

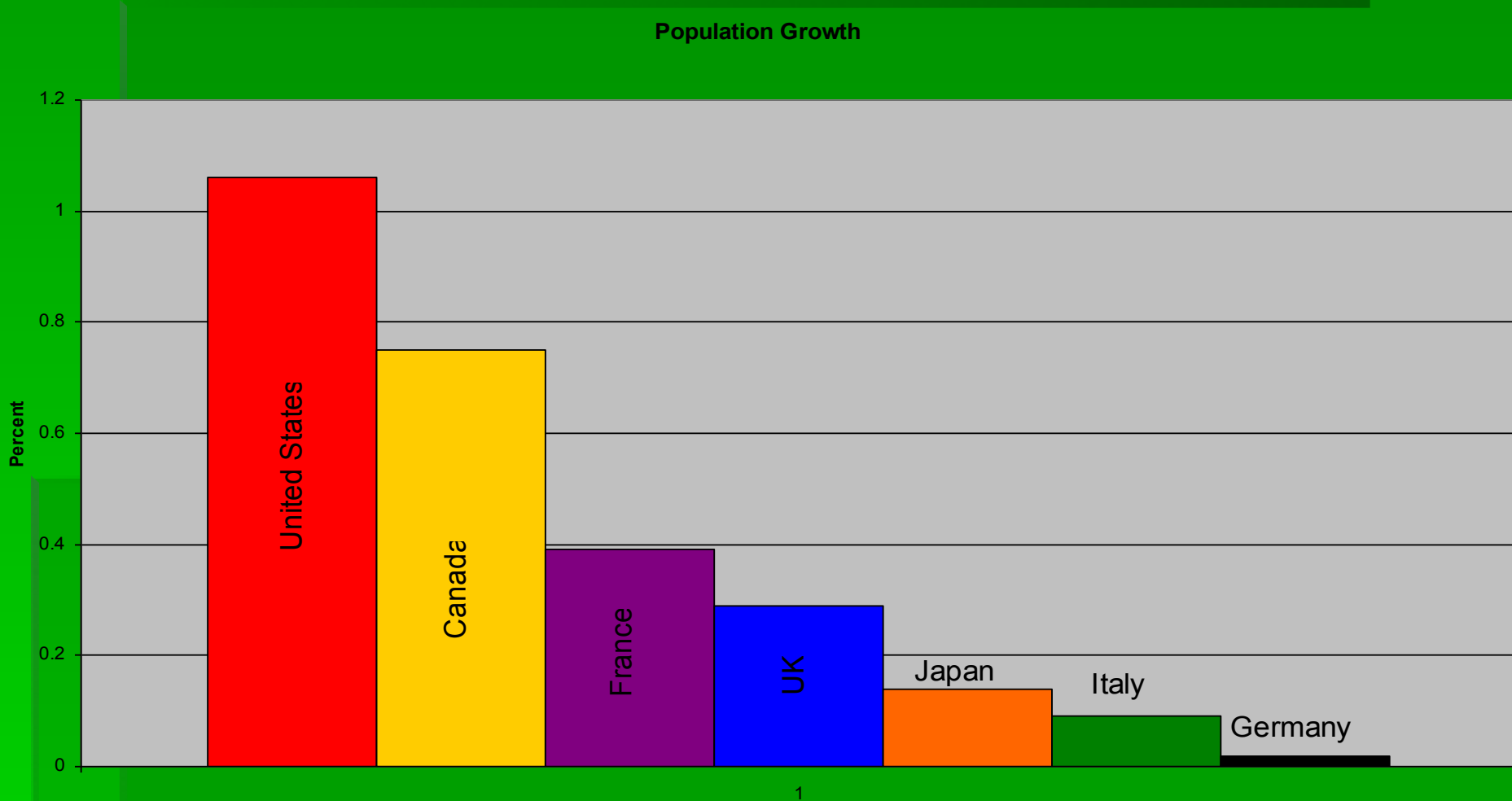
The Future of Social Security and Medical Care in the U. S.

