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A $40 TRILLION LEGACY?[1]

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A popular bumper sticker reads: ***We are spending our children's inheritance.*** But that's not all we're doing. We're passing along trillions of dollars in obligations to pay for Social Security and Medicare benefits that we expect to receive but not pay for.

According to the 2005 Trustees Reports, the unfunded obligation as of January 1, 2005 for current participants in the Social Security program was $13.7 trillion. This is the value today of all future benefits that will be paid to current participants, for which no funds have been accumulated and with respect to which no future taxes have been scheduled to be collected from current participants. In other words, this is the amount, together with future interest thereon, and scheduled future taxes payable by current participants, that would be just sufficient to pay all future benefits that have been promised to current participants. The unfunded obligation as of January 1, 2005 for current participants in Medicare-Part A (the HI program) is $9.6 trillion.

The grand total unfunded obligation for Social Security and Medicare-Part A is thus $23.3 trillion. The intention is to finance this $23.3 trillion unfunded obligation as follows:

(1) The Social Security trust funds contain $1.7 trillion of Treasury securities, and the Medicare trust funds contain $0.3 trillion of Treasury securities; therefore, such securities represent the authorization to collect $2.0 trillion in future general revenue taxes from all taxpayers (both current and future participants in the systems).

(2) Future participants will pay Social Security and Medicare payroll taxes as soon as they enter the systems, but will not collect significant benefits until many years in the future; therefore, most of their payroll taxes (with a present value of approximately $8.7 trillion) will be available to finance benefit obligations for current participants—creating, of course, a <u>new</u> unfunded obligation for these future participants. (The future payroll taxes payable by current participants have already been taken into account in calculating the $23.3 trillion unfunded obligation.)

(3) Even after the funds in items (1) and (2) are provided, obligations with a present value of approximately $12.6 trillion will still be unmet. The method of eliminating this remaining long-range deficit has not yet been determined; however, as stated in the Trustees Report, "This can be achieved by raising additional revenue or reducing benefits (or some combination) for current and future participants . . ."

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In addition to the $23.3 trillion unfunded obligation of the Social Security and Medicare-Part A systems, there are significant obligations for Medicare-Part B (the SMI program), and Medicare-Part D (the prescription drug and related benefits program). Technically, these are not considered unfunded obligations since the law states that the government (i.e., future taxpayers) will provide general revenue in whatever amounts are necessary to pay all benefits—a rather audacious commitment, of which most taxpayers are not aware.

For example, under Medicare-Part B, the present value of future benefits for current participants as of January 1, 2005, is $13.2 trillion. The present value of beneficiary premiums payable by current participants is $3.3 trillion. This leaves $9.9 trillion to be financed by general revenue.

Under Medicare-Part D, the present value of future benefits for current participants as of January 1, 2005, is $8.8 trillion. The present value of beneficiary premiums payable by current participants is $1.1 trillion; and the present value of transfers from State governments is $0.9 trillion. This leaves $6.8 trillion to be financed by general revenue.

Thus, under Medicare-Parts B and D, the present value of future general revenue required to finance benefits for current participants is $16.7 trillion. If this amount of general revenue is actually collected, some of it will be paid by current participants (taxpayers) and some of it will be paid by future participants (taxpayers). On the other hand, if the Federal government continues to operate at a deficit, this $16.7 trillion will probably be financed by borrowing—and the obligation thus passed on to future generations. If so, this $16.7 trillion, when added to the $23.3 trillion obligation for Social Security and Medicare-Part A, will yield a total of $40 trillion, which will be passed on to future generations to worry about.

A $40 trillion obligation is difficult to comprehend, so here are some figures to help place it in perspective. As of January 1, 2005, the acknowledged National Debt was approximately $7.6 trillion. The Gross Domestic Product, the value of all goods and services produced in the U.S. in one year, is estimated at $12.4 trillion for 2005. One way to think about it is that it will require more than three years of national effort just to satisfy our obligations to the current participants in Social Security and Medicare. Another way is to note that this $40 trillion debt amounts to $135,600 for every person in the U.S. resident population of 295 million on January 1, 2005.

Analysts sometimes express concern about the size of the acknowledged National Debt of $7.6 trillion. The $40 trillion debt (only $2.0 trillion of which is included in the $7.6 trillion National Debt) should cause even greater concern. In addition to the obligations of the Social Security and Medicare systems, there are obligations for many other government programs: Medicaid, Supplemental Security Income, Federal employee and military retirement systems, etc. The total obligations for all these programs will almost certainly exceed the nation's ability to produce such amounts.

This is probably what led Federal Reserve Chairman Alan Greenspan to make statements in Congressional testimony this year such as: "I fear that we may have already committed more physical resources to the baby-boom generation in its retirement years than our economy has the capacity to deliver." The resources needed for the Social Security and Medicare programs as they are constructed today seem "increasingly likely to make current fiscal policy unsustainable." And, he characterized most of the proposals to bolster the present Social Security system's solvency as merely "patching a system which is fundamentally inappropriate for the future of this country."

In the words of former Senator Russell Long, Social Security "is nothing more than a promise to a group of people that their children will be taxed for that group's benefit." Analysts usually refer to this euphemistically as a covenant between generations.

Is it responsible to have a covenant between a generation of workers and their children, many of whom are yet unborn—particularly one that imposes such an onerous burden? Thomas Jefferson did not seem to think so when he wrote:

> "*We may consider each generation as a separate nation, with a right, by the will of the majority, to bind themselves, but not to bind the succeeding generation, any more than the inhabitants of another country.*"

A $40 trillion obligation just for Social Security and Medicare is a lot to transfer to succeeding generations. In fact, it is highly unlikely that such a transfer will be possible—try as we might.

What, then, should we do about this $40 trillion legacy? To begin with, we should invoke the first rule of hole digging: *When you find that you've dug yourself into a hole, stop digging*. However we restructure Social Security and Medicare, we should do it in a way that prevents the unfunded obligation from getting any larger. In other words, we should quit promising more in benefits than we are able to finance currently. The longer we keep the present systems, the larger the unfunded obligation will grow—and the more difficult it will be to satisfy that obligation or pass it on to future generations.

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