



The Concord Coalition's Series On Social Security Reform

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Reform Should Not Wait For A Crisis

It is often said that our political system only responds to a crisis. If that is true, we are in for big trouble. Whether we use the term “crisis” or some less alarming term to describe Social Security’s problems, the program does need the immediate attention of lawmakers.

Social Security benefits are not immediately threatened nor are those of Medicare and Medicaid — the other two large entitlement programs for the aged. Yet, a broad bipartisan consensus exists that the projected growth of these three programs puts our overall fiscal policy on an unsustainable path. No one can say exactly when a crisis will hit, but by the time it does we will have likely burdened the economy with a debilitating amount of debt; leaving painful benefit cuts and steep tax increases as the only solutions. Waiting for this outcome, knowing full well that is coming, would be an act of fiscal and generational irresponsibility.

A Growing Burden on the Budget and Economy

The reasons why Social Security needs legislative changes today differ significantly from the reasons that led to past reforms. In 1983, when the last major Social Security reforms were enacted, the program faced an immediate cash crunch. Factors such as recession, high inflation, and a technical flaw with Social Security’s benefit formula severely strained the program’s finances forcing lawmakers to act quickly and decisively to keep the benefits flowing. That is not the case today. Social Security tax revenues are projected to exceed benefit payments this year and for another 13 years.

Yet the lack of an immediate cash-flow problem belies a much more fundamental problem — the huge stress Social Security and other government entitlement programs will soon place on the federal treasury and the economy.

The Social Security trustees project that the program’s cost will grow from roughly 4.3 percent of the nation’s gross domestic product (GDP) today to 6.3 percent in 2030, rising modestly thereafter to 6.6 percent in 2075. While seemingly a small increase, it means Social Security will draw half as much more out of the economy in 2030 as it does today.

The Concord Coalition • 1011 Arlington Blvd, Suite 300 • Arlington, VA 22209
Phone 703-894-6222 • Fax 703-894-6231 • www.concordcoalition.org
Executive Director: Robert L. Bixby • National Field Director: A. Harry Zeeve

Expressed as a share of workers' pay (taxable payroll), Social Security will grow from about 11 percent today to nearly 17 percent in 2030, then rise more slowly to over 19 percent in 2075. This means the Social Security program will require nearly twice as much from workers' wages as it does today.

Social Security does not exist in a vacuum

Perhaps if viewed in isolation, Social Security's long-term cost growth might be bearable. But Social Security is not a "hardened silo," and its long-term outlook must be assessed in a broader context. What matters fiscally and economically is the rising total cost burden of entitlements in our aging society.

Older people rely heavily on government entitlement programs and their numbers are soon expected to grow as the post World War II baby boomers enter their retirement years. There are 37 million people in the population age 65 and older today. By 2025, this number is estimated to rise to 62 million. By 2045, it will rise to nearly 80 million, or more than double the current number. In contrast, by 2025 the number of workers is estimated to rise by only 13 percent, and by 2045, only 20 percent. As a result, the number of workers paying into the Social Security system relative to the number of beneficiaries is estimated to fall from 3.3 today to just 2 by 2040.

This dynamic has consequences that go beyond Social Security. For Medicare and Medicaid it is even more troublesome. Yet for these programs, the looming demographics are only part of the issue. Health care prices continue to outpace economic growth and this phenomenon will simply compound the growing costs attributable to the rising number of beneficiaries. The Congressional Budget Office (CBO) projects that the combined cost of Medicare and Medicaid could increase from 4.2 percent of GDP today to 11.5 percent in 2030.

Current fiscal policy is unsustainable

Without a policy response, the overall cost of government as a share of the economy could grow to levels not seen since World War II — the big difference being that instead of spending the money on a life and death struggle against totalitarian aggression we would be spending it on an ever-rising stream of benefit payments for ourselves.

Today, the total cost of government programs, which excludes interest payments on the debt, absorbs 18.4 percent of GDP. Social Security, Medicare and Medicaid make up nearly half of that amount. Under what CBO sees as a plausible range, government programs could absorb over 30 percent of GDP by 2050 — with Social Security Medicare and Medicaid making accounting for more than three-quarters of the total. To put this in perspective, if the cost of government programs rose to 30 percent of GDP, that would consume 60 percent more of the economy than it does today.

Left unchecked, such spending growth would inevitably lead to unprecedented tax levels or economically unsustainable deficits. Federal tax receipts have averaged 18 percent of GDP over the past half century. Today they stand at 16.8 percent. The federal budget deficit, at about \$400 billion, stands at 3 percent of GDP. If senior entitlements are allowed to grow on autopilot, pushing the cost of government programs to 30 percent of the economy, and Americans' intolerance for

taxes above 20 percent of the economy holds true, the resulting deficits will rapidly escalate to dangerous levels. Consider that a deficit of 10 percent of GDP in today's terms is the equivalent of \$1.2 trillion a year. That sum is equal to roughly half of today's total government expenditures.

