

Taxes, Entitlements, Social Security and Medicare

Mudd Economics

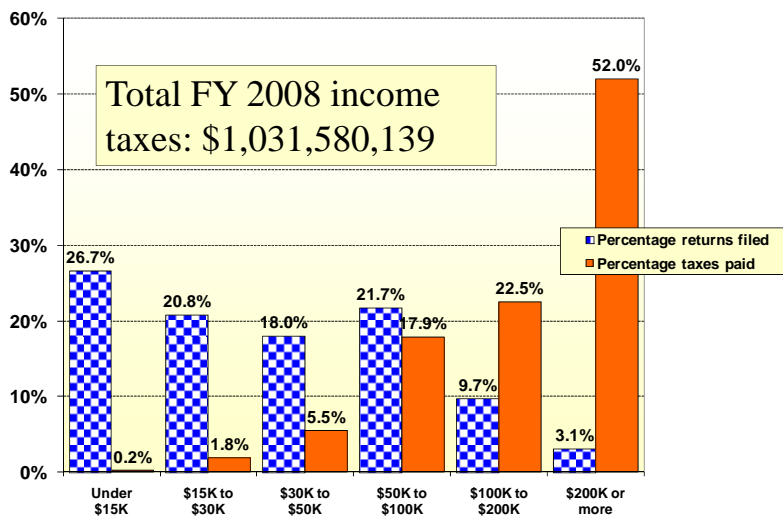
picture of you teacher worrying
about entitlements



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Who pays income taxes: Five income groups, 2008, percentages

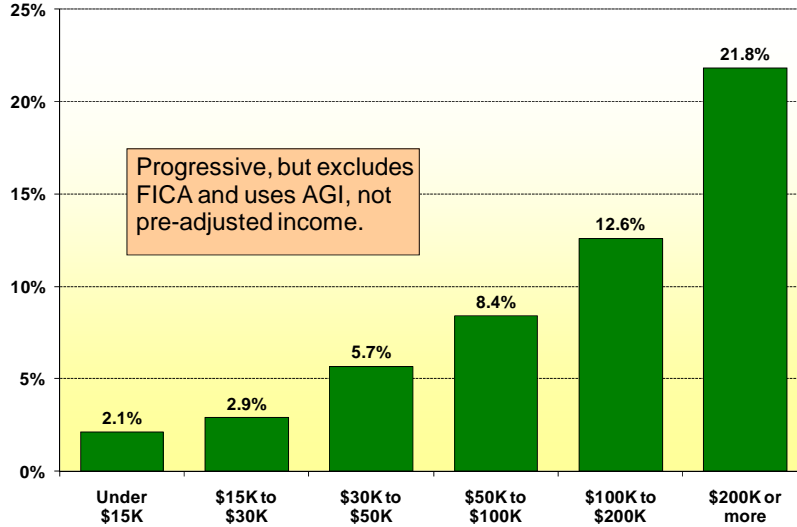
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Source: irs.gov SOI Tax Stats, 2008, aggregated from various tables including Table 1.1.

Effective income tax rates

Taxes paid as % of Adjusted Gross Income, 2008



Source: <http://www.irs.gov> - SOI Tax Stats, 2008, aggregated from various tables including Table 1.1.

The FICA/SECA Payroll Tax

This tax is clearly regressive, offsetting some of the progressive structure of the income tax.

The self-employed Social Security Tax was reduced from 12.4% to 10.4% by the 2010 Tax Relief Act.



Employment (FICA/SECA) tax rates effective 2011

	Employer/Employee (each)	Self-employed*
Social Security:	6.2% \$106,800 cap	10.4% \$106,800 cap
Medicare:	1.45% No cap	2.9% No cap
Total (each):	7.65%	13.30%
Total (combined):	15.30%	

Source: IRS Publication 1038, 2011.

