Professor Richard Kaplan of the University of Illinois College of Law, an expert in income tax and elder law; Professor Joel Handler of the UCLA School of Law; and my research assistants at the Penn State Dickinson School of Law: Stephen Anderson, Marc Boiron, Grace Hahn, Jake Mattinson, and Becky Sue Thompson. Also, during the development of this paper, I benefited from discussions I had with Professor Kaplan and Professor Preston Green of the Penn State Dickinson School of Law. The ideas discussed and any mistakes are, of course, my own.

1 Budget deficits are the annual differences between revenues collected and expenditures made by the federal government. CONG. BUDGET OFFICE, GLOSSARY 6 (2012), *available at* http://www.cbo.gov/sites/default/files/cbofiles/attachments/glossary.pdf.

2 Debt is the aggregate federal government debt held by the public, including foreigners. *Id.*

3 NAT'L COMM'N ON FISCAL RESPONSIBILITY & REFORM, THE MOMENT OF TRUTH: REPORT OF THE NATIONAL COMMISSION ON FISCAL RESPONSIBILITY (2010) [hereinafter DEFICIT COMM'N PROPOSAL], *available at* http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf. The Commission, which was appointed by President Obama, was chaired by former Republican Senator Alan Simpson of Wyoming and Democrat Erskine Bowles, the former Chief of Staff to President Clinton. *About the National Commission on Fiscal Responsibility and Reform*, FISCALCOMMISSION.GOV, http://www.fiscalcommission.gov/about (last visited Apr. 17, 2012); *Commission Members*, FISCALCOMMISSION.GOV, http://www.fiscalcommission.gov/members (last visited Apr. 17, 2012).

4 PAUL RYAN, HOUSE COMM. ON THE BUDGET, 112TH CONG., THE PATH TO PROSPERITY: RESTORING AMERICA'S PROMISE (2011) [hereinafter RYAN PROPOSAL], *available at* http://budget.house.gov/UploadedFiles/PathToProsperityFY2012.pdf.

April 13, 2011 (the Obama Proposal).[5] These proposals are sometimes referred to here as "the Three Proposals."

B. Introduction to the Proposal Here for "Phasing-Out" Social Security and Medicare

As discussed below, the three main reasons for the long-term problem with budget deficits and debt are (1) Social Security, (2) Medicare, and (3) Medicaid. In this Article, I set forth a proposal for reforming Social Security and Medicare that none of the Three Proposals address: a "phase-out" of benefits. Under the phase-out proposed here, retirees with high incomes would (1) pay a portion (and in some cases, all) of the cost of Medicare insurance and (2) receive a reduced (and in some cases, no) Social Security payment. Thus, the impact this proposal has on Social Security and Medicare benefits is similar to the impact on the federal income tax of President Obama's "Buffett Rule" and my article, *Beyond the "Buffett Rule": Making the Income Tax More Progressive*.[6]

The phase-out reforms proposed here are not even discussed in the Congressional Budget Office's March 2011 publication *Reducing the Deficit: Spending and Revenue Options*.[7] However, a March 2011 study on the means-testing of Social Security by the Center for Economic and Policy Research reports that "[m]ore than 90 percent of [Social Security] benefits go to individuals with non-Social Security incomes of less than $50,000 a year."[8] As indicated below, the phase-outs proposed here would begin at approximately $50,000 of non-Social Security income and, therefore, could be expected to result in savings of less than 10% of Social Security payments.[9]

These reforms are consistent with the fundamental safety net principles underlying Medicare and Social Security, and if adopted, these proposals

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[5] Barack Obama, President of the United States, Remarks by the President on Fiscal Policy at George Washington University (Apr. 13, 2011) [hereinafter Obama Proposal], *available at* http://www.whitehouse.gov/the-press-office/2011/04/13/remarks-president-fiscal-policy.

[6] Under President Obama's Buffett Rule, millionaires would be subject to higher taxes. *See* Samuel C. Thompson, Jr., *Beyond the "Buffett Rule": Making the Income Tax More Progressive*, 133 TAX NOTES 705 (2011).

[7] *See* CONG. BUDGET OFFICE, REDUCING THE DEFICIT: SPENDING AND REVENUE OPTIONS (2011), *available at* http://www.cbo.gov/ftpdocs/120xx/doc12085/03-10-ReducingTheDeficit.pdf. This document contains several proposals for reforming, *inter alia*, Social Security, Medicare, and Medicaid, but none of the proposals deal with a phase-out for Social Security or Medicare. *See id.*

[8] DEAN BAKER & HYE JIN RHO, CTR. FOR ECON. & POLICY RESEARCH, THE POTENTIAL SAVINGS TO SOCIAL SECURITY FROM MEANS TESTING (2011), *available at* http://www.cepr.net/documents/publications/ss-2011-03.pdf.

[9] *See* discussion *infra* Part VI.

would be a positive step in putting Medicare and Social Security on a sustainable fiscal basis.

Before elaborating on these proposed reforms, Part II briefly discusses background information on deficits and debt and the harm they may cause to the economy. This Article next briefly outlines how the issues with Social Security and Medicare are addressed in the Deficit Commission Proposal (Part III), the Ryan Proposal (Part IV), and the Obama Proposal (Part V). This Article then (1) discusses the phase-out proposal for Social Security and Medicare (Part VI); (2) briefly touches on the political problem raised by this proposal (Part VII); (3) briefly addresses the economic argument that marginal tax increases (which these proposals arguably implement) have harmful incentive effects (Part VIII); and (4) provides a conclusion (Part IX).[10]

A July 20, 2011 op-ed by this author appearing in the *Christian Science Monitor* discusses these proposals and is based on a prior draft of this Article.[11] The op-ed generated several comments, some of which are addressed below.

