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Federal Spending for Older Americans

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Summary

The federal government currently spends more than one-third of its budget on benefits and programs for older Americans. For people age 65 and over, estimated FY2005 spending for Social Security, Medicare, and Medicaid alone is $713 billion. Spending for retired federal employees and military personnel and for veterans is also significant, and smaller programs add to the total as well. In addition, tax expenditures might be taken into account to obtain a more complete budget picture.

Most observers predict that federal spending for older Americans will grow substantially. These predictions are fueled by a growing share of the U.S. population being of retirement age, real increases in Social Security benefits due to wage growth, and rising health care costs. While some of this growth can be predicted with confidence, at least for the next several decades, likely scenarios for other spending, particularly for heath care, remain uncertain. The rate of economic growth and the country's willingness to pay for benefits could also affect spending increases that actually occur.

Whatever the magnitude, growing federal spending for older Americans will confront Congress with difficult policy dilemmas. As both the Congressional Budget Office (CBO) and Government Accountability Office (GAO) are warning, current spending policies are likely unsustainable; they would require markedly higher taxation or debt levels that at some point adversely affect the economy. At the same time, reductions in public spending for older Americans could erode living standards for future generations of retirees. This report will be updated.

The federal government provides important income and other assistance to older Americans through a number of programs. The most significant support comes from three entitlement programs: Social Security, which pays monthly cash benefits to more than 36 million older Americans, including retired workers and their spouses age 62 and over, and widows and widowers age 50 (age 60 if not disabled) and over; Medicare, which provides health insurance to 35 million individuals age 65 years and over; and Medicaid, which provides health coverage and long-term care to 5 million individuals age 65 or older. Other assistance includes pension and retiree health insurance for former federal employees and members of the military, as well as pensions and medical care for certain veterans. Additional assistance is provided to impoverished elderly individuals through the Supplemental Security Income (SSI) program, and special funding is made available for housing, nutrition, social services, energy assistance, and other needs.

How much the federal government spends on benefits and programs for older Americans cannot be measured with precision. The meaning of the term “older Americans” depends on the context: in addition to people age 65 and over, it might include people as young as 62 (when Social Security retirement benefits are first available), 59½ (when the early withdrawal penalty no longer applies to qualified retirement plans), or 55 (when federal employees may retire if they have sufficient years of service). A further problem is that program data generally are not broken down by age. While good outlay estimates for people age 65 and over are available for Social Security, Medicare, and Medicaid, estimates for other programs are usually harder to obtain. It is not clear whether spending should be counted only once individuals reach a given age or whether it should also include advance funding such as government contributions to retirement accounts of younger workers. It is also not clear how outlays for administrative expenses should be classified, nor outlays for auxiliary payments such as Social Security benefits for dependent children of retired workers.

Estimated FY2005 federal spending (outlays) for Social Security for people age 65 and over totals about $391 billion.[1] Estimated FY2005 federal Medicare spending for people age 65 and over is about $276 billion. (This figure does not account for Medicare premiums, estimated to be nearly $28 billion for people age 65 and over in FY2005; were they subtracted, net spending would be less.) For Medicaid, estimated FY2005 federal spending for this age group is about $46 billion. (Medicaid also receives funding from states; their spending for people age 65 and over is not included in this figure.) Together, federal spending for these three entitlement programs totals $713 billion.[2]

Estimated FY2005 spending for federal employee retirement benefits for people age 65 and over is about $46 billion; this sum includes pension benefits being paid to both retirees and their survivors. Federal retirement benefits are different from the three entitlement expenditures just mentioned, and some might argue they would be better classified as an employment expenditure, notwithstanding that they are being paid to retired workers.

FY2005 federal spending for the three entitlement programs and federal employee pensions for persons age 65 and over is estimated at about $759 billion. This sum represents more than 31% of anticipated total federal outlays for FY2005 and over 6% of the gross domestic product (GDP, which is one measure of the size of the U.S. economy). There are other federal benefits and programs for people age 65 and over for which good FY2005 outlay estimates are not available; were they to be added to the $759 billion, the total would represent over 34% of federal outlays and almost 7% of GDP. (These other benefits and programs are identified in the CBO study cited in the next section.)

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[1] Throughout this report, FY2005 amounts for people age 65 and over are CRS estimates based on program and CBO data.

