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

Robert J. Gordon
Federal Reserve Bank of Chicago,
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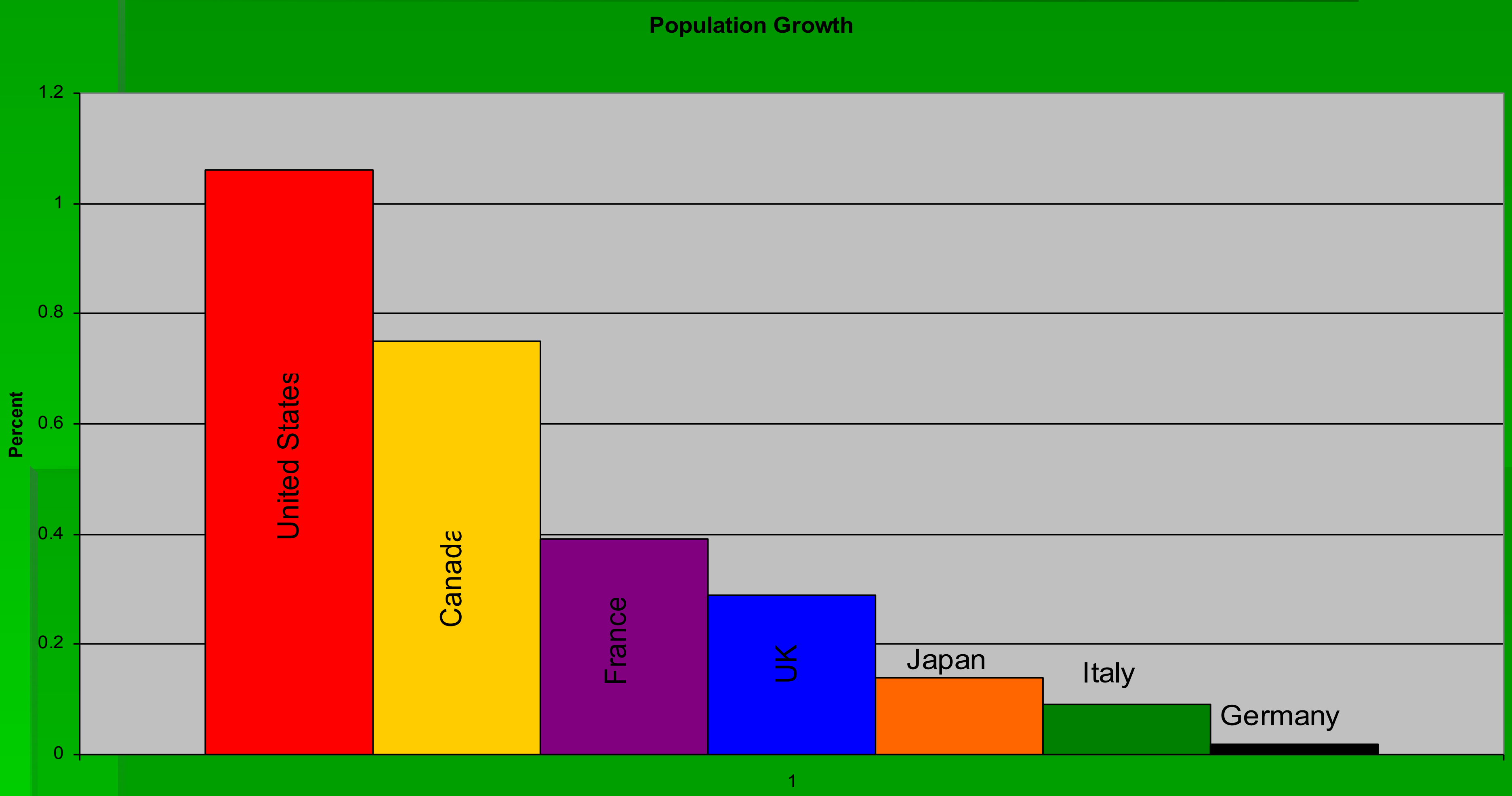
One is Simple and the other is Difficult

