Confronting the Challenges Presented by an Aging Population  
Testimony before the Senate Labor and Human Resources Committee, Subcommittee on Aging  
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Introduction:
Our difficulties in making budgetary decisions is a reflection of our own ability to govern ourselves. This difficulty, however, needs to be put in context. Although we may be living in a period of political constraint, it is a period of economic opportunity. Our incomes are growing, not declining. Resources available to government are rising hand-in-hand with incomes. Meanwhile, the end of the Cold War has produced yet another peace dividend, as reflected in declining portions of our income being spent on defense. The ratio of elderly to workers is unusually small for the next couple of decades, as a baby bust population born in the Depression and World War II fills in the ranks of the elderly while the post World War II baby boomers temporarily swell the size of the working population.

Every once in a while I wake up from a dream where a researcher from the National Institutes of Health comes running into a Congressional hearing such as this one and proclaims, "Eureka, I’ve found a cure for cancer." Rather than celebrating and jumping up and down with glee, the members of the subcommittee instead beat their brows and begin to commiserate among themselves. "What is going on here? What is their problem?" I ask myself. Then suddenly I realize that they can see only the effect of a new medical miracle on the budget: higher health costs associated with a new technology and higher Social Security costs associated with longer lives.

Before you reject this dream as being unworldly, I invite you to consider what is going on in public policy today. What parts of the budget have grown the most in recent decades and are the greatest concern for the future? While health, retirement, and disability comprised less than 10 percent of the federal budget in 1950, they are now approaching one-half (see Figure 1). The remaining half includes defense, interest on the debt, and everything else that the government does. Both retirement and health costs, moreover, will rise significantly once baby boomers begin to retire early next century—thus putting even more pressure on the rest of the budget.

It is vital to recognize that spending on retirement and health has been on a five-decade growth path that is not sustainable even if there were no demographic problem caused by declining birth rates and the upcoming retirement of the baby boom population. This demographic problem is highlighted by the movement of the baby boom hump through the age distribution (see Figure 2). The budgetary problem, therefore, is really a dual one. No proposal for budget reform even in 1995 and 1996 dealt fully even with moving off of an unsustainable path, much less the second one related to demographics.

The phenomenal past growth in retirement and health expenditures hardly has derived from a deterioration of conditions in society. Unlike high crime rates, educational test scores that either decline or fail to rise, or growing numbers of children growing up without both parents, our budgetary problems in the fields of health and retirement come about mainly from gains to society. The issue in retirement and health is how to distribute the gains in well-being due to better health and longer lives—not how to overcomes losses or new threats.

I am among those who are quite concerned about the impact of our deficits—indeed, government deficits through out much of the industrial world—on saving. Certainly reducing the deficit and attempting to make more saving available for private investment is a worthy goal. Reducing the deficit, however, is not enough.
Government doesn't exist merely to cut back its own deficit. If all we achieve is to get government debt onto a stable path for the long term—and that is no small objective—we will not have succeeded in regaining control over our budget and our destiny. Spending today and tomorrow will still be determined primarily by decisions made in the past. Our ability to respond to current needs will remain diminished.

The push for larger and larger shares of our budget to be spent on additional years of retirement and greater amounts of health benefits increasingly makes our budget one oriented toward consumption. A larger share for retirement and health means a smaller share for everything else. It becomes difficult, in particular, to devote resources to promote productive activity among the young through programs of education, training, mentors, and after-school activities—whatever it takes to move them away from the boredom, inactivity, isolation, and segregation that leads to so many of our social problems.

Built-in budget growth deters us from providing to our Presidents and Congresses the economic levers they must have to promote our interests as a world economic and political power. Even among the elderly, determining growth through past formulas has oriented increased resources less toward the needs of the poorer and older elderly and more toward additional years of retirement of relatively prosperous near elderly and younger elderly. In sum, we have taken from ourselves the freedom to allocate government resources by relying mainly upon past decisions and formulas to determine how today's expenditures should grow. This is reflected in part in the declining share of our budget which is discretionary—going down to less than 30 percent by the end of the decade (see Figure 3). As a consequence, our budget is increasingly likely to be oriented toward lower priorities and lesser needs.

In the reminder of my testimony, I would like to concentrate in more detail on some of these long-term budgetary implications.