Interesting facts about taxes (2006 and now)

- ✓ Those who earn incomes (AGI and including MFJ) above \$200,000 file 2.9% of total tax returns but pay 52.3% of all taxes.
- ✓ Obama wants to raise marginal tax rates for AGI above \$25,000 (who pay about 50% of all taxes.
- ✓ The highest MTR under Bush is 33%; Obama wants to restore 39% (?)
- ✓ This would add about \$35 billion in revenues annually. Is it fair?

... from **Red Ink**:

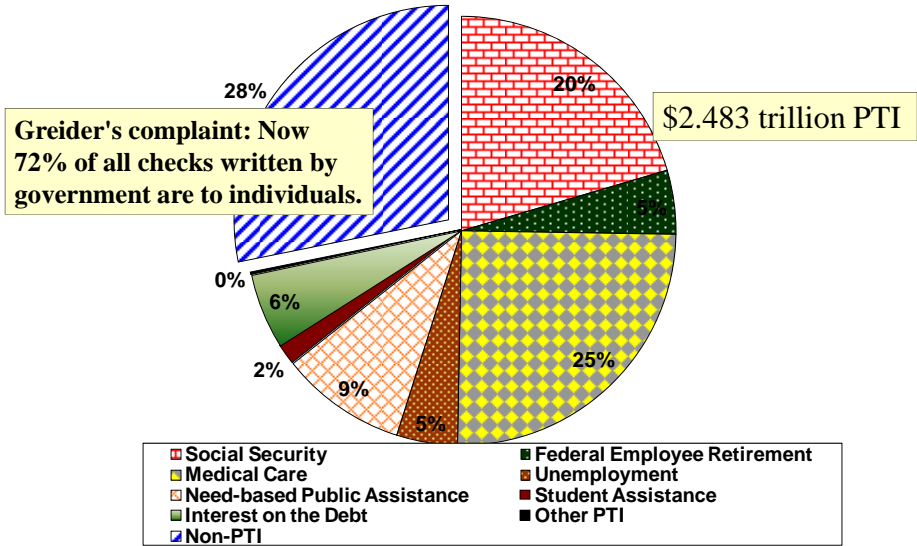
The Government as Check Writer

The author William Grieder once wrote that "the most important function of the federal government is mailing checks to citizens." By that he meant Social Security checks, pension, welfare, and veterans' checks, checks to hospitals and doctors for medical care, and checks sent for a host of other reasons.

When Grieder wrote that in 1981, such disbursements equaled 48% of outlays. Now

Red Ink page 108.

Payments to Individuals - 2010



Source: 2012 Budget of the United States Government, Historical Tables, Table 11.3

What are entitlements?

- The law extends a financial right ...
- ... which implies an ongoing legal financial obligation of government ...
- ... therefore outlays over time are determined by
 1. ... the original law and any amendments
 2. ... demographics
- Examples
 - Social Security, Medicare, need-based programs, federal pensions