II. BACKGROUND INFORMATION ON THE PROBLEM WITH DEFICITS AND DEBT

A. The CBO's Projections of Deficits and Debt

In its January 2011 *Budget and Economic Outlook*, the bipartisan Congressional Budget Office (CBO) paints the following picture of the annual budget deficits the country faces and the impact of these deficits on the nation's outstanding debt for the ten-year projection period, 2011–2021:

> The amount of federal debt held by the public has varied markedly over the past few decades. After reaching nearly 50 percent of GDP in 1993, it dropped to 33 percent in 2001 as a result of several years of declining budget deficits and then surpluses . . . .
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> . . . [I]n the three years between 2008 and 2010, . . . debt held by the

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[10] This Article does not discuss potential changes in the structure of the tax system applicable to Social Security and Medicare, except to briefly mention in Part VIII this author's position on Paul Krugman's proposal to increase tax rates rather than to means test Medicare. The phase-out proposals set out here should be adopted without regard to potential changes in the tax structures supporting these programs.

[11] Sam Thompson, Op-Ed., *Why US Should Not Pay Warren Buffet's Social Security and Medicare*, CHRISTIAN SCI. MONITOR, July 20, 2011, *available at* http://www.csmonitor.com/Commentary/Opinion/2011/0720/Why-US-should-not-pay-Warren-Buffet-s-Social-Security-and-Medicare.

> public as a percentage of GDP [rose] from 36 percent at the end of 2007 to 62 percent at the end of 2010. Under [certain assumptions], . . . debt held by the public is projected to rise to 69 percent of GDP this year and 77 percent of GDP by 2021 . . . . That amount of debt relative to GDP would be the highest recorded since 1950.[12]

The CBO gives the following explanation of the likely explosion in deficits and debt that could occur beyond the ten-year projection period:

> Beyond the 10-year projection period, further increases in federal debt relative to the nation's output almost certainly lie ahead if current policies remain in place. The aging of the population and rising costs for health care will push federal spending as a percentage of GDP well above that in recent decades. . . . If revenues stay close to their average share of GDP for the past 40 years, that rise in spending will lead to rapidly growing budget deficits and surging federal debt.[13]

The CBO elaborates as follows on the impact of Social Security, Medicare, and Medicaid on the deficit:

> CBO estimates that Social Security, Medicare, Medicaid, and other health programs will account for nearly 70 percent of mandatory spending (excluding offsetting receipts) in 2011. In the absence of any changes in law, outlays for those programs will exceed 80 percent of mandatory spending by 2021. Spending for those programs will equal 10.6 percent of GDP in 2011 but will grow to 12.7 percent by 2021.[14]

The May 13, 2011 report of the Social Security and Medicare Boards of Trustees highlighted the importance of addressing Social Security and Medicare.[15] The report found that (1) "in 2036, one year earlier than was projected in last year's report, the Social Security Trust Fund will exhaust its assets and incoming revenues will be insufficient to maintain payment of full benefits," and (2) the "Medicare's Hospital Insurance Trust Fund will

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[12] CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2011 TO 2021 19 (2011) [hereinafter BUDGET AND ECONOMIC OUTLOOK], *available at* http://www.cbo.gov/ftpdocs/120xx/doc12039/01-26_FY2011Outlook.pdf.

[13] *Id.* at 25.

[14] *Id.* at 60.

[15] BD. OF TRS., FED. OLD-AGE & SURVIVORS INS. & FED. DISABILITY INS. TRUST FUNDS, THE 2011 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS, H.R. DOC. NO. 112-23, at 1 (2011), *available at* http://www.ssa.gov/oact/tr/2011/tr2011.pdf; *see* SOC. SEC. & MEDICARE BDS. OF TRS., A SUMMARY OF THE 2011 ANNUAL REPORTS (2011), *available at* http://www.ssa.gov/oact/TRSUM/index.html.

exhaust its assets in 2024, five years earlier than was projected in last year's report."[16]

B. Assessment of the Impact of Deficits and Debt on Economic Growth

In evaluating the impact of deficits and debt on the economy, the CBO first points out that "deficits during or shortly after a recession generally hasten economic recovery . . . ."[17] The CBO then discusses several reasons, "[s]ome of [which] would arise gradually,"[18] why we should be concerned with rising deficits and debt. The gradual consequences include potential harms from "crowding out" private investment and higher marginal tax rates.[19] In addition to these potential gradual consequences, the CBO points out that there is also concern that "a growing federal debt . . . would increase the probability of a sudden fiscal crisis . . . ."[20] However, the CBO goes on to explain that "because interest rates on Treasury securities are unusually low today, such a crisis does not appear imminent in the United States."[21]

Although this evaluation by the CBO does not necessarily mean that our projected deficits and debt will ruin our economy, it is commonly accepted that they may have an adverse effect on our economy if they are not addressed. For example, similar risks were discussed by (1) President Obama in his April 2011 Budget Speech,[22] (2) the Deficit Commission,[23] and (3) Congressman Ryan in his Proposal, which was even more apocalyptic in its projection.[24]

C. Standard & Poor's Rating of U.S. Debt

On April 18, 2011, Standard & Poor's affirmed its triple-A rating of U.S. debt, while at the same time stating that its "Outlook [was] Revised to Negative."[25] On August 2, 2011, the Budget Control Act of 2011[26] was

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16 Press Release, Dep't of the Treasury, Remarks by Treasury Sec'y Tim Geithner on the Release of the Social Security and Medicare Trustees Reports (May 13, 2011), *available at* www.treasury.gov/press-center/press-releases/Pages/tg1175.aspx.

