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HOW LIFETIME BENEFITS AND CONTRIBUTIONS POINT THE WAY TOWARD REFORMING OUR SENIOR ENTITLEMENT PROGRAMS

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August 2011

Over the past year, Congress, the President and several commissions have advanced numerous proposals to reform our big-ticket senior entitlement programs. These ideas are expected to receive continued attention in the coming months as the new “super committee” formed by the debt ceiling agreement develops its deficit reduction plan. As these discussions move forward, we think it is helpful to examine lifetime contributions and benefits for Medicare and Social Security to understand the programs’ internal fiscal situations and their broader role in overall budget policy and, most importantly, as a way toward a more unified and coherent approach to entitlement reform for our seniors.

LIFETIME CONTRIBUTIONS AND BENEFITS

Our recent analyses of lifetime contributions and expected benefits in Medicare show that, over a wide range of scenarios, beneficiaries retiring at age 65 in 2011 can expect to receive dramatically more in total benefits than they have paid in dedicated taxes.¹ For example, single beneficiaries and dual-earner couples who had earned the average wage throughout their working careers can expect to receive about \$3 in Medicare benefits for every \$1 paid in Medicare payroll taxes (Figure 1, top panel). If only one member of the couple had worked, we calculate a six-fold difference between contributions and benefits since both spouses

are eligible for Medicare yet only one has paid taxes. Higher earning workers will have paid somewhat higher Medicare taxes, but their expected lifetime benefits still far outpace their lifetime contributions (data not shown).

Social Security benefits and contributions come closer to balancing out over the lifetime for many beneficiaries (middle panel), but the one-earner couple again comes out far ahead due to a Social Security system that was designed decades ago around the stereotypical family of the past, with a working father and a stay-at-home mother. While a single woman who worked a full career at the average wage can expect to receive Social Security benefits roughly in line with her payroll contributions, a married woman who never worked but whose husband paid the same taxes as the single woman can expect to receive about \$180,000 in spousal and survivor benefits. Unlike private pensions, these additional benefits are essentially free but only to those who are married, regardless of need, contributions or any child rearing. They are financed by all Social Security taxpayers, including single mothers who get no spousal or survivor benefits at all.

Examining both programs together (bottom panel) highlights the large dollar value of benefits being paid out and the fact that total lifetime benefits consistently outweigh lifetime contributions across a range of scenarios. It is no wonder these programs now account

for one-third of all federal spending each year. Furthermore, our projections for people retiring in 2030 (data not shown) reveal a continuation of the difference between benefits and contributions under the current unsustainable structure of these programs.

ECONOMIC AND DEMOGRAPHIC FORCES

Several economic and demographic forces are behind these gaps between contributions and benefits and drive projected future deficits in these programs. For one thing, tax rates in Social Security and Medicare have always been low, while benefits have almost continually increased faster than wages. In Medicare specifically, ineffective control of medical spending has allowed nearly unabated growth in benefit costs relative to the incomes of workers who pay to support the elderly. Gains in life expectancy mean that both programs also are now providing more years of support than when they began. A 65-year old coming onto Medicare today can expect about four more years of benefits than when the program began, and the average person retiring at the full retirement age of 66 today can expect to collect Social Security for about 3.8 years longer than the 65-year old retiree of 1950. In addition, with more people retiring early, the average age at retirement has fallen from 68 in the 1940s and 1950s to 63 today. This trend has only recently begun to reverse as the recession and large losses in retirement accounts have caused older workers to postpone retirement.

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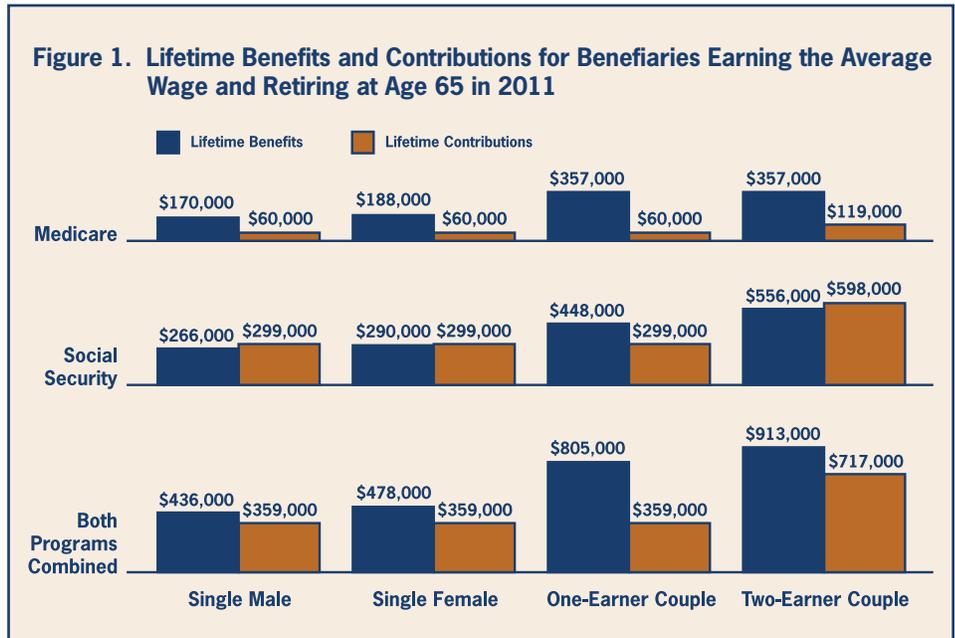
Throughout their histories, Social Security and Medicare have operated mainly as pay-as-you-go systems: money paid in by current workers is used to provide benefits to current retirees. The falling birth rates since the mid-1960s and the movement of the baby boomers into retirement mean fewer taxpaying workers to support a burgeoning retiree population – a double whammy of lower revenues and higher costs that will worsen over time. While there are more than 3 workers to support each retiree today, that ratio is expected to fall to about 2 to 1 by 2030.²