Robert J. Gordon,
OFCE, Paris, December 15, 2004

One is Simple and the other is Difficult

- Social Security is Simple in the U. S.
 - Other Nations should envy our population growth
 - Our official projections are incredibly pessimistic
 - The required “fixes” are very minor
 - The political battle: are personal accounts worth the transition cost?
- Medical care is complex and difficult, many self-inflicted wounds

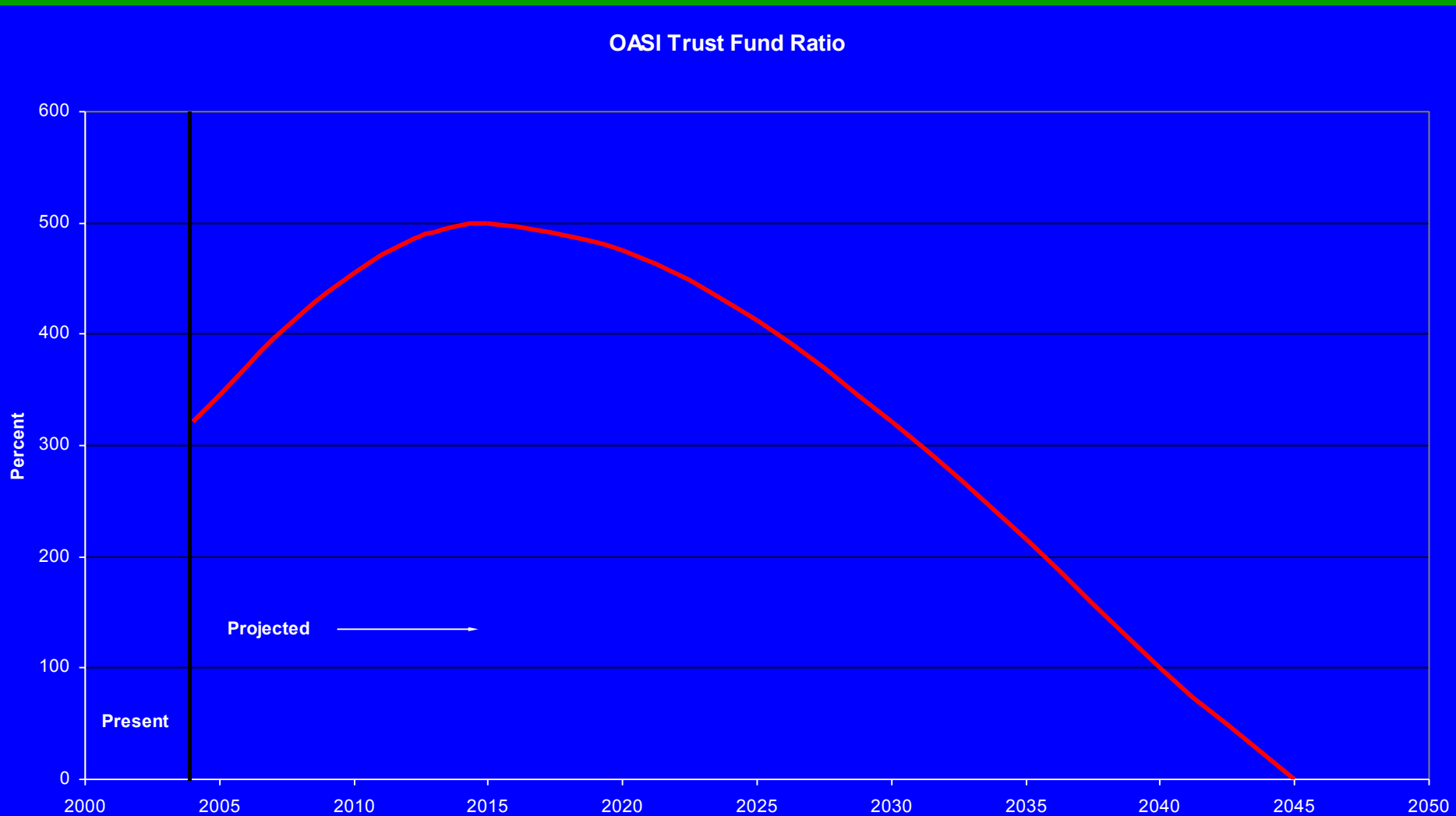
Population Growth per annum, 2000-2004



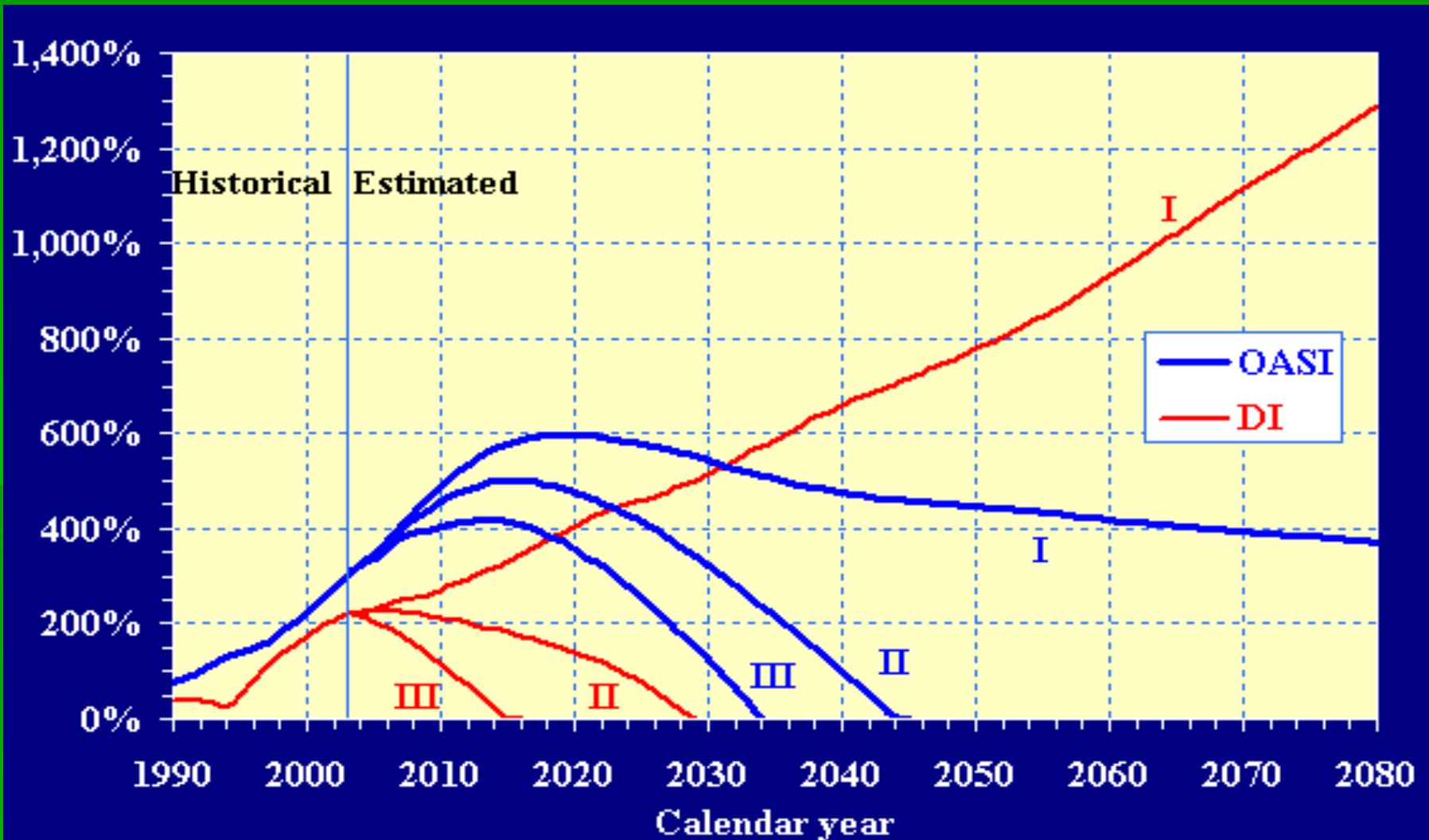
Why Should the U. S. Have a Problem?

- Not quite “pay as you go”
- 1983 Reforms built up quite a head start on the baby boom problem
 - 1983 reforms together with Reagan and Bush tax cuts => subtle exercise in class warfare
- Will peak in 2012-15, then decline until zero in ~2045
 - The “exhaustion date” depends on assumptions, particularly
 - Productivity growth
 - Population growth (fertility, mortality, immigration)

The Trust Fund: Peak Date and Exhaustion Date



With Optimistic Assumptions *there is no Exhaustion Date*



Caution on what “Exhaustion” Means

- After the trust fund is gone, revenues will still cover 81% of benefits
- Increase in tax rate from 12 to 15 or 16 percent will keep system solvent forever
- These numbers must look very low to French eyes!