It is totally unrealistic to assume that we could carry that amount of new debt year after year without stifling the economy. Indeed, a long-term simulation of current policy prepared by the Government Accountability Office (GAO) shows that ballooning interest payments on a steadily rising debt could use up virtually all federal revenues by 2040.¹

The driving factor is clear. By 2040, Social Security, Medicare and Medicaid could more than double as a share of the economy. As U.S. Comptroller General David Walker has observed, "Neither slowing the growth of discretionary spending nor allowing the tax provisions to expire – nor both together – would eliminate the imbalance...Accordingly, substantive reform of Social Security and our major health programs remain critical to recapturing our future fiscal flexibility."²

Prompt action produces the best results

The projected path of fiscal policy has important implications for the timing and nature of Social Security reform. Those who argue that we have no problem until the 2040s because the trust funds are projected to be "solvent" until then overlook the fact that the government's fiscal position will become untenable long before then. Similarly, those who advocate large scale borrowing to fund personal accounts in return for presumed savings in the 2050s and beyond overlook the fact that the new borrowing may well hasten our plunge over the fiscal cliff and render the long-term savings from such plans irrelevant. Neither argument offers a viable solution to the seeds of fiscal crisis that have been sown.

Whether through increased taxes or constrained spending (or some combination thereof), major action by lawmakers will be necessary to restore balance between future governmental receipts and expenditures. While some have suggested that the projections are exaggerated or that the strain could be overcome by strong economic growth, the potential gap between receipts and expenditures is so large that it would be irresponsible to ignore it. No realistic projection of economic growth would be enough for us to grow our way out of the problem.

The sooner action is taken, the more effective it will be in restoring a sustainable fiscal policy. It is important to remember that the "miracle of compound interest" becomes a nightmare when it applies to debts rather than assets. Moreover, prompt action will allow for gradual and less painful remedies than if we wait for a crisis to hit. The political system can easily adjust to unexpected good news. More problematic are the potentially wrenching and sudden adjustments of deferring action on bad news projections that prove correct.

¹ GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, GAO-05-325SP, February, 2005 p.6.

² Statement of David M. Walker, Comptroller General of the United States, *Long-Term Fiscal Issues*, Senate Budget Committee, February 8, 2005 p.7.

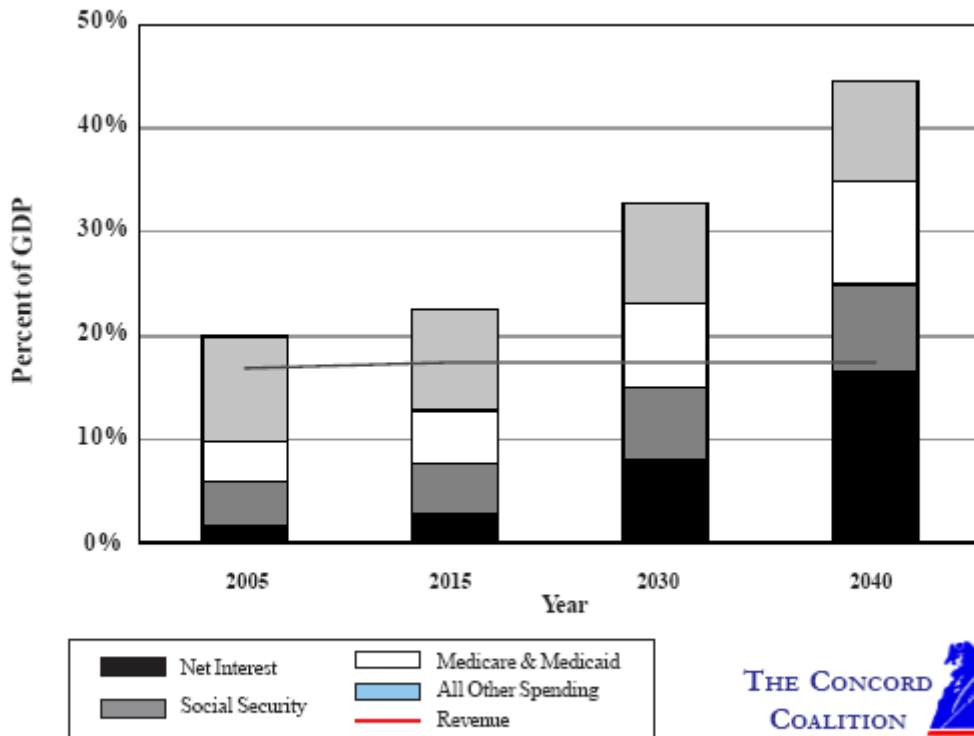
Not acting is a choice with grim consequences

Society is aging with improvements in longevity and lower birth rates. The demands on government entitlement programs will rise rapidly as the impending tidal wave of new recipients engulfs them. The oldest segment of the 75-million strong baby boom generation, turning 59 this year, will begin drawing on their Social Security benefits in three years ... in six years they will be eligible for Medicare. And while Medicare is projected to grow faster than Social Security, this more daunting problem only makes achieving savings in Social Security more urgent.

The choices we make now will determine what kind of America our children and grandchildren inherit 20 and 30 years from now. Every year that alterations are put off greatly raises the risk of large tax increases or sudden benefit reductions in the future. But the window of opportunity to act is rapidly closing.

The real crisis today is the threat of political gridlock. Any genuine reform has a fiscal and political cost, so it's tempting to pretend that the status quo can continue indefinitely. It can't. Not acting is itself a choice, and one that will have grim consequences for today's midlife adults and even bigger ones for their children. Reforming Social Security today would not free society from future fiscal imbalances, but it would be a good place to start.

Current Fiscal Policy is on an Unsustainable Path



The simulation assumes that discretionary spending grows with the economy after 2005, and that all expiring tax provisions are extended through 2015. After 2015, revenue is held constant as a share of GDP.

Source: Government Accountability Office, February 2005