17 BUDGET AND ECONOMIC OUTLOOK, *supra* note 12, at 25.

18 *Id.*

19 *Id.*

20 *Id.*

21 *Id.*

22 Obama Proposal, *supra* note 5.

23 DEFICIT COMM'N PROPOSAL, *supra* note 3, at 11.

24 *See* RYAN PROPOSAL, *supra* note 4, at 21.

25 STANDARD & POOR'S, GLOBAL CREDIT PORTAL, UNITED STATES OF AMERICA 'AAA/A-1+' RATING AFFIRMED; OUTLOOK REVISED TO NEGATIVE (2011) [hereinafter S&P APRIL 2011 REPORT].

enacted after a long and public dispute between President Obama and Republican members of Congress regarding raising the U.S. debt ceiling. A failure to raise the debt ceiling would have caused the United States to default on some of its debt and other obligations on or about August 3, 2011.[27] This Act involved the introduction of several complex mechanisms, such as the creation of the Congressional Joint Select Committee on Deficit Reduction (sometimes called the "super committee").[28]

Notwithstanding the enactment of the Budget Control Act, on August 5, 2011, S&P lowered its rating of U.S. bonds, explaining that (1) the "prolonged controversy over raising the statutory debt ceiling and the related fiscal policy debate indicate that further near-term progress containing the growth in public spending, especially on entitlements, or on reaching an agreement on raising revenues is less likely than we previously assumed," and (2) the "fiscal consolidation plan that Congress and the Administration agreed to . . . falls short of the amount that we believe is necessary to stabilize the general government debt burden by the middle of the decade."[29] The April 2011 S&P report makes it clear that the principal contributors to the long-term budgetary issues are Social Security, Medicare, and Medicaid.[30]

The phase-out for Social Security and Medicare proposed here would address, at least in part, S&P's concern that the percentage of federal spending for these programs will "continue increasing as long as these entitlement programs remain as they currently exist."[31]

III. TREATMENT OF MEDICARE AND SOCIAL SECURITY IN THE DEFICIT COMMISSION PROPOSAL

In its chapter on Health Care Savings, the Deficit Commission makes several rather technical recommendations relating to Medicare. The total cost savings would be $298 billion through 2020, which is about 4% of the

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[26] Budget Control Act of 2011, Pub. L. No. 112-25, 125 Stat. 239 (2011).

[27] *See, e.g.*, Jeanne Sahadi & Charles Riley, *Debt Ceiling: What Happens If Congress Doesn't Raise It?*, CNN MONEY, July 22, 2011, http://money.cnn.com/2011/07/21/news/economy/debt_ceiling_consequences/index.htm.

[28] *Times Topics: Joint Select Committee on Deficit Reduction (Deficit "Super Committee")*, N.Y. TIMES, Nov. 21, 2011, http://topics.nytimes.com/top/reference/timestopics/organizations/c/congress/joint_congressional_committee_on_deficit_reduction/index.html.

[29] Press Release, Standard & Poor's, United States of America Long-Term Rating Lowered to 'AA+' Due to Political Risks, Rising Debt Burden; Outlook Negative (Aug. 5, 2011), *available at* http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316529563.

[30] S&P APRIL 2011 REPORT, *supra* note 25, at 5.

[31] *Id.*

$7.6 trillion the CBO estimates will be spent on Medicare during the ten-year forecast period, 2011–2021. None of the changes would seem to have a significant adverse impact on the benefits Medicare recipients receive.

In its chapter on Social Security, the Deficit Commission also proposes several technical changes. Although no costs estimates are included with the proposed changes, Figure 17 to the Deficit Commission Report shows that the "Total Deficit Effect of Social Security Reform" is to increase the deficit by $238 billion over the 2012–2020 forecast period. This increase arises because many of these proposals, including a proposal to make the benefit formula more progressive, would enhance the Social Security payments received by lower-income workers.

The Deficit Commission essentially keeps in place the current structure of Medicare and Social Security. Its changes are on the margins of these programs and do not adversely impact the safety net role these programs provide.

IV. TREATMENT OF MEDICARE AND SOCIAL SECURITY IN THE RYAN PROPOSAL

The Ryan Proposal sets out the following major proposed changes to Medicare, which would partially privatize Medicare:

> For younger workers, when they reach eligibility, Medicare will provide a Medicare payment and a list of guaranteed coverage options from which recipients can choose a plan that best suits their needs. These future Medicare beneficiaries will be able to choose a plan the same way members of Congress do. Medicare will provide additional assistance for lower-income beneficiaries and those with greater health risks.[32]

This proposal is referred to here as the "Ryan Medicare Voucher Proposal," although the Ryan Proposal describes itself as a "premium-support"[33] program. The Ryan Proposal explains that wealthier retirees

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[32] RYAN PROPOSAL, *supra* note 4, at 44.

