

Comparing Budgetary and Trust Fund Measures of the Outlook for Social Security and Medicare

The most comprehensive view of the financial outlook for Social Security and Medicare comes from estimating the resources that the federal government would need to draw for the programs from the nation's economic output—that is, the share of gross domestic product (GDP) that they would consume. That type of measure is conventionally used for the federal budget as a whole. In contrast, the reports of the Social Security and Medicare trustees are required by law to focus on the status of the trust fund accounts that the Treasury Department maintains for the programs and to indicate whether the Congress has granted them sufficient spending authority to cover their expected payments.

The concepts employed in the trustees' assessments, such as trust fund reserves and actuarial balance, illuminate the programs' accounting, but not the real economic resources they require. First, because the assessments are based on measures of income and spending that are effectively averaged over 75 years, they do not reveal the magnitude of the programs' rising resource requirements. Second, they treat transfers from the government's general fund to the trust funds and the reserves of the funds as resources to pay benefits. However, those transfers and fund reserves are simply the result of credits exchanged between Treasury accounts—and thus reflect the government's commitment to pay the benefits but not necessarily the means to do so.

Although the trustees are required to focus on the status of the trust fund accounts and to base their conclusions on trust fund measures, in recent years they have increasingly brought attention to the growing impact of Social Security and Medicare on the economy. When the future resource requirements of the two programs are shown year by year as a share of GDP, they more than double by 2075, rising from 6.9 percent of GDP today to a projected 16 percent in 2075 (see *Figure 1*). In contrast, when shown using summarized trust fund measures, taxes for Social Security and the Hospital Insurance (HI) part of Medicare would need

to be only one-fourth larger than currently scheduled to restore actuarial balance—an amount less than 2 percent of GDP, on average (see *Figure 2*). Furthermore, no imbalance is shown for the Supplementary Medical Insurance (SMI) part of Medicare, even though its costs are projected to rise from 1 percent of GDP today to 4 percent in 2075 and three-fourths of its financing is drawn from the Treasury's general fund.¹

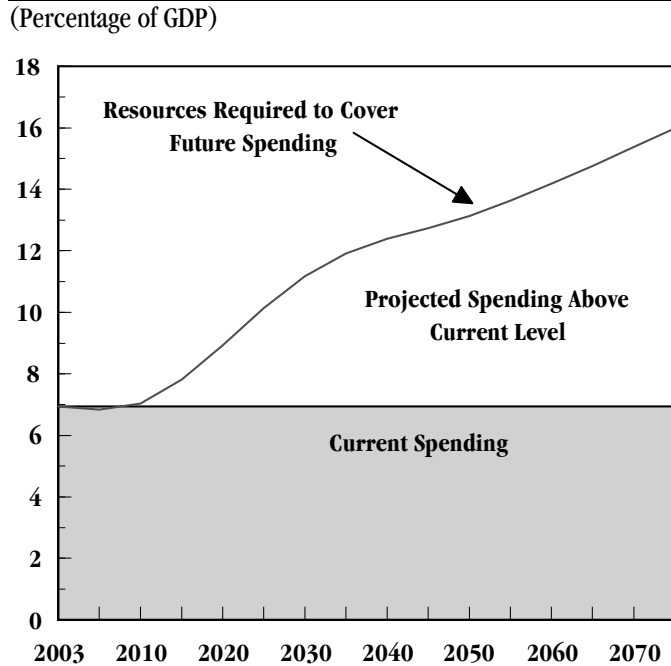
Presenting the financial implications of Social Security and Medicare as they are projected to change over time using the broadest financial denominator—their relative share of gross domestic product—allows for a fuller and more transparent view of their growing impact on the economy.

