

Status of the Social Security and Medicare Programs

**A SUMMARY OF THE
2001 ANNUAL REPORTS**

**Washington, D.C.
March 2001**

**Social Security and Medicare
Boards of Trustees**

Hypertext versions of the Social Security and Medicare Trustees Reports as well as this document are available on the Internet at the following addresses:

Social Security (OASDI): <http://www.ssa.gov/OACT/TR/TR01/index.html>
Medicare (HI and SMI): <http://www.hcfa.gov/pubforms/tr/>
Summary: <http://www.ssa.gov/OACT/TRSUM/trsummary.html>

A MESSAGE TO THE PUBLIC:

Each year the Trustees of the Social Security and Medicare trust funds report in detail on the funds' current status and their projected condition over the next 75 years. Here we summarize and synthesize the major findings contained in the 2001 Annual Reports. But first, we highlight the most significant implication of these findings, which is that both Social Security and Medicare need to be reformed and strengthened at the earliest opportunity.

The near-term financial conditions of both Social Security and Medicare have improved since last year's reports, but the programs continue to face substantial financial challenges in the not-too-distant future that need to be addressed. In both cases the long-term financing gap is large, and closing that gap will require innovative solutions that can also present opportunities to strengthen the programs.

- For Medicare, solutions to its financial problems also provide the opportunity to enhance the quality of medical care by tapping into the tremendous potential for improvements in underlying health care productivity.*
- For Social Security, the traditional solutions have focused on benefit cuts and tax increases, but could be expanded to include finding ways for workers to benefit from the economy-wide rate of return on private capital.*

With informed public discussion and creative thinking that relates the well-established principles underlying the Social Security and Medicare programs to the economic and demographic realities of the 21st century—and with timely legislative action—these programs can continue to play their critical role in the lives of all Americans.

Medicare

Medicare's financial condition has improved in recent years, but this should not lead to complacency. Medicare still faces financial difficulties that come sooner—and in many ways are more severe—than those confronting Social Security. While both programs face similar demographic challenges, Medicare costs per enrollee are projected to rise faster than wages and eventually will place larger demands on the Federal budget and beneficiaries.

Although the short-term solvency of Medicare has improved, the most significant change reflected in this year's reports is that health care costs per capita are assumed to increase at a faster rate than had been assumed in previous reports. The change in this key assumption was recommended by an independent, expert panel of actuaries and economists convened last year to review the assumptions and methods underlying the reports. It has the effect of substantially raising the long-term cost estimates for both the Medicare Hospital Insurance (HI) and Supplementary Medical Insurance (SMI) programs and in our judgment represents a more realistic assessment of likely long-term cost growth.

While these reports present the HI and SMI Trust Funds separately, it is important to recognize the financial challenge facing the Medicare program as a whole and the need for integrated solutions.

- Costs for the two program components combined will grow from 2.3 percent of gross domestic product (GDP) today to 4.5 percent in 2030 and 8.5 percent in 2075 based on intermediate economic and demographic assumptions. By comparison, total HI and SMI revenues (excluding interest) will only grow from 2.4 percent of GDP today to 3.7 percent in 2030 and 5.3 percent in 2075. If the HI financing gap is not addressed, SMI general revenues would eventually constitute a larger share of total Medicare income than HI payroll tax revenues.*
- Because of the new long-term growth assumption, the current projection of combined expenditures as a share of GDP in 2075 is nearly as large as the projections made prior to the Balanced Budget Act of 1997, indicating that the need for long-term reform has not substantially abated despite the improvements brought about in recent years.*
- Medicare spending is ultimately projected to exceed the costs of Social Security. The financing gap for HI alone—which constitutes just over one-half of total Medicare costs—is larger than the gap for Social Security, and the HI Trust Fund will become insolvent 9 years sooner than the combined Social Security trust funds.*

The HI Trust Fund is projected to remain solvent until 2029, an improvement of 4 years over last year's report, reflecting both stronger-than-expected economic growth and lower-than-expected program costs due to reduced payment errors, low increases in health care costs generally, and reduced utilization of skilled nursing facility services in 2000. Even so, projected tax income falls short of outlays beginning in 2016. Over the long range, the HI Trust Fund fails by a wide margin to meet our test of

financial balance. The sooner reforms are made the smaller and less abrupt they will have to be in order to achieve solvency through 2075.

