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Benefits for the Aged and the Federal Budget: Short- and Long-Term Projections

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Summary

As the 108th Congress addresses short-term budget decisions, it may also want to consider the long-run impacts of those decisions and the major shifts in budget composition that are underway. Mandatory entitlements, particularly benefits for the aged, are projected to become even more dominant in federal budget policy. Spending on the aged under current policy as projected by the Congressional Budget Office will account for 43% of all federal outlays by 2010. A Congressional Research Service analysis of the President's FY2003 budget found that one-half of all federal outlays will benefit the aged, disabled, and survivors of deceased workers. While the retirement of the Baby Boom generation will accelerate this trend, population aging is a long-term phenomenon that will outlast the Baby Boomers. By 2075, continuation of current policy may find these programs accounting for 18% of gross domestic product (GDP), about twice their current GDP share. Furthermore, Congress may be pressed to add new benefits in response to population aging, such as improved support for long-term care and broader Medicare drug coverage. (This report will be updated as new information becomes available.)

Congressional consideration of fiscal policy in the 21st century began under circumstances far different from the deliberations of the late 20th century, as sizable budget surpluses replaced 3 decades of annual deficits. However, after briefly experiencing the "politics of budget surplus," deficit spending has resumed for the near term, brought on mainly by the recession, large tax cuts, and the costs of the war against terrorism. While surpluses may return later in this decade, long-term fiscal policy must allow for the expectation that financing problems related to population aging will mount for Social Security and Medicare, placing added pressure on future budgets. The onset of these funding problems could be delayed by legislative action or better-than-expected economic performance, but avoiding them is unlikely under current policies. In addition, other social policy issues may arise as the Baby Boom generation reaches old age, and addressing them could place heavy new claims on federal revenue.

Policy questions related to the aging of the U.S. population may outlive the Baby Boomers themselves, because the trend toward an older society predated the Baby Boom and is likely to continue beyond that generation's lifespan. Indeed, the U.S. population has grown older almost without interruption since the country's founding. For example, in 1900 only 4% of the U.S. population was age 65 or older. By 1980, the proportion in old age had nearly tripled to 11%. By the time all Baby Boomers will have reached age 65 in 2030, the Census Bureau projects that 20% of the population will be age 65 or older. While the *rate* of population aging should then slow, the aged sector of the population will continue to rise slowly, reaching 23% by 2060.[1]

Short-Term Budget Projections

Federal programs that benefit the aged (Americans age 65 and older) are primarily *entitlements,* the size of which are limited only by the laws that define benefit eligibility and benefit amounts. These programs' spending levels generally are not subject to control through the annual appropriations process. The following presentation of budget trends shows, first, the impact of entitlements and other mandatory spending on federal budget totals and, second, the size of all spending that directly benefits the aged. The three largest entitlement programs (Social Security, Medicare, and Medicaid) comprise a large part of the federal "safety net" for older Americans, providing, respectively, an income floor, insurance for acute health care, and open-ended nursing home stays.

Current Policy Budget Projections. Projections released by the Congressional Budget Office (CBO) in August 2002 are summarized in **Table 1**. These projections show outlay and revenue estimates for the federal government by fiscal year through FY2012 based on: (1) continuation of current laws pertaining to *mandatory spending* and taxation; (2) maintenance of *current services* for other programs by allowing *discretionary spending* to rise at the annual rate of inflation; and (3) a resumption of economic growth, averaging 3% a year above the inflation rate. (Although the congressional budget process excludes Social Security spending and revenue for some purposes by placing that program "off budget," this report includes Social Security budget data in order to depict the full impact of benefits for the aged on the overall budget.)

Using the abovementioned assumptions, CBO projects that the budget surpluses realized in FY2000 ($236 billion) and FY2001 ($127 billion) will yield to deficits for FY2002-FY2005. Surpluses are projected to resume in FY2006, reaching $522 billion in FY2012. (An excess of Social Security revenue over benefit payments accounts for $337 billion of this FY2012 surplus.) These anticipated surpluses result from a projected rise in revenue of 57% from FY2005 to FY2012, compared to an outlay increase of 31%.

While outlay growth is projected to lag revenue growth over that 7-year period, the *composition* of outlays is expected to change dramatically. The proportion of yearly outlays attributable to discretionary spending will change little, varying between 33% and 37% over the 12-year period shown in **Table 1**. Net interest payments will fall from 12% of total outlays to 5% because of recent surpluses and low interest rates. In contrast, mandatory spending will rise from 53% of all spending in FY2000 to 62% in FY2012.

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[1] These "middle series" projections assume that recent demographic trends will continue with respect to longevity increases, fertility rates, and immigration levels.