[33] *Id.* at 46. Henry Aaron, an outstanding public-finance economist, explains why the Ryan Proposal is a voucher system and not a premium-support plan:

> Of late, various sponsors of plans to change the terms of Medicare [including the Ryan Proposal] have applied the term "premium support" to plans that provide vouchers, but lack one or more of the protections that distinguish the two approaches. People are, of course, free to redefine terms: trying to avoid tainted terms is commonplace—people are no longer "fired" but are given "new career opportunities." But it is important that the affective trappings of the term "premium support" not protect the harsher realities of voucher plans from the scrutiny they deserve.

would receive less premium support than low-income retirees.[34] The Ryan Proposal would apply to people who are now fifty-five or under.[35]

It does not seem clear from the Ryan Proposal how much of a reduction in Medicare benefits would result from adoption of the Ryan Medicare Voucher Proposal. However, in addressing this reduction in benefits issue in his budget speech, President Obama asserts:

> [The Ryan Medicare Voucher Proposal] says that 10 years from now, if you're a 65-year-old who's eligible for Medicare, you should have to pay nearly $6,400 more than you would today. It says instead of guaranteed health care, you will get a voucher. And if that voucher isn't worth enough to buy the insurance that's available in the open marketplace, well, tough luck – you're on your own. Put simply, it ends Medicare as we know it.[36]

Also, in an analysis of the Ryan Proposal, the CBO estimates that in 2022, under that Proposal, "a typical 65-year-old would pay 61 percent of the [costs of] benchmark [medical services]."[37] On the other hand, under the current Medicare rules, the CBO estimates that "the typical 65-year-old would pay 27 percent of the benchmark . . . ."[38]

Henry Aaron, *Vouchers or Premium Support: What's in A Name?*, HEALTH AFFAIRS BLOG (Apr. 6, 2011), http://healthaffairs.org/blog/2011/04/06/vouchers-or-premium-support-whats-in-a-name/.

[34] RYAN PROPOSAL, *supra* note 4, at 47.

[35] *Id.*

[36] Obama Proposal, *supra* note 5.

[37] CONG. BUDGET OFFICE, LONG-TERM ANALYSIS OF A BUDGET PROPOSAL BY CHAIRMAN RYAN 23 (2011), *available at* http://cbo.gov/doc.cfm?index=12128.

[38] *Id.* Henry Aaron describes the differences between the present system and the Ryan Proposal as follows:

> It is not surprising . . . that the Congressional Budget Office estimates that [under the Ryan Proposal] the share of health care expenses that a typical elderly beneficiary would have to pay out of pocket would go up in 2030—from 25–30 percent under current law, to 68 percent under the Ryan plan. Since the same adjustment factor would be used for Medicaid, which Ryan would convert into a block grant, it is also not surprising that federal health care spending would be reduced by approximately two-thirds by 2050.

Aaron, *supra* note 33. And a report of the Center for Economic and Policy Research points out that the Ryan Proposal will become much more onerous on beneficiaries as they age:

> According to the CBO analysis, [under the Ryan Proposal] rising health care costs will quickly make a Medicare equivalent plan unaffordable to most beneficiaries. Also, since costs rise as beneficiaries age, a Medicare equivalent plan will become less affordable to the same beneficiary as she gets older. Finally, this plan implies a huge transfer of income from beneficiaries to health care providers and insurers, since the cost of delivering the same quality care will be substantially higher under Representative Ryan's plan than under the existing Medicare system.

Although the Ryan Proposal sets out several general principles regarding the need for Congress and the President to reform Social Security, the Proposal makes no change to Social Security payments over the forecast period.[39] The CBO makes it clear that the Ryan Medicare Voucher Proposal is an attempt to shift a significant portion of the cost of Medicare to the retired.[40] The Ryan Proposal would thus erode the safety net function of Medicare, but not of Social Security.

V. TREATMENT OF MEDICARE AND SOCIAL SECURITY IN THE OBAMA PROPOSAL

First, the President rejects out of hand the Ryan Proposal to move to a voucher system for Medicare.[41] Second, the President proposes cost-savings reforms with Medicare without fundamentally altering the benefits.[42]

Like the Deficit Commission Proposal and the Ryan Proposal, the Obama Proposal acknowledges the long-term problem with Social Security but does not make any concrete proposals for addressing the problem, other than rejecting the privatization of Social Security.[43]

Although the President has acknowledged that changes are needed, he has not proposed specific changes to the current benefit structure of these programs. Thus, he too has "punted the ball down the field" on the entitlement issue. However, in a July 15, 2011 news conference in which he addressed the debt crisis, "President Obama indicated that in an effort to address the long-term problems with Medicare (and presumably Social Security), he would be willing to consider 'means testing' these programs . . . ."[44]

DEAN BAKER & DAVID ROSNICK, CTR. FOR ECON. & POLICY RESEARCH, THE RYAN MEDICARE PLAN: WINNERS AND LOSERS 5 (2011) [hereinafter CEPR ON RYAN PLAN].

[39] *See generally* RYAN PROPOSAL, *supra* note 4.

[40] *See id.* at 23.

[41] Obama Proposal, *supra* note 5.

[42] *Id.*

[43] *Id.* ("[B]oth parties should work together . . . to strengthen Social Security for future generations. But we have to do it without putting at risk current retirees, or the most vulnerable, or people with disabilities; without slashing benefits for future generations; and without subjecting Americans' guaranteed retirement income to the whims of the stock market.").

[44] Thompson, *supra* note 11.

VI. PROPOSALS FOR PHASING-OUT MEDICARE AND SOCIAL SECURITY FOR HIGH INCOME RETIREES

A. Introduction to This "Phase-Out" Proposal

1. Basic Principles

The Three Proposals all acknowledge that, in view of the aging of the American population, there are long-term funding problems with Social Security and Medicare. Although the Ryan Proposal suggests the adoption of a voucher system for Medicare, none of these proposals directly addresses the fundamental problem with entitlements under these programs.

