

**Fiscal and Generational Imbalances:  
New Budget Measures for New Budget Priorities**

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# Changing Nature of Federal Outlays

- Increasingly dominated by SS and Medicare

- \* Declining short-term legislative control

- \* Increasing outlays on long-term obligations

- Need *forward looking* budget measures

- \* Debt Held By the Public...

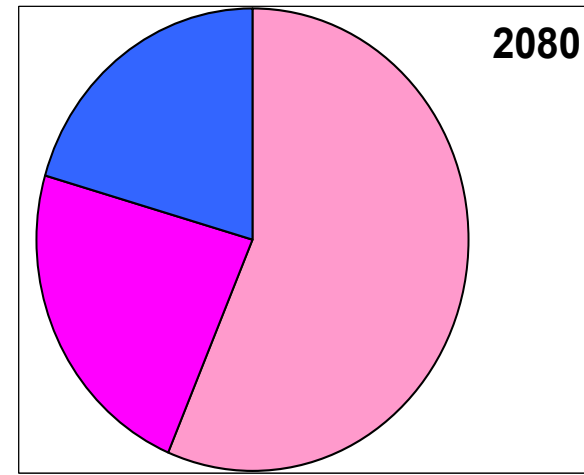
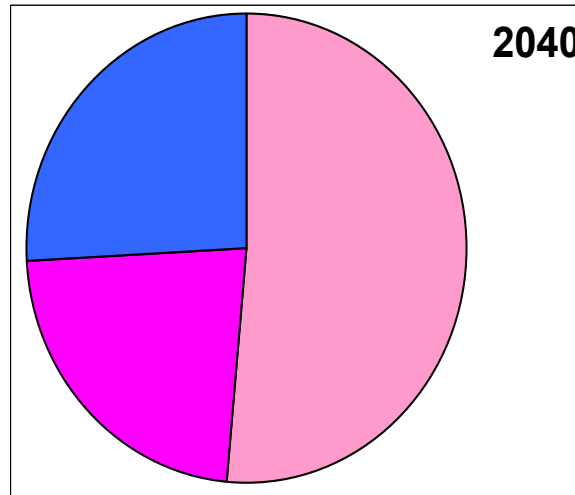
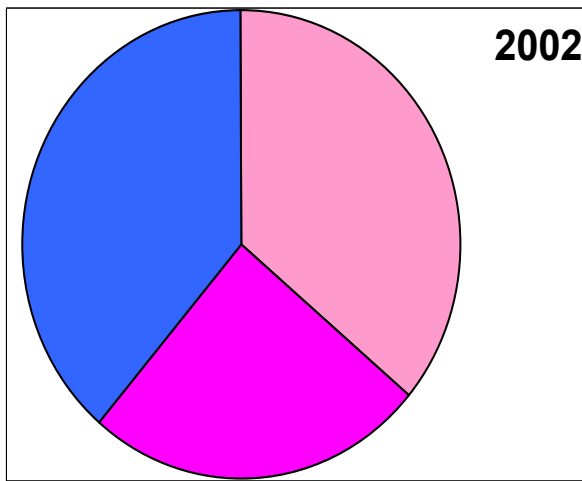
- \* Annual deficits...



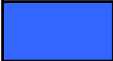
- \* 75-year actuarial deficits...

...are inadequate

# Federal Non-Interest Outlays

(Projections: FY2004 U.S. Budget)



	<b>Social Security and Medicare Outlays</b>
	<b>Fed. Retirement, Means Tested, and Other</b>
	<b>Discretionary Outlays</b>

# Dimensions of Inadequacy

- Debt, deficits, and 75-year measures...
  - \* Understate prospective federal financial shortfall
    - SS Trustees' -- understatement by 2/3<sup>rds</sup>
  - \* Introduce a *bias in in policymaking*

# Policy-Bias (Example 1)

## An SS “carve out” plan — *actuarially fair*

- **Part of payroll tax invested in personal accounts**
- **Future SS benefits reduced in equal present value**
- ✧ Debt held by the public increases
- ✧ Other unfunded obligations decrease equally—by construction
- ✧ *Zero impact on total unfunded obligations*
- ✧ Focus on Debt held by the public → federal liabilities appear to be larger → “carve out” plan looks bad rather than neutral

