

CRS Report for Congress

Received through the CRS Web

The Entitlements Debate

David Stuart Koitz
Specialist in Social Legislation
Education and Public Welfare Division

Summary

Federal entitlement programs make payments directly to recipients who meet eligibility criteria set by law. There are about 400 of them with Social Security being the largest. Generally, entitlement spending is not subject to control through annual appropriations, and once an entitlement program is established, its scope can be altered only by amending the law that created it. Over the past 25 years, entitlement spending has risen much faster than the federal budget and the gross domestic product (GDP). Proponents of curbing entitlements believe it is the key to controlling federal spending in the long run. Left unchecked, they fear, entitlement spending will place a large strain on federal budgets far into the future, limiting policy options and forcing future generations to bear an enormous tax burden, especially when post-World War II baby boomers retire and draw on these programs. They put heavy emphasis on projections made by the Social Security and Medicare trustees that suggest the programs will not be actuarially sound in the long run unless major reforms are made.

Others argue that entitlements *per se* are not the problem. They contend that it is Medicare and Medicaid that have grown rapidly, driven largely by the rise in the cost of medical care nationally. They fear that the current "crisis" atmosphere about these programs will undermine public support for them, lead to changes that do not address the root causes of their growth, and result in major reductions in health care for vulnerable populations and a shifting of costs to patients and health insurers. They argue that some reformers are raising the specter of major problems for Social Security in order to justify replacing it with a privatized system. They contend that such a system would bring more risk to retirement planning and ignore the functions Social Security now plays in providing adequate incomes to low and moderate income retirees. They argue that only modest changes are needed to shore up the system's long-range condition.

As a result of legislation enacted last summer, a special 17-member panel has been formed to examine Medicare's financing problems. The Speaker of the House, Newt Gingrich, raised the possibility of creating a separate panel to address Social Security's problems and the President has pledged action on the issue early in 1999.

Background

Federal entitlement programs make payments directly to recipients (both individuals and institutions) who meet eligibility criteria set by law. There are about 400 of them with 10 accounting for 93% of all entitlement spending. Social Security is the largest. Generally, entitlement spending is not subject to control through annual appropriations made by Congress. Once an entitlement program is established, its scope can be altered only by amending the law that created it. Although “pay-as-you-go” budget rules make entitlement expansions more difficult to enact, entitlement spending is immune from spending caps that are imposed on federal discretionary programs (i.e., those that are subject to annual appropriations). In recent years, the fastest growing entitlements have been Medicare and Medicaid.

Over the past 25 years, *entitlement* spending has risen much faster than the federal budget and GDP. It rose from 37% of federal outlays in FY1970 to 55% in FY1995, and its share of GDP climbed from 7.2% to 11.4%. Under recent Congressional Budget Office projections, it could reach 68% of federal outlays by 2007 if not restrained. For the “big 3” entitlements — Social Security, Medicare, and Medicaid — spending could rise from 8% of GDP today to 15% in 2030.¹

Concern about *entitlement* spending has been building for years, and entitlement constraints of one sort or another have been enacted routinely since the late 1970s. Most significant were those affecting Medicare payments to doctors and hospitals, although Social Security, federal civilian and military retirement programs, and many others were altered incrementally to save money or raise revenue. In 1992, President Bush had proposed putting an overall cap on entitlements allowing them to increase for population growth, inflation, and certain other factors (Social Security and interest on the debt would have been excluded). While not enacted, it was given serious consideration on the Senate floor. One year later, President Clinton’s proposed a number of piecemeal entitlement constraints in his initial economic program. They were enacted as part of the Omnibus Budget Reconciliation Act of 1993 — P.L. 103-66 — which was expected to result in nearly \$500 billion in cumulative deficit reductions over the FY1994-FY1998 period.

Significant steps were taken to constrain *discretionary* spending as part of omnibus deficit-reduction laws enacted in 1990, 1993, and 1997 (P.L. 101-508, P.L. 103-66, and P.L. 105-33). Those laws “capped” discretionary programs by setting overall *dollar* limits on the amounts that could be appropriated for them each year through FY2002. They also created House and Senate floor procedures making it more difficult to legislatively expand entitlement programs or create new ones through FY2002. The latter measures, however, do not constrain their growth under current laws resulting from inflation, wage growth, or increases in their eligible populations.

In 1994, a commission appointed by President Clinton, the Bipartisan Commission on Entitlement and Tax Reform, was asked to examine ways to constrain entitlements and reform the tax system. Led by Senators Robert Kerrey and John Danforth, the panel was

¹See Congressional Budget Office, *The Economic and Budget Outlook, Update*, September 1997, and *Long-Term Budgetary Pressures and Policy Options*, March 1997.

composed of 22 Members of Congress and 10 people from the public at large. In December 1994, the two chairmen proposed a package of options to address the issue, including measures to: gradually raise the age for full social security benefits to 70, establish mandatory personal savings plans using part of the current payroll tax, means test Medicare and raise its premiums and deductibles, and alter congressional and civil service pensions. The panel, however, could not reach a consensus, and in the end agreed only to advise the President and Congress of the financial demands of entitlement programs that eventually will emerge from the aging of the baby boomers and that changes need to be made starting today so that they can be phased in.