**Social Security and Medicare: Some Long-Term Patterns**

One way to illustrate the full impact of Social Security and Medicare growth on the federal government's fiscal posture is to show how spending in these programs is expected to change as a percentage of the national economy or GDP. The assumptions here are based on the 1995 best estimates of the Social Security Administration and the Health Care Financing Administration, as well as some very conservative assumptions that growth in health costs will be brought under control almost immediately.

By 2030, the ratio of Old Age and Survivors (OASI) beneficiaries to workers is expected to rise by about 60 percent (see Figure 4). Partly for this reason, Old Age, Survivors, and Disability (OASDI) outlays (less income taxes on benefits) are expected to increase from 4.7 percent of GDP in 1996 to about 6.4 percent by 2030 (see Figure 5). Although projections of health spending are highly speculative, net Medicare spending would rise from 2.4 percent in 1996 to 6.4 percent in 2030 under intermediate projections of Social Security's trustees. Even under an extraordinarily optimistic assumption that Medicare costs per enrollee grow at the same rate as per capita GDP after 1996, health costs would still rise to approximately 3.8 percent of GDP by 2030. Demographic effects alone, therefore, imply that we will be spending close to 3.1 percent more of GDP on Social Security and Medicare; in today's dollars, that is about $227 billion more than if real spending merely kept pace with real growth in GDP. If we add current projections of inflation in real health costs, the additional amount to be spent rises to about 5.8 percent of GDP. These figures, moreover, do not take into account the growth in cost of Medicaid, including the substantial portion that goes for long-term care.

Now consider the bind that government will find itself in when projected growth of Social Security and Medicare is combined with already potent deficit pressures. If average tax rates were to remain constant at 1996 levels, and spending other than OASDI and Medicare are also held constant as a percent of GDP, then the deficit would rise to 7.7 percent of GDP by 2040 (see Figure 5). If one were to focus solely on taxes as a correction, and I do not suggest such action, it would eventually require and increase in Social Security tax rates of about 4 to 5 percentage points as we move toward the middle of the next century simply to prevent OASI from spending more than it takes in revenues. An increase of even greater magnitude would be required to keep Medicare taxes and expenditures in balance.

The notion, by the way, that Social Security can spend interest earnings and "deposits" in the trust funds—essentially paper transactions within government itself—ignores the impact of a future Social Security deficit on the total budget. The figures I cite above show roughly the combined impact of future Social Security deficits when combined with a non-Social Security deficit of today's magnitude.

**Lifetime Benefits.** An alternative way of viewing the cost of programs is by looking beyond annual costs toward the value of lifetime benefits—the amount of money it would take for households to buy a private insurance policy that provided equivalent benefits. Many believe that Social Security has grown so large because of decisions such as those to index the system for inflation. In my view this is misleading.

In Figure 6, I show Social Security benefits in the first year of retirement—a number that would not change no matter what is done with indexing for inflation. What essentially happens here is that these annual benefits grow as fast as wages in the economy over time, which, in turn, grow faster than inflation. Thus, Social Security is designed over time to provide higher and higher levels of real benefits.

Annual benefits, however, can be misleading. Perhaps the most important budgetary decision we have made over the years in Social Security has been to provide more and more years of retirement support. Figure 7 shows one aspect of this: the increase in life expectancy at age 65. People, however, are also retiring much earlier and many more are living to receive retirement benefits. For a couple retiring at age 62 today, annuity payments can be expected to last for one-quarter of a century on average. That is, the longer living of the
two—Social Security operates like an insurance policy with a right of survivorship—will on average receive 25 years worth of Social Security benefits.

The combination of real growth in annual benefits, combined with more years of retirement support, lead to a significant increase in lifetime benefits. For an average income one-earner couple retiring at age 65 in 1960, for instance, total Social Security cash benefits were worth about $99,000 (in 1993 dollars). Today those benefits would cost $223,000. In another 25 years, the Social Security pensions of new retired couple with average incomes will have a value of about $313,000 (see Figure 8). Remember again that one reason these lifetime costs are this high is that benefits are scheduled to last for more than two decades.

