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SOCIAL SECURITY STILL NEEDS FIXING

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Retirement and Disability

Recent strength in the economy has boosted payroll tax revenue, and increased income and capital gains have forced more of the elderly to pay taxes on their Social Security benefits. As a result, the Social Security Old Age and Survivors Insurance and Disability Insurance programs (OASDI) are projected to run operating surpluses — taxes in excess of outlays — through 2015, a year longer than in last year's Report. The deficit spending authority given by the system's trust funds is expected to cover subsequent deficits until 2037, three years longer than in last year's Report. At that point, however, OASDI revenue from payroll taxes and taxation of benefits will cover only 73% of benefits, and the system will not be able to make payments on time.

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Long term, the annual OASDI shortfalls are projected to grow very large. The deficits will be 4.7 percent of taxable payroll by 2035, after the baby boom has retired, and almost 6.2 percent of taxable payroll by the end of the 75 year planning period. Ultimately, either the payroll tax will have to be boosted by 6.2 percentage points, or benefit growth will have to be trimmed, or other tax revenue will have to be diverted to OASDI. (Add Medicare's projected Hospital Insurance program, and the tax hike will have to be nearly 9.5 percentage points.)

It is not true, as some may claim, that a 1.89 percentage point hike in the payroll tax would fix the system. The OASDI system is sometimes (unfortunately) summarized by its 75 year average annual surplus or deficit. The 75 year balance is now a negative 1.89 percent of payroll, less of a shortfall than the negative 2.07 percent of payroll in last year's Report. In past years, advocates of the status quo for Social Security have claimed that the 75 year average deficit indicates the system is not in serious trouble, and that an immediate but (in their opinion) modest hike in the payroll tax of about 2 percentage points would fix the system "for the long term". This is misleading.

The 75 year balance adds together the current trust funds, projected short-run surpluses, and never-ending deficits thereafter (cut off at 75 years, with a target end of period trust fund balance), and expresses the result as a percent of

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taxable payroll. The trust funds (past OASDI surpluses plus interest) are only a record of money that the government has spent on other federal programs. Near-term surpluses will be spent to reduce the national debt (insofar as the rest of the budget is in surplus and doesn't need the revenue). None of that money will be available to pay benefits in the distant future, when OASDI will be in deficit by more than 6 percent of payroll. Boosting the current surplus with a 1.89 percentage point tax hike would reduce the national debt faster, but would still leave the system short of balance by over 6 percent of payroll long term.

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Every few years, the system's defenders push for a one or two percentage point payroll tax hike, increased taxation of benefits, or other changes to "fix" the system by bringing the 75 year average into balance. Then, as the calculation period moves forward, additional years of deficit are brought into the average, the long-term imbalance reemerges, and the system's advocates ask for another "fix". In this manner, Congress and the public are tricked into a series of gradual tax increases to fund the system. The 1977 and 1983 Social Security Amendments and the 1993 Budget Act are cases in point.

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If the Congress and the public were more aware of the full scope of Social Security's costs and imbalances, they might opt for a real change. Ideally, that change would involve reduced reliance on the pay-as-you-go Social Security tax-transfer system and increased reliance on real private saving for retirement.

The only correct way to view the Social Security system is to look at its future surpluses and deficits on a year by year basis. If Social Security is in deficit in a given year, the Treasury must borrow, raise taxes, or cut other spending in that year to make ends meet. And those deficits will require drastic action, the new Trustees Report notwithstanding.

Medicare

Medicare Part A, Hospital Insurance (HI) is reported in slightly better shape than a year ago. Outlays actually fell in 1999 versus 1998 due to provisions of the Balanced Budget Act of 1977. However, outlays will soar as the baby boomers retire and as life expectancy improves. The numbers of elderly, especially the "old old" over age 85, will jump dramatically over the next 35 years. HI deficits will be almost 2 percent of payroll by 2035 and nearly 3.3 percent of payroll by 2075.

Fixing OASDI and HI by raising the payroll tax would mean boosting the tax rate from 15.3 percent to 24.77 percent of payroll. Such a tax hike would throw 6 to 10 million people out of work.

Spending on Supplemental Medical Insurance (SMI, Medicare Part B, doctors and outpatient coverage) will be nearly as expensive as Part A. About 25 percent of Part B is paid for by beneficiaries' monthly premiums; 75 percent is covered by general revenues from the Treasury. Adjusting for inflation, projected Treasury outlays in excess of premiums for SMI *in real 2000 dollars* will be $63 billion in 2000, $285 billion in 2035, and $530 billion in 2075. For comparison, the equivalent general revenue obligation in terms of percent of payroll is 1.7 percent in 2000, 4.4 percent in 2035, and 5.1 percent in 2075.

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> ***The slight improvement in the Medicare outlook has come increasingly from squeezing providers and denying coverage. If we continue down that road, the quality of care will deteriorate the way it has in Britain and Canada.***

Congress and the Administration are exploring ways to add prescription drug coverage to Medicare. Even with the slightly improved outlook, Medicare cannot handle a major new liability. The addition of a prescription drug benefit should be accompanied by a substantial reform of the system along the lines recommended by the National Commission on Medicare Reform. Ideally, the elderly would receive a means-tested contribution for insurance from the government which they could then use directly or via a Medical Savings Account to buy private insurance or to join HMOs that provide prescription drug coverage.

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Note: Nothing written here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before Congress.