JOINT ECONOMIC COMMITTEE DEMOCRATS

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KEEPING THE SOCIAL SECURITY AND MEDICARE TRUSTEES' REPORTS IN PERSPECTIVE: THE ADMINISTRATION'S TAX AND SPENDING POLICIES ARE THE REAL FISCAL CRISIS

Executive Summary

On March 23rd, the Social Security and Medicare trustees released their annual reports on the status of the Social Security and Medicare Hospital Insurance (HI) programs. These reports, while providing evidence about the financial challenges facing Medicare and Social Security, do not support claims that there is a crisis in either program or that there is a need for radical restructuring.

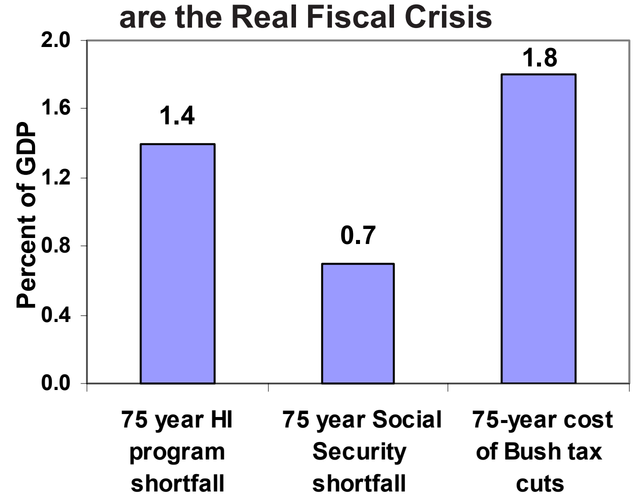
Administration policies have hurt Medicare's near-term financial status. First, the failure to address the prolonged jobs deficit has reduced payroll tax revenues coming into the program. Second, provisions in the new Medicare law that increase payments to private HMOs deplete trust fund resources.

Under the Administration's policies as estimated by the Congressional Budget Office (CBO), every dollar of Social Security and HI surpluses over the next 10 years will be used to meet general fund expenditures rather than reducing the indebtedness of the nation and preparing and investing for the retirement of the baby boom generation. While Republicans may use the latest trustees' reports to claim there is a crisis in Medicare and Social Security, they deceive the American public by ignoring the fact that the revenue loss from permanently extending the tax cuts enacted in 2001 and 2003 is nearly equal to the expected combined shortfall in Medicare and Social Security over the next 75 years, as shown in the chart.

The Administration's tax and spending policies are the real financial crisis and are in need of more immediate attention than the solvency problems of Medicare and Social Security. The squandering of the $5.6 trillion surplus when President Bush took office is reflected in increased interest costs. By 2014, the interest cost of the imbalance in the rest of the budget (not including Social Security) will reach $664 billion. The long-run 75-year present value of those interest costs is approximately $18 trillion, considerably greater than the 75-year imbalance in both Social Security and Medicare.

Chart 1

The Bush Administration's Tax Policies are the Real Fiscal Crisis



Source: 2004 Medicare and Social Security Trustees' Reports. William G. Gale, Peter R. Orszag, "Should the President's Tax Cuts Be Made Permanent?" Tax Notes. March 8, 2004.

Medicare: Bush Policies Reduce Solvency

While not as strong as last year's report, this year's estimate of the period of expected solvency of the Medicare Hospital Insurance (HI) program still ranks high. The HI program can pay full benefits until 2019 when the HI trust fund will be depleted. This is seven years sooner than estimated in the 2003 trustees' report.

In the short term, Medicare funding levels are more than adequate to finance benefits. The trustees estimate that annual revenues for the Medicare Hospital Insurance (HI) program will exceed annual benefit outlays for the next five years. As a result, the HI trust fund surplus is expected to grow from $263.6 billion in 2004 to $283.8 billion in 2009. However, once the first baby boomers reach the Medicare eligibility age of 65 in 2011, demographic pressures will accelerate, and the trust fund will begin to draw down reserves.

The Bush administration's policies have reduced the solvency of the HI trust fund in three ways. First, the new Medicare law has richly subsidized enrollment in private health plans, diverting resources from the core program. Second, the administration's economic policies have prolonged the jobs slump, reducing current payroll tax revenue. Third, the enormous increase in federal debt will reduce future economic growth and thus will reduce future trust fund receipts.