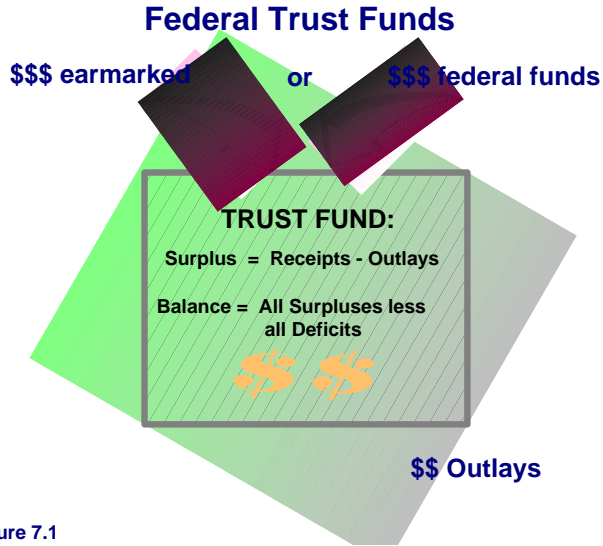


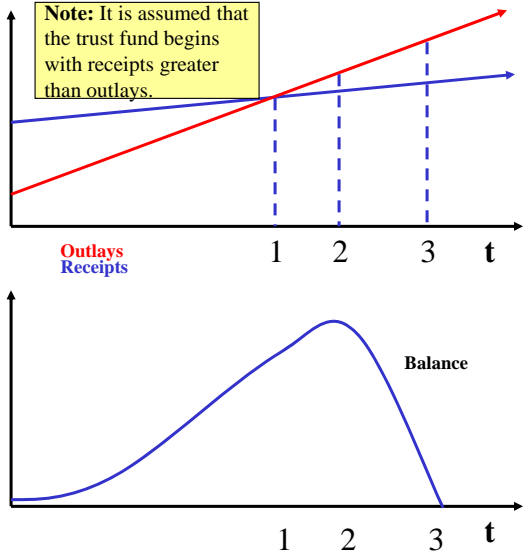
Figure 7.1

About Trust Funds

- Subaccounts within the Unified Budget
 - like a check book within a checkbook
- Revenue sources internal and external
- Balances held as non-marketable U.S. Treasury Debt
- If externally financed (like Social Security)
 - fund surplus reduces the unified deficit
 - interest earned is internal

Three critical inflection points for Trust Funds

1. When outlays exceed receipts. At this point the trust fund is adding to the deficit.
2. When outlays exceed receipts by more than interest earned by the trust fund.
3. When interest earned goes to absolute zero and trust fund balances are depleted and spending authority is eliminated.



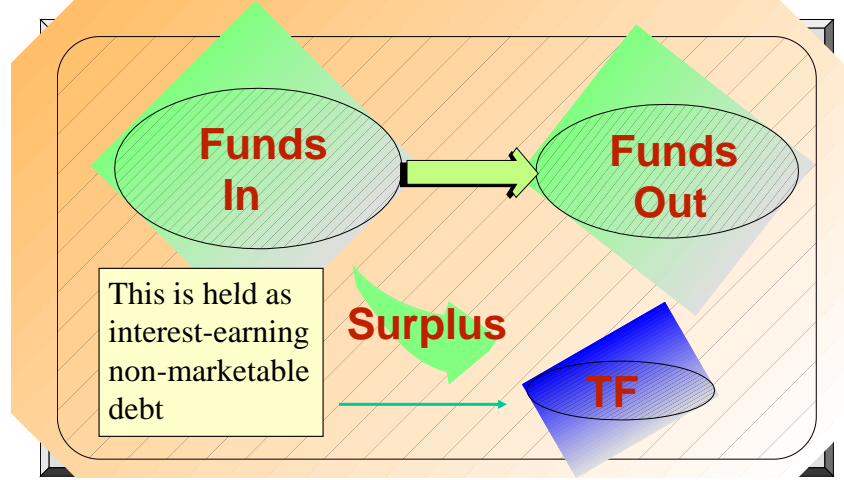
... from Red Ink

College students graduating in 1996 will begin paying, as soon as they find work, 7.65% of their earned income into three federal trust funds, and their employers will make a matching contribution. These students will be expected to make this contribution, and possibly more, throughout the 45 years or so they are employed. One of these trust funds, the Medicare Trust fund is running a deficit for the first time in 1996 and is expected to run out of funds in the year 2006. ... The largest share of taxes goes to .. the Social Security retirement fund, currently running a sizeable surplus which contributes to a large fund balance presently. ... By current projections the retirement fund will begin running a deficit around the year 2012 and the funds revenues are expected to be exhausted in the year 2031, about the time these students turn 55.

Red Ink - chapter 7, page 7. The forecasts are made by the trustees of the funds, published under "Actuarial Status of the Social Security and Medicare Programs," Summer 1995.

Note: Since this publication, the date for fund deficit has changed to 2017 and exhaustion has been bumped up, to 2041 in 2008.

