MI ISSUES 2·0·1·6 | REALITY CHECK

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Entitlement Programs Are Unearned Welfare Transfers From Younger, Poorer Americans to Older, Wealthier Ones

Jared Meyer

In Reality

Social Security and Medicare—America's government-pensions and medical-insurance programs for the elderly—require dramatic reform if they are to survive. The programs have exploded beyond their initial scale, with seniors now receiving many times more than what they contributed in taxes.

More health care innovation and faster economic growth can help, but they cannot wipe away the hundreds of trillions of dollars in unfunded liabilities hanging over younger Americans. Closing this enormous fiscal gap through large tax increases on the young would be particularly inequitable, given that seniors possess many times the wealth of younger households.

Key Findings

- In 2014, Social Security and Medicare spending accounted for 8.5 percent of U.S. GDP. In 2035, absent reform, the two programs will account for 11.4 percent of GDP.
    - In 1940, there were 159 workers for each retiree; today, there are fewer than three.
    - Social Security covers 265 times more beneficiaries than in 1940—at nearly 15,000 times the inflation-adjusted cost.
    - Medicare covers 2.7 times more beneficiaries than in 1970—at 15 times the inflation-adjusted cost.
- U.S. seniors who turned 65 during 2000–2010 will receive \$2.87–\$7.00 of Medicare benefits for every dollar they paid in Medicare taxes—even after accounting for the potential investment growth of such taxes.
    - The average U.S. household headed by an individual 65 or older has nearly 50 times the wealth of a household headed by an individual under 35—up from ten to one in 1984.
- Absent reform, future government spending on health and pensions for the elderly will exceed future tax receipts by about \$210 trillion.
    - Closing this fiscal gap would require all federal taxes to be immediately and permanently raised by 57 percent.
    - In 2050, payroll taxes would have to more than double—to a 31 percent combined rate for employers and employees—to cover Medicare and Social Security spending.

"Let me be clear: raising the retirement age and slashing Medicare benefits for seniors who have been working for decades is theft… Social Security and Medicare aren't welfare, they are earned benefits."[1]

MIKE HUCKABEE

"I founded a caucus called the Defending Social Security Caucus. My view is that when you have millions of seniors in this country trying to get by—and I don't know how they do on \$11,000, \$12,000, \$13,000 a year—you don't cut Social Security, you expand it."[2]

BERNIE SANDERS

On the Record

"Decades of unfunded promises from Washington have turned Social Security and Medicare into programs that redistribute our children's future income to some of today's wealthiest Americans."

