Statement of
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Congressional Budget Office

before the
Subcommittee on Economic Resources,
Competitiveness, and Security Economics
Joint Economic Committee
United States Congress

July 31, 1986

NOTICE

This statement is not available for public release until it is delivered at 9:30 a.m. (EDT), Thursday, July 31, 1986.

The number of older Americans has grown substantially in recent years. At the same time, their economic well-being has improved--in part as a result of public policies that have directed an increasing share of the federal budget toward them. Because the elderly will continue to grow in absolute numbers and as a share of the U.S. population well into the next century, considerable concern has been expressed about the implications of continuing current policies for the federal budget and for society at large.

My remarks today will cover three topics:

- First, trends in the size and composition of the elderly population;
- Second, changes in the economic circumstances of older Americans, and the role that the federal government has played in those changes;
- Third, implications for the federal budget of the continued aging of the population.

TRENDS IN THE SIZE AND COMPOSITION OF THE ELDERLY POPULATION

The graying of America is not a new phenomenon, nor will it end soon. Between 1950 and 1985, the number of Americans age 65 or older grew from about 12 million to more than 28 million, increasing from 8 percent to 12

percent of the U.S. population. Under a range of projections prepared by the Bureau of the Census, the number of elderly people is expected to grow to between 56 million and 83 million by the year 2050, accounting for between roughly one-fifth and one-fourth of all Americans. (Figures 1 and 2 show the past increase in the elderly population and the projected growth under the "middle" Census forecast.) 1/

Growth in the number of "old elderly" is expected to be particularly sharp. Under the middle Census projection, while the number of people between the ages of 65 and 74 is projected to peak around 2030, the number of people between 75 and 84 will continue to grow for another decade after that, and the number of Americans age 85 and over is expected to rise into the latter half of the twenty-first century. The number of people age 85 and over is projected to increase from 2.7 million to 16 million between now and the year 2050, rising from about one in 90 Americans today to one in 20 by the middle of the next century.

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1. The Census projections are prepared using alternative assumptions regarding fertility rates, mortality rates, and immigration. Only assumptions regarding mortality rates and immigration affect estimates of the number of elderly people between now and the year 2050. All three assumptions affect estimates of the size of the elderly population as a share of the total population.

FIGURE 1

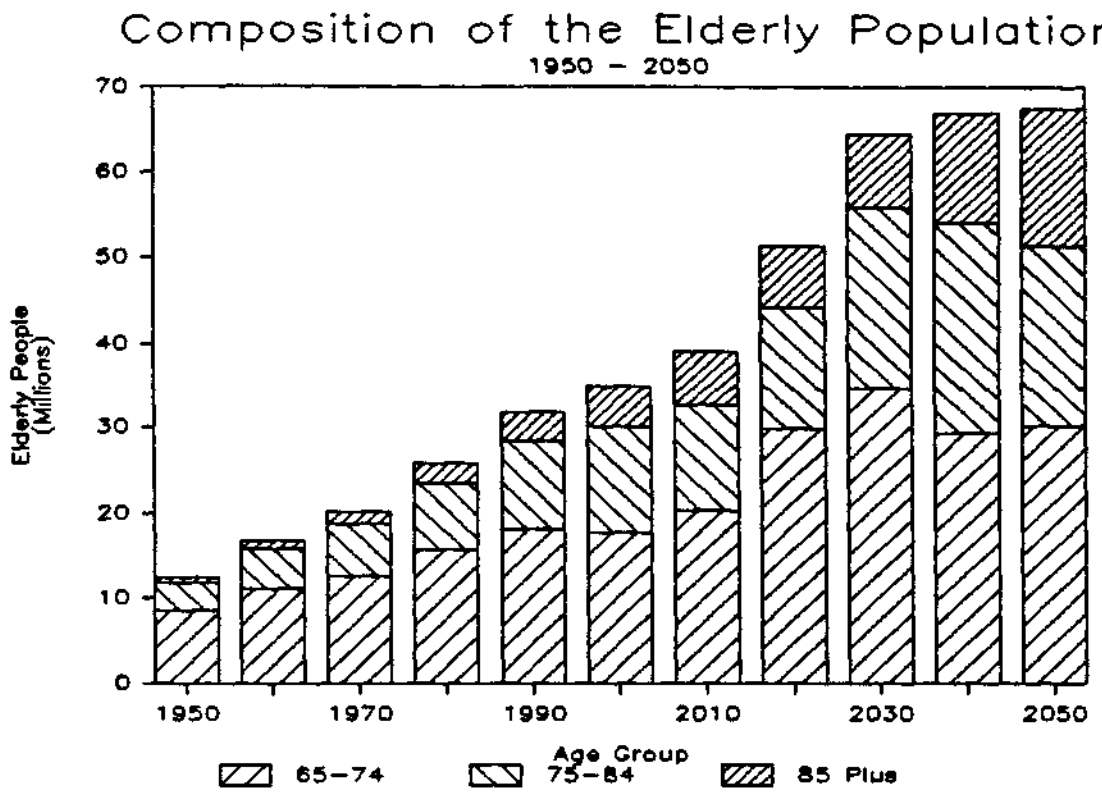
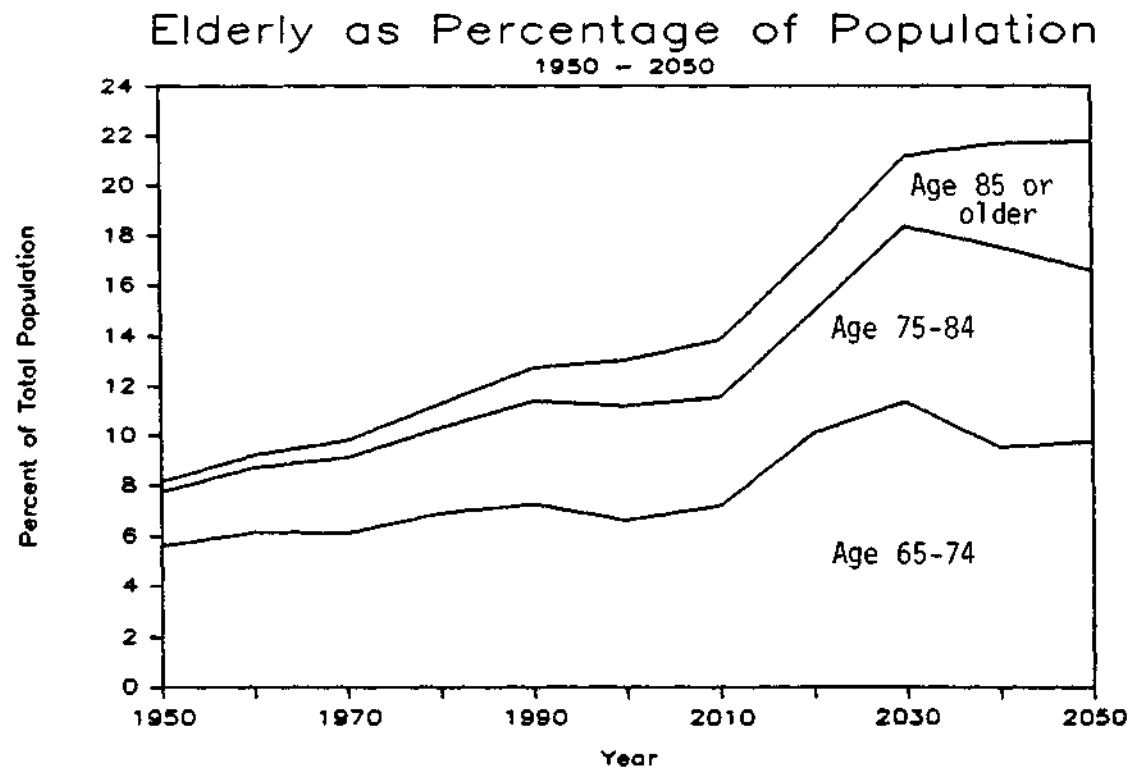


