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The CLASS Act: Repeal Now, or Face Permanent Taxpayer Bailout Later

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Abstract: *Proponents of Obamacare claim that it will simultaneously provide millions of Americans with health insurance and reduce the budget deficit by hundreds of billions of dollars. Yet Obamacare's proclaimed budgetary discipline rests on unlikely assumptions and budget gimmicks—none worse than the CLASS Act, a national long-term-care insurance program. CLASS is essentially a Ponzi scheme that will run initial surpluses followed by massive deficits—virtually guaranteeing program bankruptcy or, more likely, massive taxpayer bailouts. The surest way to avoid this fate is to repeal the program—preferably before it enrolls participants on January 1, 2011. The Heritage Foundation's Brian Riedl and Visiting Fellow James Capretta explain why repeal is the right action for Congress to take.*

Talking Points

- CLASS, a new national long-term-care insurance program, was added to Obamacare so that CLASS's total $70 billion surplus from 2011 to 2019 would cover up Obamacare's other deficits.
- CLASS is supposed to be self-financing and not cost taxpayers a dime. However, its design virtually guarantees that the program will run large deficits after 2019, and reach bankruptcy shortly thereafter.
- Senate Budget Committee Chairman Kent Conrad (D–ND) has acknowledged CLASS's unsustainability by calling it "a Ponzi scheme of the first order, the kind of thing that Bernie Madoff would have been proud of."
- The surest way to avoid a future of massive, permanent taxpayer bailouts is for Congress to repeal CLASS before it begins enrolling participants on January 1, 2011.

This paper, in its entirety, can be found at: *http://report.heritage.org/bg2441*

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Proponents of the recently enacted health law argue that it will provide millions of Americans with health insurance as it simultaneously eases budgetary pressures with entitlement reform. What they do not mention is that their claims of budgetary discipline depend on a series of implausible assumptions and budget gimmicks—none more egregious than the inclusion of the Community Living Assistance Services and Supports Act (CLASS Act) in the final legislation.

The CLASS Act's stated purpose is to provide a fully funded insurance program for long-term-care (LTC) assistance. The program has no bearing on the other provisions of the new law, which are aimed at expanding and regulating health insurance coverage for acute care. The Obama Administration and Congress chose to attach the CLASS Act to the broader health legislation for one reason only: It made the budget numbers look better on paper.

Budget gimmicks are sometimes relatively benign and inconsequential accounting tricks, but not so in this case. The CLASS Act hitched a ride on the health law to help hide the near-term budgetary costs of a major Medicaid expansion and a new subsidy program for health insurance. But in so doing, Congress created another ticking entitlement time bomb that is certain to explode on future taxpayers if not defused sooner rather than later.

CLASS Act Basics

The CLASS Act is a national insurance program for LTC assistance. Current workers pay premiums, set by the Department of Health and Human Services (HHS), and then qualify for financial assistance, also determined by HHS, should they meet the LTC-assistance criteria. The criteria are based on difficulty in meeting the normal activities of daily living required to remain independent.

CLASS is voluntary. Employers can choose to enroll their workers in the program, and employees can opt out on a worker-by-worker basis. Premiums are paid entirely by those workers who elect to stay in the program.

CLASS is funded on a pay-as-you-go basis. Premium payments from current workers will finance benefit payouts for beneficiaries—mainly disabled and retired former workers—who qualify for assistance.

Insurance experts, including the chief actuary for the Medicare program, who have analyzed the CLASS Act believe it is near certain to suffer from "adverse selection." That is, because it is voluntary and enrollment is likely to be relatively expensive, only workers who already suffer from some conditions that make them high risks for disability will want to sign up. Consequently, premiums are likely to fall short of obligations, forcing administrators to either raise premiums even more or cut promised benefits. This will further discourage healthy workers from participating.

The CLASS Act Double-Count

It is easy to see why Senate Budget Committee Chairman Kent Conrad (D–ND) called CLASS "a Ponzi scheme of the first order, the kind of thing that Bernie Madoff would have been proud of."[1] Common sense says one cannot spend the same dollar twice, but that is exactly what Congress intends to do with premiums collected under CLASS.