While there is no one solution, it is proposed here that at least a partial solution to the funding problem is to "phase-out" the entitlements under these programs for high-income individuals. This "phase-out" principle can be illustrated by analyzing the treatment of the following two hypothetical retirees, Joe and Sally, who are polar opposites when it comes to assets and income. Under the phase-out proposal here, income is broadly measured and includes income excluded from gross income under the federal income tax, such as interest on state and local bonds and income earned in tax-exempt retirement accounts. It does not include a payout of principal in a retirement account. This income is referred to here as "Broadly Measured Income." Joe and Sally are both retired and have the following assets and income:

> Joe is a seventy-year-old retired bus driver, who has $500,000 in investable assets[45] and $50,000 in annual Broadly Measured Income, including his Social Security. Sally is a seventy-year-old retired executive who has $5 million in investable assets and $250,000 in annual Broadly Measured Income, including her Social Security.

Under the phase-out proposal set out below, Joe would get his full Social Security payment and would be covered under Medicare as he presently is under current law. On the other hand, because of her financial resources, Sally would not receive any Social Security payment and would have to pay 100% of a premium covering the economic costs[46] of her Medicare benefits if she chose to participate in Medicare. As discussed

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[45] Investable assets do not include personal residences and other personal property. They include investments such as stocks and bonds, whether or not held in retirement accounts. CONG. BUDGET OFFICE, GLOSSARY, *supra* note 1, at 7.

[46] The "economic costs" would include the cost of benefits and administrative costs.

below, under the proposal here, (1) the Social Security Benefit would be phased out as individuals move from $75,000 of annual Broadly Measured Income to $175,000 (the Social Security Phase-Out Requirement); and (2) to participate in Medicare, retired persons would be required to pay an increasing portion of the economic costs of a premium for Medicare benefits as they move from $75,000 of annual Broadly Measured Income to $175,000 (the Medicare Premium Payment Requirement).[47]

If Sally's income drops below the $75,000 threshold, she would then be entitled to full participation in Medicare and Social Security. Thus, these programs would be there as safety nets for any individual who is initially not covered but because of, for example, a significant decrease in the fair market value of investable assets, his or her income drops below $75,000.

2. Justification for the Social Security Phase-Out Requirement

The Social Security Phase-Out Requirement is similar to the approach in Canada, which begins to reduce Social Security payments once a retiree's income exceeds approximately $67,000 in Canadian dollars.[48] The Social Security payment is completely eliminated at approximately $150,000 in Canadian dollars.[49] This phase-out feature of the Canadian Social Security system is apparently one of the reasons Canada does not face the same long-term budgetary problems the United States faces.[50]

Sally, the executive, would not suffer a material adverse effect from elimination of the Social Security payment because it is a small percentage of her income and will not have a material impact on her standard of living. In fact, Sally is unlikely to spend the Social Security payment at any time during her life, and the most likely disposition of any Social Security benefit she receives will be to increase her heirs' inheritances. This illustrates that for many high-income retirees, the economic impact of current Social Security benefits is to increase the inheritances their heirs receive. No sensible retirement policy could support such a bizarre economic effect.

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[47] Although the Medicare Premium Payment Requirement is not labeled a phase-out, it has the economic effect of phasing out the Medicare benefit.

[48] *The Repayment of Old Age Security Pension Benefits*, SERV. CAN., http://www.servicecanada.gc.ca/eng/isp/pub/factsheets/oasrepay.shtml (last visited Apr. 17, 2012).

[49] *See id.*

[50] *See* Press Release, Human Res. & Skills Dev. Can., Canada Pension Plan and Old Age Security Benefit Rates Effective January 1, 2011 (Dec. 3, 2010), *available at* http://news.gc.ca/web/article-eng.do?nid=641249 (noting that "Canada's public pensions are fully sustainable for generations to come.").

On the other hand, the Social Security payment received by Joe is a material part of his income, and his living standard likely would be adversely affected in a material way if he did not receive it. Unlike Sally, the executive, Joe is likely to spend his Social Security payment on the current needs of his family. Also, it is likely that Joe's life expectancy will be shorter than Sally's, and as a consequence, under the current system, Joe will get a smaller aggregate benefit from Social Security than Sally. The proposal here would eliminate much of this type of regressivity (i.e., giving the wealthy proportionately more benefits) in the current system.

3. Justification for the Medicare Premium Payment Requirement

Turning to Medicare, why should the federal government provide free Medicare benefits to Sally just because she is older than sixty-five? The money Sally saves as a result of receiving Medicare benefits under the current system will likely not be spent by Sally on her immediate needs; rather, such money likely will go to Sally's heirs in the form of increased inheritances. Thus, like the Social Security benefit Sally receives under the current system, the Medicare benefits Sally currently receives are likely to merely increase the inheritances her heirs receive. In any event, under the Medicare Premium Payment Requirement, Sally could purchase Medicare insurance if she chose to do so; however, she would have to pay the full cost of the premium.

In discussing the purpose of Medicare, the Ryan Proposal explains: "In urging the creation of Medicare, President Kennedy said that such a program was chiefly needed to protect, not the poor, but people who had worked for years and suddenly found all their savings gone because of a costly health problem."[51] The phase-out of benefits under Medicare is certainly consistent with this purpose, and under the proposal here, no person otherwise eligible for Medicare would "suddenly [find] all [of his or her] savings gone because of a costly health problem."[52] As a practical matter, any person who is not initially covered would be entitled to full coverage once his or her investable assets drop below approximately $1 million.

This can be illustrated as follows. Assuming an average 5% return (i.e., income and capital gains) on investments, under the phase-out proposed

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[51] RYAN PROPOSAL, *supra* note 4, at 45 (citing John F. Kennedy, President of the United States, Address at a New York Rally in Support of the President's Program of Medical Care for the Aged (May 20, 1962)).

