Taxes, Entitlements, Social Security and Medicare

... from Red Ink:

The Government as Check Writer

The author William Grieder once wrote that "the most important function of the federal government is mailing checks to citizens." By that he meant Social Security checks, pension, welfare, and veterans' checks, checks to hospitals and doctors for medical care, and checks sent for a host of other reasons.

When Grieder wrote that in 1981, such disbursements equaled 48% of outlays. Now ....

Red Ink page 108.
Greider's complaint: Now 73% of all checks written by government are to individuals.

What are entitlements?

- The law extends a financial right ...
- ... which implies an ongoing legal financial obligation of government ...
- ... therefore outlays over time are determined by
  1. ... the original law and any amendments
  2. ... demographics
- Examples
  - Social Security, Medicare, need-based programs, federal pensions
Federal Trust Funds

TRUST FUND:

Surplus = Receipts - Outlays
Balance = All Surpluses less all Deficits

About Trust Funds

- Subaccounts within the Unified Budget
  - like a checkbook within a checkbook
- Revenue sources internal and external
- Balances held as non-marketable U.S. Treasury Debt
- If externally financed (like Social Security)
  - fund surplus reduces the unified deficit, fund deficit adds to it
  - interest earned is internal and basically a bookkeeping entry, and nothing else
Three critical inflection points for Trust Funds

1. When outlays exceed receipts. At this point the trust fund is adding to the deficit.
2. When outlays exceed receipts by more than interest earned by the trust fund.
3. When interest earned goes to absolute zero and trust fund balances are depleted and spending authority is eliminated.

... from Red Ink

College students graduating in 1996 will begin paying, as soon as they find work, 7.65% of their earned income into three federal trust funds, and their employers will make a matching contribution. These students will be expected to make this contribution, and possibly more, throughout the 45 years or so they are employed. One of these trust funds, the Medicare Trust fund is running a deficit for the first time in 1996 and is expected to run out of funds in the year 2006. ... The largest share of taxes goes to .. the Social Security retirement fund, currently running a sizeable surplus which contributes to a large fund balance presently. ... By current projections the retirement fund will begin running a deficit around the year 2012 and the funds revenues are expected to be exhausted in the year 2031, about the time these students turn 55.


Note: Since this publication, the date for fund deficit has changed to 2021 and exhaustion has been bumped up, to 2033 (in 2011).
Social Security Financing

.. the general picture

Funds In

Funds Out

This is held as interest-earning non-marketable debt

Surplus

TF

Govt. Account NM Debt = Trust Fund Assets

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>Marketable</td>
<td>11,033.4</td>
</tr>
<tr>
<td>Bills</td>
<td>1,626.5</td>
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<tr>
<td>Notes</td>
<td>7,320.9</td>
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<tr>
<td>Bonds</td>
<td>1,236.7</td>
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<tr>
<td>Inflation-indexed</td>
<td>849.5</td>
</tr>
<tr>
<td>Non-Marketable</td>
<td>5,394.1</td>
</tr>
<tr>
<td>Government Account</td>
<td>4,846.1</td>
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<tr>
<td>Non-marketable privately held</td>
<td>548.0</td>
</tr>
<tr>
<td>TOTAL PUBLIC DEBT:</td>
<td>16,457.6</td>
</tr>
<tr>
<td>NET PUBLIC DEBT:</td>
<td>11,611.5</td>
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</tbody>
</table>

(Net is total less govt. account but not less FRS holdings)


These are the trust fund balances, including the all-important Social Security and Medicare Trust Funds.
Social Security OASI Trust Fund
status end of FY2012

... still running a small but declining surplus, but is running a cash deficit for the first time last year because interest earned, which is a bookkeeping entry only, exceeds the surplus. This puts this trust fund in region II.

In 2011/12 there is a new obscure entry called General Fund Payments for Payroll Tax Holiday. It gives the trust fund new NM debt assets to offset cut in FICA taxes.

Source: FY2014 Budget of the United States Government, Table 13-1. Payroll Tax Holiday data are found in Appendix, page 1193.

Medicare Hospital Trust Fund
status at end of FY 2012

This hopeless trust fund, the heart of Medicare, is well into region II, is contributing to the current overall deficit, and will be gone within 8 years.

Note: New Medicare Prescription Drug Plan (passed 2003) added about $15 billion per year to Medicare costs and was largely unfunded.

Source: FY2014 Budget of the United States Government, Table 13-1.

Under the long-range intermediate assumptions, the Trustees project that annual cost for the OASDI program will exceed non-interest income in 2012 and remain higher throughout the remainder of the long-range period. The projected combined OASI and DI Trust Fund assets increase through 2020, begin to decline in 2021, and become exhausted and unable to pay scheduled benefits in full on a timely basis in 2033. However, the DI Trust Fund becomes exhausted in 2016, so legislative action is needed as soon as possible. In the absence of a long-term solution, lawmakers could reallocate the payroll tax rate between OASI and DI, as they did in 1994.

For the combined OASI and DI Trust Funds to remain solvent throughout the 75-year projection period, lawmakers could: (1) increase the combined payroll tax rate for the period in a manner equivalent to an immediate and permanent increase of 2.61 percentage points (from its current level of 12.40 percent to 15.01 percent); (2) reduce scheduled benefits for the period in a manner equivalent to an immediate and permanent reduction of 16.2 percent; (3) draw on alternative sources of revenue; or (4) adopt some combination of these approaches. Lawmakers would have to make significantly larger changes for future beneficiaries if they decide to avoid changes for current beneficiaries and those close to retirement age.

