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TRUST FUNDS' RAINY DAY POSTPONED, AGAIN

Trustees' reports provide no justification for radical changes in Social Security and Medicare

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The annual reports of the trustees of Social Security and Medicare continue to show improvements in the 75-year outlook for both programs. Social Security is projected to pay full benefits until 2038, one additional year compared to last year's report, and Medicare is expected to pay all costs through 2028, an additional six years over the projection last year. For Medicare, this is the longest projected period of solvency since 1970.

However, the future would look even brighter if the trustees would abandon their unrealistic, overly pessimistic economic assumptions. History and recent experience suggest that the U.S. will enjoy greater real GDP and productivity growth than the trustees assume. The Congressional Budget Office (CBO) projects that the economy over the next 10 years will grow 0.6 percentage points faster than the trustees do. Hence, real wage and payroll tax revenue growth should be larger than predicted. That these reports continue every year to contain brighter forecasts for these programs—despite the pessimistic underlying assumptions—suggests that there is no need to privatize Social Security or fundamentally change Medicare to a program of "premium supports" (i.e., vouchers) as some policy makers propose.

Social Security

Improved finances. The 2001 report continues to push the anticipated dates of Social Security revenue shortfalls further into the future (**Table 1**). For the next 15 years, until 2016, the tax revenue of the trust fund is expected to exceed promised benefits. This is one more year than predicted just a year ago. Total income—tax revenue and interest income—will exceed expenditures until 2025 (as compared to 2024 in the 2000 report), and trust fund assets will be sufficient to cover all benefits until 2038 (compared to 2037 in the 2000 report). Tax revenues are projected to cover two-thirds of benefits in 2075.

TABLE 1
Trustees' assessment of Social Security trust fund, 1997-2001

	1997	1998	1999	2000	2001
Year when tax revenue falls short of benefits	2012	2013	2014	2015	2016
Year when trust fund income falls short of expenditures	2019	2021	2022	2024	2025
Trust fund depletion date	2029	2032	2034	2037	2038
75-year shortfall (percentage points of taxable payroll)	2.23	2.19	2.07	1.89	1.86

Source: Annual Report of the Board of Trustees of the Federal Old-Age Survivors Insurance and Disability Insurance Trust Funds, various years.

Pessimistic assumptions. The trustees' short-term projections reflect some of the economic improvements of recent years. However, the report still paints a bleaker picture of the long-term future than is warranted.

The trustees expect real economic growth to average 2.4% for the next 10 years, up from their prediction of 2.3% last year. But it is rare to have a 10-year period of real GDP growth that is this low. In fact, the average real GDP growth rate among all 10-year periods since 1959 has been 3.1%.

Other forecasts have used assumptions that come much closer to this historic average. The CBO, for instance, assumes average growth of 3.0% over the next 10 years in its projection of the $3.1 trillion on-budget surplus.

The trustees also assume that real wage growth will average 1.0% in the long run, a particularly pessimistic assumption about labor productivity growth. Others, most notably Alan Greenspan and the CBO, have argued that the faster productivity growth of the last few years is here to stay.

While testifying to the Senate Banking Committee on February 13, 2001, Alan Greenspan suggested that new technology has allowed for permanently higher productivity growth, and that old fears about financing the baby boomers' retirement are "now subject to significant question."

In their assumption of 1.5% long-range productivity growth, the trustees depart once again from historical experience. Among all 30-year periods between 1959 and the third quarter of 2000, the average growth rate was 2.0%. Higher productivity growth would mean more wage and tax growth, and thus improve the outlook for Social Security.

If the Social Security trustees changed their assumed productivity growth from 1.5% to 2.0%, the anticipated shortfall would decrease by about 27%. This would mean six years of additional solvency for the trust fund, which would then not become depleted until 2044.

Clearly the Social Security program is sound. Even the trustees' pessimistic projections show that the program will pay full benefits for 37 years, and it will have funds for two-thirds of benefits in 2075 without any changes. Thus, benefit cuts or risky privatization proposals are unwarranted and harmful to America's retirees.

A better way to strengthen Social Security, and to make the payroll tax fairer, is to eliminate the cap on earnings subject to the Social Security payroll tax. Currently, this cap is set at $80,400; earnings above this level are not taxed for Social Security. Although this change would affect just 7% of workers, whose benefits would be increased as well, it would eliminate fully three-quarters of the 75-year funding shortfall.

TABLE 2
Trustees' assessment of the Medicare Part A (HI) trust fund, 1996-2001

	1996	1997	1998	1999	2000	2001
Year when trust fund income falls short of expenditures	1995	1995	1995	2007	2016	2021
Trust fund depletion date	2001	2001	2008	2015	2025	2029
75-year shortfall (percentage points of taxable payroll)	4.52	4.32	2.10	1.46	1.21	1.97*

* Under the assumptions used in previous years, the shortfall would be 1.12 percentage points.