Although demographic challenges and the impact of medical technology create real financial difficulties, evaluation of Medicare's financial health should be kept in proper perspective. Medicare's projected solvency for the next 15 years is high by historical standards. For instance, in 1970 the trustees projected program solvency only until 1972. In 1997, the trustees projected solvency only until 2001. Each time adjustments were needed, however, Congress and the President acted to stabilize the HI program. In fact, when President Bush first took office, the 2001 report projected solvency until 2029.

Over the longer-term, if nothing is done, Medicare obligations will outstrip revenues. Total Medicare spending as a share of GDP is projected to rise from 2.6 percent in 2003 to 13.8 percent in 2078. The projected HI 75-year actuarial deficit is now 1.4 percent of GDP, up from 1.1 percent cited in the 2003 report. Over a 75-year period, the Trustees estimate an $8.2 trillion unfunded obligation in the HI part of Medicare. While there is considerable uncertainty surrounding these projections, the warning from the Public Trustees about the inadequacy of Medicare financing arrangements should be heeded.

Social Security: Financially Sound for Four Decades

The financial status of the Social Security program is little changed from last year. The trustees report projects that Social Security will be able to pay currently scheduled benefits for nearly four decades, until 2042. At that point, Social Security trust fund reserves will be depleted; however, current revenues will still be sufficient to pay about three-quarters of benefits due.

The Social Security trustees report projects three different phases for the financial status of the program. Over the next 14 years, Social Security tax revenues will exceed benefit payments, resulting in a steady increase in trust fund reserves. The current trust fund balance was $1.53 trillion at the beginning of 2004 and is expected to grow to $3.9 trillion (in 2004 dollars) by the end of 2022. Beginning in 2018, benefit payments will exceed tax revenues, but the combination of payroll tax revenues, revenues from income tax payments on Social Security benefits, and interest payments from the Treasury bonds held in the trust fund will be sufficient to pay full benefits through 2027. After 2027, the trust funds will need to redeem Treasury bonds in order to pay full benefits. In 2042, Social Security trust fund reserves will be exhausted. After that, the income from payroll tax revenues and income tax on Social Security benefits will be sufficient to pay only about three-quarters of scheduled benefits.

While the trustees' report demonstrates that Social Security does not face an immediate crisis, it does give a warning that there are problems ahead. Over the next 75 years, the shortfall in Social Security will equal 0.7 percent of GDP. Attending to the long-term Social

Security shortfall now, before it is at hand, will lessen the scope of the necessary changes to maintain long-term solvency.

Beyond the Next 75 years

This year's Medicare report presents estimates of the financial status of the HI programs in perpetuity for the first time. The Social Security report presents similar estimates for the Social Security program. While the Administration argues that a 75-year period is not long enough to provide a complete picture of the program's financial condition, estimates over an infinite horizon are extremely problematic.

- Infinite horizon estimates give far too much weight to conditions 100 or more years from now. Given the uncertainty of budget and health care expenditure projections for the next 10 years, much less for 75, projecting even further into the future fails to provide any useful information. Looking back, it would have been impossible to predict the events that have shaped economic developments over the past century.

- In December 2003, the leading professional organization for actuaries said the following about infinite-horizon projections for Social Security – they "provide little if any useful information about the program's long-range finances and indeed are likely to mislead anyone lacking technical expertise in the demographic, economic and actuarial aspects of the program's finances into believing that the program is in far worse financial condition than is actually indicated".

- It is at best a quaint idea to think of setting health care policies now for 100 years into the future. Most Americans today would scarcely recognize — let alone accept — the health practices of 1904.

- Present value dollar estimates make the long-term problem seem unmanageably large unless they are put into context. For example, over an infinite horizon GDP will total about $850 trillion. A $10 trillion deficit in Social Security over the same period is about 1.2 percent of GDP.

- It is hypocritical that the Administration emphasizes projections over 100 years and more for Social Security and Medicare, yet is unwilling to show budget estimates for even the next 10 years because it believes them to be too unreliable.

Squandered Surplus

When the President was inaugurated in January 2001, the federal government enjoyed large budget surpluses primarily because revenues to Social Security and HI exceeded outlays in those two programs. The future financial challenges facing Medicare and Social Security were well known at that time. The President could have used the surplus to eliminate much of the existing federal debt, easing the financial burden in the future when program costs begin to exceed revenue.