Table 1. The Current Policy[a] Federal Budget, FY2000-FY2012

($ in billions)

Budget category	2000 actual	2001 actual	2002 est.	2003 est.	2004 est.	2005 est.	2006 est.	2007 est.	2008 est.	2009 est.	2010 est.	2011 est.	2012 est.
Discretionary spending, total	*617*	*649*	*733*	*782*	*803*	*827*	*845*	*864*	*889*	*912*	*936*	*965*	*983*
Defense	295	306	349	368	376	387	393	399	413	424	436	452	456
Nondefense	322	343	384	414	428	440	452	465	476	488	500	514	527
Mandatory spending, total[b]	*949*	*1,008*	*1,113*	*1,161*	*1,200*	*1,248*	*1,309*	*1,386*	*1,471*	*1,560*	*1,657*	*1,771*	*1,853*
Social Security	406	429	452	474	494	516	542	571	602	637	675	717	762
Fed. civil'n/military ret.	88	93	97	101	105	109	113	118	122	126	132	136	141
Medicare	216	238	253	263	273	292	306	331	357	384	412	446	474
Medicaid	117	129	147	155	166	180	196	213	232	253	276	301	329
Other (net of offsetting receipts)	122	119	164	168	162	151	152	153	158	160	162	171	147
Net interest payments	*223*	*206*	*170*	*164*	*191*	*208*	*213*	*212*	*209*	*204*	*195*	*183*	*164*
Total federal outlays	**1,789**	**1,864**	**2,017**	**2,107**	**2,195**	**2,283**	**2,366**	**2,461**	**2,569**	**2,676**	**2,788**	**2,920**	**2,999**
Total federal revenue	**2,025**	**1,991**	**1,860**	**1,962**	**2,083**	**2,244**	**2,381**	**2,513**	**2,658**	**2,809**	**2,965**	**3,243**	**3,521**
Budget surplus (deficit)	**236**	**127**	**(157)**	**(145)**	**(111)**	**(39)**	**15**	**52**	**88**	**133**	**177**	**323**	**522**

Source: Congressional Budget Office. *The Budget and Economic Outlook: An Update.* August 2002.

Note: Details may not add to totals because of rounding.

[a]This table uses a CBO baseline that assumes discretionary spending will rise at the same rate as price inflation.
[b]Any discretionary spending associated with entitlement programs is included in the "discretionary spending" lines of this table.

Projected Spending on the Aged. A comparison of estimated federal spending on benefits for the aged is shown for FY1990, FY2000, and FY2010 (**Table 2**). (These estimates were released by CBO in July 2000 and, thus, are based on earlier budget projections for FY2010 than are the **Table 1** figures.) Benefits for the aged, which totaled $360 billion in FY1990, rose to $615 billion in FY2000 and are projected to breach the $1 trillion level in FY2010, a 71% increase over 10 years. These benefits will rise as a share of overall federal spending as well, from 29% in FY1990 to 35% in FY2000 and to 43% in FY2010. As a share of gross domestic product (GDP), benefits for the aged will grow from 6.4% of GDP in FY2000 to 7.1% in FY2010.[2]

Viewed more broadly, the large federal retirement systems benefit individuals under age 65 as well, including younger retirees, disabled workers, and survivors of deceased workers. Federal programs for low-income individuals aid disabled adults who have not yet reached old age. The Congressional Research Service, using this broader perspective to analyze data from the President's FY2003 budget, found that benefits serving all retired workers, disabled adults, and survivors, regardless of age, account for 49% of all federal spending in the current budget year.

Long-Term Budget Projections

Under current policies, spending on the aged over the next 40 years will rise substantially relative to the size of the economy. A recent CBO study projects that the three largest entitlement programs (Social Security, Medicare, Medicaid)[3] will rise from 7.6% of GDP in 2000 to 8.9% in 2010, 13.9% in 2030, and 15.1% in 2040.[4] These programs' share of GDP will grow to 21.1% in 2075. Thus, these entitlements, which in FY2000 provided 86% of all federal benefits for the aged and comprised 35% of all federal spending, will nearly triple relative to the size of the economy in 75 years. By 2075, the three entitlement programs will account for 53% of all federal spending, a shift driven largely by population aging and the rising cost of health care.[5]

These spending projections assume no new entitlements, but Congress may be pressed to consider new benefits as the needs of an increasingly elderly population are assessed. For example, Social Security or Supplemental Security Income benefits could

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[2] In addition to the benefits the aged receive from these federal programs, the largest category of *tax expenditures* (reductions in tax liability granted for specific purposes) is intended to enhance income in old age. This tax expenditure (the net deferral of income taxation on pension plans and retirement accounts) lowered federal revenue by an estimated $109 billion in FY2000. Also, favorable income tax treatment for Social Security and Railroad Retirement benefits and the additional income tax exemption for the elderly lowered FY2000 revenue by $20 billion.

[3] These long-term projections provide data for these programs in their entirety. While Social Security and Medicare serve primarily an aged population, Medicaid provides significant benefits to all age groups. In FY2000, 29% of Medicaid spending benefitted the aged.

[4] Congressional Budget Office. *A 125-Year Picture of the Federal Government's Share of the Economy, 1950 to 2075.* Long-Range Fiscal Policy Brief. July 3, 2002. **Table 2**.