[52] *Id.*

here, only individuals with more than approximately $1 million in investable assets would have to pay a portion, and in some cases all of the cost of Medicare. For example, assume that a person initially had $4 million in investable assets producing $200,000 in Broadly Measured Income before taking into account any Social Security Benefit. Because this person's Broadly Measured Income exceeds $175,000, he or she would have to pay the full cost of participating in Medicare. Assume further that this person does not purchase Medicare or other insurance and as a result must spend his or her personal resources to address a catastrophic health issue. Once this person's assets have dropped to approximately $1 million, which, under the 5% assumption here, would produce approximately $50,000 in Broadly Measured Income, he or she would qualify for full participation in Medicare without making any payment as long as the Social Security benefit, which is also included in Broadly Measured Income, did not exceed $25,000. This is because Broadly Measured Income includes the $50,000 of earnings on investable assets plus the Social Security benefit, and as long as the total is less than $75,000, there would be no phase-out. Thus, by limiting any such depletion in assets to approximately $1 million, the proposal here addresses the concern expressed by President Kennedy and highlighted in the Ryan Proposal.

B. Proposed Phase-Out of Social Security Benefit

Under the Social Security Phase-Out Requirement proposed here, any person otherwise eligible for Social Security who has greater than $75,000 in annual Broadly Measured Income would receive a ratable declining portion of the Social Security benefit that would otherwise be payable, and if the person's annual Broadly Measured Income exceeds $175,000, no Social Security payment would be made. Thus, as income rises from $75,000 to above $175,000, the Social Security payment would drop from 100% of the applicable payment to zero. Some may argue that this schedule is much too generous, because, for example, an individual with $150,000 in Broadly Measured Income, which is likely to be backed up by approximately $3 million in investable assets (i.e., 5% annual return multiplied by $3 million = $150,000), will be receiving a Social Security payment (albeit a reduced one) from the government.

C. Proposed Phase-Out of Medicare Benefits

Under the Medicare Premium Payment Requirement proposed here, any person otherwise eligible for Medicare who has greater than $75,000 in annual Broadly Measured Income would, if such person wanted to participate in Medicare, have to pay a portion (and if Broadly Measured Income exceeded $175,000, all) of a premium covering the economic costs of the Medicare benefits.

D. Some Technical Issues

In general, the phase-out would be done on the basis of the person's Broadly Measured Income in the prior year, and the Broadly Measured Income would be determined by a schedule that would be filed with the income tax return. Separate phase-out tables would be developed for, *inter alia*, married and unmarried persons in accordance with principles governing the tax rates for such persons in the Internal Revenue Code. The administrators of Social Security and Medicare would be given authority to grant hardship relief in accordance with regulations.

E. Effective Date and Transition

Implementation of this phase-out proposal should be effectuated on a delayed basis so as not to significantly interfere with the reasonable expectations of those planning for retirement. The Ryan Proposal, for changes in Medicare, would only apply to individuals fifty-five and younger,[53] and that may be a good starting point for implementing this proposal. However, for individuals with very high levels of income (e.g., above $250,000), the proposal could be phased in sooner.

F. Budgetary Impact

As indicated, the phase-out of Social Security and Medicare has not been addressed by the CBO or any of the Three Proposals discussed here. However, as discussed above, an analysis by the Center for Economic and Policy Research indicates that with a phase-out like the one proposed here, which effectively begins at approximately $50,000 of non-Social Security income (i.e., $75,000 of Broadly Measured Income including Social Security), the revenue savings would be less than 10% of the overall cost of Social Security.[54]

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[53] RYAN PROPOSAL, *supra* note 4, at 47.

[54] BAKER & RHO, *supra* note 8, at 4.

VII. THE POLITICAL ISSUE: THE LIKELY RESPONSE OF MANY HIGH-INCOME RETIREES AND POLITICIANS TO THE PHASE-OUT

A. Opposition of the Wealthy

Of course, many high-income retirees, like Sally, the retired executive discussed above, will likely argue that because they have paid into Social Security and Medicare, they should be entitled to receive full Social Security and Medicare benefits. The answer is simple: yes, one would be entitled to full Social Security and Medicare benefits if one's income ever drops below $75,000 and partial benefits if one's income is ever between $75,000 and $175,000. But as long as a person's income is higher than $175,000, he or she cannot participate in these programs, which, after all, have a safety net purpose and are not defined contribution plans where one gets back what one puts in.[55]

Further, without these and other changes, the current level of Social Security and Medicare taxes and benefits is unsustainable. As indicated in the S&P report discussed above, the Social Security, Medicare, and Medicaid "entitlements already account for almost half of federal spending . . ., and [the] percentage [will] continue increasing as long as these entitlement programs *remain as they currently exist*."[56]

The arguments against this phase-out proposal by some high-income retirees like Sally and by others who expect to become high-income retirees likely will follow along the lines of the following arguments made by one opponent to my op-ed on this topic in the *Christian Science Monitor*:

> So Sam, what do you say to the person that has worked hard their entire life, maybe at two jobs, that has been paying the max to Social Security, and keeping a healthy lifestyle? Under your proposal, they are penalized for being responsible and hard working [sic], while their neighbor who was lazy, spent wildly and lived an unhealthy lifestyle, gets the same benefits or even more.[57]

This objection is fundamentally flawed for several reasons. First, under the proposal here, many people who have "worked hard" all of their lives and paid the "max" into Social Security will get the maximum benefit under

[55] *See generally* Richard L. Kaplan, *The Top Ten Myths of Social Security*, 3 ELDER L.J. 191, 196 (1995).