- *The gap between income and costs can best be expressed relative to taxable payroll (the HI Trust Fund's funding base), and this year the 75-year actuarial deficit is projected to be 1.97 percent of taxable payroll—an increase of 0.76 percentage point from last year's estimate.*
- *This means that bringing the HI program into actuarial balance over the next 75 years could be achieved by either an immediate increase in income of 60 percent (e.g., by raising the payroll tax rate from 1.45 to 2.44 percent on both employers and employees) or an immediate reduction in program outlays of 37 percent from their currently projected levels, or some combination of the two.*

The SMI Trust Fund, which pays doctor's bills and other outpatient expenses, is projected to remain adequately financed into the indefinite future—but only because current law sets financing each year to meet next year's expected costs. Over time, this will require a rapidly growing share of general revenues and substantial increases in beneficiary premiums. Partly to reflect concerns that this automatic financing mechanism has diverted attention from the growth of SMI costs, this year's report includes a new section on the implications of SMI cost growth for beneficiaries and the Federal budget.

Social Security

Social Security solvency is slightly improved compared to last year's report, and the trust funds are projected to be adequately financed one year longer than in last year's report, or until 2038, based on intermediate economic and demographic assumptions. Individually, the Old-Age and Survivors Insurance (OASI) Trust Fund, which pays retirement and survivors benefits, is projected to be able to pay full benefits on time until 2040, and the Disability Insurance (DI) Trust Fund until 2026.

When the baby-boom generation begins to retire about 2010, however, financial pressure on the Social Security trust funds will rise rapidly, and tax income will fall short of outlays beginning in 2016. Over the long range, the combined trust funds fail by a wide margin to meet our test of financial balance. The 75-year projected actuarial deficit in the combined OASDI Trust Funds is 1.86 percent of taxable payroll, a slight decrease from last year's deficit of 1.89 percent that is largely due to recent demographic experience.

- *This deficit means bringing Social Security into actuarial balance over the next 75 years could be achieved by either a permanent*

13-percent reduction in benefits or a 15-percent increase in payroll tax income, or some combination of the two.

- *On a year-by-year basis, cash-flow deficits are projected to rise to levels in excess of 6 percent of taxable payroll by the end of the 75-year period primarily because of the upward shift in the average age of the population.*

The large annual deficits at the end of the 75-year projection period indicate that costs will very likely continue to exceed tax revenues after 2075. As a result, ensuring the sustainability of the system beyond 2075 would require larger changes than needed to restore 75-year actuarial balance. We should be prepared to take action to address the OASDI financial shortfall in a timely way because, as with Medicare, the sooner adjustments are made the smaller and less abrupt they will have to be.

By the Trustees:

*Paul H. O'Neill,
Secretary of the Treasury,
and Managing Trustee*

*Elaine L. Chao,
Secretary of Labor,
and Trustee*

*Tommy G. Thompson,
Secretary of Health
and Human Services,
and Trustee*

*William A. Halter,
Acting Commissioner
of Social Security,
and Trustee*

*John L. Palmer,
Trustee*

*Thomas R. Saving,
Trustee*

A SUMMARY OF THE 2001 ANNUAL SOCIAL SECURITY
AND MEDICARE TRUST FUND REPORTS

Who Are the Trustees? There are six Trustees: the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security and two members appointed by the President and confirmed by the Senate to represent the public. The Public Trustees are John L. Palmer, Dean and Professor of Economics and Public Administration of the Maxwell School of Citizenship and Public Affairs at Syracuse University, and Thomas R. Saving, Director of the Private Enterprise Research Center and Professor of Economics at Texas A & M University.

What Are the Trust Funds? The trust funds are financial accounts in the U.S. Treasury. Social Security and Medicare taxes, premiums and other income are deposited in these accounts, and Social Security and Medicare benefits are paid from them. The only purposes for which these trust funds can be used are to pay benefits and program administrative costs.

The trust funds hold money not needed in the current year to pay benefits and administrative costs and, by law, invest it in interest bearing securities that are guaranteed by the U. S. Government. A market rate of interest is paid to the trust funds on the securities, and when these securities reach maturity or are needed to pay benefits, the Treasury redeems them.

There are four separate trust funds. For Social Security, the Old-Age and Survivors Insurance (OASI) Trust Fund pays retirement and survivors benefits, and the Disability Insurance (DI) Trust Fund pays disability benefits. (The two trust funds are described together as OASDI.)

For Medicare, the Hospital Insurance (HI) Trust Fund pays for inpatient hospital and related care, and the Supplementary Medical Insurance (SMI) Trust Fund pays for physician and outpatient services. Medicare benefits are provided to most people age 65 and over and to most workers who are receiving Social Security disability benefits.

What Were the Trust Fund Results in 2000? In December 2000, 38.7 million people were receiving OASI benefits, 6.7 million were receiving DI benefits, and about 39 million were covered under Medicare. Trust fund operations, in billions of dollars, are shown below (totals may not add due to rounding).