- Social Security Solutions are Simple in the U. S.
  - Other Nations envy our population growth
  - Our official SS 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

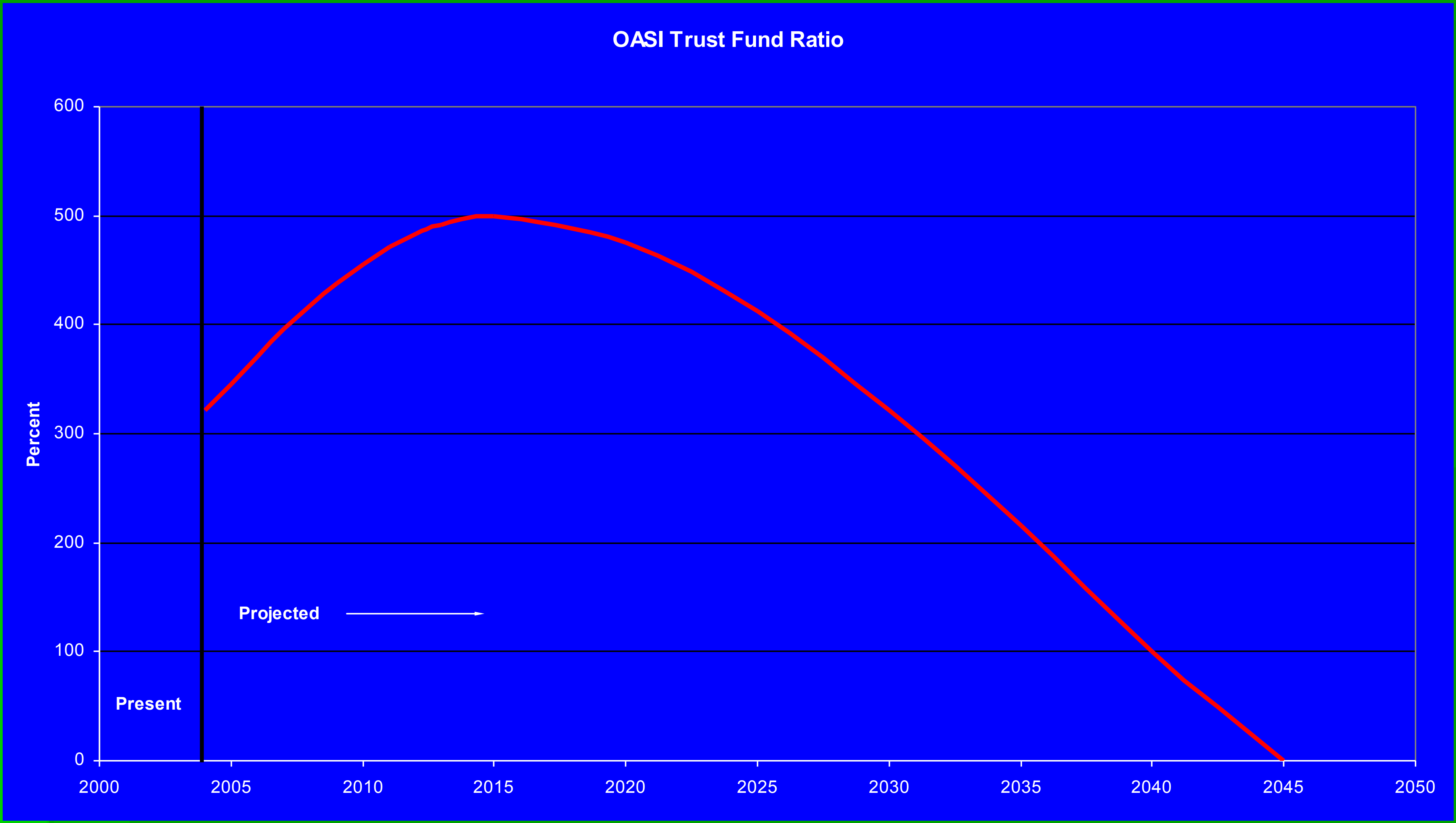
Population Growth per annum, 2000-2004



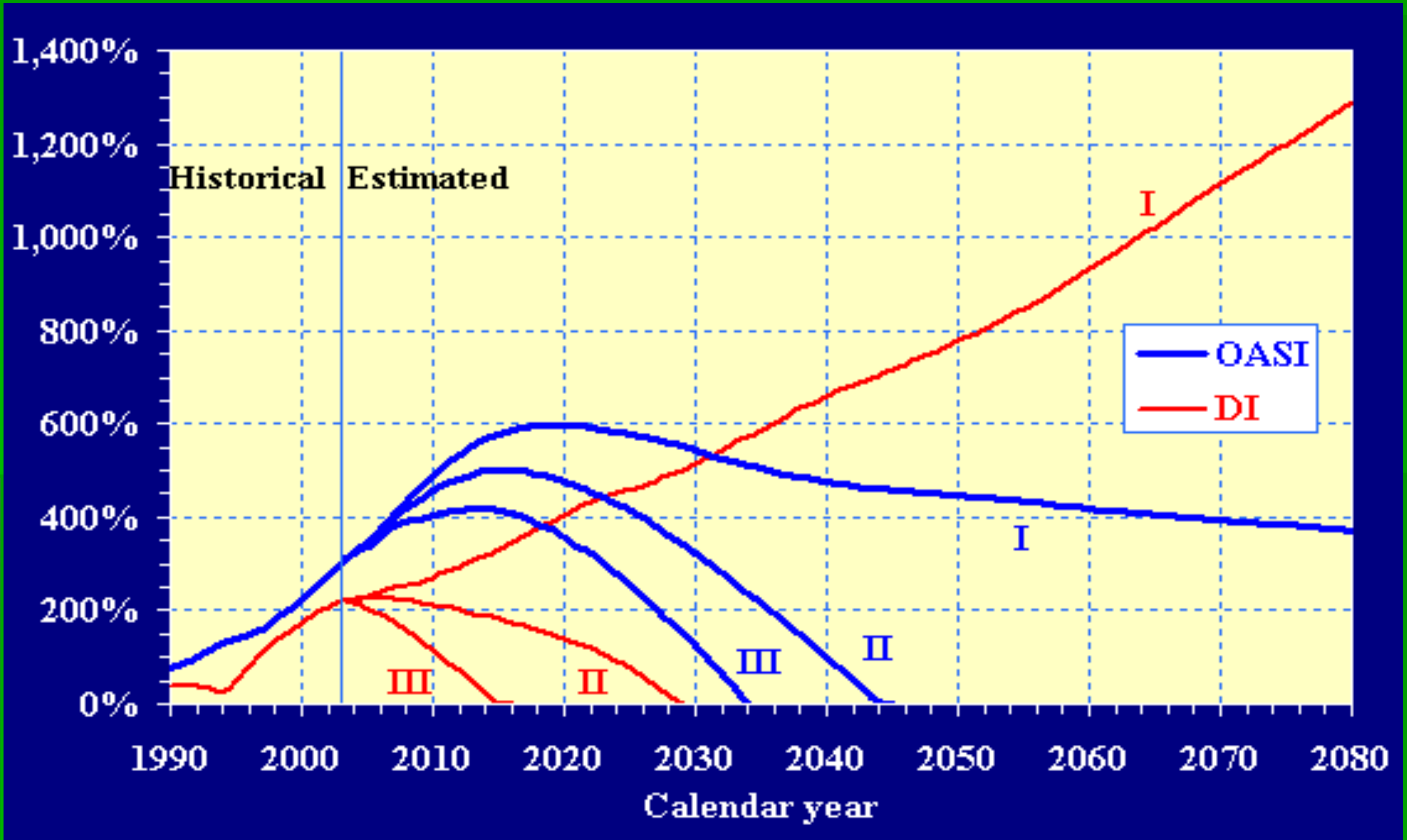
Why Should the U. S. Have a Problem?

- 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 percent will keep system solvent forever
- These tax rate numbers look incredibly low to almost any European coping with much slower population growth and earlier retirement ages

How the Assumptions Matter

- Productivity:
  - Faster productivity growth aids finances
    - Once retired, benefits grow only at inflation
- Population growth
  - Fertility (compare to Europe!)
  - Mortality assumptions may be too "pessimistic"
  - Immigration!
    - Will the population in 2080 be 415m or 600m??

