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Social Security and Medicare Projections: 2006

by Matt Moore

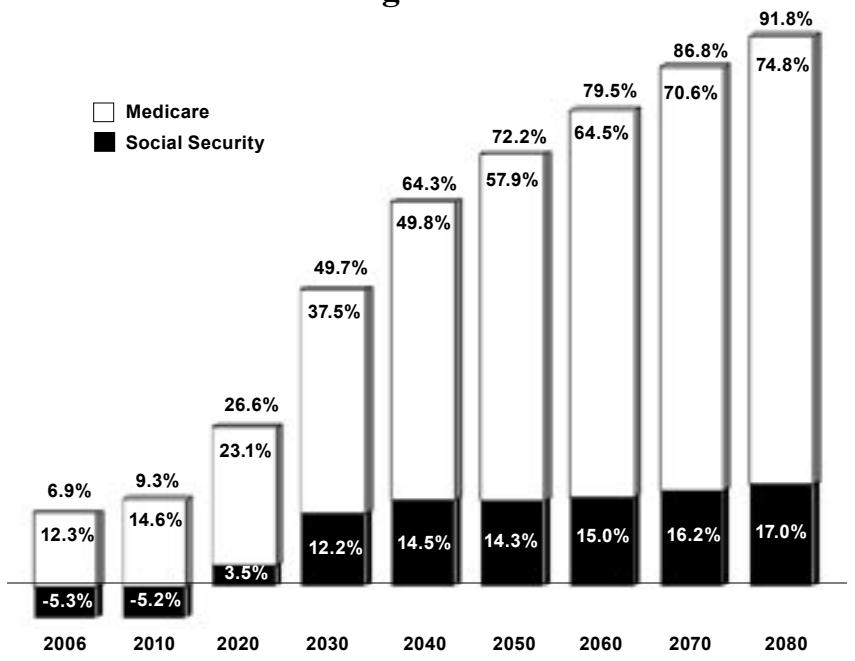
This year's annual reports for Social Security and Medicare show the combined unfunded liability of these programs is $84 trillion in today's dollars — up more than $7 trillion from last year's report. The unfunded liability identifies the difference between what has been promised to current and future generations above what will be collected in taxes. Social Security and Medicare will consume an ever-increasing portion of workers' incomes unless the government either breaks its promises to future retirees or makes significant changes to our elderly entitlement programs.

Future Payroll Tax Burdens. Today Social Security and Medicare Part A (Hospital Insurance) benefits are funded by a 15.3 percent payroll tax on wages — 12.4 percent for Social Security and 2.9 percent for Medicare. But as the 77 million baby boomers retire, spending will grow substantially. Assuming payroll tax rates rise to meet the obligations:

- When today's college students reach retirement age in 2050, paying their Social Security benefits will require a payroll tax rate of about 16.7 percent on their children and grandchildren — more than one-third greater than today's rate.
- When Medicare Part A (hospital insurance) is included, the payroll tax burden will rise to 25.1 percent — more than one of every four dollars workers will earn that year.

FIGURE I

Social Security and Medicare Deficits as a Percentage of Income Taxes



Source: 2006 Social Security and Medicare Trustees Reports and estimates by the Private Enterprise Research Center at Texas A&M University.

In addition to these two programs, taxpayers will also have to pay for three-fourths of Medicare Part B benefits, mainly covering physicians' fees. (Retiree premiums offset a quarter of the cost.) Taxpayers will also foot the bill for 86 percent of the newly enacted Medicare prescription drug program (Medicare Part D). And they will pay for seniors' medical bills through other government programs, including Medicaid and the Veterans Health Administration.

Although the cost of these programs are mainly paid from general revenues under current law, they can also be expressed as a percentage of taxable payroll:

- The burden of Social Security and all of Medicare (Parts A, B and D) will climb to 33.6 percent of payroll by 2050 — more than one in three dollars of taxable payroll.
- When other government-funded health care programs for the elderly (such as Medicaid and the Veterans Health Administration) are added, the total burden will reach 37.9 percent by mid-century.