# Policy-Bias (Example 1-Modified)

**SS personal account reform with a “*haircut*”**

**PV of future SS benefits reduced by more than payroll taxes redirected into personal accounts**

—Plan I of the President’s SS Commission

- \* Debt held by the public, again, increases
- \* Other unfunded obligations decrease by more
- \* *Total Unfunded obligations decline*
- \* Also appears bad under exclusive focus on debt and deficits

# Proposal: Report Fiscal Imbalance (FI) Annually

## ➤ Fiscal Imbalance (FI) Measure

→ Shows how far current fiscal policy is from being sustainable

$$FI = PV \text{ future outlays} + Debt - PV \text{ future receipts}$$

... as projected under current fiscal policy

= Dollars needed today to make today's policy sustainable

= How far policy must be changed to make it sustainable

= Unfunded obligation on account of past, living, and future generations

**Problem:** FI alone is insufficient...

✦ It is transparent to certain types of fiscal policies

**Solution:** Show cohort components of FI

- FI attributable to *past and living* generations (GI)
- FI on account of *future* generations (residual FI – GI)

Why is this decomposition useful?

# Motivation for Decomposition of FI (Example 2)

## New Medicare benefit financed on strictly PAYG basis

- **Expand Medicare benefit to current retirees**
- **Hike payroll taxes just enough to pay extra benefit**

$$FI = PV \text{ future outlays } (\uparrow) + Debt - PV \text{ future receipts}(\uparrow)$$

- \* FI will remain unchanged (so does Debt held by the public)
- \* Existing retirees obtain a benefit they don't pay for
- \* Young and future generations lose investment income on additional payroll taxes
  - Loss is not covered by higher Medicare benefit after retirement

# Proposal: Report Generational Imbalance (GI)

## ➤ Generational Imbalance (GI)

→ Shows contribution to FI by *past and living* generations

= *PV future outlays + Debt – PV future receipts*

... to/from those alive today

... as projected under current fiscal policy

- ❖ GI increases under the policy of Example 2
- ❖ Helps to assess gains and losses across generations

# FI-GI Composite Measure: Properties

- \* Forward looking
- \* Calculated in perpetuity
- \* Comprehensive—FI covers entire federal budget
- \* Based on current fiscal policy
- \* Correctly reflects the impact of all policies—for programs that can report GI
- \* Easily communicable: FI grows with interest

**Table 1: Properties of Alternative Fiscal Measures**

<b>Properties of Budget Measures</b>	<b>Various Budget Measures</b>					
	Annual Deficit	Debt Held by the Public	75-year actuarial deficit	Generational Accounting	Accrued Obligation Measures	FI and GI Composite Measure
Forward Looking	✗	✗	✓	✓	✓	✓
Comprehensive	✓	✓	✗	✓	✗	✓
Calculated in Perpetuity	✗	✗	✗	✓	✗	✓
Based on Current Law	✓	✓	✓	✗	✗	✓
Correctly Indicates Impact of All Policies	✗	✗	✗	✓	✗	✓
Easy to Communicate	✓	✓	✗	✗	✓	✓

Source: Constructed by the authors.

# Argument Summary

- FI shows how far policy is from being sustainable
  - \* Debt, deficits, 75-year measures...inadequate
- GI shows the distribution of FI between
  - \* Past and living generations
  - \* Future generations (FI – GI)
- Provide a powerful tool-set for policy objectives...
  - \* ...Restore (move closer to) a balanced fiscal policy
  - \* ...Choose among alternative ways of doing so—balance interests of different (current vs. future) generations

# FI and GI Estimates: U.S. Federal Government

## ➤ OMB budget projections through 2080

### \* Extended through infinity (until estimates converge)

- Detailed distribution of OMB revenue and outlay projections using age sex profiles from micro-data surveys
- Terminal year GDP growth per capita—of 1.7%--applied to extend OMB projections beyond 2080

### \* Government's long-term discount rate – 3.6%

### \* CMS methodology for health-care growth

- 1 ppt. faster than GDP growth per capita through 2080
- Decays back to GDP growth per capita over 20 years after 2080.
- Conservative—overall health care expenses per capita grew 2.3 ppts. faster than GDP per capita since 1980 (3.8% vs 1.5%)