Productivity and Real Wage Growth

- Official 75-year forecast for real wage: 1.1
- Actual growth of productivity since 1960: 1.9
- Earnings grow slightly lower than productivity, let's choose 1.6

Population: Fertility, Mortality, Net Immigration

- Fertility of 1.95 is OK
- Mortality assumption (annual reduction 0.72) is too high ("pessimistic")
  - Let's take their 0.30 assumption instead
  - Life style, Medicare, recent slowdown
- Immigration is the big banana

Immigration: Enriching our Culture and Repopulating our Central Cities

- 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 900,000 forever, so ratio declines to 0.22% 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%
- Illegal Immigrants are Paying Billions into Social Security

Adding up the Impact

- Start with official projection of 75 year income and cost rate and actuarial balance
- Income 13.87 (% of taxable payroll)
- Cost 15.79
- Balance -1.92
- Now let’s change this arithmetic

Three Fixes, How Far Do They Take Us?

- We need to find 1.92. Here it is:
- Faster productivity growth: 0.53
- Slower drop in mortality: 0.59
- Immigration per year stabilizes as percent of population: 0.75
- Total: 1.87!
- Summary: ***THERE IS NO CRISIS.*** System doesn't need any tax increases or benefit cuts

If You Believe the Pessimistic Official Forecasts

- Up to here, we've seen that alternative assumptions can solve problem:
- productivity solves 28% of funding gap, mortality solves 31% of funding gap, immigration solves 39% of funding gap
- Alternative fixes with official forecasts
  - Raise taxable ceiling 90 to 140K: 43%
  - Raise retirement age to 70 by 2083: 38%
  - Increase payroll taxes by 0.5 percent: 24%
  - Progressive indexing

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 $ “transition” financing hole
  - Thatcher paid her transition cost by a 10% tax increase on top income groups, eliminated earnings ceiling entirely
- 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

Personal Accounts Remove the Insurance from Social Security

- Your retirement income depends on your contributions
- Fundamentally different from the *redistribution* inherent in Soc Security
  - From middle-income to poor
  - From short-lived to long-lived
- In a world of personal accounts, who pays when a person outlives the actuarial predictions?

Investing in the Stock Market

- Price-earnings ratios are currently high by historical standards
- Good bet that future returns will not come close to 1982-2005. S&P with dividends:
  - 1955-2005 10.1% nominal 6.5% real
  - 1982-2005 15.3% nominal 12.8% real
- Lower Volatility in Overall Economy means a Smaller Risk Premium

Even if the Stock Market Were Going to Out-Perform, There's a Better Way

- Let the Soc Security Trust Fund Invest in Mutual Funds, Balanced Portfolio
- Avoids the Problems of Personal Accounts
  - MUCH LOWER management fees
  - Avoidance of individual risk ("I'll invest in growth accounts; the government will bail me out")
  - Avoids risks of a stock market crash in year before retirement
  - Avoidance of bad individual investment decisions ("Government should provide social insurance, not give people enough rope to hang themselves")
  - Avoidance of temptation to withdraw from personal accounts before retirement