Until recently, almost all recipients—whether rich or poor—received more in benefits than they paid in taxes and the interest they could have earned on those taxes (see Figures 9 and 10). Those who were richer, moreover, consistently received transfers (benefits in excess of taxes) as large, if not larger, than those who were poorer. To take an example, low-income couples retiring in 1980 paid into the system about $27,000 in taxes and got back $150,000—a net transfer of $123,000. High income couples retiring in that year paid in about $83,000 in taxes, but got back $316,000—a net transfer of $233,000. Only now and in the future will that situation gradually begin to reverse itself—and even then low-income households will sometimes receive fewer net OASI transfers than those with higher incomes.

When Social Security and Medicare benefits are added together, an average-income couple retiring today is promised benefits not far from 1/2 million dollars—growing toward $800,000 by the year 2030 (see Table 1). For some high-income couples retiring in the future, the value of benefits will approach 1 million dollars.

The growth in future costs, of course, is unsustainable. The rise in value reflects what is promised, not what can be delivered. Based upon lifetime values, however, even today's benefits are not trivial. The difficulty is that we have given up control over how to allocate them. Rather than devoting them, for instance, toward keeping all the elderly out of poverty, we continue to provide substantial numbers of years in retirement and more and more in the way of health benefits. In the latter case, of course, some of the increased cost tends to go toward higher prices for health care rather than more services, and to support higher compensation levels among health care providers.

**Efforts Required**

Over the years I have had the opportunity to be involved in many budget, tax, and expenditure reform exercises under both Democratic and Republican Presidents. One difficulty of these exercises is that they often focus on particular programs or interest groups without going back to more fundamental principles. That is, to save on time and simplify decision-making, a deficit-cutting process often gets pushed into a "laundry list" approach: picking off programs or perhaps interest groups. A bottom line figure is achieved by adding together all the cuts made.

A more fundamental reform of entitlements and programs for the elderly and near-elderly, however, requires a systematic examination of each program, a task that extends beyond simply identifying which programs have either unreasonable or unsustainable built-in growth rates. It requires looking at individual, not just group, circumstances. In my work with Jon Bakija on Social Security, for instance, we suggested a number of reforms such as increasing the retirement age, Social Security tax reform of the tax base, and counting all years of contributions in determining benefits. At the same time, we suggested some reforms that, if considered in isolation, might be cost-increasing. For instance, there is really not excuse in so generous a program for continuing to have so many poor elderly. Secondary workers are treated inequitable and often get almost no additional return on their additional tax contributions, even while some wealthy individuals are given additional returns on additional contributions. The earning test in Social Security in our view should be abandoned because it tends to tell the elderly that they are unproductive and sends a strong message not to work, while the requirement that Medicare be a secondary payor to private employers is a significant penalty that probably forces many elderly out of the work force.

**Conclusion**

From a Budget perspective, the current design of programs for the elderly and near-elderly present two major problems. First, many have built-in rates of growth that are far in excess of what the nation can pay even if tax rates were raised substantially. Second, they deprive each generation of the right to decide how to allocate the revenues available to it; by pre-determining future budgets, they weaken each generation's ability to orient resources toward those new needs that they deem most important. Meanwhile, the built-in growth of many programs creates significant pressures on the deficit, so that future generations are denied not only the right to decide how to allocate revenues, but required to spend increasing portions of tax dollars simply to pay off debt left to them from the past.

A couple of years ago President Clinton furled the colors of the U. S. Army's Berlin Brigade, a detachment of soldiers that remained in that city for approximately one-half century. This commitment from past generations helped leave posterity, both here and abroad, with a world that was safer and more democratic. Their gift and sacrifice was costly to them and extraordinarily generous to us. As I read about this event, I began to wonder what Gifts from today will historians acknowledge in another half century. What hard choices will they say we made toward confronting the most important needs of our time and leaving the world better for our children and their children? I have my doubts that these future historians will be moved by budgets that in time of opportunity leave more and more debt to future generations, that are oriented toward more consumption and less investment, that treat individuals as unproductive for their last tow decade of life, and
that expand rapidly a reactive "sick care" system rather than a broader system that tries to prevent many of our societal and health problems from occurring in the first place.