FIGURE 2



SOURCE: Bureau of the Census, Projections of the Population of the United States, by Age, Sex, and Race: 1983-2080 (Series P-25, no. 952, May 1984), using middle projection series.

CHANGES IN THE ECONOMIC CIRCUMSTANCES OF THE ELDERLY AND IMPACTS ON THE FEDERAL BUDGET

While the elderly have grown as a share of the U.S. population in recent years, as a whole their standard of living has improved. This progress has been made possible by real income growth throughout most of the economy and by expansion in federal programs designed to benefit the elderly. In effect, the nation has become better off, and we have used a portion of our increased incomes to raise the living standards of our oldest citizens.

Changes in the Economic Circumstances of the Elderly

Though sizable numbers of the elderly remain in or near poverty, as a group older Americans are better off today than they have been in the recent past. As shown in Table 1, in the 15 years between 1969 and 1984, the median per-capita, pre-tax income of the elderly grew from $5,100 to $7,600 in constant 1984 dollars--increasing from about 76 percent of the equivalent figure for nonelderly people to 97 percent, or virtual parity. 2/ During this period, the proportion of elderly Americans living below the official poverty thresholds declined from 25.3 percent (more than double the poverty rate among younger people) to 12.4 percent (two percentage points less than the rate for

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2. The relative income position of the elderly is even better on an after-tax basis, because they benefit from certain tax preferences (discussed on page 12) that are not available to younger taxpayers. On the other hand, because elderly people are more likely than younger ones to be living alone or in only two-person families, they are less likely to enjoy the economies of scale that are available to younger families in running households.

the rest of the population). (See Table 2.) On the other hand, another 16.7 percent of all elderly people had incomes in 1984 of no more than 50 percent above poverty--nearly twice the comparable figure for the rest of the population.

Some groups within the elderly population are particularly likely to still be living in or near poverty. While less than 17 percent of all married elderly people had incomes of no more than 150 percent of the poverty line in 1984, more than 40 percent of all single elderly people lived in or near poverty. Among single black women age 65 or older--one of the poorest groups within the elderly population--fully 71 percent had incomes of no more than 150 percent of the poverty line.

TABLE 1. MEDIAN PER-CAPITA INCOME OF THE ELDERLY AND NONELDERLY: 1969 AND 1984 (In 1984 dollars)

	1969	1984
Median Per-Capita Income of the Elderly in 1984 Dollars a/	5,100	7,600
Median Per-Capita Income of the Nonelderly in 1984 Dollars a/	6,750	7,800
Ratio of Median for Elderly to Median for Nonelderly	.76	.97

SOURCE: Congressional Budget Office calculations based on data from the March 1970 and March 1985 Current Population Surveys.

NOTE: Data include only the noninstitutionalized population.

a. In this table, per-capita income is calculated as the total income of the nuclear family--consisting of a person, his or her spouse (if any), and any minor children living with them--divided by the number of people in that family. People are classified as elderly or nonelderly according to whether their own age is greater than or equal to 65, or less than 65.

The improvement in the economic status of older Americans reflects primarily an increase in their retirement income--much of it the result of public policy decisions. Between 1969 and 1984, for example, the proportion of the elderly receiving Social Security benefits, or whose spouses received such benefits, rose from 84 percent to 93 percent (see Table 3). During that period, the median per-capita Social Security benefit for those receiving it increased from about $2,850 to $4,600 in constant 1984 dollars. This rise reflects the substantial increases in benefits that were enacted during this period and the effect of higher earnings histories on the benefits of more recent retirees.

TABLE 2. PERCENTAGES OF PEOPLE BY FAMILY INCOME IN RELATION TO POVERTY THRESHOLDS: 1969 AND 1984 a/

	1969			1984		
	Below 100% of Poverty	100% to 150% of Poverty	150% of Poverty and Above	Below 100% of Poverty	100% to 150% of Poverty	150% of Poverty and Above
All Elderly People	25.3	18.1	56.6	12.4	16.7	70.9
Married people	16.5	18.1	65.3	6.0	10.9	83.1
Single women	35.9	18.0	46.1	20.6	23.5	55.9
Single men	29.8	17.9	52.3	16.8	22.5	60.7
All Nonelderly People	10.8	10.2	79.0	14.7	9.0	76.3

SOURCE: Congressional Budget Office calculations based on data from the March 1970 and March 1985 Current Population Surveys.