How the Assumptions Matter

- Productivity:
 - Current system raises benefits by real wage through retirement, then only inflation
- Population growth
 - Fertility = 2.0 (compare to Europe!)
 - Mortality ignores medicare effect (explain)
 - Immigration!
 - Will the population in 2080 be 415m or 600m??

Immigration: the Shining Light

- Immigration / Population ratio grew at 3.5 percent per year 1970-2002
- Ratio currently at $1.4/300 = 0.46\%$
- Official projections based on constant 1.2 million forever, so ratio declines to 0.29% by 2080
- Allowing ratio to taper off to a constant 0.5% implies 2080 population of 600 million, not 415
- Implies permanent population growth of 1.0%, not 0.2%

Solutions are Easy

- Faster Productivity Growth puts off crisis
- Faster population growth puts off crisis
- How to solve crisis, whenever it comes
 - Index retirement age to life expectancy
 - Raise ceiling on taxable income (currently \$87K)
- Unnecessary to cut benefits or raise tax rates
 - Raising retirement age is an implicit cut in total benefits but not in benefits paid out per year
 - Raising ceiling makes financing system less regressive

Bush Proposal: Personal Accounts

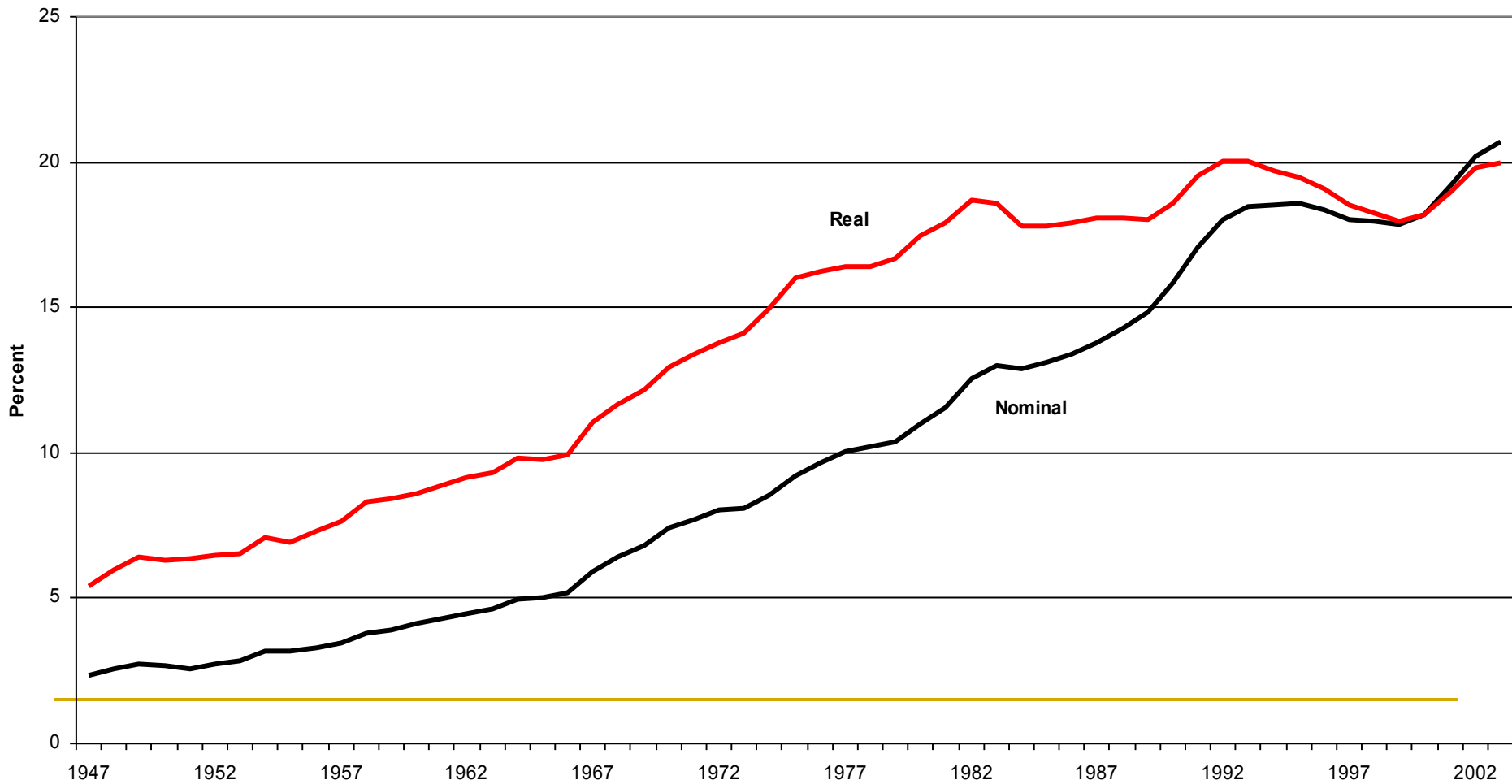
- Divert 2% into personal accounts from existing tax of 12%
- This robs the system of 1/6 of its revenue
- Creates a multi-trillion \$ financing hole
- The assumption of a continuing equity premium ignores history
 - Greater macroeconomic stability implies less risk
 - Remaining equity premium, if any, is a reward for risk

