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## Can The United States Afford Social Security and Medicare In the Long Term?

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# Background

- Together, Social Security and Medicare comprise 7.5% of the US Gross Domestic Product (GDP)
- By 2082, this percentage is projected to grow to 16.6%
- Can we continue to afford the promised benefits?
- There are two parts to this question

# Economic Considerations

- Can living standards continue improving if increasing resources diverted from workers to non-workers?
- In the past, economy has accommodated large changes in the allocation of resources if gradual
- Proportion of income transferred should not exceed proportion of non-workers in economy
- In the case of Social Security and Medicare, this cap is of theoretical interest only

# Values

- How much are workers willing to be taxed to pay for social insurance programs?
- This is a political issue for which there is no ready answer
- The answer will vary from country to country and from time to time

# Financing Social Insurance Programs

Sources of revenue:

- Premiums paid by program beneficiaries
- Dedicated payroll tax paid by participants while working
- Dedicated payroll tax paid by employers
- Dedicated non-payroll tax, *e.g.*, a value added tax (VAT)
- General revenues
- Borrowing

# Financing Social Insurance Programs

The ultimate source of revenue for social insurance programs is the participants

Two exceptions:

- Revenue from bonds purchased by non-participants
- Revenue from taxes paid by non-participants, e.g., on exported natural resources

# Funding Social Insurance Programs

Timing of revenue relative to payment of benefits

- Unfunded, also known as pay-as-you-go
- Fully funded
- Partially funded

Social Security and Medicare Part A partially funded

Medicare Parts B and D are unfunded

# Funding Social Insurance Programs

- All the money to pay benefits comes from sources which would otherwise be available for other spending purposes at the time benefits are paid
- This is most obvious for unfunded programs

# Funding Social Insurance Programs

## Partial funding with government bonds

- If payroll tax income exceeds benefit payments, excess used to purchase government bonds, proceeds from bond sales spent immediately for government programs
- If benefit payments exceed payroll tax income, general tax revenue must be used to redeem government bonds in trust fund

# Funding Social Insurance Programs

## Partial funding with private securities

- If payroll tax income exceeds benefit payments, excess used to purchase private securities, proceeds from security sales spent immediately according to the needs of the seller
- If benefit payments exceed payroll tax income, private sector funds must be used to purchase securities from the trust funds
- Purchasing securities has same effect as taxation on private sector consumption

# Funding Social Insurance Programs

Full funding with private securities, *e.g.*, individual accounts

- No difference in economic effect from partial funding
- Except for the timing of purchases and sales

# Sustaining Social Insurance Programs

- Nearly all the cost of Social Security and Medicare is borne by program participants at the time benefits are provided
- There is little if anything the nation can do in advance to mitigate the burden of financing these programs

# Sustaining Social Insurance Programs

Possible sources of economic limits on financing Social Security and Medicare

Money diverted to Social Security and Medicare:

- Reduces the size of the economy
- Reallocates resources from more to less productive economic sectors
- Lowers returns on investments
- Reduces worker incentives
- Boosts government borrowing to unsustainable levels

# Sustaining Social Insurance Programs

- All developed countries face challenges due to aging populations
- The US is better off than most in this respect
- Some economic factors put the US at a disadvantage with respect to developing countries
- This disadvantage should be temporary as living standards and longevity in developing countries improve

# Conclusion

- The needs of the elderly and disabled and their dependents will be there whether or not they are met through Social Security and Medicare
- Trimming these programs alone does nothing to mitigate the cost of meeting these needs
- Increasing the combined payroll tax rate by 0.2% per year would finance most of the projected 75-year deficits for these programs
- And would use up less than 20% of the increase in real wages based on the Trustees intermediate assumption set

# Conclusion

- There is certainly some limit to how much the US can afford to pay for Social Security and Medicare
- But there is no good evidence that limit would prevent the US from financing benefits under current law
- The US may decide through the political process that it cannot or does not want to provide the necessary financing
- This would be a political decision, not one based on economic necessity