# Table 1

## Fiscal and Generational Imbalances:

(Present values in billions of constant 2002 dollars--projected)

### Total Federal Government

Fiscal Year-End	2003	2004	2005	2008
Total Fiscal Imbalance--U.S. Federal Government	45,470	46,930	48,548	53,962

### Social Security

1. Fiscal Imbalance (FI) in Social Security	7,204	7,436	7,692	8,569
Imbalance on Account of Past and Living Generations (GI)	8,943	9,171	9,424	10,289
Imbalance on Account of Future Generations <sup>112*</sup>	-1,739	-1,736	-1,732	-1,720

### Medicare Part A

2. Fiscal Imbalance in Medicare--Part A	21,071	21,764	22,513	24,939
Past and Living Generations	8,867	9,265	9,696	11,088
Future Net Benefits of Living Generations <sup>†</sup>	12,204	12,499	12,817	13,851

### Medicare Part B

3. Imbalance in Medicare--Part B	16,519	16,978	17,479	19,144
Past and Living Generations	6,853	7,109	7,392	8,343
Future Net Benefits of Living Generations <sup>†</sup>	9,666	9,869	10,087	10,801

## Table 1 (continued)

### Fiscal and Generational Imbalances:

#### Rest-of-Federal Government

(Present values in billions of constant 2002 dollars-projected)

	2003	2004	2005	2,008
<b>4. Fiscal Imbalance (FI) in the Rest-of-Federal-Government</b>	676	753	864	1,310
Future Outlays	81,701	83,161	84,780	90,202
Future Revenues	-86,552	-88,295	-90,103	-95,938
Living Generations <sup>†</sup>	-33,273	-34,141	-34,997	-37,698
Future Generations <sup>††</sup>	-53,278	-54,154	-55,106	-58,240
<b>Excess Future Outlays Over Revenues</b>	-4,851	-5,134	-5,323	-5,736
<b>Liabilities to Social Security and Medicare Trust Funds</b>	1,734	1,894	2,069	2,644
<b>Debt Held by the Public</b>	3,793	3,993	4,119	4,402

Note: Positive items increase the Fiscal Imbalance.

<sup>†</sup> Those born 15 years ago and earlier. In the year 2002, for example, this category includes people born before 1988.

<sup>††</sup> Those born 14 years ago and later. In the year 2002, for example, this category includes people born during 1988 and later.

§ Calculated as FI minus GI.

Source: Authors' calculations.

**Table 2:**  
**Tax Hikes/Outlay Cuts Required to Eliminate the Fiscal Imbalance,**

<b>Fiscal Year-End</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2008</b>
FI as a Percent of PV of Payroll	16.7	17.0	17.3	18.2
FI as a Percent of PV of Income Taxes	69.3	70.1	70.9	73.7
FI as Percent of PV of Payroll Taxes	95.4	96.7	98.2	102.7
FI as a Percent of PV of Discretionary Outlays	*	*	*	*
FI as a Percent of PV of Non-Social Security and Non-Medicare Outlays	55.7	56.4	57.3	59.8
*Greater than 100 percent.				
Source: Authors' calculations.				

# Sensitivity to Economic Assumptions

**Table 7: Sensitivity of Required Wage Tax Hike (Fiscal Year-End 2003)**

	Baseline	High	Low
<b>Discount Rate (high=3.9; low=3.3)</b>	<b>16.7</b>	<b>15.0</b>	<b>18.8</b>
<b>Productivity Growth Per Capita (high=2.2; low=1.2)</b>	<b>16.7</b>	<b>14.8</b>	<b>18.2</b>
<b>Mark-Up of Health Care Outlay Growth Per Capita (high=1.5, low=0.5)</b>	<b>16.7</b>	<b>24.2</b>	<b>11.1</b>

**Source: Authors' calculations.**

# Conclusion

- Traditional fiscal measures are inadequate
  - \* Understate federal unfunded obligations
  - \* Introduce a bias in policymaking
  
- FI-GI composite would rectify both shortcomings
  
- Cause for Optimism...
  - Administration officials and others--recognize need for change
  - SS Trustees adopted the measures (2003)
  
- Need for new budget measures is urgent enough...
  - \* legislation formalizing adoption in official budget reports

