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LIFETIME SOCIAL SECURITY AND MEDICARE BENEFITS

Eugene Steuerle and Adam Carasso

IN CONSIDERING REFORMS FOR SOCIAL Security and Medicare, a crucial issue is whether benefits will be adequate both under current law and any proposed reform. Traditionally, lawmakers have assessed this adequacy by looking only at the *annual* benefits in the Social Security program alone. However, it is the *lifetime package* of retirement benefits that gives the most comprehensive picture of what government is being asked to provide and how the elderly are treated relative to other age groups. Moreover, it is only by considering benefits as a whole that reformers can consider trade-offs among cash versus medical benefits, more years of retirement versus higher annual benefits, and benefits for the old old versus the young old. This brief provides estimates of the value of lifetime benefits promised under current law.

One of the most cited figures on retirement benefits is the Social Security Administration's estimate of average, annual retiree benefits ($10,740 in 2003). This figure by itself is of limited value. In the first place, it excludes Social Security survivors benefits that widows and widowers receive, and, more importantly, fails to reflect the number of years that the elderly will receive these benefits.

Any estimate of Social Security benefits alone, moreover, leaves out a crucial part of the retirement benefits story—*Medicare.* Because Medicare costs are growing so rapidly, Medicare benefits are projected to rise from about 27 percent of the expected lifetime benefits for a typical couple retiring in 1970 to 42 percent for one retiring in 2000 to more than half of all benefits for one retiring in 2030. Annual Medicare benefits are typically low when retirement begins but mount in later years as health worsens; also, health costs grow along with demand for medical goods and services and often-hefty medical price inflation. Here too, then, a *lifetime* approach reflects both the growth in annual costs and number of years of benefit receipt.

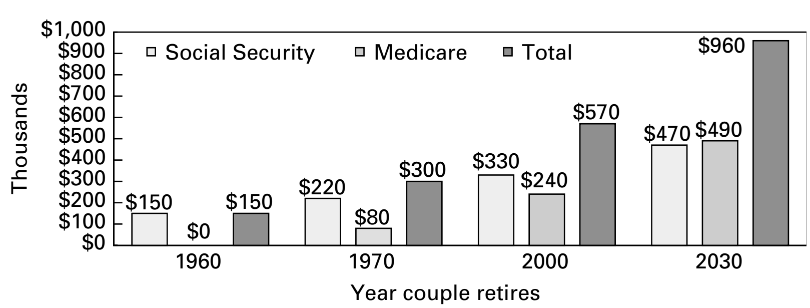
In the accompanying figures, we provide estimates of lifetime benefits for three typical couples: an average-wage worker married to a low-wage worker; two average-wage workers; and a high-wage worker married to one earning average wages.[1] By lifetime benefits, we mean what this couple would have to pay if it were to go to an insurance company at age 65 and put down the amount of money (in 2002 dollars) necessary to pay up front for its package of benefits. This calculation effectively credits interest; hence, total actual benefits will exceed this cost.

Assuming a normal life expectancy, the average-wage worker married to a low-wage spouse retiring in 2000 is promised lifetime Social Security benefits of $330,000 (figure 1). By 2030, that same couple can expect lifetime Social Security benefits of $470,000. Adding the lifetime value of Medicare benefits brings the package of benefits to $570,000 in 2000 and $960,000 by 2030 for this couple. For couples with higher wages, the package of benefits easily exceeds $1 million.

Although Social Security cash benefits play a significant part in the soaring costs, Medicare accounts for much of the growth. From 1970 to 2030, real Social Security lifetime benefits are scheduled to grow 110 percent. During the same

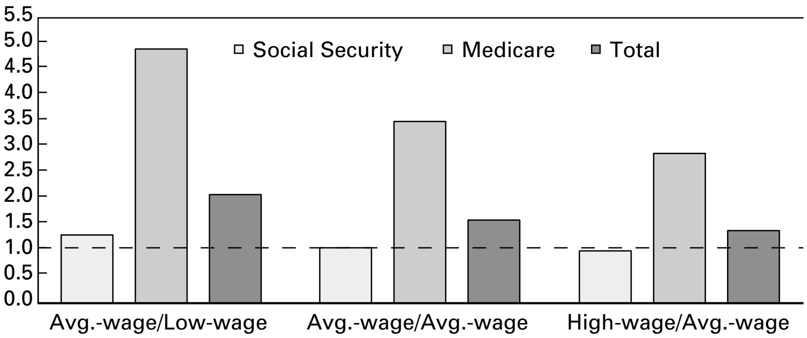
1. The average wage is projected to be $36,609 in 2003; low wage, $16,474; and high wage, $58,574.