	<u>OASI</u>	<u>DI</u>	<u>HI</u>	<u>SMI</u>
Assets (end of 1999)	\$798.8	\$97.3	\$141.4	\$44.8
Income during 2000	490.5	77.9	167.2	89.9
Outgo during 2000	358.3	56.8	131.1	90.7
Net increase in assets	132.2	21.1	36.1	-0.8
Assets (end of 2000)	931.0	118.5	177.5	44.0

How Are Social Security and Medicare Paid for? For Social Security and the Hospital Insurance part of Medicare, the major source of financing is payroll taxes on earnings that are paid by employees and their employers and by the self employed. People who are self employed are charged the equivalent of the combined employer and employee tax rates. The payroll tax rates are set by law and for OASI and DI apply to earnings up to a certain annual amount. This amount rises as average wages increase, and in 2001, it is \$80,400 for OASDI. HI taxes are paid on total earnings. The tax rates (in percent) for employees and employers each under current law are:

Year	OASI	DI	OASDI	HI	Total
2001 and later . .	5.30	0.90	6.20	1.45	7.65

The Supplementary Medical Insurance part of Medicare is financed largely by payments from Federal general revenues supplemented by monthly premiums charged beneficiaries (\$50.00 in 2001). Trust fund income by source in 2000 is shown in the table below.

Source (<i>in billions</i>)	OASI	DI	HI	SMI
Payroll Taxes	\$421	\$71	\$144	—
General Revenue	—	—	—	\$66
Interest Earnings	58	7	11	3
Beneficiary Premiums . .	—	—	1	21
Taxes on Benefits	12	1	9	—
Other	—	-1	1	—

What Were the Administrative Expenses in 2000? Administrative expenses, as a percentage of total expenditures, were:

	OASI	DI	HI	SMI
Administrative Expenses 2000	0.6	2.9	2.0	2.0

How Are Estimates of the Trust Funds' Future Status Made?

Short-range (10-year) and long-range (75-year) estimates are reported for all funds. The estimates are based on current law and assumptions about all of the factors that affect the income and outgo of each trust fund. Assumptions include economic growth, wage growth, inflation, unemployment, fertility, immigration, and mortality, as well as factors relating to disability incidence and the cost of hospital and medical services.

Because the future cannot be predicted with certainty, three alternative sets of economic and demographic assumptions are used to show a range of possibilities. The intermediate assumptions (alternative II) reflect the Trustees' best estimate of future experience. The low-cost alternative I is more optimistic for trust fund financing, and the high-cost alternative III is more pessimistic; they show trust fund projections if economic and demographic conditions are more or less favorable for trust fund financing than the best estimate.

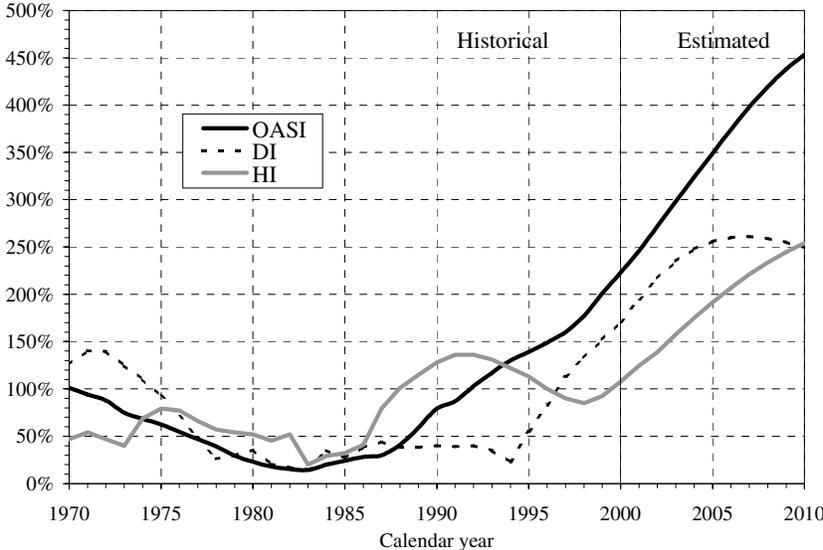
The assumptions are reexamined each year in light of recent experience and new information about future trends, and are revised as warranted. In general, greater confidence can be placed in the assumptions and estimates for earlier projection years than for later years. While estimates of income and expenditures usually have been close to actual experience, any estimates for as long as 75 years into the future are inherently uncertain. Nonetheless, careful updating of the assumptions on an annual basis provides an indication of the range of future possibilities.

