NATIONAL CENTER FOR POLICY ANALYSIS

Is Uncle Sam Bankrupt?

Brief Analysis No. 689 by Laurence J. Kotlikoff January 29, 2010

When it comes to nondisclosure, the United States government is the father of all financial malfeasants. Indeed, Uncle Sam has been misrepresenting the nation's finances for decades. In the process, he has run up an undisclosed bill that makes the financial bailout and economic stimulus spending look paltry.

Dallas Headquarters:
12770 Coit Road, Suite 800
Dallas, TX 75251
972.386.6272
Fax: 972.386.0924
www.ncpa.org

Washington Office:
601 Pennsylvania Avenue NW,
Suite 900, South Building
Washington, DC 20004
202.220.3082
Fax: 202.220.3096

Federal Financial Obligations. According to David M. Walker, former chief comptroller general of the United States, the federal government's current liabilities to Medicare, Social Security and the federal debt total $56.4 trillion. To put this in perspective:

- The average Social Security, Medicare and Medicaid benefit payment per retiree is currently $30,250 — or about 80 percent of per capita U.S. gross domestic product (GDP).
- In 20 years, when the baby boomers are fully retired, the average benefit per retiree will be the equivalent of $50,000 today (adjusted for inflation). [See the figure.]
- Multiplied by 78 million (the approximate number of baby boomers in the United States), the total would be equivalent to $4 trillion per year today.

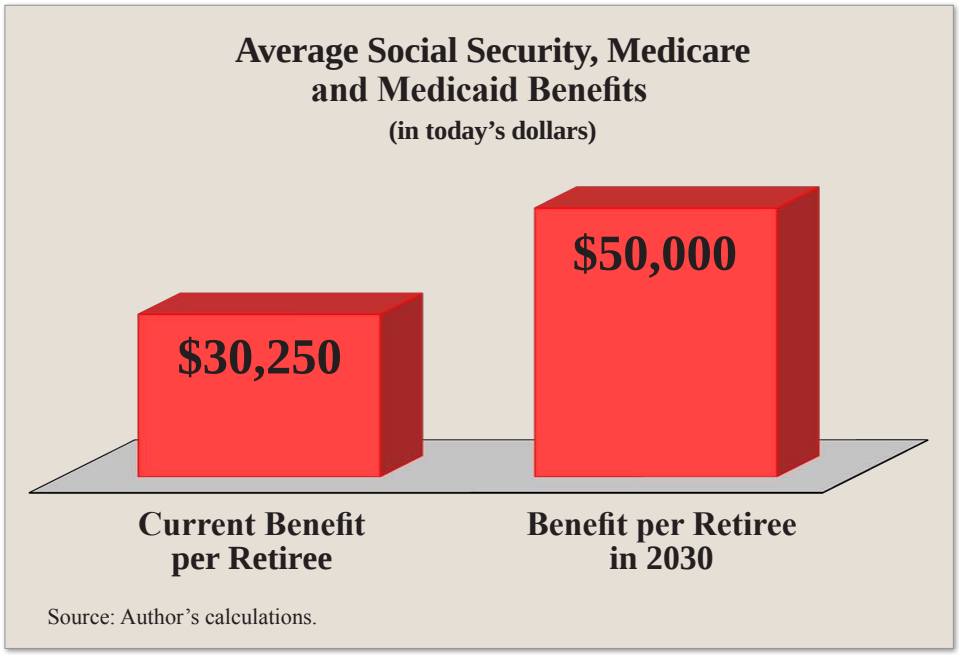
But the $50,000 estimate assumes that the Medicare plus Medicaid real average benefit will grow at only 3.6 percent per year, whereas between 1970 and 2002 the average level of real Medicare plus Medicaid age-specific benefits grew at a rate of 4.6 percent annually. In contrast, real per capita GDP grew at a rate of only 2 percent per year.

Estimating the Fiscal Gap Using Generational Accounting. Generational accounting is a well-established methodology to measure the burden of government. A generational account for any given generation measures the generation's remaining lifetime net tax bill as a present value — what the generation will pay net of what it will receive, all valued as of today. If the generational accounts of all current and future generations are added together, assuming no change in fiscal policy, the sum amounts to what all current and future citizens are going to pay, on net, in taxes to the government (measured as a present value). This amount has to cover the government's official debt plus the present value of all future government purchases of goods and services (discretionary spending).

The fiscal gap is the difference between the government's official debt plus discretionary spending and the amount of taxes current and future citizens will pay. It incorporates all of the government's fiscal activities — including its financial obligations under Medicare, Medicaid, Social Security, welfare, un-

employment, and interest and principal on government debt.

Taking into consideration all of the government's financial liabilities and projected future tax receipts, the current fiscal gap in the United States is estimated by Jagadeesh Gokhale of the Cato Institute and Kent Smetters of the University of Pennsylvania at $77 trillion — more than five times the United States' present GDP. In order to close a gap of this size, the Federal Insurance Contribution Act (FICA) payroll tax — currently 15.3 percent — would need to be more than doubled immediately and permanently.



To understand how this figure can be so large, consider:

- There are now roughly 33 million adults in the United States receiving retirement benefits.
- When the 78 million baby boomers retire, there will be more than twice the number of retirees receiving benefits than there are currently.
- While there will be a significant increase in those dependent on government programs like Social Security and Medicare when the boomers retire, there will only be about 2.7 workers per retiree to help pay the benefits — down from 3.28 workers per retiree in 1985 and 3.43 in 2000.

Adjusting for Risk. There is reason to believe that the $77 trillion figure would be even larger were the government's future cash flow discounted, taking into account that future benefit payment outlays appear to be more certain than do future tax receipts.

For example, according to the Social Security Trustees Report, Social Security is 27 percent underfunded. That is, achieving long-term solvency would require an immediate and permanent 27 percent increase in the 12.4 percent employer and employee payroll tax rate that funds Social Security.

Social Security's long-term solvency estimate also fails to adjust for the riskiness of the system's cash flow. Periods of high unemployment, for example, might require increased borrowing by the Treasury in order to fund benefits. Preliminary analysis from a recent Boston University study suggests that Social Security's failure to risk-adjust its cash flow understates its long-term financial gap by more than 20 percent. Thus, if Gokhale's and Smetters' projections of all the federal government's unfunded obligations were risk-adjusted, they would undoubtedly be much higher.

Conclusion. Given the magnitude of the fiscal gap, the country is broke. The United States is currently short more than $77 trillion and this figure will only increase. In fact, it is estimated that the total gap will amount to nearly $80 trillion in 2010. The United States government, through its various financial agencies, is assuming away the country's fiscal problems rather than confronting and correcting them. Without dramatic and immediate changes in policy, future generations are likely to face lifetime net tax rates that are twice those imposed now.

Laurence J. Kotlikoff is a professor of economics at Boston University and a senior fellow with the National Center for Policy Analysis. This article is adapted from his forthcoming book, Jimmy Stewart Is Dead: Ending the World's Ongoing Financial Plague with Limited Purpose Banking.