**FIGURE 1: CHANGE IN THE COMPOSITION OF THE FEDERAL BUDGET, 1950-2002**


**FIGURE 2: BABY BUST, BABY BOOM, BABY BUST**

*The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime, if she were to experience the birth rates by age, observed or assumed, for the selected year, and if she were to survive the entire child-bearing period. Source: C. Eugene Steule and Gordon Mermin, THE URBAN INSTITUTE. Historical data from the Social Security Administration, Office of the Actuary (1992) and the annual report of the Board of Trustees of the OASDI Trust Funds (1995).*
FIGURE 3: MAJOR SPENDING CATEGORIES AS PERCENTAGE OF TOTAL FEDERAL OUTLAYS

C. Eugene Steuerle and Gordon Mermin, THE URBAN INSTITUTE. Deposit insurance and offsetting receipts are not included in total federal outlays. Calculations based on historical and baseline data from the Congressional Budget Office (December, 1995).

FIGURE 4: SOCIAL SECURITY BENEFICIARIES PER WORKER GROW


FIGURE 5: FUTURE GROWTH IN SOCIAL SECURITY AND MEDICARE MEANS HIGHER TAXES, LARGER DEFICITS, OR LOWER SPENDING ON EVERYTHING ELSE
SMI premiums and income taxes on OASI benefits are counted as expenditure reductions. Assumes SMI premiums remain at 25% of program costs indefinitely and spending - besides OASDI and Medicare - and taxes remain constant as % of GDP after 1996.


**FIGURE 6: OASI BENEFIT IN FIRST YEAR OF RETIREMENT IN THOUSANDS OF CONSTANT 1993 DOLLARS**

Assumes retirement at the normal OASI age and couples are the same age.


**FIGURE 7: LIFE EXPECTANCY AT AGE 65**
FIGURE 8: LIFETIME OASI BENEFITS FOR AN AVERAGE-WAGE ONE-EARNER COUPLE (1993 DOLLARS)

Discounted to present value at age 65 using a 2% real interest rate. Adjusts for the chance of death in all years after age 21. Includes actuarial value of all OASI worker’s, spousal, and survival benefits payable over a lifetime.


FIGURE 9: LIFETIME OASI BENEFITS, TAXES, & TRANSFERS FOR AN AVERAGE-WAGE ONE-EARNER COUPLE (1993 Dollars)
Discounted to present value at age 65 using a 2% real interest rate. Adjusts for the chance of death in all years after age 21. Includes actuarial value of all OASI worker's, spousal, and survival benefits payable over a lifetime.

### Table 1
Federal and State Medicaid Expenditures, 1988-1995

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<th>Expenditures</th>
<th>1988</th>
<th>1992</th>
<th>1995</th>
<th>Average Annual Growth</th>
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<tr>
<td>Total</td>
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<td>Benefits</td>
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<td>98.5</td>
<td>132.8</td>
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<td>Acute Care</td>
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<td>55.5</td>
<td>60.4</td>
<td>21.6%</td>
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<tr>
<td>Long-term Care</td>
<td>25.1</td>
<td>42.9</td>
<td>52.3</td>
<td>14.3%</td>
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<tr>
<td>Benefits by Group</td>
<td>50.6</td>
<td>98.5</td>
<td>132.8</td>
<td>18.1%</td>
</tr>
<tr>
<td>Elderly</td>
<td>18.1</td>
<td>31.4</td>
<td>39.4</td>
<td>14.7%</td>
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<tr>
<td>Blind and Disabled</td>
<td>19.3</td>
<td>36.2</td>
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<td>17.0%</td>
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<td>Families</td>
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<td>30.9</td>
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<td>2.4</td>
<td>3.9</td>
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<td>12.2%</td>
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</table>

### About the Author

**C. Eugene Steuerle** is a senior fellow at the Urban Institute and author of a weekly column, "Economic Perspective," for *Tax Notes* magazine. At the Institute he has conducted extensive research on budget and tax policy, social security, health care and welfare reform. Earlier in his career, he served in various positions in the Treasury Department under four different Presidents and was eventually appointed Deputy Assistant Secretary of the Treasury for Tax Analysis. Dr. Steuerle serves or has recently served as an advisor, consultant, or board member for the American Tax Policy Institute, the Joint Committee on Taxation, retreats of the Senate Finance Committee and the House Ways and Means Committee, the International Monetary Fund, the Internal Revenue Service, the Entitlement Commission, the Department of Labor, the National Commission on Children, a technical panel to the Social Security Advisory Council, the National Council on Aging, and as a member of the Capital Formation Subcouncil of the Competitiveness Policy Council. His publications include six books, and more than 100 reports and articles, 350 columns and 35 Congressional testimonies or reports.

### Other Publications by the Authors

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