What is the Short-Range Outlook (2001-2010) for the Trust Funds?

For the short range, we measure the adequacy of the OASI, DI, and HI Trust Funds by comparing their assets at the beginning of a year to projected benefit payments for that year (the “trust fund ratio”). A trust fund ratio of 100 percent or more—that is, assets at the beginning of a year at least equal to projected benefit payments for that year—is considered a good test of a fund’s short-term adequacy. This level of assets means that even if income fell short of expenditures in one or more years, the trust fund could pay full benefits, allowing time for legislative action to restore financial adequacy.

By this measure, the OASI, DI, and HI funds are considered financially adequate throughout the short range because the assets of each fund are over the 100 percent level through the year 2010. Chart A shows these trust fund ratios under the intermediate assumptions.

Chart A—OASI, DI, and HI Trust Fund Ratios
[Assets as a percentage of annual expenditures]



For SMI, a less stringent annual “contingency reserve” asset test applies because its financing—provided by beneficiary premiums and Federal general revenue payments—is automatically adjusted each year to meet expected costs. Thus, under current law SMI is fully financed throughout the 75-year projection period.

The table below shows the projected income and outgo, and the change in the balance of each trust fund over the next 10 years.

ESTIMATED OPERATIONS OF TRUST FUNDS

(In billions—totals may not add due to rounding)

Year	Income				Expenditures				Change in fund			
	OASI	DI	HI	SMI	OASI	DI	HI	SMI	OASI	DI	HI	SMI
2001	\$520	\$84	\$173	\$98	\$378	\$61	\$142	\$104	\$142	\$23	\$30	-\$6
2002	553	90	184	113	395	65	150	114	158	24	34	-1
2003	586	95	195	123	413	71	154	122	173	24	41	1
2004	622	101	206	131	433	77	162	130	188	24	45	1
2005	661	107	219	141	456	84	171	140	205	23	48	1
2006	702	113	232	151	480	91	182	149	221	22	50	1
2007	746	119	246	161	508	99	193	159	238	20	53	1
2008	791	125	260	173	538	108	205	171	253	17	55	3
2009	840	132	275	186	574	116	218	183	266	15	57	3
2010	891	138	291	200	613	125	233	196	278	13	59	4

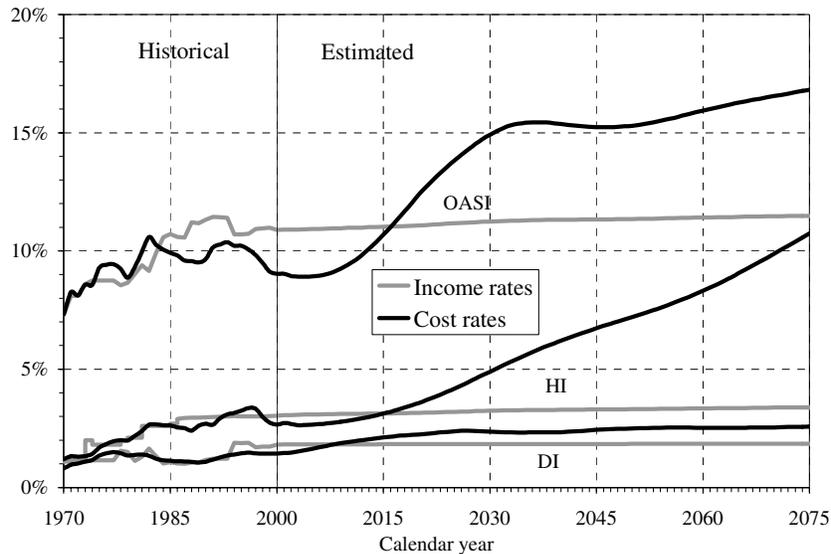
What is the Long-Range (2001-2075) Outlook for the OASI, DI, and HI Trust Funds? Over the long term neither the OASI, the DI nor the HI Trust Fund is projected to be in balance. Chart B compares, under the intermediate assumptions, the income and cost rates of these funds over the next 75 years.

In Chart B the long-range income and cost of OASI, DI, and HI are measured in percentage of taxable payroll rather than in dollars because the value of a dollar changes over time. (Taxable payroll is the portion of total wages and self-employment earnings taxed under the OASDI and HI programs.) Over the 75-year period, the income rates for OASI, DI, and HI remain relatively constant, while the cost rates rise substantially.