Social Security Financing .. the general picture



Govt. Account NM Debt = Trust Fund Assets December 2010 \$ billions

Instrument	Amount
Marketable	8,841.1
Bills	1,768.9
Notes	5,568.2
Bonds	888.4
Inflation-indexed	615.6
Non-Marketable	5,208.3
Government Account	4,629.8
Non-marketable privately held	549.1
TOTAL PUBLIC DEBT:	14,049.4
NET PUBLIC DEBT:	9,419.6
(Net is total less govt. account)	

Source: U.S. Treasury Bulletin, March 2011, Tables FD-1 and FD-2.

Social Security OASI Trust Fund

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status end of FY2010

... still running a small but declining surplus, but is running a *cash deficit* for the first time this year because interest earned, which is a bookkeeping entry only, exceeds the surplus. This puts this trust fund in *region II*.

Source: FY2012 Budget of the United States Government, Table 13-1.

Social Security Old Age Survivors Insurance Trust Fund ID 20-8006-0-7-651 FY2010 \$ Billions		
	Receipts and Outlays	Balance
Beginning of Year		2,296.2
RECEIPTS		
FICA/SECA Taxes	540.0	
Interest earned	108.6	
Other	33.9	
Total Receipts	682.5	
OUTLAYS		
Retirement payments	572.5	
Total Outlays	580.0	
SURPLUS	102.5	
End of Year		2,398.7

Medicare Hospital Trust Fund

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status at end of 2010

This hopeless trust fund, the heart of Medicare, is well into region II, is contributing to the current overall deficit, and will be gone within 10 years.

Note: New Medicare Prescription Drug Plan (passed 2003) added about \$15 billion per year to Medicare costs.

Source: FY2012 Budget of the United States Government, Table 13-1.

Medicare Federal Hospital Insurance Trust Fund ID 20-8005-0-7-571 FY2010 \$ Billions		
	Receipts and Outlays	Balance
Beginning of Year		309.8
RECEIPTS		
FICA/SECA Taxes	180.1	
Interest earned	14.6	
Other	27.9	
Total Receipts	222.6	
OUTLAYS		
Hospital Payments	249.9	
Total Outlays	253.6	
Deficit	-31.0	
End of Year		278.8

The problem with Medicare (in 2006)

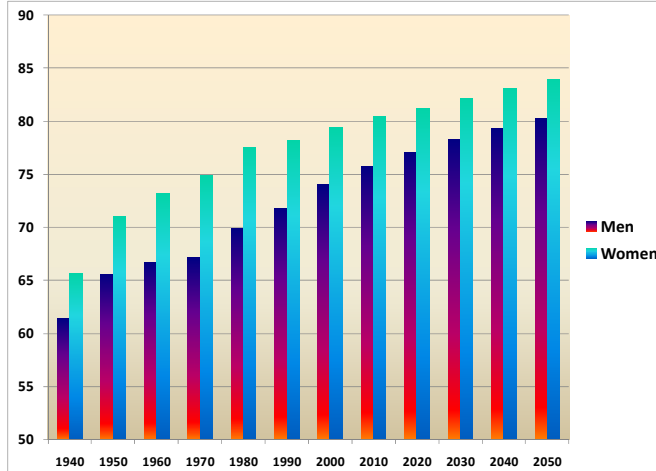
The projected 75-year actuarial deficit in the HI Trust Fund is now 3.51 percent of taxable payroll, up from 3.09 percent in last year's report due primarily to greater costs in 2005 than expected, changes in managed care assumptions, advancing the projection period, and more recent data that suggests higher utilization of health services in the future. The fund again fails our test of short-range financial adequacy, as assets drop below the level of the next year's projected expenditures within 10 years—in 2012. The fund also continues to fail our long-range test of close actuarial balance by a wide margin. The projected date of HI Trust Fund exhaustion moves forward to 2018, from 2020 in last year's report, and projected HI tax income falls short of outlays in this and all future years. HI could be brought into actuarial balance over the next 75 years by an immediate 121 percent increase in program income, or an immediate 51 percent reduction in program outlays (or some combination of the two). As with Social Security, however, adjustments of far greater magnitude would be necessary to the extent changes are delayed or phased in gradually, or to make the program solvent on a sustainable basis over the next 75 years and beyond.