The Congressional Budget Office (CBO) projects that CLASS will produce a total $70 billion surplus by 2019.[2] But this surplus is temporary, resulting from a mismatch between CLASS's evolution and the 10-year window used for congressional budget assessments. CLASS's program rules require that participants pay five years' worth of premiums before becoming eligible for payouts, which means that CLASS will begin collecting premiums in 2011, but not pay out benefits until 2016. From that point forward, annual program surpluses will begin declining as CLASS pays benefits to an escalating population of retiring baby boomers. Depending on future premium increases or benefit cuts, a broad range of experts expect the program to fall into permanent deficit at some point in the 2020s or early 2030s.[3]

Once CLASS falls into deficit, the excess premiums collected in the program's initial years of operation would be needed to cover growing benefit obligations. But the Administration and congressional leaders will have already spent that $70 billion initial surplus to partially cover the massive, multi-trillion-dollar costs of their other

1. Lori Montgomery, "Proposed Long-Term Insurance Program Raises Questions," *The Washington Post*, October 27, 2009, at *http://www.washingtonpost.com/wp-dyn/content/article/2009/10/27/AR2009102701417.html* (July 19, 2010).
2. Congressional Budget Office, "H.R. 4872, Reconciliation Act of 2010 (Final Health Care Legislation)," March 20, 2010, at *http://www.cbo.gov/doc.cfm?index=11379* (July 10, 2010). By contrast, the Department of Health and Human Services estimates that the program will run a $38 billion surplus in the first decade. See Department of Health and Human Services, Centers for Medicare & Medicaid Services, "Estimated Financial Effects of the Patient Protection and Affordable Care Act, as Amended," April 22, 2010, p. 2, at *https://www.cms.gov/ActuarialStudies/Downloads/PPACA_2010-04-22.pdf* (July 10, 2010).

health care ambitions.[4] So when the CLASS Act runs short of funding, Congress will have to either tax or borrow an additional $70 billion to compensate for having already spent the CLASS Act funds on another entitlement program.

Budget rules require Congress to pay for only the first decade of new programs. The CLASS Act gimmick was popular because it gave the appearance of paying for two new entitlements. In short, congressional leaders shamelessly decided to take advantage of this mismatch in timing between CLASS Act premiums and payouts. They are using the same $70 billion to pay for expanded health insurance over the next 10 years, and again later to pay for LTC claims. But, of course, common sense has it right: It is not possible to spend the same money twice. What Congress has really done is hide an additional $70 billion in new government debt incurred to pay for future CLASS Act spending by employing a gimmick. Another future liability dumped on our children and grandchildren.

Other Taxpayer Costs

CLASS is supposed to be fully self-financing and therefore not cost taxpayers a dime. This status is notionally guaranteed by language empowering the Secretary of Health and Human Services to adjust premiums and benefits as necessary to keep the program solvent over a 75-year period. Even in the unlikely event that this occurs, future taxpayers will still be forced to subsidize the program. When that initial $70 billion surplus is lent to the Treasury to shore up Obamacare's deficits, it will begin earning interest on those bonds. This interest income can then be counted as program revenues to keep CLASS solvent. And who pays the interest on these government bonds? The taxpayers.

Additionally, even the $70 billion in future taxes that will be necessary to replenish the raided funds will shore up the program's deficits for only a few years. After that, additional bailouts will likely be needed.

CLASS is designed similarly to the Social Security program. Its initial surpluses will be diverted into other government spending. Eventually, the program will fall into deficit and (without accumulated assets, only IOUs) leave future taxpayers on the hook for promises made long ago. Like all Ponzi schemes, the early CLASS participants will get full benefits, while later participants (and, in this case, taxpayers) lose their shirts.

Possible Outcomes

CLASS appears to have been designed more to subsidize the first decade of Obamacare than to provide a sustainable long-term health care program. This poorly crafted program will likely have one of the four following outcomes:

- **Death Spiral Followed by Bankruptcy.** As stated above, the Secretary of Health and Human Services is empowered to adjust premiums as necessary to keep the program solvent for 75 years. However, for healthy individuals, CLASS will likely charge higher premiums and pay lower benefits than what is currently available on the market. As healthy individuals bypass the program, only those who expect to incur substantial long-term costs will find it profitable to participate. Maintaining solvency would then require broad-based premium increases or benefit cuts, which would subsequently drive more of the comparatively healthy participants (and potential participants) out of the program—requiring additional premium increases or benefit cuts for the dwindling number of participants.

3. CLASS's long-term deficits are addressed in: Congressional Budget Office, letter from CBO director Douglas W. Elmendorf to the Honorable George Miller, Chairman of the House Committee on Education and Labor, November 25, 2009, at *http://www.cbo.gov/ftpdocs/107xx/doc10769/CLASS_Additional_Information_Miller_letter.pdf* (July 19, 2010); Department of Health and Human Services, Centers for Medicare & Medicaid Services, "Estimated Financial Effects of the Patient Protection and Affordable Care Act, as Amended," p. 14; and American Academy of Actuaries, "Actuarial Issues and Policy Implications of a Federal Long-Term Care Insurance Program," July 22, 2009, p. 2, at *http://www.actuary.org/pdf/health/class_july09.pdf* (July 19, 2010).
4. Congressional Budget Office, letter from CBO director Douglas W. Elmendorf to Speaker of the House Nancy Pelosi, March 20, 2010, at *http://www.cbo.gov/ftpdocs/113xx/doc11379/AmendReconProp.pdf* (July 19, 2010).

This adverse-selection death spiral would eventually bankrupt the program.