[5] Although the Social Security and Medicare trust funds are projected to become insolvent before 2075 under current policies, CBO's projections assume that all benefit rights under current law will be honored. Program reforms to avoid insolvency could result in more or less spending, depending on the specific reforms.

be increased for the most vulnerable beneficiary groups. (To erase poverty for the aged would cost at least $6 billion a year.) Prescription drug coverage could be expanded for Medicare eligibles. (CBO has estimated that covering half of beneficiaries' expenses would cost $728 billion over 10 years.) Federal assistance could be broadened for long-term care. (Individuals spent an estimated $31 billion out-of-pocket for long-term care in 2000 according to the Centers for Medicare and Medicaid Services.) Tax expenditures associated with retirement saving could be expanded. (Retirement-related provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001, passed by the 107th Congress, will cost $50 billion over 10 years, and further tax incentives for retirement saving and long-term care insurance have been proposed.)

Table 2. Estimated Federal Spending on Benefits for the Aged, FY1990, FY2000, and FY2010

($ in billions)

	Federal spending on benefits for aged[a]		
Program	**1990**	**2000**	**2010**
Social Security (OASI) and Railroad Retirement (Tier 1)	196	307	471
Fed. employee retirement (CSRS, FERS, other civilian employee ret.)	21	33	50
Military retirement	7	14	21
Retired federal employees' health benefits	2	4	9
Special benefits for coal miners (black lung benefits)	1	1	1
Supplemental Security Income (SSI)	4	6	10
Veterans' compensation and pensions	7	9	14
Medicare (HI, SMI)	96	189	377
Medicaid	14	33	73
Food stamps	1	1	1
Housing assistance	4	7	10
Veterans' medical care	6	9	13
Services funded by Administration on Aging	1	1	1
Low Income Home Energy Assistance Program (LIHEAP)	[b]	[b]	1
Total federal spending on persons age 65 and older	**360**	**615**	**1,050**
Total spending on aged as percent of all federal spending	*28.7*	*34.8*	*42.8*
Total spending on aged as percent of GDP	*6.3*	*6.4*	*7.1*

Source: Congressional Budget Office. *Federal Spending on the Elderly and Children.* July 2000.

[a]Figures in this table are estimates of each program's spending that benefits persons age 65 and older.
[b]Less than $500 million.

Implications of Spending Trends

Assuming continuation of current policy, mandatory spending programs, particularly spending on benefits for the aged, will become increasingly prominent. By 2012, over half of federal spending will be accounted for by Social Security, Medicare, and Medicaid. By 2030, CBO projects that the budget will return to deficit status under some scenarios.[6] These trends, driven in the short run by the retirement of the unusually large Baby Boom generation, are expected to continue beyond that generation's lifespan because of the long-term trend of population aging.

The congressional budget process focuses on the next few years. However, if Congress takes a longer view, it may anticipate growing budget pressures that come from demographic forces (lengthening lifespans, low fertility rates) and promised benefits to the aged. Unless countervailing trends develop (e.g., older workers delaying their retirement dates), these long-run pressures will force a choice among three fiscal policy alternatives: (1) reforms in programs for the aged to curtail the spending growth that will occur under current law; (2) reduced spending in other sectors of government below current policy levels; and/or (3) an increase in the size of government relative to the economy to accommodate societal aging without large cuts in government spending.

The first option (program reform) would require legislative action to restructure the big entitlements, with action needed soon, given the political difficulties associated with the scaling back of benefits for those nearing old age. The second option (reduced spending on other government programs) would require significant cuts in government services to which the public is accustomed (e.g., worldwide deployment of the armed forces, space exploration, an extensive national park system). The third option (allowance for growth in the share of GDP channeled through government programs) would require higher taxes and/or increased borrowing. Currently, federal spending amounts to 20% of GDP. The CBO long-term projection cited earlier shows spending will double to 40% of GDP by 2075, a level exceeded in the past only during World War II (when spending peaked at 44% of GDP).[7]

In the long run, either the way we live in old age will change markedly, with longer working lives and more reliance on individual saving, or the relative size of government will reach unprecedented levels. Since it is preferable that major changes in old-age entitlements be made well in advance of the time when the consequences are felt, near-term decisions by Congress may need to consider these long-run questions.

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[6] Congressional Budget Office. *A 125-Year Picture of the Federal Government's Share of the Economy, 1950 to 2075.* Long-Range Fiscal Policy Brief. July 3, 2002. **Table 3**.

[7] Some nations that have experienced population aging in advance of the United States have seen an increase in their public sectors. From 1970 to 2000, government receipts as a share of GDP have risen by about one-half in Japan and Italy, by about 30% in France, and by about 20% in Germany. (CRS Report RL30560, *The U.S. Fiscal Position Compared to Selected Industrial Nations*, by Gregg A Esenwein, May 19, 2000; **Table 1**.) Of course, these changes are related to many factors, of which demographic change is only one.