The problem with Medicare (in 2006)

The projected 75-year actuarial deficit in the HI Trust Fund is now 3.51 percent of taxable payroll, up from 3.09 percent in last year’s report due primarily to greater costs in 2005 than expected, changes in managed care assumptions, advancing the projection period, and more recent data that suggests higher utilization of health services in the future. The fund again fails our test of short-range financial adequacy, as assets drop below the level of the next year’s projected expenditures within 10 years—2012. The fund also continues to fail our long-range test of close actuarial balance by a wide margin. The projected date of HI Trust Fund exhaustion moves forward to 2018, from 2020 in last year’s report, and projected HI tax income falls short of outlays in this and all future years. HI could be brought into actuarial balance over the next 75 years by an immediate 121 percent increase in program income, or an immediate 51 percent reduction in program outlays (or some combination of the two). As with Social Security, however, adjustments of far greater magnitude would be necessary to the extent changes are delayed or phased in gradually, or to make the program solvent on a sustainable basis over the next 75 years and beyond.

However, Medicare’s status given the passage of the affordable care act is uncertain, but possibly improved.

Source: Report from the Board of Trustees, Status of the Social Security and Medicare Program, May 1, 2006.
Life Expectancy of Those Born in the Years Indicated

<table>
<thead>
<tr>
<th>Year</th>
<th>Men</th>
<th>Women</th>
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<tbody>
<tr>
<td>1940</td>
<td>61.4</td>
<td>65.7</td>
</tr>
<tr>
<td>1950</td>
<td>65.6</td>
<td>71.1</td>
</tr>
<tr>
<td>1960</td>
<td>68.7</td>
<td>73.2</td>
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<tr>
<td>1970</td>
<td>67.2</td>
<td>74.9</td>
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<tr>
<td>1980</td>
<td>69.9</td>
<td>77.5</td>
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<tr>
<td>1990</td>
<td>71.8</td>
<td>78.2</td>
</tr>
<tr>
<td>2000</td>
<td>74.0</td>
<td>79.4</td>
</tr>
<tr>
<td>2010</td>
<td>75.8</td>
<td>80.4</td>
</tr>
<tr>
<td>2020</td>
<td>77.1</td>
<td>81.2</td>
</tr>
<tr>
<td>2030</td>
<td>78.3</td>
<td>82.2</td>
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<tr>
<td>2040</td>
<td>79.3</td>
<td>83.1</td>
</tr>
<tr>
<td>2050</td>
<td>80.3</td>
<td>84.0</td>
</tr>
</tbody>
</table>

Implications for Medicare and Social Security are obvious.

The period life expectancy for a given age for a given year represents the average number of years of life remaining if a group of persons of that age were to experience the mortality rates for that year over the course of their remaining lives.


From Red Ink

Population Aged 65 and Above as % Total and Median Population Age, Select Years

Figure 7.2
Three critical inflection points for Trust Funds

1. When outlays exceed receipts. At this point the trust fund is adding to the deficit.
2. When outlays exceed receipts by more than interest earned by the trust fund.
3. When interest earned goes to absolute zero and trust fund balances are depleted and spending authority is eliminated.

Note: OASI, DI, and Medicare are all now past inflection point 1.
These variables drive the projections ...

Key Demographic and Economic Long-Term Assumptions for Three Scenarios for the OASDI Trust Fund

<table>
<thead>
<tr>
<th></th>
<th>Best Case I</th>
<th>Intermediate</th>
<th>Worst Case III</th>
<th>Currently</th>
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<tbody>
<tr>
<td>Total fertility rate (2036):</td>
<td>2.29</td>
<td>2.0</td>
<td>1.71</td>
<td>2.03</td>
</tr>
<tr>
<td>Annual net immigration 2012-86:</td>
<td>1,375,000</td>
<td>1,080,000</td>
<td>790,000</td>
<td>900,000</td>
</tr>
<tr>
<td>Productivity gain annual (2024):*</td>
<td>1.98</td>
<td>1.68</td>
<td>1.38</td>
<td>1.59</td>
</tr>
<tr>
<td>Wage gain annual:</td>
<td>3.5</td>
<td>3.9</td>
<td>4.3</td>
<td>3.6</td>
</tr>
<tr>
<td>CPI annual (2012):</td>
<td>1.8</td>
<td>2.8</td>
<td>3.8</td>
<td>3.7</td>
</tr>
<tr>
<td>Unemployment rate % (2021):</td>
<td>4.5</td>
<td>5.5</td>
<td>6.5</td>
<td>8.3</td>
</tr>
<tr>
<td>Trust Fund real interest rate %:</td>
<td>3.4</td>
<td>2.9</td>
<td>2.4</td>
<td>1.0</td>
</tr>
</tbody>
</table>

*Productivity gains defined as the ratio of Real GDP to hours worked by all workers. Gains shown currently are average 2005-10.

Source: 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, Table II.C.1

The Three Trustee Scenarios

Figure II.D6.—Long-Range OASDI Trust Fund Ratios Under Alternative Scenarios [Assets as a percentage of annual cost]

Historical

High fertility (2.3), high immigration, high productivity, low inflation, low unemployment

Estimated

This is their intermediate forecast that is so well publicized. It is capped now with full depletion in 2033. This estimate was 2037 in 2010.

If the present is the future.

Primary fiscal concerns

- How will these deficits be eliminated?
- How will this integrate with FRS monetary policy?
- Does the fix imply inflation?
- Will Social Security and Medicare be “fixed”?
- Will future medical costs be met?
- Will the arrangement be fair?