NOTE: Data include only the noninstitutionalized population.

a. Income relative to poverty thresholds includes the income of all family members as designated by the Census Bureau.

TABLE 3. PER-CAPITA INCOME OF THE ELDERLY, BY SOURCE: 1969 AND 1984 (In 1984 dollars) a/

Income Source	1969		1984	
	Percent of All Elderly with Income from Source	Median Per-Capita Income from Source for Those Receiving It	Percent of All Elderly with Income from Source	Median Per-Capita Income from Source for Those Receiving It
Social Security	83.8	2,850	92.8	4,600
Pensions b/	23.2	2,600	39.2	2,450
Income from Assets	49.8	1,050	70.5	1,550
Earnings	33.6	3,700	22.2	3,450
Means-Tested Benefits	9.8	1,900	7.3	1,400
Other	10.8	1,700	8.5	1,050

SOURCE: Congressional Budget Office calculations based on data from the March 1970 and March 1985 Current Population Surveys.

NOTE: Data include only the noninstitutionalized elderly.

a. In this table, per-capita income is calculated as the total income of the nuclear family--consisting of a person, his or her spouse (if any), and any minor children living with them--divided by the number of people in that family. People are classified as elderly or nonelderly according to whether their own age is greater than or equal to 65, or less than 65.

b. Includes pensions earned by employees of federal, state, and local governments and by people who worked for private employers.

The proportion of all elderly people receiving public-employee or private pensions, or whose spouses received such benefits, also increased over the last decade and a half--from 23 percent in 1969 to 39 percent in 1984. This growth reflects past expansions in the coverage of workers, and the aging of the workforce previously covered. 3/ The federal government has long provided tax incentives for contributions to pension funds. In addition, since the passage of the Employee Retirement Income Security Act in 1974, the federal government has further encouraged the spread of pensions by requiring that where plans exist they meet certain standards regarding the breadth of coverage and how quickly workers vest. 4/

The increase in nonemployment income of the elderly has helped permit growing numbers of them to retire at earlier ages. As one measure of this trend, between 1969 and 1984 the proportion of all elderly people

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3. The typical benefit for those receiving pensions edged down slightly in real terms between 1969 and 1984. This small drop might reflect the expansion of pension coverage to include more lower-paid workers relative to earlier cohorts of retirees.

4. Wealth--that is, the difference between a family's assets and its liabilities--also contributes economic resources. As of 1984, the median net worth of households headed by a person age 65 or older was about $60,000--higher than the equivalent figure for any other age group except those between ages 55 and 64. Home ownership accounts for a significant share of wealth for the elderly. More than 70 percent of all households headed by an elderly person own the homes in which they live. Of that group, a majority own their homes free and clear, that is unencumbered by a mortgage. As of 1984, for all elderly homeowners--including those who were still making mortgage payments--the median equity they held in their homes was about $46,000. (The federal government helps promote home ownership for people of all ages by allowing owner-occupants to deduct mortgage interest payments and property tax payments from taxable income in calculating their federal tax liability.)

reporting any income from wages and salaries, or whose spouses reported such income, fell from about one-third to less than one-fourth. The elderly have also used some of their increased retirement income to maintain households independent of their children or other relatives--apparently a long-standing desire of most older people. 5/ Between 1960 and 1984, the proportion of all noninstitutionalized elderly people residing with their adult children or with extended family members fell from approximately 40 percent to about 22 percent.

Finally, in the last two decades, the elderly have been granted greatly expanded access to health care--again, largely as a result of federal programs. Since the mid-1960s, through the Medicare and Medicaid programs, the federal government has paid a large share of both the acute health-care and long-term-care costs of the elderly.

Federal Budgetary Impacts

Past growth in the size of the elderly population--and decisions to cover an increasing share of their needs through public programs--have significantly altered the shape of the federal budget. As shown in Table 4, between 1965 and 1985, spending for the elderly under major federal transfer programs

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5. In surveys dating back to the mid-1950s, a sizable majority of older people has consistently expressed a preference to live independent of their grown children.

TABLE 4. ESTIMATED FEDERAL SPENDING FOR THE ELDERLY UNDER SELECTED PROGRAMS: FISCAL YEARS 1965-1985

	1965	1971	1975	1980	1985
	In Billions of Dollars				
Social Security	a/	27.1	51.8	81.2	140.4
Railroad Retirement	a/	1.7	2.8	3.6	4.7
Federal Civilian Retirement	a/	2.3	5.5	7.8	13.7
Military Retirement	a/	0.7	1.1	1.8	4.3
Benefits for Coal Miners b/	a/	0.1	0.2	1.3	1.5
Supplementary Security Income	a/	1.4c/	1.8	2.3	3.2
Veterans Pensions d/	a/	0.9	1.5	3.3	5.4
Medicare	a/	7.5	12.8	29.3	61.4
Medicaid	a/	1.9	2.6	4.7	8.5
Food Stamps e/	a/	0.2	1.0	0.5	0.6
Housing Assistance	a/	0.2	0.4	2.3	4.5f/
Other g/	a/	n.a.	n.a.	6.1	10.3
Total	18.8	44.0	81.3	144.2	258.6
Total in 1985 Dollars	62.6	113.1	158.5	191.0	258.6
Federal Spending for the Elderly Relative to Total Federal Outlays, the Size of the Elderly Population, and GNP					
Spending for the Elderly:					
Per aged person, in 1985 dollars	3,390	5,500	6,980	7,430	9,060
As a percent of total federal outlays	15.9	20.9	24.5	24.4	27.3
As a percent of total federal outlays, excluding defense and net interest	31.9	37.8	36.5	35.7	45.8
As percent of GNP	2.8	4.2	5.3	5.4	6.6

(continued)

TABLE 4. (Continued)

SOURCES: Figures for 1971-1985 from 1986 Statistical Abstract of the United States; figures for 1965 from R. Clark and J. Menefee, "Federal Expenditures for the Elderly: Past and Future," The Gerontologist, April 1981.