America's Disfunctional Medical Care Non-system

- A multi-part indictment
 - High spending with no payoff in life expectancy
 - Large uninsured population
 - High drug prices subsidize research for the rest of the world
 - Bush proposals would make matters worse

Real vs. Nominal Medical Care Spending as a Share of GDP

Medical Spending As a Share of GDP



Medical Care Spending Ratios Compared

- U. S. 13.9 percent of GDP
- Germany 10.7
- Canada 9.7
- France 9.5
- Italy 8.4
- Japan 8.0
- U. K. 7.6

Doctors per Capita

- Italy 4.3
- France 3.3
- Germany 3.3
- **U. S. 2.7**
- Canada 2.1
- U. K. 2.0
- Japan 1.9

Hospital Beds per capita

- Germany 6.3
- Italy 4.3
- France 4.2
- U. K. 3.9
- Canada 3.2
- **U. S. 2.9**

And that inconvenient fact . . .

- U. S. is in the middle of the league table of rich nations for life expectancy, nowhere near the top
- In a recent survey of 13 countries, U. S. ranks second from bottom for 16 available health indicators
 - Bottom in infant mortality, 10th in life expectancy at age 15
- Poor people line up in emergency rooms and aren't getting preventive care

Diagnosis

- Compensation is more unequal in U. S., so need to pay more to attract doctors from the talent pool
- Fragmented organization gives more market power to the supply side than the demand side
- Much of the extra expense is soaked up by the administrative complexity

Administrative Complexity

- “Truly bizarre” system with thousands of payers
- Payment systems differ for no socially beneficial reason
- 25% of U. S. expenses go to administrative costs
- Administrative costs for private insurance are 2.5 to 3x higher than public programs

Decentralized Federal System adds more complexity

- “Medicaid” (free health care for the very poor) is administered at the state level
- Individual states differ in who is covered
- Fiscal deficits at state level have resulted in cutbacks of eligibility, coverage
- Federal-financed “medicare” for the elderly is very partial, no coverage for drugs

Pharmaceutical Prices

- Other nations use market power of central government buying to hold down drug prices
- As a result of lack of regulation in U. S. (explicitly mandated in recent bill) drug buyers in U. S. subsidize research for the rest of the world
- More than half of U. S. drug revenue goes for administrative costs, sales costs, and net profit

Policy Solutions: the Bush Approach

- “Health Costs are high because people have too much insurance and purchase too much medical care”
- Solution: health savings accounts with very high deductibles
 - Like all personal tax-deductible accounts, a subsidy to the rich
 - High deductibles reduces preventive care

Kerry's Approach was too Timid

- Keep present system, have government pay for catastrophic care
- Does not deal with basic flaw: tying medical care to employment
- Makes U. S. firms uncompetitive in international comparisons
 - G. M. has medical costs of \$1,400 per auto produced relative to Toyota
 - Pushes firms to offer part-time employment with no medical benefits
 - Helps explain slow growth of employment in this 2001-2004 economic recovery

Solution? Why Can't the U. S. be more like France?

- Americans hear many complaints about the Canadian system
- We know virtually nothing about medical care financing in Europe or Japan
- Your turn . . .