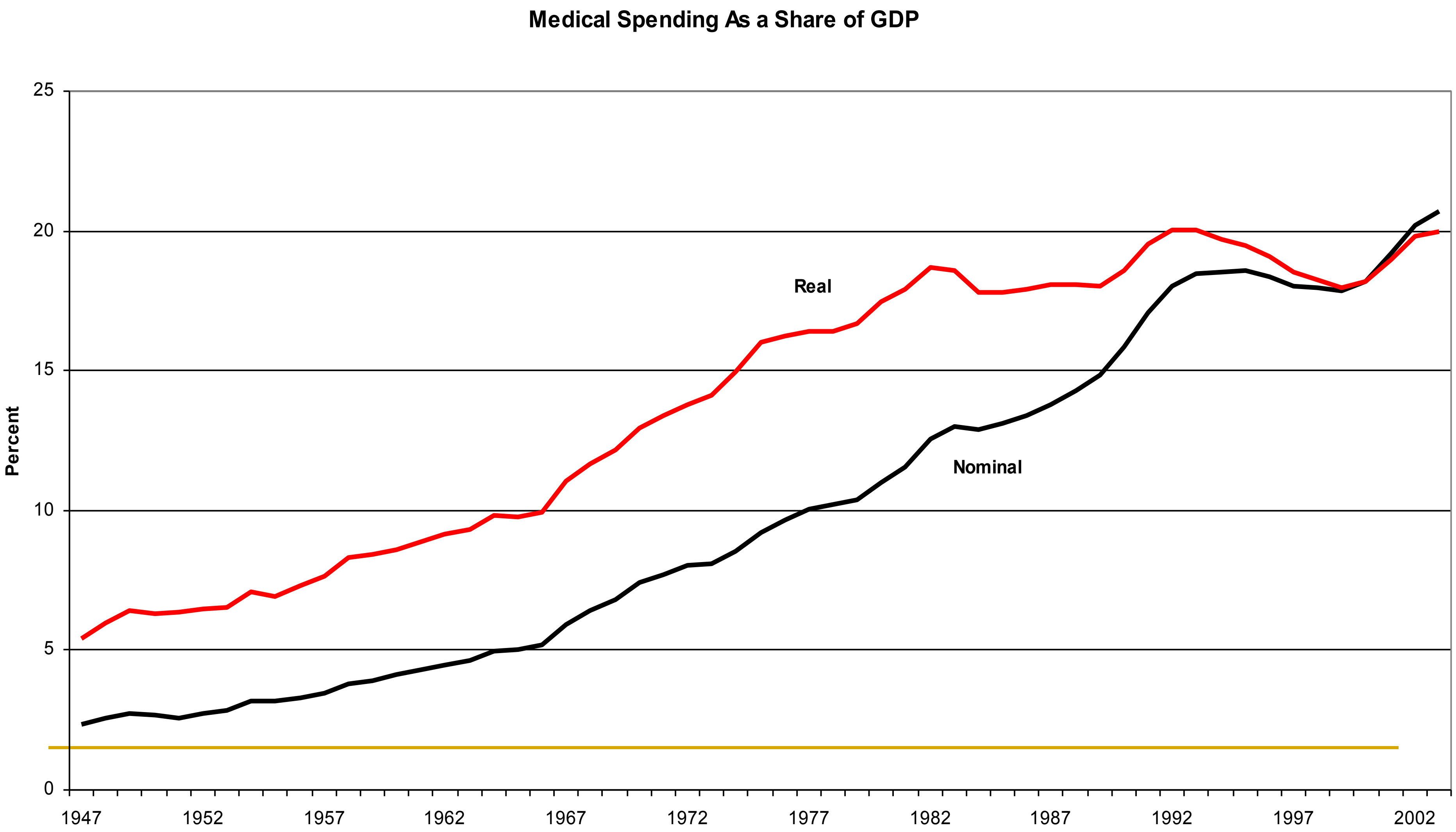
You Want Private Accounts, Change the Way People Sign Up for 401(K)'s

- Two ways to sign people up
  - #1, make them decide to enroll
  - #2, enroll them automatically and make them decide to opt out
- Research shows that the sign-up rate is enormously greater with option #2

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
  - Every aspect of Bush proposals would make matters worse

Real vs. Nominal Medical Care 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

"The story of my wife's mailbox"

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
- Inundated by mail at the Gordon household

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
- A good start would be to ban advertising for drugs
  - The “Soap Operas” are now the “Drug Operas”

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 reduce preventive care
  - Me: $7,000 for three routine tests in past 4 months
    - My HMO charged me 3 * $20 co-pay

Kerry's Approach was too Timid

- Keep present system, have government pay for catastrophic care
- Does not deal with two basic flaws: tying medical care to employment and using private insurance companies to administer payment
- 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?

- Unlike Britain and Canada, no problem of queues
- Universal Coverage
- Financed for 4% of GDP less each year
- A Place to Start in the U. S. Context: Kaiser-Permanente which combines insurance with health-care provision