NOTES: Reported spending includes only federal outlays directed toward the elderly. Figures do not include federal outlays benefiting younger people or spending by state and local governments.

Details may not add to totals because of rounding.

n.a. = not available.

a. Estimated total spending for the elderly in 1965 was taken from a source that did not report spending separately by program.

b. Prior to 1980, represents benefits for miners' widows only.

c. Represents grants to states to aid the aged, blind, and disabled.

d. Includes other veterans' compensation for aged beginning in 1980.

e. Includes nutrition assistance to Puerto Rico.

f. Adjusted to eliminate outlays resulting from changing the financing procedures for public housing.

g. Includes, among other items, Administration on Aging programs, National Institute on Aging spending, housing loans for the elderly, and energy assistance.

grew from about $63 billion to nearly $260 billion in constant 1985 dollars, or from about $3,400 per elderly person to more than $9,000 in constant dollars. During that period, spending for the elderly rose from 16 percent to 27 percent of all federal outlays, or from about one-third to nearly one-half of all outlays for domestic programs--that is, spending other than for defense and net interest payments. Relative to the economy, federal spending for the elderly grew from 2.8 percent to 6.6 percent of the gross national product (GNP).

Tax benefits also play a major role in affecting the income available to the elderly after retirement. The favorable treatment granted to accumulations in qualified retirement programs, including individual retirement accounts, resulted in $63 billion in forgone tax revenues for the federal government in fiscal year 1985. 6/ Other major tax benefits for the elderly include the exemption from taxation of most Social Security payments (resulting in about $17 billion in forgone revenues in 1985), and the double personal exemption provided to the elderly (resulting in $3 billion in forgone revenues in the last fiscal year). Largely because most Social Security benefits are exempt from federal income taxation, currently only about one-half of all elderly people pay any federal payroll or income taxes; this compares with about 90 percent of all other adults who pay such taxes.

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6. These provisions benefit people during their working years by allowing them to defer taxation of part of their income until after they reach retirement age. To the extent that these tax provisions enhance total savings, they also increase the income available to workers after they retire.

IMPLICATIONS FOR THE FUTURE

How the United States accommodates the continued aging of its population will depend on many factors. Of paramount importance will be the rate at which the economy grows between now and the next century. It will help determine the amount of resources available to support the consumption needs of all citizens, including the elderly. In turn, the rate at which young people save may affect the overall growth rate and will certainly influence their standard of living in later years, because it will determine the amount of private assets they will have to draw on in retirement.

The outlook for the federal budget will depend on these factors, and on future public policy decisions. Though precise budgetary impacts cannot be forecast, it is possible to identify in broad terms how demographic trends would affect major categories of federal spending if current policies were unchanged.

Social Security

The aging of the population will be felt substantially in the Social Security Old-Age, Survivors, and Disability Insurance (OASDI) programs, which pay retirement benefits to the great majority of all elderly people and disability

benefits to many others. 7/ Social Security expenditures are financed principally through a payroll tax that applies to more than 90 percent of all workers, supplemented by the inclusion in taxable income of up to half the benefits of higher-income recipients.

Through much of the history of the program, Social Security benefits have been increased in real terms, new types of benefits have been authorized, and earmarked revenues have been increased. In 1983, however, when faced with the prospect of imminent insolvency in the Social Security trust funds, the Congress acted to constrain growth in benefits while increasing earmarked revenues. Earlier this year, the Board of Trustees of the OASDI trust funds estimated that revenues into the funds in 1986 would total $215 billion; outlays were estimated to equal $202 billion, or about 4.9 percent of GNP.

Under any of four sets of economic and demographic assumptions prepared by the Social Security trustees, annual tax revenues into the trust funds are projected to exceed outlays at least through the first decade of the next century. As shown in Table 5, under the Alternative II-B

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7. Although people receiving benefits by virtue of a disability are shifted from the Disability Insurance (DI) program to the Old-Age and Survivors Insurance (OASI) program upon reaching age 65, a large share of those receiving assistance under the DI program are close to that age. As of 1983, 36 percent of all disabled workers receiving DI benefits were 60 years old or older, and another 23 percent were between age 55 and age 59. Beginning in the year 2000, the age at which beneficiaries are shifted from OASI to DI will be phased up from 65 to 67.

TABLE 5. PROJECTED FUNDING UNDER ALTERNATIVE II-B ASSUMPTIONS FOR COMBINED OLD-AGE, SURVIVORS AND DISABILITY INSURANCE (OASDI) TRUST FUNDS: 1986-2050 (In billions of 1986 dollars, and as percent of GNP)

	1986	1990	2000	2010	2020	2030	2040	2050
				In Billions of 1986 Dollars a/				
Revenues								
Taxes b/	212	255	326	399	468	545	640	746
Interest	4	11	41	99	142	129	76	5
Total	215	266	367	498	611	674	716	751
Outlays c/	202	220	262	329	485	654	769	891
Trust Fund Assets	44	156	750	1,759	2,482	2,215	1,280	33
				As Percent of GNP a/				
Revenues								
Taxes	5.1	5.5	5.5	5.4	5.4	5.3	5.1	5.0
Interest	0.1	0.2	0.7	1.3	1.6	1.2	0.6	0.0
Total	5.2	5.7	6.2	6.8	7.0	6.5	5.7	5.0
Outlays	4.9	4.8	4.4	4.5	5.5	6.3	6.2	6.0
Trust Fund Assets	1.1	3.4	12.6	23.9	28.4	21.4	10.3	0.2

SOURCE: Harry C. Ballantyne, "Long-Range Estimates of Social Security Trust Fund Operations in Dollars," Actuarial Note No. 127, Social Security Administration, April 1986.

NOTE: Details may not add to totals because of rounding.

a. All dollar amounts were deflated using the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), as projected by the trustees under Alternative II-B. The gross national product (GNP) projections were also made by the trustees under Alternative II-B.

b. Income from OASDI payroll taxes, taxation of benefits, and reimbursements from the General Fund of the Treasury for the costs associated with special benefits to certain uninsured recipients who attained age 72 before 1968.

c. Most outlays are for benefit payments to OASDI recipients. A small portion is for administrative expenses, transfers to the Railroad Retirement program, and payments for vocational rehabilitation services for disabled recipients.