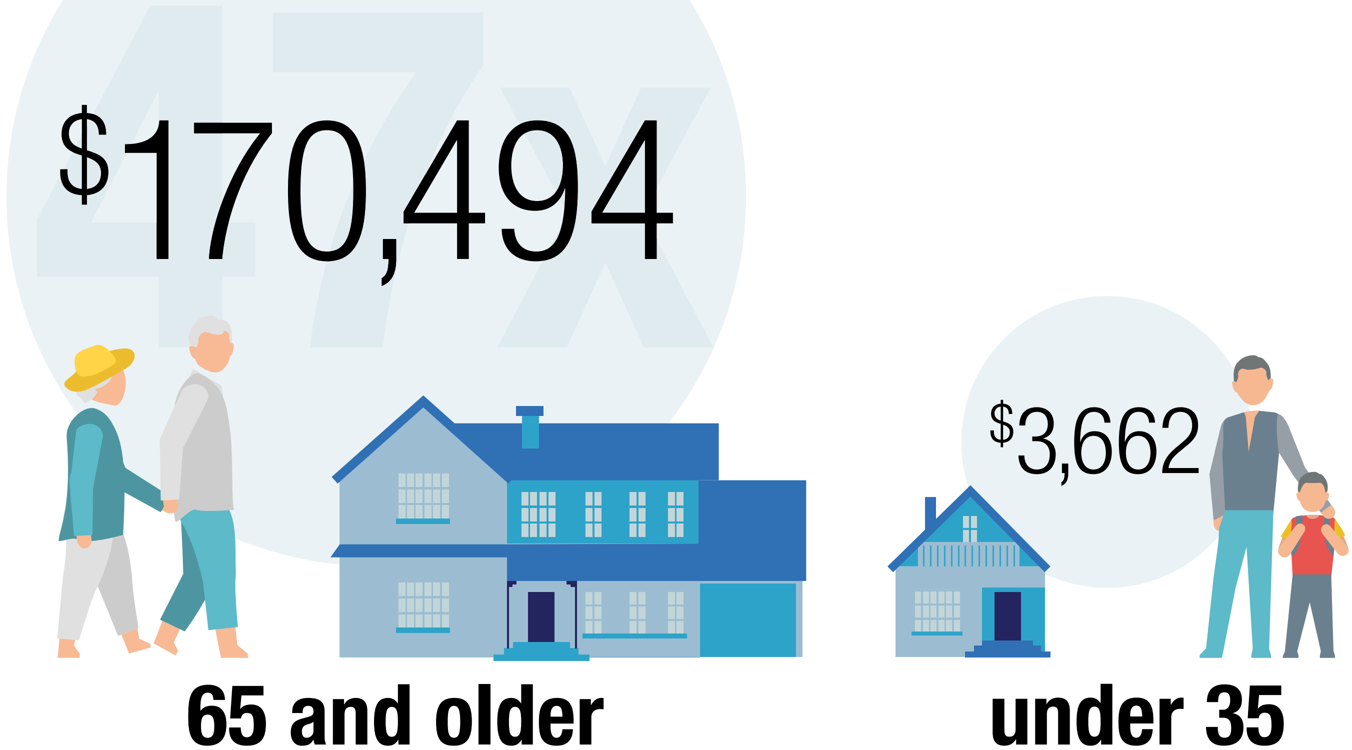
Jared Meyer, Fellow, Manhattan Institute

On the Record

"It has long been a bipartisan mistake to make irresponsible, unfunded promises to retirees while dumping the costs onto younger generations. Retirees' prospects have greatly improved since Social Security and Medicare were created. These programs need to change to reflect today's new realities. Making commonsense adjustments to the retirement age, as well as to the rate of benefit increases, is not only advisable; it should be a national priority."

Jared Meyer, Fellow, Manhattan Institute

The average U.S. household headed by an individual 65 or older has nearly 50 times the wealth of a household headed by an adult under 35.



U.S. seniors receive entitlement payments worth far more than the taxes they paid into the system. Social Security and Medicare were designed many decades ago for seniors facing very different circumstances from those experienced at present. Nevertheless, these programs—which transfer wealth from less affluent young Americans to wealthier older Americans—are amassing massive debts that will require implausible tax increases to sustain them.

Their Fair Share?

America's elderly now receive far more in Medicare benefits than they paid in Medicare taxes: seniors who turned 65 between 2000 and 2010 will receive $2.87–$7.00 in benefits for every dollar paid in taxes.[3] As for Social Security, workers have been led to believe that the government would invest a portion of their earnings to help provide them with a secure retirement. Alas, this is a myth—Social Security operates on a pay-as-you-go (non-prefunded) basis—and conceals the fact that Social Security is a redistribution program for the elderly: on each dollar paid in, recipients typically receive back $0.90–$1.54 (even after accounting for likely returns, had retirees been allowed to privately invest their mandatory contributions).[4]

Claims that Social Security provides the majority of cash income for 65 percent of seniors mislead, too:[5] less than a quarter of non-disabled Americans over 65 participate in the labor force.[6] Instead, the relevant metric is wealth, not income. While poverty continues to afflict some seniors, the elderly are, on average, far more financially secure than younger Americans: the average U.S. household headed by an individual 65 or older has nearly 50 times the wealth of a household headed by an adult under 35; in 1984, this ratio was only ten to one.[7]