For OASI, the income rate is projected to remain above the cost rate for 16 years. Starting in about 2010, however, the OASI cost rate will begin increasing rapidly as the leading edge of the “baby-boom” generation reaches retirement age. In 2017 and later, the cost rate for OASI will exceed the income rate by growing amounts—by the end of the 75-year projection period the cost rate for OASI will be almost 1½ times as large as the income rate.

The income rate for DI is higher than the cost rate only through 2008, after which the annual shortfall of tax income is projected to increase slowly over the 75-year period.

Chart B—Income and Cost Rates
[Percentage of taxable payroll]



The cost rate for HI is lower than the income rate through 2015, after which costs exceed income by growing amounts—by 2075, the HI cost rate is projected to be more than 3 times the HI income rate.

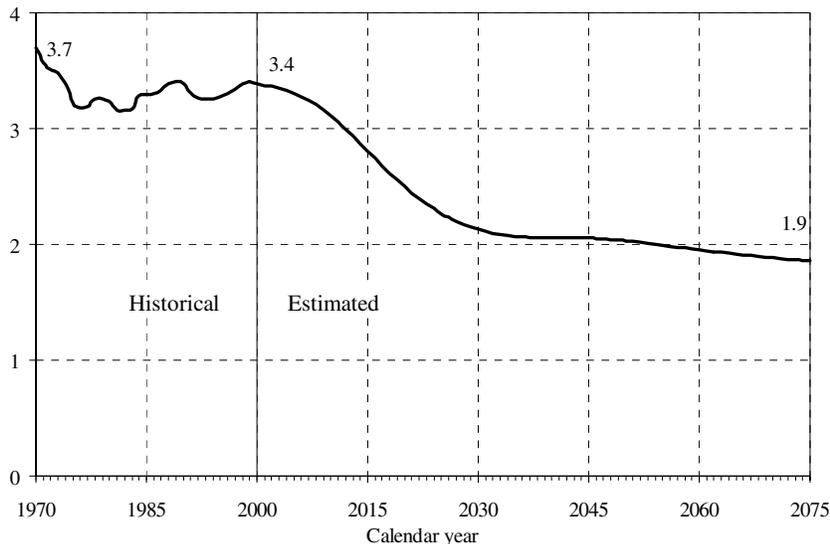
The income rates in the future for OASI, DI, and HI remain relatively constant in Chart B because the payroll tax rates for the programs are not scheduled to change. Income from taxation of OASDI benefits will rise gradually, primarily because a greater proportion of beneficiaries will become subject to taxation in future years, and this accounts for the slight upward trend in the income lines.

Why Do Costs Rise Faster Than Income? The OASI cost rate increases steeply between 2010 and 2030 because the number of people receiving benefits will increase rapidly as the “baby-boom” generation retires. The OASI cost rate grows more moderately thereafter due primarily to projected increasing life expectancy. The number of workers paying payroll taxes grows slowly in the future because current low fertility rates, relative to historical U.S. experience, are projected to continue.

The HI cost rate increases not only because of growth in the number of beneficiaries per worker, but also because of increases in both the use and cost of health care per person. In particular, continuing development and use of new technology is expected to cause health care expenditures to grow faster than gross domestic product (GDP) in the long term.

Chart C shows the number of workers per OASDI beneficiary over the 75-year period. (The ratio of workers to HI beneficiaries is similar.)

Chart C—Number of Workers per OASDI Beneficiary



What is the Long-Range Actuarial Balance of the OASI, DI, and HI Trust Funds? Another useful way to view the outlook of the payroll-tax-financed trust funds is in terms of their long-range actuarial balances over the full 75-year valuation period. The actuarial balance of a fund is essentially the difference between annual income and costs, expressed as a percentage of taxable payroll, summarized over the 75-year projection period.

The OASI, DI, and HI Trust Funds each have an actuarial deficit under the intermediate assumptions, as shown below. Each actuarial deficit can be interpreted as the percentage that could be added to the current law income rate for each of the next 75 years, or subtracted from the cost rate for each year, to bring the funds into actuarial balance. However, such uniform changes, while adequate on average, would close less than one-third of the gap shown in Chart B between the income and cost rates for OASI and HI, and less than one-half of the gap for DI, in 2075.

ACTUARIAL DEFICIT OF THE OASI, DI, AND HI TRUST FUNDS
(As a percentage of taxable payroll)

	<u>OASI</u>	<u>DI</u>	<u>OASDI</u>	<u>HI</u>
Actuarial Deficit	1.53	0.33	1.86	1.97

What Are Key Dates in Long-Range OASI, DI, and HI Financing?