What Trust Fund Measures Show

When the Social Security and Hospital Insurance trust funds' total income over the following 75 years is estimated to be within 5 percent of their total expenditures, the funds are considered to be financially sound—or in close actuarial balance.² Having reserves credited to the funds throughout

-
1. The Medicare program has two parts. Hospital Insurance, or Part A, helps pay for inpatient hospital care, home health care, skilled nursing, and hospice care for the aged and disabled. Supplementary Medical Insurance, or Part B, helps pay for physicians' services, outpatient hospital care, and other services.
 2. The Social Security and Medicare trustees employ other tests of actuarial balance, but the 75-year summary measure receives the most attention. They also provide supplementary estimates of the programs' rising share of GDP, but their conclusions about actuarial balance stem primarily from summarized averages of the trust funds' income and expenditures. See Social Security Administration, *The 2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (March 17, 2003); and Centers for Medicare and Medicaid Services, *The 2003 Annual Report of the Board of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds* (March 17, 2003).

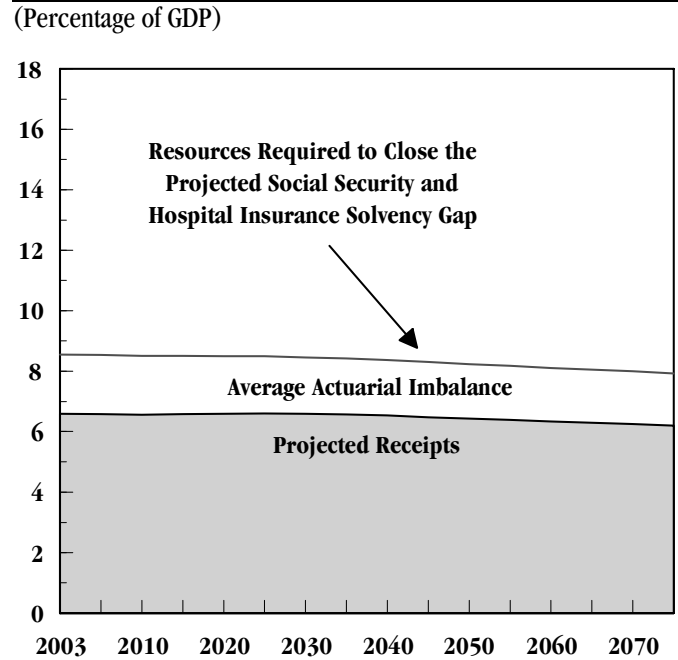
Figure 1.
Projected Social Security and Medicare Spending



Source: Congressional Budget Office based on Social Security Administration, *The 2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (March 17, 2003) and Centers for Medicare and Medicaid Services, *The 2003 Annual Report of the Board of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds* (March 17, 2003).

Note: This figure depicts spending for Social Security and for Medicare’s Hospital Insurance and Supplementary Medical Insurance programs.

Figure 2.
Projected Combined Deficits for the Social Security and Hospital Insurance Trust Funds Under Summarized Trust Fund Measures



Source: Congressional Budget Office based on Social Security Administration, *The 2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (March 17, 2003) and Centers for Medicare and Medicaid Services, *The 2003 Annual Report of the Board of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds* (March 17, 2003).

Notes: This figure depicts the average long-range combined deficit for the Social Security trust funds and for the Hospital Insurance trust fund. No long-range deficit is reported for the Supplementary Medical Insurance trust fund.

The trustees present summarized trust fund estimates for Social Security and for Hospital Insurance as percentages of taxable payroll (see *The 2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, pp. 168-171). For purposes of comparing this figure to Figure 1, CBO converted those summarized estimates into percentages of GDP.

the period is also necessary. Those reserves are the source of authority for the Treasury to write benefit checks; they represent permission to spend. The point at which no reserves remain is technically when benefits can no longer be paid in full or paid on time if income lags behind expenditures.

In presenting assessments of the trust funds' 75-year actuarial status, the trustees' reports show projected income and expenditures as a percentage of the total earnings and self-employment income in the economy that is subject to Social Security or HI taxation, or what is referred to as taxable payroll. In their latest reports, the trustees project that the income of the Social Security trust funds will be 13.78 percent of taxable payroll for the 75-year period as a whole and that the expenditures will be 15.70 percent, leaving a gap, or deficit, of 1.92 percent. The trustees of the HI trust fund project income of 3.37 percent of that fund's (higher) taxable payroll,³ expenditures of 5.77 percent, and a deficit of 2.40 percent. The combined deficit for the two programs is projected to be 4.32 percent of taxable payroll, resulting in an average actuarial imbalance roughly equal to 25 percent of their combined income.