Made for the Twentieth Century

Social Security and Medicare's funding imbalances are vast because both programs were designed when America's demographics were radically different. In 1940, Americans who lived until 65 could expect to live another 13.8 years, on average;[8] today, Americans turning 65 can expect to live another 20 years.[9] In 1940, fewer than six in ten people who survived until age 21 would reach 65; today, eight in ten do so.[10] In 1940, 159 workers supported each retiree; today, there are 2.9 workers for each Social Security recipient (falling to 2.2 workers in 2030)[11] and 3.2 workers for each Medicare recipient (falling to 2.4 workers in 2030).[12]

The Social Security Act of 1935 was created to provide for the needy and destitute. In 1940, the first year of monthly benefit payments, the program covered 222,488 Americans, at a cost of $592 million (2014 dollars).[13] In 2014, it covered 59 million Americans,[14] at a cost of $845 billion.[15] Medicare, enacted in 1965, was designed to provide medical care for Americans 65 and older, at a time when life expectancy was about 70.[16] By 1970, 20 million seniors had enrolled in Medicare,[17] at a cost of $40 billion (2014 dollars);[18] in 2014, 54 million seniors were enrolled, at a cost of $600 billion.[19]

In 2014, spending on Social Security and Medicare accounted for 8.5 percent of U.S. GDP,[20] up from 3.8 percent in 1970.[21] In 2035, absent reform, these two federal entitlement programs will account for 11.4 percent of GDP.[22] Rising life expectancy should, of course, be celebrated. But Social Security and Medicare have not been adjusted to account for the fact that Americans now live significantly longer.

Hundreds of *Trillions* of Dollars in the Hole

America is officially $18 trillion in debt.[23] Yet when future spending obligations on Medicare and Social Security are compared with future tax obligations, the country's fiscal gap is about $210 trillion.[24] Without benefit cuts, closing this fiscal gap will require all federal taxes to be immediately and permanently raised by 57 percent; or all (non-debt service) federal spending must be immediately and permanently slashed by 37 percent.[25] Neither option is politically feasible, but the consequences of delaying reform will only worsen as obligations accrue.

U.S. workers and employers now pay a combined 15.3 percent payroll tax to cover Social Security and Medicare spending—thereby funding current retirees with contributions that younger generations will, absent reform, never receive back in full.[26] In 2050, if current trends continue, an employer-employee payroll tax cost rate of 31 percent will be needed to cover Medicare and Social Security spending.[27]

Absent reform, the Social Security trust fund will be depleted by 2034—in 20 years, retirees will receive, at most, three-quarters of promised benefits.[28] Absent reform, Medicare's hospital insurance component will exhaust its trust funds by 2030[29]—after which Medicare spending will only come from the program's tax revenues, which will fall well short of the needs of America's graying population. And, absent reform, young Americans will be decidedly worse off than their parents and grandparents—on the hook for crippling tax raises without higher benefits; or forced to pay current rates with benefits cut dramatically.

RESPECTIVE FUND DEPLETION DATES

Endnotes

1. See http://www.cnbc.com/2015/10/26/save-social-security-from-the-gop-huckabee-commentary.html.
2. See http://www.cbsnews.com/news/the-first-democratic-debate-full-rush-transcript.
3. See http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412945-Social-Security-and-Medicare-Taxes-and-Benefits-over-a-Lifetime.PDF. Why such variance? Taxes paid—and, thus, benefits accrued—depend on when individuals turned 65, the number of earners in a household, and a household's earnings. To make the figures more comparable with workers' likely returns had they been allowed to privately invest their mandatory contributions, the author assumes an annual return on Medicare taxes paid of 2 percentage points above inflation. U.S. seniors thus receive three to seven times more than they could have expected, even if allowed to invest their Medicare tax dollars and reap the returns.
4. See http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412945-Social-Security-and-Medicare-Taxes-and-Benefits-over-a-Lifetime.PDF.
5. See https://www.ssa.gov/policy/docs/statcomps/income_pop55/index.html.
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