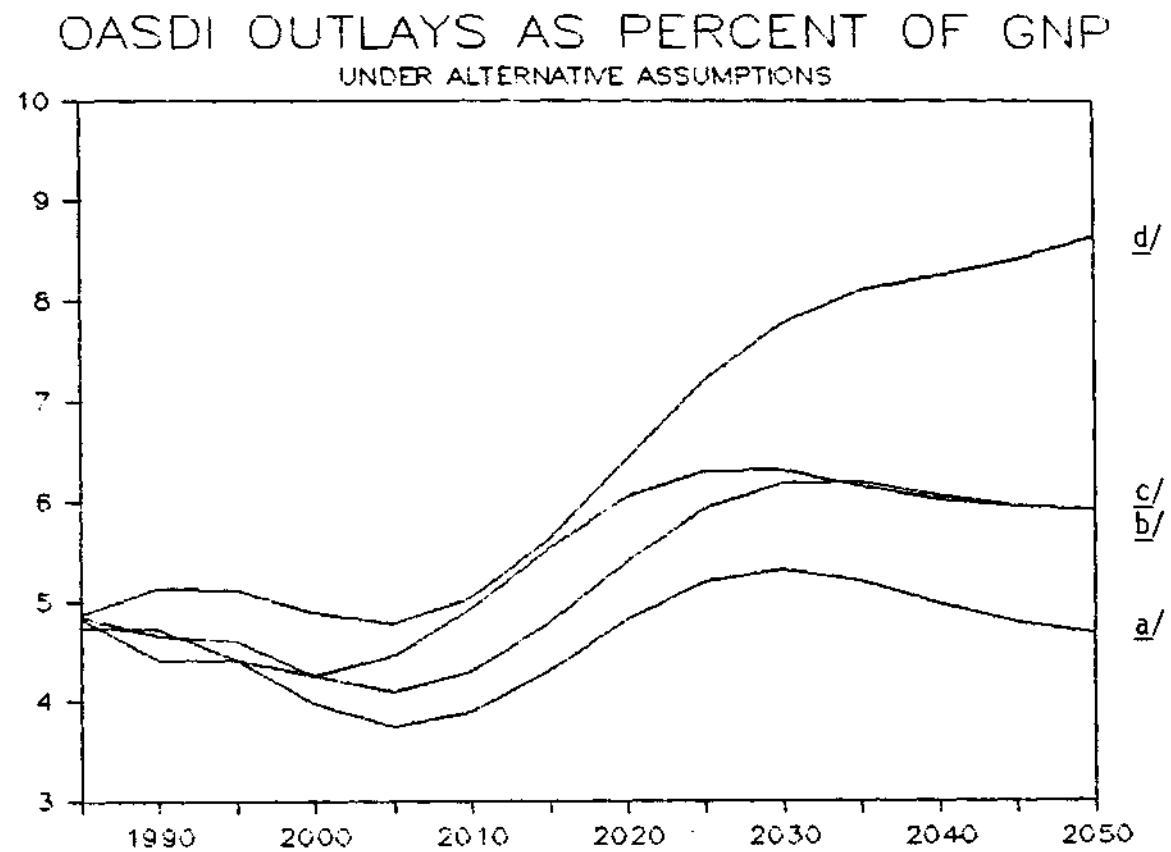
"intermediate" assumptions, revenues from taxes are projected to exceed outlays until around the year 2020. Beginning then, annual OASDI outlays would substantially exceed tax revenues, as the post-war baby boom generation expands the beneficiary rolls. Because the trust funds would have accumulated a very large pool of assets by that time, interest income would continue to expand fund balances for at least part of the following decade. After 2030, outlays would exceed total revenues, and the trust fund balances would be virtually exhausted by the year 2050. Under this scenario, expenditures would peak at about 6.3 percent of GNP around 2030, declining to 6.0 percent of GNP in 2050.

All such projections should be treated with caution, however, because they are enormously sensitive to the assumptions on which they are based. As shown in Figure 3, under the trustees' most optimistic assumptions, Social Security outlays are expected to amount to 4.7 percent of GNP in 2050, and the trust funds are projected to remain solvent at least until the year 2060. By contrast, under the most pessimistic assumptions, OASDI outlays would exceed 8 percent of GNP by the middle of the next century, and trust fund assets would be exhausted by 2025.

Acute Health Care

Further growth in the number of elderly people will also increase federal spending under the Medicare program, which pays about 85 percent of public

FIGURE 3



SOURCE: 1986 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds and Harry C. Ballantyne, "Long-Range Estimates of Social Security Trust Fund Operations in Dollars," Actuarial Note No. 127, Social Security Administration, April 1986.

a. Alternative I ("Optimistic") assumptions: real economic growth ranges between 3.1 percent and 4.2 percent annually between now and the year 2010, and equals 3.0 percent thereafter. Inflation ranges between 2.0 percent and 3.2 percent between now and 2010, and equals 2.0 percent thereafter. Average life expectancy at age 65 increases by between one and two years between now and the year 2050.

b. Alternative II-A ("Intermediate") assumptions: real economic growth ranges between 2.7 percent and 3.7 percent annually between now and the year 2010, and equals 2.4 percent thereafter. Inflation ranges between 2.9 percent and 3.9 percent between now and 2010, and equals 3.0 percent thereafter. Average life expectancy at age 65 increases by between three and four years between now and the year 2050.

c. Alternative II-B ("Intermediate") assumptions: real economic growth ranges between 2.3 percent and 3.1 percent annually between now and the year 2010, and equals 2.0 percent thereafter. Inflation ranges between 3.2 percent and 4.9 percent between now and 2010, and equals 4.0 percent thereafter. Average life expectancy at age 65 increases by between three and four years between now and the year 2050.

d. Alternative III ("Pessimistic") assumptions: real economic growth averages about 2 percent annually between now and the year 2010, and equals 1.4 percent thereafter. Inflation ranges between 4.2 percent and 5.8 percent between now and 2010, and equals 5.0 percent thereafter. Average life expectancy at age 65 increases by between about six and seven years between now and the year 2050.

costs and about 60 percent of total costs of providing acute health care for older Americans. 8/

Hospital Insurance. The hospital insurance (HI) component of Medicare--the largest federal health care program--helps pay for hospital care for nearly all elderly people; it is financed through a payroll tax levied in conjunction with the Social Security tax. Since its creation in 1965, expenditures for HI have risen sharply as a result of growth in the number of beneficiaries, increased services per beneficiary, and price increases throughout the U.S. health-care system. Much of this outlay growth reflects improved benefits to the elderly, but the design of the program also contributed to expenditure growth. As first designed, HI paid hospitals whatever "reasonable" costs they incurred in treating Medicare patients, thus creating little incentive for them to provide services as efficiently as possible.