In the 104th Congress, welfare reform was enacted abolishing the “individual entitlement” nature of Aid to Families with Dependent Children (AFDC) and certain related programs through the adoption of state block grants with relatively “fixed” allotments through 2002 (creating a sort of “capped” entitlement to the states). However, attempts to constrain other entitlements, notably Medicare and Medicaid, were not successful, blocked by vetoes by President Clinton because of disputes over the magnitude and nature of the proposed changes.

In the 105th Congress, as part of a major effort to balance the federal budget by FY2002, the President and Congress reached agreement on near-term constraints on Medicare and Medicaid (P.L. 105-33). They were estimated to render \$385 billion in Medicare savings over the next 10 years and \$37 billion in Medicaid. However, while having some modest impact on long-range costs, these measures were not designed to address the large impact of the retirement of the baby boomers. Attempts were made to include measures to raise the age of eligibility for Medicare from 65 to 67, to introduce income testing of the Medicare Part B premium, and require a copayment for health care benefits — all of which were sought by proponents of curbing the program’s long-range costs — but they were struck from the final legislation.² In their place, a 17-member *National Bipartisan Commission on the Future of Medicare* was created to examine the long-range problem and recommend changes to address it. The panel is required to make its report by March 1, 1999.

The Debate

Intense concern remains about entitlement growth. The costs of Medicare and Medicaid, although abating recently, have risen at or near double-digit annual rates for at least 2 decades. The prospect of ongoing budget deficits and the passing along of a large federal debt to future generations adds a deep layer of apprehension. In the long run, the demographic shift caused by the retirement of the post World War II baby-boomers raises questions about the affordability of the entire spectrum of age-based entitlement programs, including Social Security. In addition, annual trustees’ reports for Social Security and Medicare now show that both programs have significant long-range financing problems — their funding is projected to be insufficient to cover their rising expenditures. Problems for the Hospital Insurance portion of Medicare could begin as soon as 2006. While there is considerable consensus that one or more of these

²These measures were passed by the Senate as part of H.R. 1015, but were not included in the House bill. They were set aside when conferees for the two bodies met to resolve the differences in their respective bills.

circumstances provides a basis for action, there is far less consensus about the magnitude of the problem and how to deal with it.

The Case for “Aggressive” Reform

The main focus for many proponents of curbing entitlements is on the long-range strain that entitlements may impose because of demographic factors, specifically the aging of the baby boomers and the low birth-rates that have prevailed since the mid-1960s. The ratio of people aged 20-64 to those 65 and older is projected to fall from 5.1 to 1 in 1980 to 2.8 to 1 in 2030, reflecting the general condition that there will be far fewer workers to support the number of entitlement recipients. As their costs are directly linked to the aging of the population, Social Security, Medicare, and Medicaid — the “big three” entitlements — are expected to grow rapidly when the baby boomers begin retiring in or around 2008. Proponents of imposing gradual constraints on these programs feel that to leave their growth unchecked would ultimately require higher taxes that would severely strain the economy. They contend that the levels required would be prohibitive and would limit the taxes the government could levy to cover the costs of its many other functions or pressing new functions that may emerge in the future.

Many fear that the federal debt held by the public, now standing at \$3.8 trillion as a result of decades of borrowing to cover budget deficits, puts an unsustainable mortgage on the future. They worry that the Nation’s savings rate is much too low, in part because the federal government has borrowed so heavily from the financial markets. Given that discretionary programs represent only one-third of federal spending and already have been “capped” through FY2002, they feel that entitlements are the only logical place to look for additional constraints. Entitlements are “where the money is.” Simply put, these proponents feel that entitlements are too big to ignore.

Still others point out that irrespective of any general concerns about entitlements, Social Security and Medicare have their own financing problems. Even with Medicare constraints recently enacted as part of the legislation to achieve a balanced budget, the Medicare Hospital Insurance (HI) trust fund is projected to be insolvent in 2006. The Social Security funds would be insolvent by 2029. Hence, these proponents argue that Social Security and Medicare need to be altered, if only to deal with their own financial inadequacies. They argue that steps need to be taken today so that whatever is done can be phased in slowly, thereby giving today’s workers time to adjust a lifetime of expectations about their retirement and what these programs will provide them. Waiting, they fear, would require precipitous changes in the future in the form of sharp tax increases or greatly reduced benefits.

Yet others contend that immediate action is needed as a matter of *fairness*. They argue that only 25% of entitlement expenditures goes to the poor, and that the sums going to people who are well off are too large and unnecessary to afford them a comfortable retirement. They point out that today’s retirees on average get back more than they paid into Social Security and Medicare and that even in the absence of long-range constraints, today’s retirees get back far more than baby boomers will get. These proponents contend that to put off changes in these programs to the next century is unfair to today’s workers who must pay for overgenerous and non-targeted “transfer” payments with the prospect that their own benefits will have to be scaled back substantially.