Lawmakers are highly unlikely to allow this outcome. Program bankruptcy would mean that lawmakers created an entitlement, collected premiums, and then failed to provide the promised benefits. This is no more likely to happen than Washington announcing to all retirees turning 65 that they will not receive any Social Security benefits, despite a lifetime of payroll taxes.

- **Compulsory Participation.** CLASS is guaranteed-issue, meaning all workers 18 and older, regardless of health status, are eligible to enroll. Additionally, CLASS is prohibited from charging higher premiums to those with higher health risks (who will likely require more benefits), which also means that healthy individuals who require fewer benefits would not receive a discount. Lawmakers could avoid an adverse-selection death spiral by requiring that all American adults participate in the program. This would ensure that enough healthy individuals pay CLASS premiums to subsidize those who require large benefits.

  This outcome is also unlikely. Healthy individuals rationally intend to bypass CLASS because it is a bad deal for them, especially compared to insurance policies they could purchase on the open market. A compulsory participation law would concede this point, because its purpose would be for Washington to use the net profits from healthy participants to subsidize the chronically sick. Politically, requiring everyone to pay an expensive premium for a benefit that only a few want would be enormously unpopular, not to mention unaffordable for low-income individuals.

- **Taxpayer Bailouts.** With Washington unlikely to accept the two options above, the only way to shore up CLASS and pay all promised benefits would be with another taxpayer bailout. Unlike the Troubled Asset Relief Program (TARP), this would not be a one-time bailout, but would continue as long as anyone who has ever paid into the system may require benefits. Given America's serious long-term budget challenges—trillion-dollar budget deficits and the challenge of paying Social Security and Medicare benefits to 77 million baby boomers[5]—taxpayers cannot afford yet another expensive, permanent bailout.

- **Repeal CLASS.** The only way to avoid program bankruptcy or (more likely) decades of taxpayer bailouts is to repeal the program—preferably before it begins enrolling participants and collecting premiums on January 1, 2011.

  Nonsensically, repealing this budget-busting program would actually violate the Pay-As-You-Go (PAYGO) law. PAYGO is supposed to ensure that, for a given year, the sum of tax and entitlement legislation does not increase the budget deficit over the following decade. Because CLASS would "save" $70 billion over the first decade, it passes the PAYGO fiscal-responsibility test—even if it runs up trillions of dollars in debt after 2020. The flip side is that repealing CLASS would count $70 billion against the PAYGO scorecard—even as it saves trillions of dollars over the long-run.

  CLASS is yet another example of PAYGO's failed approach to deficit reduction.[6] Congress was able to count this unsustainable new entitlement as a deficit-reducer that would hide the rest of the health care law's deficits over the first decade. If the true spirit of PAYGO is to prevent deficit spending, then Congress should set aside the PAYGO law and repeal this debt-ridden entitlement.

Stopping a Mistake Before It Starts

The history of federal entitlement programs provides a cautionary lesson. With a few exceptions, once a federal entitlement is started, it has been extremely difficult to reverse course. Citi-

5. Brian M. Riedl, "Federal Spending by the Numbers 2010," Heritage Foundation *Special Report* No. 78, June 1, 2010, at *http://www.heritage.org/Research/Reports/2010/06/Federal-Spending-by-the-Numbers-2010*.
6. Brian M. Riedl, "PAYGO is an Unworkable Gimmick," Heritage Foundation *Commentary*, July 2, 2009, at *http://www.heritage.org/Research/Commentary/2009/07/PAYGO-is-an-unworkable-gimmick*.

zens who participate in the program become strongly invested in its continuation, and politicians are not eager to be accused of reneging on a government promise.

So even if CLASS is widely seen as structurally unsound in future years, Congress may very well find it difficult to cut off enrollment if a large number of people have already signed up for it and are receiving or expecting to receive its benefits.

Consequently, the most prudent step is for Congress to repeal the CLASS Act before any enrollment has started. Under the terms of the new law, the program could begin accepting enrollments as early as January 2011, but it now seems more likely that the program will not launch until regulations give it more definition, perhaps several months later. Regardless, it would be far preferable to reverse course on CLASS before the program builds momentum toward implementation.

Congress Must Act Now

Proponents of the new health law have claimed repeatedly that it will improve the nation's long-term budget outlook. That is an illusion based on implausible assumptions, sleights of hand, and outright budget gimmicks, with CLASS topping the list. The CLASS Act is an ill-conceived concept that was included in Obamacare only because of the appearance of surplus funding. In reality, CLASS is destined to run short of funds, creating pressure for another massive taxpayer bailout. The biggest threat to the long-term prosperity of the country is the massive unfunded liabilities for the nation's major entitlement program. The last thing Congress should be doing is adding to the burden of future taxpayers, which is why CLASS Act repeal is the most fiscally responsible—and ethical—course to follow.

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