WebMemo

Published by The Heritage Foundation

No. 1054

May 1, 2006

Medicare and Social Security: Big Entitlement Costs on the Horizon

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Social Security and Medicare have promised $37 trillion more in benefits to senior and disabled workers than the programs will be able to pay, according to a new report. The 2006 annual report of the trustees of the Social Security and Medicare trust funds concludes that both programs will require progressively larger transfers from general revenues to maintain the projected levels of spending.

Medicare and Social Security will require growing amounts of federal income tax revenue. Today, 6.9 percent of federal income taxes go towards the two programs. Dr. Thomas Saving of Texas A & M University, a public trustee of the Medicare and Social Security trust funds, estimates that, in 2020, 26.6 percent of all federal income taxes will go to paying for Medicare and Social Security. By 2030, that number will increase to 49.7 percent.

Medicare's Financial Crisis. Of the two programs, Medicare presents the greatest challenge to Congress and taxpayers. The Hospital Insurance Trust fund is projected to be exhausted by 2018, a change from the previous date of 2020, and the cost of the Supplemental Medical Insurance program (SMI) is increasing faster than Medicare trustees had projected. According to the trustees, Medicare's long-term debt, based on a 75-year actuarial projection, is now estimated to be $32.4 trillion. Of that amount $8 trillion is directly attributable to the Medicare prescription drug entitlement. The trustees did revise the size of the Medicare portion of the debt, which was estimated at $8.7 trillion in 2005, because the drug costs have risen more slowly than projected, as have the rates of enrollment. What is unknown is the extent to which employers, who now get federal subsidies for maintaining approved drug coverage for retirees, will continue to maintain that coverage or drop it with the passage of time. Accordingly, the cost of Medicare's drug entitlement remains a huge uncertainty.

Current and future taxpayers will be faced with enormous burdens in trying to sustain the Medicare program as it is today. According to Dr. Saving, without any change in the program, Medicare will consume a larger share of federal income taxes, rising to 23.1 percent of all federal income taxes by 2020 and 37.5 percent of all federal income taxes by 2030.

The only responsible policy option for Congress and the Administration is to embark quickly on serious reform of the Medicare program and changing it from an open-ended entitlement to a defined-contribution program, adjusting contributions for age, health costs and income.

Social Security's Growing Deficits. In present value terms, Social Security owes $6.5 trillion dollars more in benefits than it will receive in taxes. That number includes $1.9 trillion, in net present value terms, to repay the bonds in Social Security's

This paper, in its entirety, can be found at:
www.heritage.org/Research/Budget/wm1054.cfm

Produced by the Thomas A. Roe Institute for Economic Policy Studies

Published by The Heritage Foundation
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Washington, DC 20002–4999
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trust fund and $4.6 trillion to pay benefits after the trust fund is exhausted in 2040. This is an $800 billion increase, more than12 percent, over last year's $5.7 trillion number.

Net present value measures the amount of money that would have to be invested today in order to have enough money on hand to pay its future obligations. In other words, Congress would have to invest $6.5 trillion today in order to have enough money to pay all of Social Security's promised benefits between 2017 and 2080. These funds exclude what Social Security receives during those years from payroll taxes.

Social Security will continue to collect more in taxes each year than it will spend on benefits until 2017, the same year as in the 2005 report. The trust fund will run out of money in 2040, a year earlier than last year's report because low interest rates on government bonds will result in the trust fund earning less than previously expected. The projections also reflect a slight increase in the projected future birth rate and a slight increase in projected productivity increases. Neither change significantly affected the program's projected future deficits.

What most reports will miss is that Congress will have to start to deal with reduced surplus Social Security tax collections much faster than it or the public expect. Starting in 2009, the roughly $100 billion annual Social Security surpluses that Congress has been borrowing and spending on other programs will begin to shrink. From that point on, Congress will have to find other sources to replace the money that it annually borrows from Social Security or reduce spending. The surpluses will end completely in 2017, the year when Social Security begins to spend more than it takes.

In a little more than 15 years, today's $100 billion annual Social Security surplus will turn into a $100 billion annual deficit—a $200 billion change. From 2017 on, Social Security will require large and growing amounts of general revenue money in order to pay all of its promised benefits. Even though this money will technically come from cashing in the special issue bonds in the trust fund, the money to repay them will come from other tax collections or borrowing. Moreover, the billions that go to Social Security each year will make it harder to find money for other government programs such as Medicare.

Conclusion. The 2006 Medicare and Social Security trustees report shows that the two entitlement programs cannot remain in their current forms. It is irresponsible to saddle our children and grandchildren with the $37 trillion in additional taxes that will be needed to pay full benefits into the future. And, the cost just continues to grow every year. Unless Congress begins to work now to fix this country's most important programs for senior citizens, our children will face the choice of paying for programs for their parents or paying for education for their children. Delay will only make that dilemma worse.

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