The Case for “Moderate” Changes

Those who favor a more restrained approach argue that the singular focus on entitlements is wrong. They feel the word “entitlements” is too amorphous because it encompasses many programs with very different purposes, and fear that it will lead to indiscriminate “capping” of program spending that will be misdirected and not address the long-range issues effectively. While acknowledging that growth of some entitlement programs is a major issue, they feel that each program should be looked at separately.

Some argue that talking about “entitlement reform” is a way to avoid talking about Social Security and Medicare (which together represent 60% of all entitlement spending). They feel that some reformers are using the entitlement forum to attack Social Security and Medicare with the hope of eroding support for them. They contend that the financial problems of these programs are resolvable through traditional tax and spending changes and that many of the programs’ critics are raising the specter that the programs will “bankrupt the Nation” as a means of promoting major structural reforms, such as privatization.

Others argue that entitlements are not the real budget issue. With the exception of Medicare and Medicaid, they have not been growing that rapidly, but in fact, have represented a relatively stable share of GDP since the mid-1970s. They contend that the problems with the federal budget and the mounting debt result mostly from revenue losses arising from major tax cuts enacted during the first year of the Reagan Administration. While acknowledging that Medicare and Medicaid have grown very rapidly, they argue that simply constraining these programs (while ignoring cost pressures in the health sector generally) will only transfer their costs to private insurers and other payers of health costs.

Advocates for civil service and military retirees feel that their programs have become “scapegoats” as policymakers press for budget cuts, even though together they represent only 8% of entitlement spending. They feel that policymakers are fearful of tampering with Social Security and are looking elsewhere for cuts. They argue that their recipient populations, unlike those of Social Security, Medicare, and Medicaid, do not reflect demographic trends in society and that the recent downsizing of the federal civilian and military workforces will have a favorable impact on the costs of their retirement systems in the long run. Moreover, they contend that the relative generosity of their systems has been exaggerated and that their benefits are comparable to those of private sector workers when those workers’ Social Security and private pensions are considered together.

Still others argue that “tax expenditures” need to be considered as much as spending reductions. They are another form of entitlement, the existence of which causes large amounts of income to go untaxed. The largest of them — the mortgage interest, pension, and health insurance deductions and exclusions — represent nearly \$200 billion annually in “foregone” tax revenues.

Yet others say that the concern about entitlements is overblown. They argue that as people live longer, they will work longer, and that as relatively fewer younger people enter the workforce, there will be labor market inducements for older people to remain on the job. They argue that the projected low ratio of workers to dependents is not unprecedented; it existed when the baby boomers were in their youth. Moreover, they point out that the baby boomers are entering their prime working and savings years, and

today's low savings rates reflect the greater consumption needs that people have at earlier stages of their lives. They contend that the rate will rise as the baby boomers age.

The Outlook

To some extent the existence of large and persistent federal budget deficits has given impetus to both short and long-range entitlement reforms. With passage of legislation to bring the federal budget into balance by FY2002, the outlook for further changes is uncertain. While significant Medicare spending constraints were enacted with the recent budget-balancing legislation, major Medicare proposals included in the Senate-passed version — to raise the age for Medicare eligibility from 65 to 67, to require higher monthly premiums for higher income households, and to impose a co-payment on home health care services — were dropped from the final bill. Instead, that legislation deferred consideration of the program's long-range problem and possible measures to resolve it to a new 17-member commission. Under the legislation, the commission's report is not due until March 1999. In the meantime, the \$385 billion in Medicare constraints (impact over a 10-year period) that were enacted in the budget legislation are expected to defer the insolvency of the HI trust fund until 2006 or 2007. Although the Social Security program faces a long-range deficit, insolvency of its trust funds is not projected until 2029 (under the Social Security trustees' "best guess" assumptions). A recent advisory council did recommend that action be taken soon to address Social Security's problems so that the necessary changes could be made gradually, and hearings have been held and a number of bills introduced in recent years to examine and alter the program. However, neither the President nor the congressional Committees with jurisdiction over the program (Ways and Means in the House and Finance in the Senate) have proposed specific legislation to move the issue. The President and Speaker of the House, Newt Gingrich, have suggested the possibility of forming another panel or Commission to tackle the problem, and in his State of the Union address on January 27, 1998, the President pledged action on the issue early in 1999. He stated that he wanted to conduct bipartisan forums around the country in the coming months to draw out the public's views, hold a White House Conference on Social Security in December, and next year, convene congressional leaders to craft bipartisan legislation.

For Additional References

CRS Report 96-43. *Current social security issues*, by David Koitz and Geoffrey Kollmann.

CRS Report 95-543. *The financial outlook for social security and medicare*, by David Koitz and Geoffrey Kollmann.

CRS Report 97-620. *Budget reconciliation in the 105th Congress: achieving a balanced budget by 2002*, by David Koitz and Dawn Nuschler.