The projected actuarial deficit for each of the trust funds indicates that at some point in the next 75 years the assets of the fund will be completely used to meet expenses. At that point, however, payroll taxes and other income will continue to flow into the fund. In 2038 when the combined OASI and DI funds are projected to be exhausted, tax income to the combined funds is estimated to be sufficient to pay 73 percent of program costs, but that fraction is projected to decline to 67 percent by 2075 as program costs rise faster than income due to steadily increasing life expectancy and continued relatively low fertility. For HI, tax revenue would cover an estimated 68 percent of costs in 2029 (at the time of asset exhaustion) and would meet only 32 percent of costs in 2075.

Before a trust fund is exhausted, the cash flow of the fund changes in stages. When combined OASDI expenditures exceed current tax income beginning in 2016, in order to pay benefits the program would need to utilize interest earned on invested assets, and beginning in 2025 it would need to redeem a portion of those assets. The comparable dates for HI for beginning use of interest income and of the fund’s principal balance are 2016 and 2021. These key dates regarding cash flows are shown below.

KEY DATES FOR THE TRUST FUNDS

	OASI	DI	OASDI	HI
First year outgo exceeds income excluding interest	2016	2008	2016	2016
First year outgo exceeds income including interest	2027	2015	2025	2021
Year trust fund assets are exhausted	2040	2026	2038	2029

What Are Trust Fund Exhaustion Dates Under Alternative Assumptions? As noted earlier, the future cannot be predicted with certainty, and three sets of assumptions are used to project the range of possibilities. The year the trust funds are projected to be exhausted varies significantly under the three sets of assumptions. The table below shows this range.

YEAR OF TRUST FUND EXHAUSTION

Set of Assumptions	OASI	DI	OASDI	HI
Alternative I (Low Cost)	(a)	(a)	(a)	(a)
Alternative II (Best Estimate)	2040	2026	2038	2029
Alternative III (High Cost)	2030	2014	2027	2016

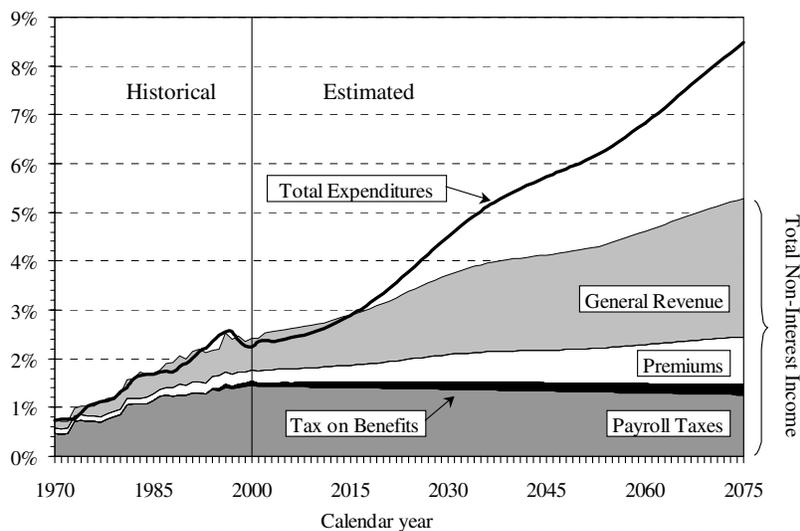
a. Not exhausted within the 75-year projection period.

How Large Are Total Medicare Expenditures Compared to Revenue?

Although the reports display the financial status of the HI and SMI Trust Funds separately, it is important to recognize the financial challenge facing the Medicare program as a whole. Chart D shows costs and current-law non-interest revenue sources for HI and SMI combined as a percentage of GDP.

Medicare costs are projected to grow from 2.3 percent of GDP today to 8.5 percent by 2075. By comparison, combined HI tax revenue, SMI premium revenue, and general revenue dedicated to SMI will rise from 2.4 percent of GDP today to 5.3 percent in 2075, resulting in a shortfall of over 3 percent of GDP in that year. The growing difference arises from the projected imbalance between HI tax income and expenditures, since SMI revenues would continue to approximately match SMI expenditures under present law.