[56] S&P APRIL 2011 REPORT, *supra* note 25, at 5 (emphasis added).

[57] Thompson, *supra* note 11, at Big Mama Comment.

Social Security because the phase-out does not begin until a retiree has approximately $1 million in investable assets.

Second, the "lazy neighbors" likely will have paid lower Social Security taxes and will get lower Social Security benefits. In fact, the Social Security benefits paid to the "lazy neighbors" will in many cases not be enough to keep them out of poverty. So, the commenter is dead wrong when she says that "laziness, riotous living is rewarded . . . by the plan."[58]

Third, the people living a "healthy lifestyle" will likely live longer than the people who live an "unhealthy lifestyle" and, consequently, will collect Social Security for a longer period than the people living "unhealthy lifestyles." Because of reduced life expectancy, the Social Security taxes paid by the people living the "unhealthy lifestyles" may be subsidizing the Social Security benefits paid to the people living the "healthy lifestyles."

Fourth, assume that a "hard working" person initially has sufficient investable assets to give rise to a phase-out of some or all of his or her Social Security or Medicare benefits. However, at a later point the investable assets drop below approximately $1 million. In such case, the person would, at such time, be entitled to full Social Security and Medicare benefits. Thus, even for the well-off, the proposal here provides a safety net. For them, it serves an insurance function, which is described as follows by one of the commenters to the op-ed who supported the concept:

> To some extent, Social Security and Medicare are insurance policies. You don't get to collect on your home-owners insurance unless your house burns down. If your house doesn't burn down, your premiums are gone—they cover the home where the smoker fell asleep, the unwatched child tried to make toast . . . .[59]

B. Opposition from Left-Leaning Democrats and Right-Leaning Republicans

The phase-outs proposed here will likely be opposed by left-leaning Democrats and right-leaning Republicans for the same reasons these polar opposite political groups opposed means-testing of the premiums for Medicare Part B, the non-hospitalization benefit.

With respect to the Democratic opposition, Professor Kaplan explains:

> Democrats in the House opposed means-testing Medicare because they thought that such a concept was contrary to the social insurance role that

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[58] *Id.*

[59] *Id.* at SarahC Comment (replying to Big Mama Comment).

> they wanted Medicare to play. . . . House Democrats opposed means-testing Medicare Part B because they were concerned that if Medicare Part B began to take on certain characteristics of a welfare program—*e.g.*, fewer benefits (or higher costs) for persons with greater income—then Medicare might become vulnerable to the sort of attack that federal welfare programs had endured the previous year.[60]

The reasoning behind this opposition by some Democrats seems to me to be the equivalent of a decision to bribe high-income individuals into supporting Medicare. The proposal here does not bribe high-income individuals.

With respect to the Republican opposition, Professor Kaplan explains that "House Republicans believed that calibrating Medicare Part B premiums according to income was a back-door tax on retirees who had worked and invested conscientiously throughout their working lives."[61] High-income individuals are not the only ones who "work and invest conscientiously." The well-off in this country do not have a monopoly on hard work.

Notwithstanding the likely left and right opposition to the phase-out proposal here, if politicians from across the political spectrum are truly concerned with long-term debt, then in the interest of retaining the current benefit structures of Social Security and Medicare for those retired Americans who are in need of them, these debt-concerned politicians should coalesce around this, or a similar, proposal.

Discussions that could lead to this type of coalescence could be on the horizon. For example, an article published by MSNBC in April 2011 states: "Calling Social Security 'broken,' three Republican senators unveiled a plan . . . to overhaul the 75-year old entitlement program by raising the retirement age and *reducing benefits for some wealthier Americans*."[62] Under this proposal, "seniors making over $43,000 a year would have their monthly benefits reduced by $300 to $400 by 2032."[63] It is noteworthy that the means-testing in the senators' plan would (1) begin at a much lower threshold ($43,000) than the threshold for the means-test proposed here

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[60] Richard L. Kaplan, *Means-Testing Medicare: Retiree Pain for Little Governmental Gain*, *in* U. ILL. C. L., PUB. L. & LEGAL THEORY RES. PAPER SERIES, at 32, 34 (No. 06-10, 2006), *available at* http://ssrn.com/abstract=918100.

[61] *Id.*

[62] Doug Adams, *GOP Senators: Raise Retirement Age, 'Means Test' Social Security*, FIRST READ ON MSNBC.COM (Apr. 13, 2011), http://firstread.msnbc.msn.com/_news/2011/04/13/6464594-gop-senators-raise-retirement-age-means-test-social-security (emphasis added).

[63] *Id.*

($75,000), and (2) would only cut back, and not phase-out benefits, which is proposed here.

VIII. THE ECONOMIC ARGUMENT AGAINST MEANS-TESTING: INCREASED MARGINAL TAXES

As explained by Paul Krugman, a recipient of the Nobel Prize for Economics, "means-testing benefits does the same thing"[64] as raising marginal tax rates. Economists argue that an increase in marginal tax rates can act as a disincentive to work.[65] For example, assume that the highest marginal tax rate imposed on a taxpayer making $250,000 of taxable income is 40%. If the tax law is changed to increase the marginal tax rate on income above $250,000 from 40% to 50%, then the taxpayer arguably has less of an incentive to put in the additional work needed to make, for example, an additional $10,000 of taxable income. Before the tax increase, the additional $10,000 of taxable income would be taxed at only 40% leaving $6,000 in after-tax income. After the tax increase, the additional $10,000 of taxable income would be taxed at 50% leaving only $5,000 of after-tax income.