After a series of changes intended to control the rate of increase in HI expenditures under the cost-based system, the Congress enacted a

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8. Under the Medicaid program, the federal government shares with states the expense of covering some of the acute-care costs of low-income elderly people. Medicaid pays their premiums under the Supplementary Medical Insurance component of Medicare, covers their Medicare cost-sharing requirements, and pays for certain services not covered by Medicare. The total of all federal and state expenditures for these purposes accounts for 7 percent of all public spending on acute care for the elderly, however, and makes up less than 13 percent of all Medicaid outlays.

"prospective payment system" (PPS) in 1983. Hospitals are now paid fixed amounts, known in advance, for each Medicare patient in each of nearly 500 diagnosis-related groups. While the PPS offers the prospect of slowing the growth in Medicare outlays, expenditures have continued to increase more rapidly than the economy. In 1986, HI outlays are expected to total $49 billion, or about 1.2 percent of GNP. Hospital-based services account for just over 90 percent of the total; payments to patients in skilled nursing facilities and for home health care make up the remainder.

Under a wide range of assumptions, HI outlays are expected to continue to grow more rapidly than the economy, eventually outstripping the revenues earmarked to pay for them. As shown in Figure 4, under the most recent projections prepared by the Medicare trustees, HI expenditures are forecast to rise to between 1.7 percent and 5.7 percent of GNP by the year 2050; the HI trust fund is projected to be depleted by anywhere between the mid-1990s and some time in the first half of the next century. (Under the "intermediate" assumptions, expenditures would amount to 3.0 percent of GNP by the year 2050, and the trust fund would remain solvent until the last years of this century.) 9/ The eventual course for HI expenditures will depend on such factors as how rapidly the Secretary of Health and Human

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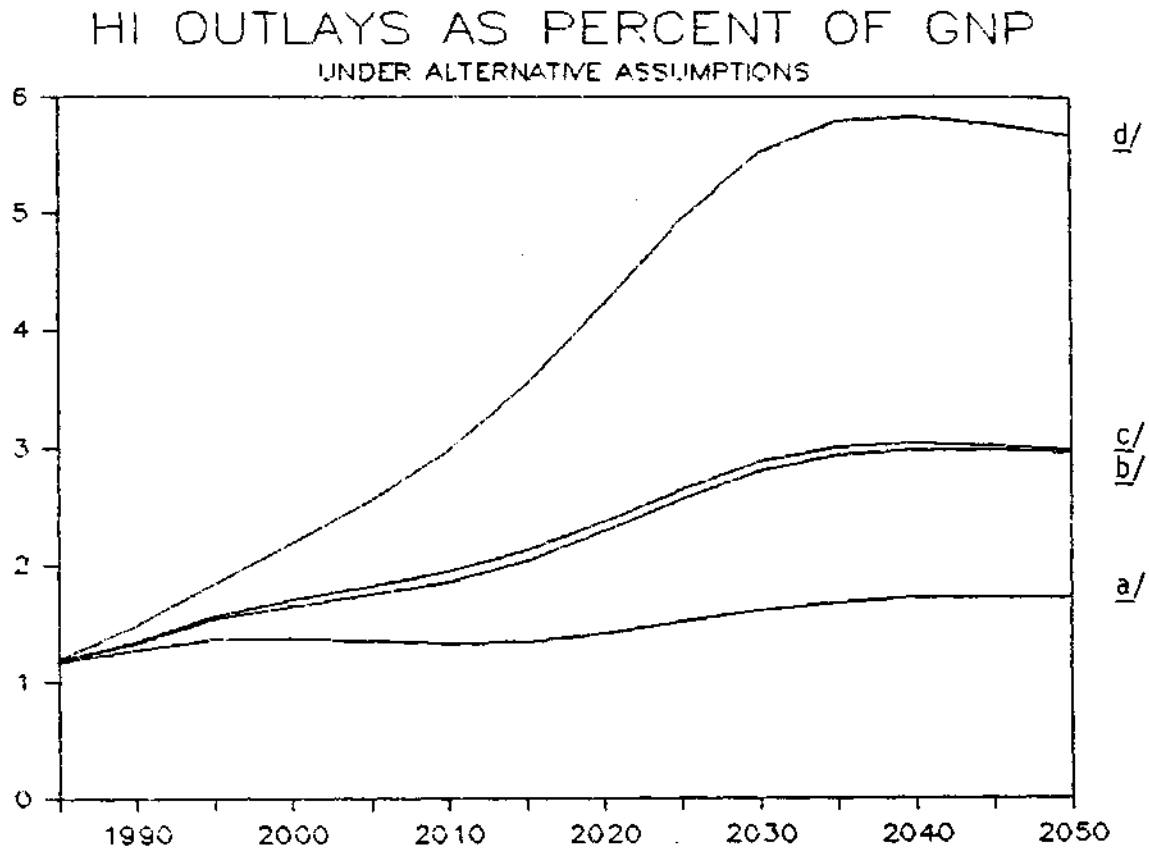
9. These projections were prepared before enactment earlier this year of the Consolidated Omnibus Budget Reconciliation Act (COBRA), which is expected to slow somewhat the growth in HI outlays. Updated projections prepared by the Department of Health and Human Services indicate that under the HI trustees' intermediate assumptions, COBRA would delay the date of insolvency for the HI trust fund by two years and would increase the 75-year actuarial balance of the fund by about 10 percent.