Thus, almost 40 percent of the wages workers will earn in 2050 has already been committed to pay benefits promised under current law. That is before any bridges or highways are built and before any teachers' or police officers' salaries are paid. If any new entitlement benefits are added, such as more generous prescription drug coverage or long-term care, the future burden will be even higher.

Impact on the Federal Budget. Another way to look at the Social Security and Medicare deficits is to assume we do not raise payroll taxes but fill the gap with general

income tax revenues as we are doing right now. By 2020, the combined projected deficits of Social Security and Medicare will equal more than one-fourth of federal income taxes. [See Figure I.] Roughly this means that in just 15 years, if the federal government is to keep its promises to seniors, it will have to stop doing more than one-fourth of everything it does today. Alternatively, we will have to raise income taxes by one-fourth or borrow an equivalent sum of money.

By 2030, about the midpoint of the baby boomer retirement years, federal guarantees to Social Security and Medicare will require almost one in every two income tax dollars. By 2050, they will require nearly three in every four. Eventually, the deficits in these two programs will absorb the entire federal budget.

Total Unfunded Obligations. This year's annual reports for Social Security and Medicare show that the difference between what has been promised to current and future generations and what will be collected in taxes is $84 trillion in today's dollars. [See Figure II.]

- Medicare's unfunded liability is almost six times larger than Social Security.
- In fact, the new Medicare Part D prescription drug benefit added a new long-term debt to the government's books larger than the unfunded liability of Social Security.

The unfunded liability of Social Security and Medicare together is more than six times the size of the economy and 10 times the size of the outstanding national debt.

Social Security and Medicare Are Pay-As-You-Go. Elderly entitlement programs are in trouble precisely because they are based on pay-as-you-go financing. Every dollar in payroll taxes is spent. Nothing is saved. Nothing is invested. The payroll taxes contributed by today's workers pay the benefits of today's retirees. However, when today's workers retire, their benefits will be paid only if the next generation of workers agrees to pay even higher taxes.

What about the Trust Funds? Like other trust funds (highway, unemployment insurance, etc.), the Social Security and Medicare trust funds do not receive cash deposits and do not make real investments. The Social Security and Medicare Trust Funds exist purely for accounting purposes — to keep track of surpluses and deficits in the inflow and outflow of money. The accumulated Social Security surplus actually consists of paper certificates (nonnegotiable bonds) kept in filing cabinets in Social Security offices in West Virginia.

These bonds cannot be sold on Wall Street or to foreign investors. They can only be returned to the Treasury. In essence, they are little more than IOUs the government writes to itself.

Every payroll tax check signed by employers is written to the U.S. Treasury. Every Social Security benefit check comes from the U.S. Treasury. The trust funds neither receive money nor disburse it. Moreover, every asset of the trust funds is a liability of the Treasury. Summing over all three agencies of government (both trust funds plus the Treasury), the balance is zero. For the Treasury to write a Social Security check, the government must first tax or borrow.

FIGURE II

Increase in the Unfunded Liabilities of Social Security and Medicare
(in trillions of dollars)

	2005 Estimate	2006 Estimate	Increase/Decrease
Social Security	$11.1	$13.4	$2.3
Medicare A	$22.7	$28.1	$5.4
Medicare B	$25.0	$26.2	$1.2
Medicare D	$17.7	$16.2	-$1.5
Medicare (Total)	$65.4	$70.5	$5.1
Total	**$76.5**	**$83.9**	**$7.4**

Source: 2006 Social Security and Medicare Trustees Reports and estimates by the Private Enterprise Research Center at Texas A&M University.

Conclusion. The Social Security and Medicare deficits are on a course to engulf the entire federal budget. If our policymakers wait to address the growing debts until they are out of control, the solutions will be drastic and painful.

Matt Moore is senior policy analyst with the National Center for Policy Analysis.