Figure 1. Growth in Social Security and Medicare Lifetime Benefits for an Average-Wage/Low-Wage Two-Earner Couple, 1960–2030



Notes: Benefits sums are discounted to present value at age 65 using a 2 percent real interest rate. Figure assumes each spouse survives to at least age 65. Projections based on intermediate assumptions of the 2002 Old-Age Survivors and Disability Insurance and Hospital Insurance/Supplementary Medical Insurance Trustees Reports.

Figure 2. Ratio of Benefits to Taxes for Three Types of Retired, Married Couples in 2030



Notes: Ratios above "1" mean the couple receives more than it pays in. The first total bar is Social Security lifetime benefits divided by Social Security taxes; the second is Medicare (HI) lifetime benefits divided by Medicare lifetime taxes; and the third is total lifetime benefits divided by total lifetime taxes. Lifetime payroll taxes and benefits are discounted to present value at age 65 using a 2 percent real interest rate. (Lifetime payroll taxes include both the employee and the employer share of FICA taxes.) Figure assumes each spouse survives to at least age 65. Projections based on intermediate assumptions of the 2002 Old-Age Survivors and Disability Insurance and Hospital Insurance/ Supplementary Medical Insurance Trustees Reports.

period, Medicare benefits are expected to grow 510 percent. Total benefits are expected to grow 220 percent over that period.[2]

Who pays for these benefits? Under Social Security and Medicare, current workers earn entitlement to retirement benefits by paying a certain percentage of their annual wages in Social Security or FICA taxes. For the most part, this money is not saved, and the expectation is that when this generation of workers retires, there will be new generations of workers to pay their benefits.[3] Since the tax rate is set in law, we can construct a measure of lifetime payroll taxes just as we did for lifetime retirement benefits. Even for current and many future retirees, the amounts of payroll taxes continue to be dwarfed by the amounts of benefits received, as seen in figure 2.

Note that while Medicare pays out two types of benefits—Hospital Insurance (HI) and Supplementary Medical Insurance (SMI)—only HI receives a dedicated portion of the Social Security payroll tax. SMI is the fastest growing component of Medicare and since it is paid for out of general revenues each year, there is no easy way to attribute its cost to workers alone—the income taxes of workers and the retired, those of corporations, and excise, gift, and other taxes are pooled in general revenues—so we omit any "prepayment" of SMI from our calculations of lifetime payroll taxes.

2. Based on annual data for average Medicare expenditures by age.
3. Medicare first paid benefits in 1967.

Although the gap between lifetime benefits and taxes shrinks for couples with higher incomes, they, too, receive more from the system than they pay in. As shown in figure 2, under current law, a couple in which one spouse earns a high wage and the other earns the average wage will pay lifetime taxes equal to just 70 percent of its retirement benefits even as late as 2030. While a shifting of tax burdens to future generations is possible for a very long time, it is not sustainable—hence the call for reform. For now, however, Medicare taxes are so low relative to promised benefits (even if we added some imputation of income taxes as a prepayment for SMI) that *most current workers, rich or poor, may never be fully required to pay for their own benefits*.[4]

In considering reform, one tough issue is deciding how many additional burdens should be shifted to future generations versus current generations in the form of lower benefits or higher taxes. Complicating the issue is that the system is meant to redistribute to those with greater needs, so someone must pay for such redistribution. The data presented here can enlighten these reform choices. At a minimum, they suggest that considering Social Security and Medicare separately, as if each operates in a vacuum, is ill-advised. They are inextricably linked by their financing problems, the demographic pressures they face, and, most importantly, the package of benefits and taxes they offer each participant.

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Eugene Steuerle is a senior fellow at the Urban Institute, where his research includes work on Social Security reform. **Adam Carasso** is a research associate at the Urban Institute.

4. Assumes a real interest rate of 2 percent, more than likely available from a private insurance company for a policy with this many protections.

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