FIGURE 4



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a. Alternative I ("Optimistic") assumptions: real economic growth ranges between 3.1 percent and 4.2 percent annually between now and the year 2010, and equals 3.0 percent thereafter. Inflation ranges between 2.0 percent and 3.2 percent between now and 2010, and equals 2.0 percent thereafter. Average life expectancy at age 65 increases by between one and two years between now and the year 2050.

b. Alternative II-A ("Intermediate") assumptions: real economic growth ranges between 2.7 percent and 3.7 percent annually between now and the year 2010, and equals 2.4 percent thereafter. Inflation ranges between 2.9 percent and 3.9 percent between now and 2010, and equals 3.0 percent thereafter. Average life expectancy at age 65 increases by between three and four years between now and the year 2050.

c. Alternative II-B ("Intermediate") assumptions: real economic growth ranges between 2.3 percent and 3.1 percent annually between now and the year 2010, and equals 2.0 percent thereafter. Inflation ranges between 3.2 percent and 4.9 percent between now and 2010, and equals 4.0 percent thereafter. Average life expectancy at age 65 increases by between three and four years between now and the year 2050.

d. Alternative III ("Pessimistic") assumptions: real economic growth averages about 2 percent annually between now and the year 2010, and equals 1.4 percent thereafter. Inflation ranges between 4.2 percent and 5.8 percent between now and 2010, and equals 5.0 percent thereafter. Average life expectancy at age 65 increases by between about six and seven years between now and the year 2050.

Services allows hospitals' payment rates to increase, the long-term response of hospitals to the PPS, the health of future cohorts of the elderly, and the effects of changes in medical technology on the frequency and cost of treatment.

With the HI trust fund facing the prospect of eventual insolvency, some future Congress will have to either raise taxes or curtail expenditures. One option would be to use some of the revenues that are now earmarked to pay for the OASDI programs to finance HI instead. While such a funding shift would improve the financial outlook of the HI fund, it would diminish the assets available to pay future Social Security benefits. Other options for increasing revenues include raising the HI payroll tax or making up some or all of the trust fund deficiency from general revenues. Options for curtailing spending include requiring that Medicare enrollees pay a greater share of their own health-care expenses; further limiting reimbursements to hospitals, with attendant risks to the quality of care; or directly rationing the amount of care available to the elderly.

Supplementary Medical Insurance. The Supplementary Medical Insurance (SMI) component of Medicare presents a similar set of issues. The SMI program provides insurance to pay part of the costs of physicians' fees and certain other medical services, while charging enrollees a premium equal to about one-fourth of the total cost of the coverage. The remaining three-fourths are made up through general federal revenues.

As with HI, reimbursements under SMI have grown more rapidly than can be accounted for by increased patient loads and general inflation. This growth was the result in part of a reimbursement system that provides little incentive for physicians either to restrain fee increases or to limit the volume of services provided to their patients. A cost-based index was introduced in 1972 to limit growth in payment rates, and payment rates were left unchanged from July 1983 through April 1986; in contrast to the HI program, however, there have been no fundamental changes in the incentives for providers. 10/ In the current fiscal year, outlays for SMI net of enrollees' premiums are expected to amount to $19.2 billion, or 0.5 percent of GNP.

Although long-term forecasts of SMI outlays are not available, estimates prepared by the Congressional Budget Office (CBO) suggest that the rapid growth in expenditures will continue at least in the near term. Our most recent projections foresee SMI net outlays increasing at an annual rate of 8 percent per enrollee over and above the general rate of inflation

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10. Payment rates were frozen for all physicians through April 1986. The freeze was lifted for "participating" physicians on May 1, but continued for "nonparticipating" physicians until January 1, 1987. (Participating physicians are those who have agreed to accept assignment for all their Medicare patients. Accepting assignment means that the physician bills Medicare directly for its payment share and agrees to accept Medicare's approved amount as the fee. Physicians who refuse assignment bill their patients for the full billed charge, and patients must then seek reimbursement from Medicare for Medicare's share of its approved amount.)

through 1991. As shown in Table 6, SMI outlays net of enrollees' premiums are expected to nearly double by then to $38 billion, or 0.6 percent of GNP.

Faced with rising costs, the Congress can continue to offer SMI in its current form--using general revenues to make up the growing gap between premiums and program costs--or it can curtail the growth in SMI spending. Options for reducing spending are similar to those for HI. The Congress could increase the share of program costs borne by enrollees. For example, premiums could be raised to pay for more than one-fourth of total outlays. Alternatively, the Congress could limit payment rates to providers or limit the use of services. One specific option would be to adopt a fee schedule to pay doctors fixed amounts for each type of procedure or service performed, combined with systematic utilization review to guard against unwarranted increases in the volume of services provided. Another approach would be to encourage Medicare recipients to enroll in group payment plans such as health maintenance organizations (HMOs) that limit annual federal costs to a fixed amount per enrollee.

Long-Term Care

The aging of the population is likely to have a particularly serious impact on the need for long-term care (LTC) services, ranging from limited assistance with the tasks of daily living to skilled medical care provided in a nursing home or other institutional setting.

TABLE 6. PROJECTED OUTLAYS AND PREMIUM COLLECTIONS UNDER SUPPLEMENTARY MEDICAL INSURANCE (SMI) PROGRAM: 1986-1991 (In billions of dollars, and as a percent of GNP)

	1986	1987	1988	1989	1990	1991
Total SMI Outlays	24.8	28.1	32.4	36.6	41.3	46.8
Premium Collections	-5.7	-6.5	-7.5	-8.0	-8.5	-9.0
Outlays net of premiums	19.2	21.7	24.9	28.6	32.9	37.8
Net outlays as percent of GNP	0.46	0.48	0.51	0.55	0.58	0.62

SOURCE: Congressional Budget Office estimates.

NOTE: Details may not add to totals because of rounding.

