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Underfunded Social Security isn't really an entitlement program

By Stephen Levy, New America Media

Thursday, November 5, 2009 | one comment | read comments | post a comment

Every week, Americans are reminded that large federal budget deficits threaten our future because we have an "entitlement crisis" from Social Security, Medicare and Medicaid. And every week in California residents are reminded that state and local governments face a crisis in meeting health and pension obligations for retired public sector employees.

There is no question about the arithmetic for these programs in the future. The costs cannot be covered by existing funding sources.

SDNN OPINION

For discussion purposes, let's say an entitlement program is a public program where the direct participants are legally entitled to participate but pay nothing or a small share of the costs. With the exception of Medicaid, where participants pay only a small share of program costs, the other programs are funded by taxes paid by participants and their employers.

Medicare and Social Security are funded through taxes paid by future beneficiaries and their employers. Economic theory suggests that the employer contribution is primarily paid by employees, who get a lower salary package. More than that, they are promised benefits that generations have counted on for retirement. Nearly all retirees are part of Medicare and Social Security-millions and millions of families who made plans based on their promised benefits.

The state of California has between $100 billion and $130 billion in unfunded retirement liabilities to state employees and teachers. In addition, cities and counties have additional unfunded liabilities. Yet, these programs are promised benefits that arise from contract negotiations and legislative actions.

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Does language matter? Does it matter if the discussion is about entitlements or promised benefits? Let's bring public education into the discussion to make an important language point.

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Public education is the nation's largest entitlement program in terms of total spending, including nearly $600 billion in 2008–without counting support for public colleges and universities. Most of us think this entitlement is a source of pride and strength for the country and that the children in school are not worth less because they benefit from a public entitlement to free K-12 education.

Social Security and Medicare, which are not really entitlement programs, currently cost about $500 billion per year although these costs are about to increase rapidly over the next 10 years.

Is it anyone's fault that the arithmetic no longer works for these programs?

The recession has made an already difficult funding arithmetic even more challenging. The stock market decline will cause an increase in contributions to public employee pension plans. The rise in unemployment translates into a decline in revenues into Social Security and Medicare.

The Medicare and Medicaid funding challenges are largely the result of the fact that health care costs are growing faster than federal revenues. The aging of the baby boomer generation contributes to the Medicare funding challenge and has been known for a long time. The recession and the persistence of rapid increases in health care costs have pushed the funding shortfalls higher and sooner.

Yet neither the recession nor the growth in health care costs is the fault of retirees. Whatever you think is the best approach to controlling health care cost growth, a workable health care solution is the best solution to the long-term Medicare and Medicaid funding challenge.

Most current public pension and health care benefits were negotiated at a time when private sector pay and benefits were growing. In recent years many private sector employees have seen their pension and health benefits decline as companies went out of business or changed benefit arrangements. As a result public employee retirement benefits seem high in comparison to what is happening in the private sector.

If you feel that public employee retirement benefits should be cut, how should that happen? Should we change benefits for current employees retroactively (is this even legal except through negotiation) or for new employees? If you favor reducing public employee retirement benefits, do you favor cutting Medicare and Social Security benefits for people who have paid into the system and planned for these promised benefits?

We need a new social contract about public employee retirement benefits and how they are paid for. We need a new social contract about Medicare and Medicaid benefits if health-care cost savings do not solve the problem. Social Security choices are simpler but also reflect the need for a new social contract that reflects the new arithmetic of these programs.

My own opinion is that we can devise better solutions if this discussion proceeds with respect and in acknowledgment that existing arrangements reflect valid promises and social and legal contracts and treat this as a serious arithmetic challenge without blame or heated rhetoric.

Stephen Levy is director and senior economist of the Center for Continuing Study of the California Economy (CCSCE) in Palo Alto. CCSCE is a private research organization founded in 1969 to provide an independent assessment of economic and demographic trends in California. California EconoTalk, with Levy's insights and analysis on California's economic landscape, is published regularly by New America Media, an SDNN media partner. This essay originally appeared on the CCSCE Web site.

Tags: california baby boomers, california budget, california deficit, california medicare, california retirees, california revenues, california social security, SDNN

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Comment by: VW Posted: November 5, 2009, 9:16 am

Thank you very much for this article! I look forward impatiently to a serious conversation about these programs that does not vilify those that currently participate in them.

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