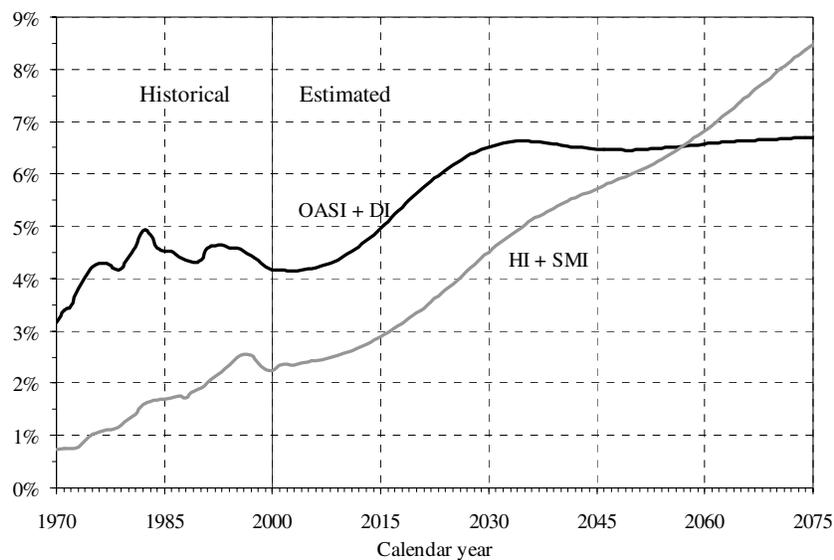
Chart D—Medicare Expenditures and Non-Interest Income by Source as a Percent of GDP



How Large Are Social Security and Medicare Compared to the Whole Economy? An additional way to view the outlook for the trust funds is in relation to the economy as a whole. Chart E shows the growth in the outgo as a percentage of GDP. Social Security (OASI plus DI) outgo amounted to 4.17 percent of GDP in 2000 and is projected to increase by about 60 percent to 6.7 percent of GDP in 2075. Medicare (HI plus SMI) outgo was smaller in 2000, 2.24 percent of GDP, but is projected to nearly quadruple to 8.49 percent of GDP in 2075.

Moreover, while Social Security costs are projected to virtually level off as a percentage of GDP after 2035, Medicare costs would continue increasing throughout the 75 years—and are projected to exceed Social Security expenditures after 2056.

Chart E—Social Security and Medicare Cost as a Percentage of GDP



A MESSAGE FROM THE PUBLIC TRUSTEES:

Our four-year terms as Public Trustees began on October 28, 2000, and we are honored that the President and the Senate have entrusted us with this responsibility. Like our predecessors, our goal as Public Trustees is to ensure the integrity of the process by which the annual Trustees Reports are prepared and the credibility of the information they contain. This goal necessitates that we approach our work in a nonpartisan way.

Two fundamental perceptions have guided our participation in the preparation of these reports. First, as emphasized in the reports, any effort to make projections regarding the financial status of Social Security and Medicare for 5 or 10, let alone 75 years, is subject to great uncertainty because of (among other things) the speed of new scientific discoveries, the development of new technology, and changes in many other aspects of our lives that affect the underlying economic, demographic and health care assumptions.

Second, we believe that the actuarial staffs assisting the Trustees bring to their tasks tremendous experience, integrity and professional competence. Thus, while uncertainty about the future is unavoidable, the projections in these reports represent, we think, the most reliable picture of the outlook for these programs under current law.

Finally, there are three substantive points that merit highlighting regarding the information in the 2001 Social Security and Medicare Trustees Reports.

Continued Positive Economic Performance

First, we note that the 2001 Trustees Reports reflect continued positive economic performance through much of last year. Payroll tax revenues were higher than projected in last year's Trustees Reports, and productivity increased substantially. The projected year when expenditures exceed tax revenues was pushed back one year to 2016 for the combined Social Security funds and pushed back 6 years to 2016 for the Medicare Hospital Insurance (HI) Trust Fund. In a similar vein, the projected year of exhaustion of the combined Social Security funds is now a year later in this year's reports, 2038 versus 2037, and that for HI 4 years later, 2029 versus 2025.

Although economic growth slowed in the second half of 2000, productivity still increased at a pace for the year that offers continued support for the possibility of a longer term shift upward from its period of low growth from 1973-1995. Such a shift would be most welcome, since it would foster stronger long-term economic growth, increase both individual and

national wealth, and make more affordable the future retirement and health care costs for our rapidly aging population. However, although the upturn in productivity that began in 1996 is extremely encouraging, our duty as Trustees mandates caution before adopting more optimistic assumptions about future economic and demographic experience for the full 75-year projection period.

Health Care Cost Growth

Based on the recommendations of an expert public panel of health economists and actuaries, the Trustees this year increased significantly the previous assumption regarding the rate of increase in age- and gender-adjusted per-beneficiary health care costs over the long term. The previous assumption had been that growth in health care costs would gradually slow to the rate of increase in average hourly earnings for HI, and to the rate of increase in per capita GDP for SMI. In this report, the long-range expenditure growth-rate assumption for both programs is the rate of increase in per capita GDP plus 1 percentage point. The expert panel recommended this higher growth assumption largely based on the past impact of advances in medical technology on health care costs, which they expect to continue at the historical rate for the indefinite future.

