The Government We Deserve
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ARE YOU PAYING YOUR FAIR SHARE FOR MEDICARE?

What do you pay in Medicare taxes? And what Medicare benefits can you expect? This issue—potent now that the first baby boomers are turning 65—was highlighted recently by Ricardo Alonso-Zaldivar in a widely read Associated Press story.

It's no secret that early generations of Social Security beneficiaries got more out of the system than they paid into it. Beneficiaries in the 1940s and 1950s paid very low Social Security taxes for only a few years, then retired and received benefits for the rest of their lives. Until recently, in fact, almost all generations of retirees fared rather well. After all, the combined employer and employee tax rate for Old Age, Survivors, and Disability insurance, or OASDI, was kept low relative to benefits that would later be received. That combined rate equaled only 3.0 percent of earnings in 1950 and 6.0 percent in 1960, and it didn't rise to its still-inadequate level of 12.4 percent until the late 1980s. Since most of these revenues weren't saved, the increased OASDI tax rate supported ever-rising transfers to beneficiaries.

The most recent waves of retirees getting Social Security can make a stronger case that they have paid for their benefits. The complication is that their Social Security taxes mainly supported their parents in retirement, and the only way they can do as well in a money-in-money-out (at times partially funded) system is to foist higher tax rates on their children.

But let's leave Social Security aside for the moment to consider an even bigger problem of the same stripe. Past and current retirees, and most working-age adults, will never pay for all their Medicare benefits. The government's Medicare costs now top 3 percentage points of GDP and are headed to above 6 percentage points of GDP by 2055. But Medicare taxes and escalating premiums cover ranges from about 51 to 58 percent over time. To pay for the rest, we borrow from China and elsewhere, and use up ever-larger shares of income tax revenues, leaving ever-smaller shares for other government functions. Bottom line: without reform, current workers would continue to shunt many of their future Medicare costs onto younger generations, just as their parents did with Social Security.

Medicare's problems, of course, extend well beyond Social Security's. True, both systems must grapple with longer life expectancies and lower birth rates—thus reducing the number of taxpayers relative to beneficiaries. But Medicare also suffers from excessive cost growth. Structured like much other health insurance, Medicare essentially lets us consumers deal with doctors over what someone else (in our government or private insurance system) will pay. For years, numbers that Medicare actuaries and many others have been crunching have pointed to the system's unsustainability. Sadly, the lack of agreement on an alternative has led us and our elected representatives to blink when it comes to tackling this core structural problem.

Not only does this current structure lead to more borrowing from abroad, it saddles future generations with most of the costs of all those marvelous, expensive discoveries from which we hope to benefit in retirement.

A better type of hip replacement comes along. A new drug for congestive heart failure. A more effective treatment for prostate cancer. Sign me up! Yes, these are real advances, and who doesn't want insurance to cover them? The trouble is, the older among us are not required to work longer or pay for more than a minor share of these extra benefits. Providers, in turn, have come to expect ever-larger shares of national income as a reward for science's leaps.

Oh, and by the way, most of us have a backup insurance policy in Medicaid. Indeed, the majority of people who end up in nursing homes for long periods turn to Medicaid for support.

What about government's "trust funds"? Alas, they were never meant to cover future costs, and they can't. Most of the money comes in only to go right back out. For one shining moment after the

1983 reform, when baby boomers had not yet started leaving the workforce, a slight surplus materialized. But the surplus represented only a tiny fraction of future obligations and will soon disappear (for Social Security, see figure 3 in http://www.urban.org/url.cfm?ID=412095).

In Medicare, payments to doctors, for instance, have come mostly from income taxes or borrowed dollars. While payments to hospitals mainly came from the Medicare tax, even that system has been so underfinanced that significant deficits are expected in the future. Without reform, we'll continue to ask China and younger taxpayers to pay for those shortfalls.

In many ways, the numbers on lifetime benefits and taxes represent nothing more than another view on why our entire budgetary system is out of whack. This is not an economic problem that leads to a political one, but a political problem that threatens undesirable economic consequences. Only political reform of how we make economic decisions—addressing inconsistent promises for low taxes and high benefits that people have come to expect—can move us away from a system where promised benefits supposedly rise forever faster than GDP and where future, not current, workers must be left to bear most of the costs and consequences.

The Government We Deserve is a periodic column on public policy by Eugene Steuerle, an Institute fellow and the Richard B. Fisher Chair at the nonpartisan Urban Institute. Steuerle is also a former deputy assistant secretary of the Treasury. The opinions are those of the author and do not necessarily reflect those of the Urban Institute, its trustees, or its sponsors.