However, Medicare's status given the passage of the affordable care act is uncertain, but possibly improved.

Source: Report from the Board of Trustees, Status of the Social Security and Medicare Program, May 1, 2006.

Life Expectancy of Those Born in the Years Indicated

	Men	Women
1940	61.4	65.7
1950	65.6	71.1
1960	66.7	73.2
1970	67.2	74.9
1980	69.9	77.5
1990	71.8	78.2
2000	74.0	79.4
2010	75.8	80.4
2020	77.1	81.2
2030	78.3	82.2
2040	79.3	83.1
2050	80.3	84.0



Implications for Medicare and Soc Sec are obvious.

The period life expectancy for a given age for a given year represents the average number of years of life remaining if a group of persons of that age were to experience the mortality rates for that year over the course of their remaining lives.

Source: 2010 Annual Report of the Board Of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Trust Funds, Table V.A.3 Period life expectancy.

From **Red Ink**

**Population Aged 65 and Above as % Total
and Median Population Age, Select Years**

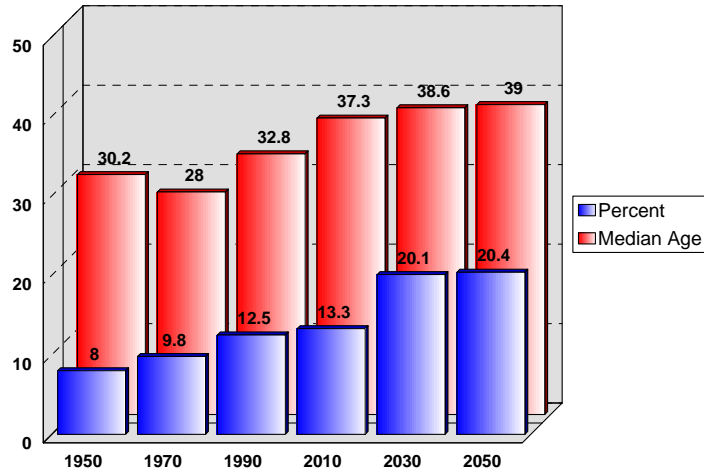


Figure 7.2

From **Red Ink**

**Ratio: Contributors to Beneficiaries
OASI (retirement) and OASDI (combined) Trust Funds**

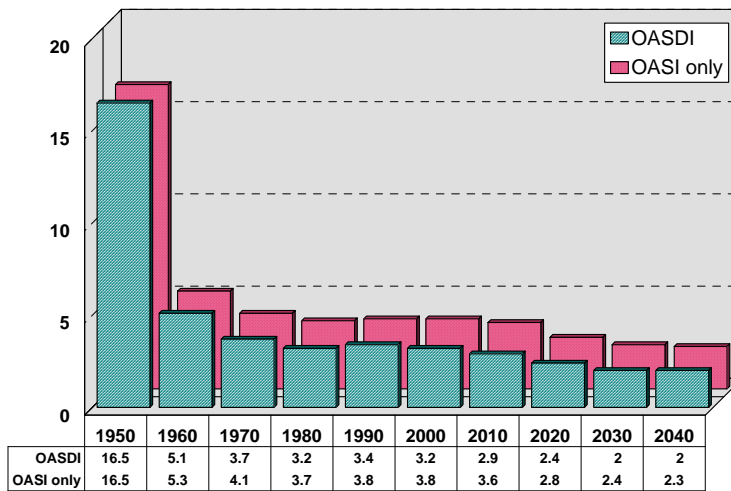


Figure 7.3

This old slide from my book still conformed, with only small differences, by Table IV.B2. Covered Workers and Beneficiaries, Calendar Years 1945-2085., 2010 Trustee's Report. Past 2010 reflect the intermediate assumptions.