Of course, the growing annual imbalance between program revenue and outlays cannot continue forever – even if current law promises this level of benefits. While the Social Security and Medicare Part A (hospital) trust funds had built up surpluses when the swell of the baby boom was in the workforce, both funds are now being drained by annual cash deficits. Because these annual shortfalls and most Medicare spending under Parts B and D tend to be covered by general revenue and borrowing, these entitlement programs represent a significant and growing cause of our federal deficits. Tax rates that have not kept pace with ever-rising benefit levels, increasing years of support, spiraling health costs, and fewer workers per retiree all imply that current and future generations of workers are going to have to do something to get these elderly benefit programs into order, either by paying higher taxes or receiving fewer benefits for themselves.

IMPLICATIONS FOR POLICY

As the discussion of needed reforms proceeds, a common demand will be that future retirees get back what they have paid into the systems. But reducing these complex discussions to a debate over “money’s worth” ignores the grim reality of the programs’ finances today, as well as the fact that these programs have always transferred money between individuals – both within, and more importantly, across generations. Our work has shown that current and near-term retirees can expect to receive benefits well above their contributions, financed by current and future workers who have little hope of realizing the same level of return on their taxes due to the economic and demographic forces that are working against them.

Unfortunately, reforms proposed to date tend to compartmentalize programs and evaluate design choices as if they were unrelated. It is our belief, however, that addressing social



support for the elderly one parameter and one program at a time leads to tinkering instead of effective policy. We suggest, instead, adopting a comprehensive view that considers total lifetime benefits and contributions and recognizes how design parameters are related across programs and across time. The sheer magnitude of dollars involved implies both a flexibility and responsibility to rethink how to best allocate these benefits and taxes in a way that accommodates demographic and economic changes and makes sense in terms of intra- and inter-generational fairness, all the while recognizing that the past cannot be altered.

This broader view asks how benefits from all programs could be allocated over all retirement years and makes tradeoffs more apparent. For example, at any given tax rate, providing more years of support forces lower annual and lifetime benefits. Within Social Security alone, recognizing the trend toward earlier retirement and thinking about lifetime rather than annual benefits could help to address the fact that a growing share of cash benefits is going to people who retire younger and healthier, at the expense of enhanced support for older and less-healthy retirees.³ And updating the spousal and survivor benefits in Social Security to reflect the American family’s changing structure could redress biases against single parents.

Social Security reforms could also be coordinated with Medicare changes that are likely to leave elderly individuals facing higher Medicare premiums and higher cost sharing. Adopting a minimum benefit within Social

Security⁴ and tying the size of that benefit to the expected out-of-pocket spending burden under Medicare would help to ensure that both systems together leave seniors with enough cash income to meet other needs.

In addition to the lifetime allocation of benefits, it is also important to consider how lifetime taxes and other burdens are assessed. Should sustainability be attained through higher payroll taxes paid by workers, greater sharing of program costs across all ages through broad-based taxes, or more work by the near-elderly and higher premiums from the elderly?

Changes to entitlement programs are inevitable as part of a sound fiscal policy. As we make these changes, we think that it is possible to achieve a more rational, sustainable and equitable support system for seniors by thinking comprehensively about benefits and contributions across programs and over the lifetime.

ENDNOTES

- 1 Steuerle CE, Rennane S. “Social Security and Medicare Taxes and Benefits Over a Lifetime.” Washington, DC: The Urban Institute. June 2011.
- 2 Board of the Trustees of the Federal Old Age and Survivors Insurance and Federal Disability Insurance Trust Funds. “The 2011 Annual Report of the Board of the Trustees of the Federal Old Age and Survivors Insurance and Federal Disability Insurance Trust Funds.” Washington, DC. May 2011.
- 3 Steuerle CE. “Social Security: A Labor Force Issue.” Testimony, Subcommittee on Social Security Committee on Ways and Means United States House of Representatives. June 2005.
- 4 Favreault M, Mermin G, Steuerle CE, Murphy D. “Minimum Benefits in Social Security Could Reduce Aged Poverty.” Older Americans Economic Security Brief No. 11. Washington, DC: The Urban Institute. January 2007.