Social Security and Medicare: Big promises, hard realities

Biden's promises are likely impossible to fulfill.

By Brian Riedl

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President Joe Biden speaks about his administration's plans to protect Social Security and Medicare and lower health care costs, Feb. 9 at the University of Tampa in Tampa, Fla.

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In his State of the Union speech this month, President Joe Biden pledged to block any reductions in scheduled Social Security and Medicare benefits. He also promised that any tax increases would be limited to families that earn more than $400,000 — roughly the top-earning 2% of American families.

Together, these promises are almost certainly economically impossible.

Over the next three decades, the Social Security system is scheduled to pay benefits $21 trillion greater than its trust fund will collect in payroll taxes and related revenues. The Medicare system is projected to run a $48 trillion shortfall. These deficits are projected to, in turn, produce $47 trillion in interest payments on the national debt. That is a combined shortfall of $116 trillion, according to data from the Congressional Budget Office. (To inflation-adjust these figures, trim by roughly one-third.)

These unsustainable figures result from demographics, rising health care costs and program design. The ratio of workers supporting each retiree, which was about 5:1 back in 1960, will fall to just over 2:1 by the next decade. People who live until age 90, a fast-growing group, will spend one-third of their adult life collecting Social Security and Medicare benefits.

Today's typical retiring couple will receive Medicare benefits three times as large as their lifetime contributions to the system, and also will come out ahead on Social Security (adjusted into present value), according to the Urban Institute and the Brookings Institution.

The president's implication that full benefits can be paid without raising taxes for 98% of families has no basis in mathematical reality.

Imagine that Congress let the Trump tax cuts expire, applied Social Security taxes to all wages, doubled the top two income tax brackets to 70 and 74%, hiked investment taxes, imposed Sen. Bernie Sanders' 8% wealth tax on assets over $10 billion and 77% estate tax on estates valued at more than $1 billion, and raised the corporate tax rate back to 35%. Combined federal income, state and payroll marginal tax rates would then approach 100% for wealthy taxpayers, and America would face among the highest wealth, estate and corporate tax rates in the developed world.

Yet total new tax revenue — 4% of GDP — would still fall short of Social Security and Medicare shortfalls that will grow to 6% of GDP over the next three decades. Not even halving the defense budget would close the remaining gap.

More realistically, if these programs aren't reformed middle-class taxpayers will have to shoulder the burden, just as they do across Europe. And the burden is massive: Closing with taxes the aforementioned Social Security and Medicare shortfalls would more plausibly mean raising the payroll tax by 9 percentage points and imposing a 20% value-added consumption tax. Taxes haven't been raised that dramatically since World War II, back when tax revenues consumed a much smaller share of our economy, and there were many more untapped revenue sources.
If such tax increases sound painful, Congress could instead close as much as two-thirds of the Social Security and Medicare shortfalls by increasing program eligibility ages and paring back the growth of benefits for non-poor retirees, according to my research at the Manhattan Institute.

Perhaps the president assumes the federal government can just borrow $116 trillion over three decades, on top of the current roughly $25 trillion in federal debt held by the public. But who will lend the government this much money? China and Japan are already paring back their roughly $2 trillion in American debt holdings. It seems unlikely that other countries would step up to take on much more. The Federal Reserve is trying to reduce its own more than $5 trillion in Treasury holdings that temporarily soared during the pandemic, and cannot monetize $100 trillion in debt without hyperinflation.

That leaves America's banks, corporations and investors, which almost surely lack both the capacity and willingness to lend $100 trillion to a government that cannot control its own finances.

At some point, the bond market will likely tap out, forcing Congress to finally confront its soaring deficits. The danger is that waiting for a debt crisis will make the inevitable reforms much more drastic and painful. At that point, retired baby boomers will be too old to absorb benefit changes, the bloated national debt will bring colossal interest costs and years of automatic benefit expansions will be even more politically difficult to pare back.

The responsible alternative would bring Democrats and Republicans together and put everything on the table — Social Security, Medicare, taxes and defense — to build a balanced solution that gradually phases in reforms and exempts low-income seniors while we still have time for this gentler solution.

Social Security and Medicare sustainability is not merely a future challenge. Their annual program shortfalls — forecast to rise from $426 billion to $2 trillion over the next decade — are the main driver of budget deficits expected to head well past $2 trillion in a decade.

Social Security and Medicare are vitally important programs that represent a commitment between generations. No White House has seriously entertained addressing their unsustainable costs since the 2011 deficit negotiations. Back then, Vice President Joe Biden courageously put all taxes and spending on the table in hopes of a grand deal on deficits. With the Social Security and Medicare trust funds headed toward insolvency within 11 years, that courage is needed again.

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