Updating the dire **Red Ink** forecast about Social Security and Medicare

Under the intermediate assumptions, OASDI cost generally increases more rapidly than tax income through 2035 because the retirement of the baby-boom generation increases the number of beneficiaries much faster than subsequent relatively low-birth-rate generations increase the labor force. From 2035 to 2050, the cost rate declines somewhat due principally to the aging of the already retired baby-boom generation.

...

Interest earnings on trust fund assets alone will be sufficient to cover the annual difference between cost and tax revenue until 2025. The dollar level of the Trust Funds is projected to be drawn down beginning in 2025 until assets are exhausted in 2037.

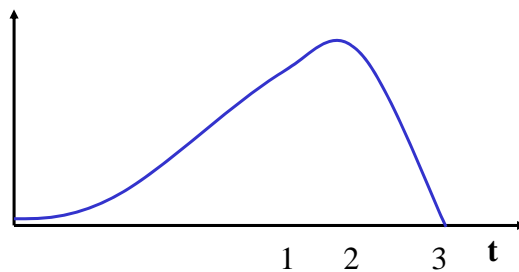
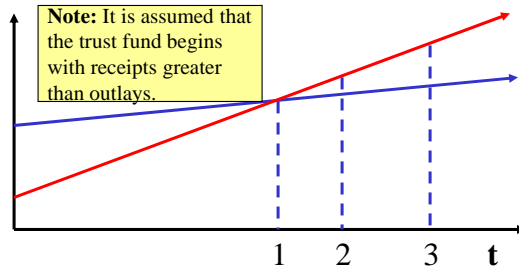
Source: The 2010 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds.

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These variables drive the projections ...

Key Demographic and Economic Long-Term Assumptions for Three Scenarios for the OASDI Trust Fund

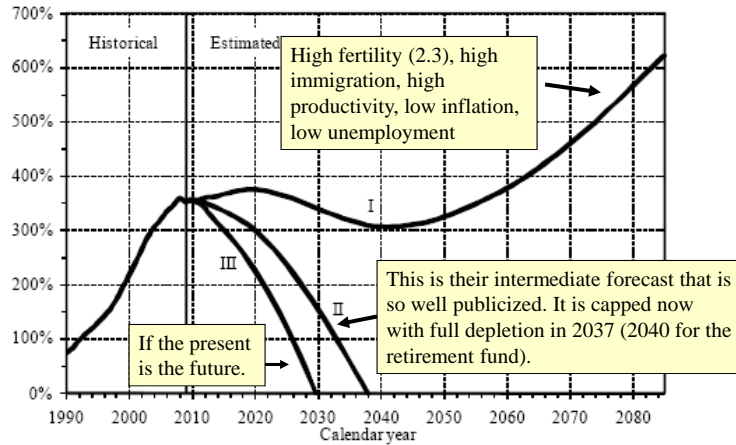
	Intermediate			Currently
	Best Case I	II	Worst Cast III	
Total fertility rate (2034):	2.3	2.0	1.7	2.1
Annual net immigration 2010-84:	1,370,000	1,065,000	780	1,215,000
Productivity gain annual (2020):*	2.0	1.7	1.4	2.1
Wage gain annual:	3.6	4.0	4.4	3.0
CPI annual:	1.8	2.8	3.8	?
Unemployment rate:	4.5	5.5	6.5	8.50%
Trust Fund real interest rate %:	3.6	2.9	2.1	0.0

*Productivity gains defined to the ratio of Real GDP to hours worked by all workers. Gains shown currently are average 2000-07.

Source: 2010 Annual Report of the Board Of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Trust Funds, Table II.C.1

The Three Trustee Scenarios

Figure II.D6.—Long-Range OASDI Trust Fund Ratios Under Alternative Assumptions
[Assets as a percentage of annual cost]



Source: The 2010 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds.

Primary fiscal concerns

- How will these deficits be eliminated?
- How will this integrate with FRS monetary policy?
- Does the fix imply inflation?
- Will Social Security and Medicare be “fixed”?
- Will future medical costs be met?
- Will the arrangement be fair?