[2] Excluding administrative expenses, which are not easily attributable to particular groups of beneficiaries (in this case, individuals age 65 and older).

A more complete budget picture for older Americans would include tax expenditures (special tax deductions, credits, and other benefits), which result in reduced tax liabilities for individuals and reduced revenue for the government. For example, the partial exclusion of Social Security and railroad retirement benefits from taxable income was estimated to reduce federal revenues by approximately $19 billion in FY2005, while the additional standard deduction for the elderly reduces revenues by $1.8 billion. One might also include revenue reductions due to the net exclusion for qualified retirement plans and accounts, the total of which are about $150 billion, even though much of this sum is attributable to active workers of all ages (rather than people who are currently retired).[3]

Trends and Projections

The most recent comprehensive study of federal spending on older Americans was completed by CBO more than four years ago.[4] This study estimated that the federal government spent about $615 billion on transfer payments and services for people age 65 and over in FY2000. The three largest expenditures were for Social Security, Medicare, and Medicaid ($529 billion); they represented 86% of the total. The next largest, federal civilian retirement, added another $33 billion, bringing the percentage to 91% of the total. These amounts are shown in the last column of **Table 1**.

Table 1. Estimated Federal Spending on the Elderly, 1971-2000

Program		**Fiscal year ($ in billions)**			
		1971	**1980**	**1990**	**2000**
Mandatory:	Social Security	$29	$85	$196	$307
	Medicare	$8	$29	$96	$189
	Medicaid	$2	$5	$14	$33
	Federal Civilian Retirement	$2	$8	$21	$33
	Military Retirement	$1	$2	$7	$14
	Veterans' Compensation and Pensions	$1	$4	$7	$9
	Supplemental Security Income	$1	$2	$4	$6
	Annuitants' Health Benefits	*	$1	$2	$4
	Benefits for Coal Miners and Black Lung	*	$1	$1	$1
	Food Stamps	*	$1	$1	$1
Discretionary programs		$1	$6	$11	$18
Total spending on people age 65 and older		**$46**	**$144**	**$360**	**$615**
Total as a percentage of the federal budget		21.7%	24.3%	28.7%	34.8%
Total as a percentage of GDP		4.2%	5.3%	6.3%	6.4%

Source: Congressional Budget Office, *Federal Spending on the Elderly and Children* (Jul. 2000).

Notes: An asterisk (*) indicates spending of less than $500 million. Discretionary programs include special assistance for housing, veterans' medical care, home energy assistance, and other activities. Dollar figures are nominal (not adjusted for inflation).

As the table shows, CBO estimated that federal spending on these programs for people age 65 and over increased from $46 billion in FY1971 to $615 billion in FY2000.

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[3] *Fiscal Year 2005 Analytical Perspectives, Budget of the U.S. Government*, Table 18-3.

[4] Congressional Budget Office, *Federal Spending on the Elderly and Children* (Jul. 2000).

(These figures are in nominal dollars; in constant FY2000 dollars adjusted for inflation, the increase would have been from $186 billion to $615 billion.) The $46 billion in FY1971 represented 21.7% of all federal spending and about 4.2% of GDP; the $615 billion in FY2000 represented 34.8% of all federal spending and about 6.4% of GDP.

More recently, to illustrate the long-run impacts of current policies and an aging population on overall federal spending and revenues, CBO mapped six alternative budget scenarios through 2050.[5] Two of these are depicted in **Figure 1**. As shown, the federal budget outlook is quite different under a scenario with high health care cost growth and revenues held at historical levels and a scenario with intermediate health care cost growth and revenues growing in adherence with current tax law.

While the federal budget is most often presented on a year-by-year basis that shows outlays over a discrete period of time, an alternative presentation is in terms of the present value of *all* projected future spending and revenues. Present value calculations allow us to determine how much money the government would need to come up with immediately to pay off the current federal debt and all projected future budget shortfalls. According to one estimate, the present value of the federal debt and all future budget shortfalls was $44.2 trillion at the end of FY2002 (in context, FY2002 GDP was $10.3 trillion).[6] Since the government does not have $44.2 trillion today, in order to balance the budget over the long term it would have to make spending cuts or revenue increases in future years that add up to this present value amount.[7]

As the population ages, growth in program enrollment is not the only factor that will drive up federal spending. Price inflation will increase the *nominal* cost of benefits, just as it increases the cost of goods and services generally. Other factors contributing to *real* spending increases in excess of price inflation include the following:

