The Daily Dish

The High Cost of Buying Budgetary Time

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It is now broadly accepted in the policy community that the federal budget is: (1) wildly out of whack (technical term) and on an unsustainable trajectory, (2) an immediate drag on the U.S. economy and a longer-term existential threat, and (3) needs to be addressed asap. The politics do not yet support this consensus, but since action is needed, the politics must ultimately come into alignment with the policy needs.

The focus must be on mandatory spending. According to the latest projections by the Congressional Budget Office, the federal government will spend $72 trillion in non-interest spending over the next 10 years. Of that, $21 trillion will be annual appropriations decisions by Congress, while the remaining $51 trillion is mandatory spending – aka entitlement spending.

But inside the larger category of mandatory spending, the numbers say that the focus must be on Social Security and Medicare. Eakinomics has made this point before, with the key being that the two programs constitute $36 trillion of the mandatory spending. If you want to solve the federal budget problem, you have to go to where the money is. The money is in Social Security and Medicare.

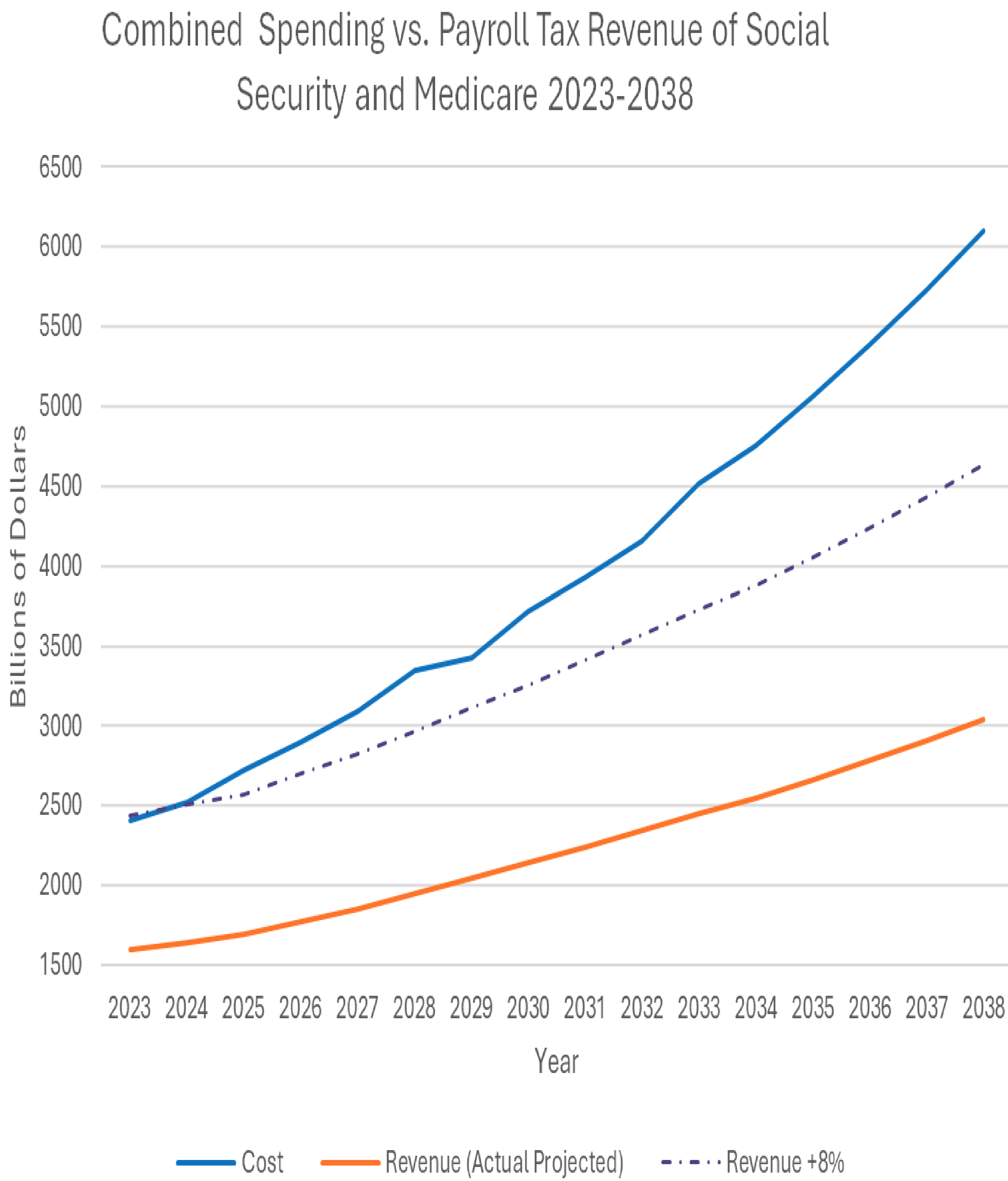
But what to do? That will be a complicated and deep political debate. But there is one clear thing to not do: just raise taxes. Eakinomics hears this all the time: “Isn’t the answer to just raise taxes?” It most certainly is not.

The reason is that not only are Social Security and Medicare larger than other spending but those programs are growing faster than everything else as well: Social Security at an average annual rate of 5.4 percent and Medicare at 7.0 percent. Raising taxes will close the budgetary gaps in those programs, but since the spending keeps growing faster than revenue, the gap reappears. And quickly.

This is illustrated in the graph below (hat tip to Sarah Murad for her help), which shows the situation for Social Security and Medicare combined. At present, combined spending is roughly $2.5 trillion (blue line) and combined payroll revenues are a bit above $1.5 trillion (orange line; ignore, for simplicity, the premium income in Medicare). One can close this gap by raising the combined Social Security and Medicare payroll tax rates by 8 percentage points. This is shown by the dotted line.

Problem solved? No. As the graph indicates, a deficit of the original size returns after only 10 years. For every 1 percentage point tax increase policymakers would buy one year and three months of time before the status quo problem reappeared.

Taxes alone cannot solve the problem. The growth of spending has to be reduced.



The same lesson is displayed for Social Security alone in the second chart (below). As before, the exercise is to raise the payroll tax enough to bring revenues into alignment with spending. Here, the needed adjustment is a roughly 1 percentage point increase in the tax rate. Unfortunately, the current deficit reappears in under two years. Once again, all policymakers would be doing is buying a little time at great taxpayer expense.

Fiscal sustainability is spending reform. Spending reform is Social Security and Medicare reform. And buying time to avoid these facts is very expensive.


Spending vs. Payroll Tax Revenue of Social Security
2023-2038
3500
3000
2500
2000
1500
1000
Billions of Dollars
2023
2024
2025
2026
2027
2028
2029
2030
2031
2032
2033
2034
2035
2036
2037
2038
Year
Cost
Revenue (Actual Projected)
Revenue +1%