We reviewed the work of the expert panel carefully and believe their recommendation is on target. Thus, projections in the current 2001 reports show higher long-range costs for both the HI and the SMI programs than estimated last year: e.g., by 2075, the cost of Medicare is projected this year to be about 60 percent higher than that projected last year. These new projections highlight questions regarding how much of their income Americans will want to devote to health care and how they will pay for that care in the decades ahead as the nation grows wealthier and health care technology continues to advance.

The expert panel found that historically individuals have consistently demanded access to new medical services and concluded that such demand will continue into the future. This view suggests that the share of GDP devoted to health care, which has nearly doubled over the past 30 years to a 13-percent share today, will continue to increase as new medical services become available. Indeed, the panel estimated that if the GDP plus 1 percentage point growth-rate assumption adopted in the 2001 Medicare reports were applied to total U.S. health care spending, by 2075 health care spending in the U.S. would equal roughly 38 percent of GDP. Such an increase in the GDP share for health care does not imply spending on other goods and services would decline but only that other such spending would continue to grow more slowly than expenditures on health care.

Effects of Trust Fund Financial Operations

As economists, we have followed with interest the discussion of the effects that the build-up and subsequent draw-down of trust fund assets will have on the Federal budget and more broadly on U.S. savings and capital investment. Those issues go far beyond the scope of the Trustees Reports, but these reports do provide useful information as to the effects trust fund operations could have on the Federal budget and the U.S. economy. Table VI.E10 on page 161 of the Social Security Old-Age, Survivors, and Disability Insurance Trust Funds (OASDI) Report shows in current dollars the projected income (excluding interest) and outgo of the payroll-tax-financed trust funds, i.e. the combined OASDHI funds. We focus here on the aggregate tax income versus total expenditures of the OASI, DI, and HI Trust Funds to highlight their effect on the Federal budget and the economy, but in fact the funds are legally separate and the cash flows of each fund are somewhat different.

Under the intermediate assumptions in the 2001 Trustees Reports, the OASI, DI, and HI Trust Funds are projected to take in each year some \$110 to \$140 billion more in tax revenues than they spend through 2011, and then have declining annual amounts of surplus taxes through 2015. These amounts by which trust fund tax revenues exceed expenditures represent net cash inflows to the Treasury and potential additions to the national total of public and private savings; but the surpluses will only ease the economic burden of the baby-boom generation's retirement if they lead to an actual increase in national savings and, consequently, in investment, productivity and economic growth.

Then, beginning in 2016, the effect of the payroll-tax-financed trust funds on the U.S. Treasury's cash flow is projected to reverse, and cash payments from the Treasury would be required in order for the funds to have sufficient income to pay the benefits now scheduled to be provided in current law. Initially, those payments will represent interest due on securities the trust funds hold as a result of the cash surpluses generated over the previous two decades; later they will include the principal amounts from redemption of those securities. As a result, the net cash flows from the Treasury to the three trust funds, combined, are projected to grow steadily from \$35 billion in 2016 to \$579 billion by 2025 (the comparable inflation-adjusted constant dollars are \$22 billion and \$269 billion, respectively).

Thus, rather than providing net revenue to the Treasury, after 2016 the combined trust funds will require rapidly growing infusions of revenues from the Treasury to pay benefits projected under current law. It is at this point—and not at the later dates when trust fund assets (i.e., the securities being redeemed) are technically exhausted—that Social Security and

Medicare will begin to be in direct competition with other Federal programs for the resources of the Treasury, requiring either growing tax increases or debt financing (or some combination of the two) to pay the benefits promised under current law and provide for the continuation of other Federal expenditures.

While there will be no sudden, wrenching effect in any future year on the Federal budget from the operations of the three payroll-tax-financed trust funds, since the year-by-year changes are gradual, the cumulative change in the operations of these funds from 2000 to 2025 on the Federal budget will require serious attention in the years ahead. As Public Trustees, we believe that national discussion of the future financing of Social Security and Medicare should continue. It is important that changes in Social Security and Medicare be initiated sooner rather than later to address the rapidly growing annual deficits these programs are projected to incur beginning with the retirement of the baby-boom population. The need for such change is underlined by the fact that, even if productivity growth were to remain at the extraordinary level of the last 5 years for the next 75 years, a significant long-term actuarial deficit would still exist for the Social Security and Medicare Trust Funds.

*John L. Palmer
Trustee*

*Thomas R. Saving
Trustee*