Many economists, particularly conservative economists, argue that this lower after-tax income that results from the higher marginal tax rates is a disincentive for work.[66] This may be so for some taxpayers, but for other taxpayers, the higher tax rate may be an incentive to work even harder. For example, if the taxpayer above decides that he or she needs an additional $6,000 of after-tax income, then with a 50% marginal rate the taxpayer may be incentivized to work to make an additional $12,000 in taxable income (rather than only $10,000) so that after-tax income will rise by $6,000. Thus, higher marginal rates can act as both a disincentive and an incentive to work.

But Warren Buffett, one of the richest men in the world and one of the most outstanding investors, has questioned the incentive effects of marginal rate increases. In an August 14, 2011 article in the *New York Times*, he argues:

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[64] Paul Krugman, *The Conscience of a Liberal: Means-Testing Medicare*, N.Y. TIMES (July 24, 2011, 2:10 P.M.), http://krugman.blogs.nytimes.com/2011/07/24/means-testing-medicare/.

[65] *See generally, e.g.*, JIM SAXTON, JOINT ECON. COMM., JOINT ECONOMIC COMM. REPORT: TAXES AND LONG-TERM ECONOMIC GROWTH (1997), *available at* http://www.docstoc.com/docs/44262045/TAXES-AND-LONG-TERM-ECONOMIC-GROWTH-A-JOINT-ECONOMIC-COMMITTEE-REPORT.

[66] *See, e.g.*, *id.*

> Back in the 1980s and 1990s, tax rates for the rich were far higher, and my percentage rate was in the middle of the pack. According to a theory I sometimes hear, I should have thrown a fit and refused to invest because of the elevated tax rates on capital gains and dividends.
>
> I didn't refuse, nor did others. I have worked with investors for 60 years and I have yet to see anyone—not even when capital gains rates were 39.9 percent in 1976–77—shy away from a sensible investment because of the tax rate on the potential gain. People invest to make money, and potential taxes have never scared them off. And to those who argue that higher rates hurt job creation, I would note that a net of nearly 40 million jobs were added between 1980 and 2000. You know what's happened since then: lower tax rates and far lower job creation.[67]

Without respect to the incentive effects of increasing marginal tax rates, means-testing Social Security and Medicare, which as proposed here, would not begin for ten years, and would have much less of an incentive effect (either by increasing or decreasing work) than an increase in marginal tax rates. This is because of the delay between (1) the time payments are made into the Social Security and Medicare systems, and (2) the time benefits are received. Thus, even though the phase-out proposals here raise marginal rates, the incentive effects should be minimal and could cut in favor of either more or less work.

In any event, for the following reasons, Krugman argues for an increase in the tax rates on high-income taxpayers in lieu of means-testing Medicare:

> So what's the difference between means-testing and just collecting a bit more taxes? The answer is, class warfare—not between the rich and poor, but between the filthy rich and the merely affluent. For a tax rise would get a significant amount of revenue from the very, very rich (because they have so much money), while means-testing would end up imposing the same burden on $400,000 a year working Wall Street stiffs that it imposes on billion-a-year hedge fund managers.
>
> What we need is actual control of health costs. Means-testing of Medicare is just a badly designed, unfair form of taxation.[68]

This class warfare argument against means-testing is more of a political argument than an economic argument and is a variant of the "need for

[67] Warren E. Buffett, Op-Ed., *Stop Coddling the Super-Rich*, N.Y. TIMES, Aug. 14, 2011, http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html.

[68] Krugman, *supra* note 64.

inclusion" argument, discussed above, made by liberal-leaning Democrats. Further, this type of class warfare has not taken place with regard to Canada's phase-out of Social Security benefits.[69] The bottom line here is that Krugman does not explain how it could make economic sense for the government (through the payment of Social Security and Medicare benefits to high-income retirees) to fund the inheritances of the children of these retirees.

Although not the topic of this Article, this author agrees with Krugman's argument that it is sensible to increase the Medicare tax rate for the wealthy. Along these lines, this author has previously argued that the cap on compensation in the Social Security tax should be removed, "so that all wage income becomes subject to the tax."[70]

IX. CONCLUSION

The Deficit Commission Proposal, the Ryan Proposal, and the Obama Proposal do not effectively address the long-term problem with the funding of Social Security and Medicare. As a tool for limiting the costs of these two entitlements and thereby helping to put these programs on a sustainable basis without reducing the effectiveness of their safety net function, Congress should phase-out the benefits under these programs for high-income retirees. Under the phase-outs proposed here:

> (1) the Social Security benefit would be phased out as individuals move from $75,000 of annual Broadly Measured Income to $175,000, and
>
> (2) to participate in Medicare, retired persons would be required to pay an increasing portion of the premium covering the economic costs of Medicare benefits as they move from $75,000 of annual Broadly Measured Income to $175,000.

One final point: I believe the overwhelming majority of Americans agree with me that it is economic folly for the federal government to be providing to Warren Buffet, one of the richest people in the world, Social Security and Medicare benefits. If this is so, then for these Americans, the adoption of a phase-out along the lines proposed here is just a matter of line-drawing. This proposal draws the line at $75,000 for beginning the

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[69] *See generally Retirement Income: OAS and CPP in Canada vs Social Security in US*, FIN. BUFF (Feb. 7, 2011), http://thefinancebuff.com/retirememnt-income-oas-cpp-in-canada-vs-social-security-in-us.html.

[70] Samuel C. Thompson, Jr., *Federal Tax Reform and Reducing the Bush Deficit by $800 Billion*, 110 TAX NOTES 1486 (2006).

phase-outs. Some will argue that this is too high; others will argue that this is too low. Americans need to have an honest discussion of where to draw the line.