Public funding for LTC services--which pays for about half of all spending on long-term care--is provided primarily through Medicaid, with the great majority of the funds going to finance nursing home care. Under Medicaid, the federal government shares with states the cost of providing LTC to all elderly people who satisfy maximum income and asset limits established by states within federal guidelines. 11/ The practical effect is that many elderly people have to "spend down" to satisfy the Medicaid income and asset limits--impoverishing themselves and their spouses in order to receive public assistance with what can be a devastatingly large cost of aging.

11. Medicaid also covers nonelderly people who receive Aid to Families with Dependent Children, others whom states deem to be "medically needy," and mentally retarded citizens who meet the income and asset criteria.

Spending for LTC has grown rapidly in recent years, driven by many of the same factors that have pushed up acute-care costs. In 1986, total public spending for LTC is expected to amount to about $27 billion, or 0.6 percent of GNP. Medicaid will account for about $20 billion of the total, with the federal government paying about 55 percent of that cost. (Spending for LTC is among the largest and most rapidly growing components of the Medicaid program. Currently, LTC expenditures account for about 45 percent of all Medicaid outlays. Because states have a great deal of flexibility in setting Medicaid rules, the share of total spending devoted to LTC services and the rate of growth in those expenditures varies appreciably around the nation.)

Remaining public spending for LTC is accounted for by Medicare, programs funded under the Social Services Block Grant to states, Veterans' Administration health care, Older Americans Act programs, and resources provided by states and localities out of their own revenues. Private spending for LTC--an amount roughly equal to public spending--is almost all paid out of pocket by patients or their families, rather than through the private insurance mechanism that is often used for acute care. In addition, many services are provided without reimbursement by family members or by other informal caregivers.

Demand for LTC services will almost certainly increase steeply in the decades ahead as the number of "old elderly" grows. While less than 2 percent of all people between the ages of 65 and 74 reside in nursing homes, 7 percent of all 75-to-84 year olds and more than 20 percent of all those age 85 or older live in such institutions. Thus, the expected doubling in the

number of 75-to-84 year olds between now and the year 2050, and the projected six-fold increase in the number of people over 85, portend a potentially enormous increase in the demand for LTC services.

Dealing with this situation will be one of the principal challenges facing the country in the years ahead. Continuing current policies in this area could more than double Medicaid LTC outlays in real terms by the end of this century, with the prospect of still further increases as the baby boom generation reaches its most advanced years. It would also mean perpetuating a system in which many elderly have to impoverish themselves and their spouses to qualify for help. In addition, it is possible that states might respond to rising LTC costs by curtailing acute-care services for the nonelderly poor--the other principal component of Medicaid.

One alternative to current policies would be to encourage more families to care for their frail elderly or disabled relatives in their homes. Financing incentives to do so could be offered through either direct payments or tax credits. For many elderly, this would be less expensive than continuing to rely primarily on institutional care; in some instances, however, home care would be infeasible. Also, in some cases, the payments would substitute for free care now given by family and friends.

A different approach would be for the Congress to develop mechanisms that would permit people to contribute in advance to cover the costs of LTC, while spreading those costs among all potential users. One option

would be to promote the use of private long-term care insurance, which is still in the experimental stage. As with any voluntary insurance scheme, however, this approach would carry some risk of adverse selection, with people who are more likely to need LTC services being more likely to enroll, thus increasing premiums. A second approach would be to expand the public role by mandating LTC insurance, perhaps combined with a dedicated tax to pay for it. Under either insurance approach, it would be necessary to act well in advance of the time when the need for LTC services will be greatest, if people who are currently of working age are to have contributed large enough sums to finance their own LTC services.

Other Programs

Numerous other smaller federal programs will also be affected by the aging of the population. Among entitlement programs, means-tested transfers benefiting the elderly constitute one potential bright spot. To the extent that further increases in average Social Security benefits, growth in public and private pensions, and increased returns on savings continue to reduce the proportion of elderly with very low incomes, spending under such programs as Supplemental Security Income (SSI) and food stamps will grow more slowly or may fall. Even today, however, spending for the elderly under these programs is small compared with retirement-income and health-care programs. Currently, federal spending for the elderly under SSI and food stamps amounts to only about 0.1 percent of GNP.

Future spending for appropriated programs benefiting the elderly--such as subsidized housing, Veterans' Administration health care, and home

energy assistance--is harder to forecast. While growth in the number of elderly could increase the demand for these services, in contrast to entitlement programs, spending under appropriated programs will not rise automatically. Instead, their cost will depend on annual funding decisions made by future Congresses.

CONCLUSION

Throughout its history, the United States has accommodated shifts in the composition of its population. Thus, while the projected growth in the size of the elderly population in the years ahead will place additional demands on society, it will not be the first such challenge we will have faced. Indeed, over the past two decades we have already accommodated some increase in the size of the elderly population while greatly improving their average standard of living.

How readily we accommodate the further aging of our population will depend crucially on the rate of growth in the economy. If economic resources expand rapidly enough, future generations of working-age people might not find it unduly burdensome to share with their parents even a somewhat larger portion of the future GNP. Slower growth would, of course, increase the strain involved in maintaining the living standards of the elderly at any particular level.

One gauge of the potential impact of the growing number of elderly people is the increase that it will cause in federal retirement and health-

care programs, if current policies are continued. Using intermediate projections prepared by the Department of Health and Human Services, spending for Social Security and the HI component of Medicare alone will rise from about 6 percent of GNP today to about 9 percent by the middle of the next century. SMI outlays could also increase sharply, but from a lower base. Federal spending for long-term care--though low today compared with either Social Security or Medicare--could grow explosively with the steep increase in the number of old elderly.

Faced with this prospect, several broad choices are available. First, the government could accommodate future demographic shifts without changing current policies, thus allowing the cost of public programs for the elderly to increase relative to the size of the economy. Alternatively, the growth in public programs could be curtailed. That would leave future generations of the elderly more heavily reliant than they would otherwise be on their own resources or on aid from family members. Finally, the government could make it possible for today's working-age population to contribute more in advance toward meeting the needs they will face in their old age by, for example, developing a system of insurance to cover long-term care costs.