- *benefit formulas* — under current law, Social Security benefits increase in real terms when wage growth exceeds price inflation in the economy;
- *reimbursement formulas* — reimbursements to Medicare providers or state Medicaid programs may increase;

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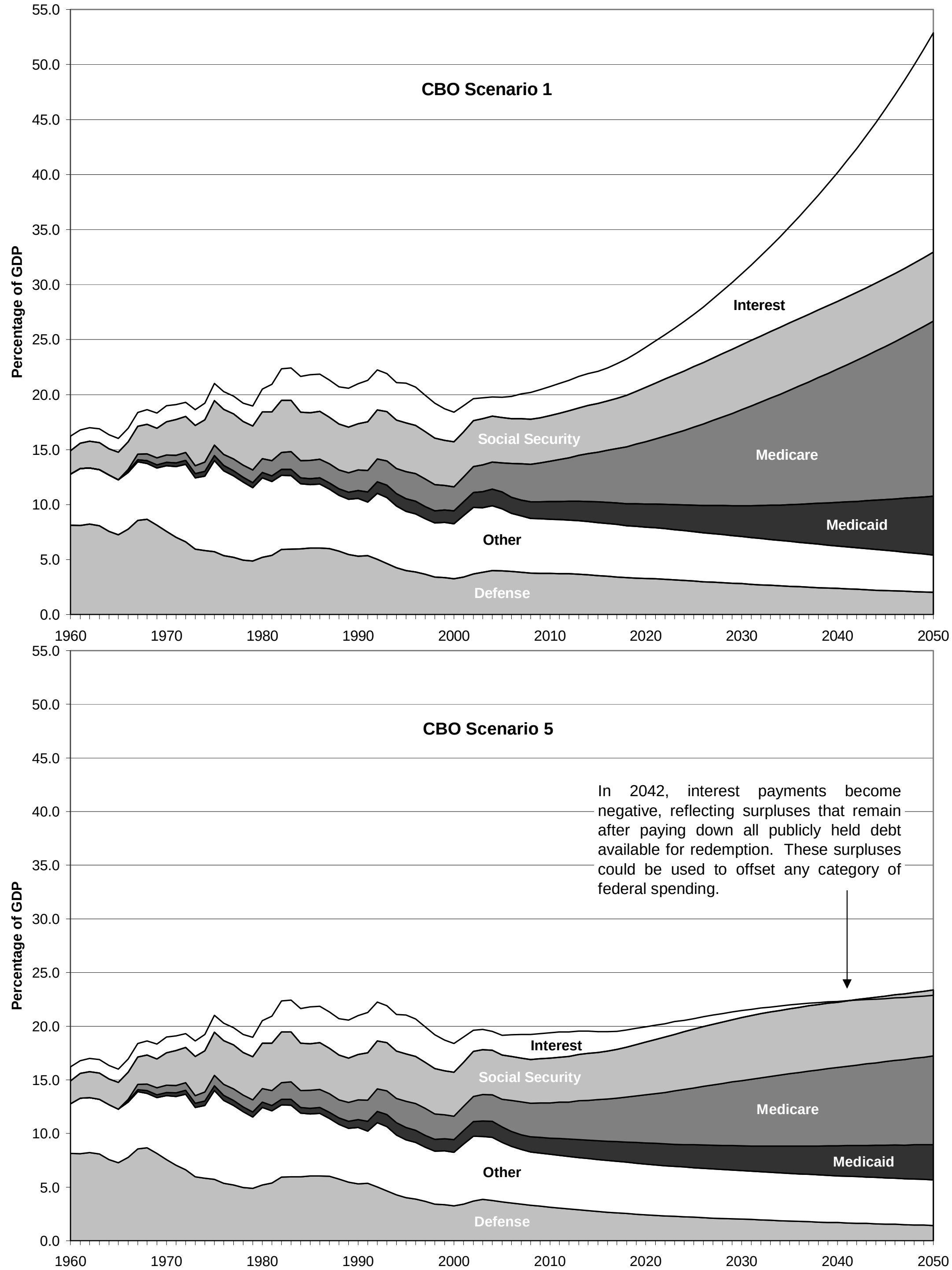
[5] On the spending side of these scenarios, growth in per enrollee costs for Medicare and Medicaid is the largest source of uncertainty. As a result, CBO assumes three alternative rates of growth for these two programs: (1) 2.5% faster than GDP; (2) 1% faster than GDP; or (3) the same rate as GDP. The intermediate 1% assumption is consistent with the Medicare trustees' assumption for their long-range forecasts, but it is lower than the 3.0% excess cost growth (i.e., growth in excess of GDP growth) that Medicare has experienced on average since 1970 and the 1.7% excess cost growth observed since 1990.