Source: Annual report of the board of trustees of the Federal Hospital Insurance Trust Fund, various years.

Medicare

Brighter future despite changed assumptions. The Social Security trustees also oversee the Medicare program and issue an annual report on its status. There are two Medicare trust funds, one for Medicare Part A—Hospital Insurance (HI)—and one for Part B—Supplemental Medical Insurance (SMI), which provides coverage for doctor visits and other outpatient services. The SMI trust fund functions as an accounting device. Part B is fully financed indefinitely into the future since, by law, one-quarter of its revenue is obtained from premiums paid by beneficiaries and the other three-quarters is automatically transferred from the treasury. Consequently, we examine only the HI trust fund.

In their 2001 report, the Medicare trustees project that income received by the Medicare HI trust fund will exceed outlays through 2020. From 2021 through 2028, the shortfall in income will be filled by redeeming trust fund assets. By 2029, the trust fund will be exhausted, and tax revenue will cover just 68% of costs (**Table 2**). Beyond 2029, assuming no change in the tax rate, payroll taxes will cover a declining share of Medicare HI costs—just 32% in 2075. To provide 75 years of actuarial balance, the payroll tax for HI would need to rise by 1.97 percentage points in 2001.

Compared to last year's report, the trustees show an improvement in the trust fund over the next 10 years—the balance in 2009 is now projected to total nearly $600 billion, over 50% more than last year's estimate. But the long-run outlook appears worse because the trustees have changed their assumptions about future cost growth. In the past, the per-unit cost of health care services received by a beneficiary was assumed to grow at the rate of average wage growth. In response to recommendations by the 2000 Medicare Technical Review Panel, this assumption has been revised upwards. The trustees now assume that costs per beneficiary will grow at the rate of national GDP growth plus one percentage point, increasing the size of the shorfall and making the 2001 projections inconsistent with earlier years. If the cost assumptions had not been changed, the 75-year shortfall would have declined to 1.12% of payroll. Of course, the true rate of future cost growth is unknown.

Despite the gloom and doom with which the Medicare trust fund projections have been received on Capitol Hill and in the media in recent years, the current estimate of 28 years of trust fund solvency is a historic record for longevity. Since 1970, in only three years have the trustees projected more than 15 years of solvency.

President Bush's proposal for the Medicare trust fund. In *A Blueprint for New Beginnings* (Office of Management and Budget 2001), President Bush proposes that the annual Medicare HI surplus be used to offset a portion of SMI costs currently paid out of general revenue. This would constitute a fundamental and severely detrimental restructuring of Medicare revenue sources. Under this proposal, the HI trust fund would be exhausted by the end of this decade instead of in 2029. The proposal would *reduce* money for Medicare just when the country is approaching a period when more money will be needed. This proposal reduction in Medicare funding would greatly weaken its financial outlook.

Seventy-five-year projections. Despite everyone's best efforts, it is essentially impossible to make even ballpark estimates 75 years into the future. Between the 1996 report and the 2000 report the trustees' projections of the 75-year HI funding shortfall *declined* by 73% (from 4.96 percentage points to 1.21). In the 2001 report, despite the large increase in assumed future costs, the 75-year shortfall (1.97 percentage points) is just 44% of the 1996 level. These large shifts over just a few years illustrate the impossibility of making accurate projections 75 years into the future. These are not numbers on which rational policy decisions can be based.

Not only are 75-year projections impossible to make with any accuracy, but they are also inherently biased against the incremental but successful cost-containment efforts that the Health Care Financing Administration has implemented in the past. It is these types of incremental changes (e.g., the fee adjustments enacted in the Balanced Budget Act of 1997) that are responsible for the dramatic improvement in the outlook for Medicare seen over the past five years. Better-than-expected economic growth also played a small role. Specifying the fine adjustments that must be made in provider payments some 25 or 50 years in the future requires a level of detail and precision that is impossible to obtain. But it is this care and specificity that has made these methods successful in containing costs with a minimal amount of disruption of the Medicare system.

Conclusion

Social Security and Medicare are two of the most successful government programs in U.S. history. They provide support for millions of Americans and do so very efficiently. They were designed to be, and for most of their existence have been, pay-as-you go systems. The notion that their strength and continued existence rests upon the demonstration of a 75-year funding stream is quite recent. Nonetheless, even the trustees' pessimistic projections show many years of full funding ahead with no change in tax rates: 37 years for Social Security and 28 years for Medicare. While some changes are needed, fundamental restructuring of these programs is not warranted.