That combined figure shows the amount by which payroll taxes would have to increase today to cover the gap (or, alternatively, how much of a tax increase could be avoided by altering the programs' benefits). Social Security and HI are funded by \$15.30 out of every hundred dollars of the earnings of most workers. As the trustees summarize the problem, if the long-range gap is closed through a payroll tax increase, an additional \$4.32 will be required starting today and continuing throughout the 75-year period.

The Medicare trustees project no long-range actuarial imbalance for SMI, even though premiums paid by beneficiaries cover only one-fourth of the program's costs. Current law requires the federal government to annually cover the remaining costs with credits from the Treasury's general fund—a practice that effectively precludes an adverse conclusion from the trustees.

3. For Social Security, taxable payroll in 2003 is estimated to be \$4.4 trillion; for Medicare's Hospital Insurance, it is estimated to be \$5.4 trillion. HI taxes are levied on all earnings, whereas Social Security taxes are levied on earnings up to a maximum level each year, currently \$87,000. HI taxes are also paid by certain members of the federal workforce and some state and local government workers who do not participate in the Social Security program.

How Budgetary Measures and Trust Fund Measures Differ

Trust fund assessments are the principal means by which the Social Security and Medicare trustees convey to policymakers the adequacy of the programs' future spending authority. But those assessments do not by themselves indicate the programs' budgetary and economic implications.

First, the trustees' focus on a 75-year imbalance of total income and spending does not reveal the long-range draw on workers' earnings that may be required to cover future benefits. Computing the imbalance on the basis of "totals" implies that surpluses projected to occur early in the period will offset later deficits. But crediting surpluses to trust funds is simply a paper transaction. When funds are needed to pay benefits, resources will have to be drawn from the economy. Crediting surpluses to the trust funds will not necessarily create those resources because the surpluses may be used to boost spending on other federal programs or allow other revenues to be lower.⁴ If the surpluses do not raise national saving and, thus, increase the size of the economy, the rate of tax on workers' earnings will have to rise to a much higher level than what is shown by the overall imbalance for the 75-year period. For 2003, the trustees project a combined surplus for Social Security and Hospital Insurance of 1.94 percent of taxable payroll; but for 2075, they project a deficit of 14.14 percent of taxable payroll. Moreover, in the calculation of the overall imbalance, the current reserves of the trust funds and future interest that the Treasury Department credits to them are assumed to offset it in part. If, instead, those reserves and interest credits are viewed as spending authority and not as real resources (that is, as money that the government can draw on), the overall 75-year deficit—and the magnitude of the legislative change needed to eliminate it—will be considerably larger.

Second, the fiscal strain could emerge much sooner than the trustees' measures suggest. The trustees project that the Social Security trust funds will have reserves to carry the program until 2042 and that the HI trust fund will have reserves until 2026. However, if those reserves merely represent bookkeeping entries, receipts for Social Security are

4. See Congressional Budget Office, *Acquiring Financial Assets to Fund Future Entitlements*, Long-Range Fiscal Policy Brief No. 8 (June 16, 2003).

projected to fall below the program's expenditures not in 2042 but in 2018; and for Hospital Insurance, in 2013 instead of 2026. Furthermore, although Medicare's surpluses are usually discussed only in the context of HI, the taxes and premiums collected for Medicare as a whole are already less than its expenditures (largely because the premiums paid by enrollees in SMI cover only one-fourth of the cost of that program).

From a budgetary perspective, those gaps between what the government receives and spends for Social Security and Medicare can only be filled by increased borrowing, higher taxes, reduced spending, or some combination thereof.

Related CBO Publications: *The Impact of Social Security and Medicare on the Federal Budget*, Long-Range Fiscal Policy Brief No. 6 (November 14, 2002); *Social Security and the Federal Budget: The Necessity of Maintaining a Comprehensive Long-Range Perspective*, Long-Range Fiscal Policy Brief No. 3 (August 1, 2002); and *Social Security: A Primer* (September 2001).

This policy brief was prepared by Dave Koitz. It and other publications by CBO are available at the agency's Web site (www.cbo.gov).