Instead, the Bush Administration chose to pursue risky and demographically blind tax cuts that have added to the future fiscal pressures on the Medicare and Social Security systems. Social Security and HI surpluses have been used to finance these large tax breaks, thus increasing the federal debt and adding to the financial burden that will be passed on to future generations. According to CBO, under Administration proposals, every dollar by which Social Security and HI revenues exceed outlays will be used to finance other expenditures rather than lower existing federal debt. If we avoided large tax cuts and worked to pay down the debt, the future revenue to finance Social Security and HI benefits would increase.

The cost of the squandered surplus can be seen most clearly by examining what has happened to interest payments on federal debt. Current interest payments on the debt, including payments to the Social Security trust funds, were nearly $240 billion in 2003 and will rise to about $660 billion a year by 2014, assuming the 2001 and 2003 tax cuts are made permanent along with necessary reform of the alternative minimum tax.

Long-term Effects of Tax Cuts Exceeds HI and Social Security Funding Imbalances

The long-term demographic challenges facing Medicare and Social Security are not news. Yet, rather than preparing for the future by reducing overall federal debt, the Bush administration has pursued a reckless policy of tax cuts and higher budget deficits. While a temporary increase in the federal budget deficit can be appropriate to provide short-term economic stimulus, persistent long-term deficits—such as those resulting from this Administration's fiscal policies—hurt the economy by reducing national savings and economic growth.

The Medicare and Social Security Trustees estimate the 75-year actuarial shortfalls at 1.4 and 0.7 percent of GDP respectively (Chart 1). Under any circumstances, these are projections that should compel policymakers to address the needs of two vital programs for our nation's seniors. However, the Bush Administration has instead pursued legislation that eroded, rather than improved, solvency. The Administration has also asked Congress to make the 2001 and 2003 tax cuts permanent, which would further deplete the resources necessary to ensure long-term fiscal stability in Medicare and Social Security.

If Congress permanently extends all of the Bush tax cuts and enacts corresponding reforms to the alternative minimum tax, the cumulative total will equal 1.8 percent of GDP over a 75-year period, about the same as the combined Medicare and Social Security imbalances (Chart 1). Various estimates place the total 75-year present value costs of the tax cuts at between $10 and $12 trillion, while the HI and Social Security trust funds are facing an $11.9 trillion deficit over the same period. Even recognizing the variety of priorities existing at the federal level, at least part of this revenue would be available to strengthen Medicare and Social Security. The President has chosen to ignore the funding needs of these programs, while pursuing a shortsighted and risky fiscal agenda.

Short-run Interest Costs of General Fund Expenditures Exceed Long-run Social Security and Medicare HI Imbalances

Yet another way of putting the 75-year imbalance in Social Security and Medicare into proper perspective is to compare the interest cost on debt because general fund expenditures (not including Social Security) have typically exceeded general fund revenues. According to the latest CBO budget projections that include a permanent extension of the 2001 and 2003 tax cuts as proposed by the Administration and reform of the alternative minimum tax, interest costs from the imbalance between on-budget revenues and expenditures will total some $664 billion or 3.7 percent of GDP in 2014. Assuming those interest costs stay constant as a share of GDP, the long-run 75-year present value of those interest costs is approximately $18 trillion, considerably greater than the 75-year imbalance in both Social Security and Medicare. This analysis is conservative and may understate the likely effect, as both long-run budget projections by the General Accounting Office (GAO) and the CBO have interest costs that grow considerably faster than the assumption used in this calculation. The Administration's tax and spending policies are the real financial crisis and are in need of more immediate attention than the solvency problems of Medicare and Social Security.

Choose Responsible Priorities

The Trustees' reports highlight financing issues facing Medicare in the future. The reports again demonstrate that there is no crisis in Social Security, but budgetary pressures will arise in future decades.

Permanently extending the Bush Administration's tax cuts will severely undercut our ability to meet the longer-term challenges facing both of these programs. The truth is that if the Bush Administration addressed itself to the short-run imbalances between general fund revenues and outlays, it would increase economic growth, lower interest costs, and better prepare the nation to meet the needs of an aging population. The President seeks to push tough choices onto the future when it will be more difficult and painful for the American people to absorb and when this Administration is no longer in charge.

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