[6] Jagadeesh Gokhale and Kent Smetters, *Fiscal and Generational Imbalaces* (AEI Press, 2003). As with all budget projections, the $44.2 trillion estimate varies when its underlying assumptions are altered.

[7] Since present value (PV) calculations recognize that a dollar today is worth more than a dollar in the future (because of inflation and interest effects), the actual dollar amounts required to reach a given PV will be higher than that PV if they are budgeted over a number of years. In any case, to reach $44.2 trillion in PV, Gohkale and Smetters estimate that uncapped payroll taxes would have to be increased by 16.6 percentage points; income taxes would have to be increased by two-thirds; or Social Security and Medicare benefits would have to be cut by 45%.

Figure 1. Federal Budget as a Percentage of GDP Under Two CBO Scenarios, 1960-2050



Source: Congressional Budget Office, *The Long-Term Budget Outlook* (Dec. 2003).

Notes: CBO mapped six alternative budget scenarios through 2050, two of which are presented here. Scenario 1 assumes that Medicare and Medicaid spending per enrollee will grow 2.5% faster than GDP and that federal revenues will remain at their historical average level of 18.4% of GDP. Scenario 5 assumes that Medicare and Medicaid will grow 1% faster than GDP and that federal revenues will reach 24.7% of GDP.

- *utilization* — Medicare and Medicaid beneficiaries may visit doctors more often, and the services they use may be more expensive (e.g., because of technological advances); and
- *new covered benefits* — new benefits might be added to Medicare and Medicaid, some of which may stem from new technologies.

Using the intermediate long-range assumptions of the Social Security trustees, CBO estimates that about 55% of the projected increase in Social Security spending through 2075 (adjusted for price inflation) is due to an increase in the number of program beneficiaries, which itself is the result of an aging, longer-lived population. The remaining 45% is due to increases in the real value of Social Security benefits.[8] CBO also estimates that about 30% of the projected growth in Medicare spending through 2075 is due to an increase in program beneficiaries, with the remaining 70% due to general growth in health care costs.[9] The latter estimates do not include the Medicare drug benefit enacted at the end of 2003.

While the focus of this paper is on federal spending for older Americans, it is important to point out that many of the trends discussed here apply to other age groups as well. For example, Medicare and Medicaid both serve a sizeable population under the age of 65, and per enrollee spending for these individuals is also expected to increase for the reasons described above. As a result, even if the size of the population under age 65 served by federal programs remains level, total federal spending on these individuals may still increase.

Implications

Both CBO and GAO are warning that current federal spending policies are unsustainable and could require a marked increase in taxation or debt levels that could adversely affect the economy.[10] Confronted with an aging population,[11] Congress will likely consider what level and type of public benefits should be provided to older Americans, as well as what level of taxation will be needed to finance them on a sustained basis. Congress may also consider the appropriate *distribution* of benefits and taxation, both across income groups and generations. In order to address these complex issues, budget analyses that focus explicitly on the long-term sustainability of existing and proposed federal commitments will be needed.[12]

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[8] Congressional Budget Office, *The Future Growth of Social Security: It's Not Just Society's Aging* (Jul. 1, 2003).

[9] Congressional Budget Office, *Medicare's Long-Term Financial Condition*, statement of Douglas Holtz-Eakin before the Joint Economic Committee (Apr. 10, 2003).

[10] Congressional Budget Office, *The Long-Term Budget Outlook* (Dec. 2003); Government Accountability Office, *Budget Process: Long-Term Focus is Critical*, statement of David M. Walker before the Subcommittee on Legislative and Budget Process, Committee on Rules, House of Representatives (Mar. 23, 2004).

[11] For a detailed discussion, see CRS Report RL32701, *The Changing Demographic Profile of the United States*, by Laura B. Shrestha.

[12] Government Accountability Office, *Budget Process: Long-Term Focus is Critical*.