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The Burden of Social Security Taxes and the Burden of Excessive Health Care Costs

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Executive Summary

Numerous politicians and commentators have claimed that the prospect of higher Social Security taxes in the future threatens the living standards of our children and grandchildren. However, the tax increases that the Social Security trustees and the Congressional Budget Office (CBO) project will be necessary to maintain the program's solvency would have far less impact on the living standard of workers than the prospect of rising health care costs.

The United States has the most inefficient medical system in the world. It pays more than twice as much per person as other wealthy countries, yet it has little if anything to show in terms of outcomes. Life expectancies in the United States are shorter than in almost every other wealthy country. The health care system in the United States is becoming increasingly inefficient through time, as health care costs are projected to continue to grow rapidly as a share of GDP over the next five decades.

This paper shows that:

- the impact of excessive health care cost growth (cost growth that exceeds per capita GDP growth) on living standards over the years from 1980 to 2004 was 7 times as large as the tax increase that the SS trustees project would be needed to keep Social Security solvent over its 75-year planning horizon. The impact of this excessive health care cost growth was 13 times the size of the tax increase that CBO projects would be needed.

- the projected impact of excessive health care cost growth over the years 2004-2014 is 4 times as large as the tax increase that the SS trustees project would be needed to keep Social Security solvent over its 75-year planning horizon. This projected excessive health care cost growth is 7 times the size of the tax increase that CBO projects would be needed.

- the projected impact of excessive health care costs over just 30 months on workers' living standards will be as large as the impact of the tax increase that the Social Security trustees project will be needed to keep Social Security solvent. The projected impact of excessive health care cost growth on workers living standards over 16 months will be equal to the impact of the tax increase estimated by the CBO.

The inefficiency of the U.S. health care system has a large and growing impact on the living standards of U.S. workers. Fixing this system will have a far larger and more immediate impact on future living standards than any possible changes to the Social Security system.

The Burden of Social Security Taxes and the Burden of Excessive Health Care Costs

To promote his Social Security agenda, President Bush has repeatedly made claims that Social Security is facing an imminent crisis, and that if nothing is done soon it will be necessary to have large benefit cuts or to impose a crushing tax burden on future generations of workers. The definition of "crisis" is of course subjective, as is the adjective used to describe a specific tax increase.

However, it is possible to make objective comparisons. The Social Security trustees and the Congressional Budget Office (CBO) have given us very precise measures of the size of the tax increase that would be needed to keep the program fully solvent over its 75-year planning horizon. The trustees project that a tax increase equal to 1.93 percentage points (split evenly between workers and employers) would be sufficient to keep the program fully solvent, with no other changes. CBO, using a slightly more optimistic projection of economic growth, calculates that a tax increase of 1.0 percentage points (also evenly split between workers and employers) would be needed to keep the program fully solvent throughout its planning horizon.

While many proponents of privatization and benefit cuts have argued that tax increases of this magnitude would be devastating to our children and grandchildren, the prospect of higher Social Security taxes is not the only threat to real wage growth and higher living standards. Most workers have had their wages sharply reduced over the last quarter century as a result of growing wage inequality (see Baker, Dean. 2005. "The Burden of Social Security Taxes and the Burden of Wage Inequality," [http://www.cepr.net/publications/social_security_wage_inequality_2005_03.pdf]). Workers have also seen their standard of living reduced by the sharp increases in health care costs over the last quarter century. Per person health care costs (adjusted for aging) are projected to continue grow far more rapidly than real wages, which means that rising health care costs will take an ever larger chunk out of workers' paychecks.

The United States currently spends $6,420 per person for health care.[2] This is more than twice the average for other rich counties. Remarkably, the United States has very little to show for this spending – virtually every other wealthy country has better health care outcomes, as measured by life expectancy, infant mortality rates, and other objective measures. Table 1 shows per capita health care spending in the United States and several other wealthy countries. It also shows life expectancy at birth in each of these countries.

[2] This figure is the Center for Medicare and Medicaid Services (CMS) estimate for per capita health care spending in 2005 (National Health Care Expenditure Projections: 2004-2014, Table 1). This estimate is different from the estimate shown in table 1 both because the year is different (2005 compared to an estimate for 2001 shown in table 1, and because there are some differences between the methodology used by CMS and the OECD. U.S. health care costs continue to rise far more rapidly than those in other wealthy countries, so the gap in per person health expenditures shown in table 1 would almost certainly be considerably larger if more recent data were available.

Table 1

International Comparisons
Life Expectancy and Health Care Costs

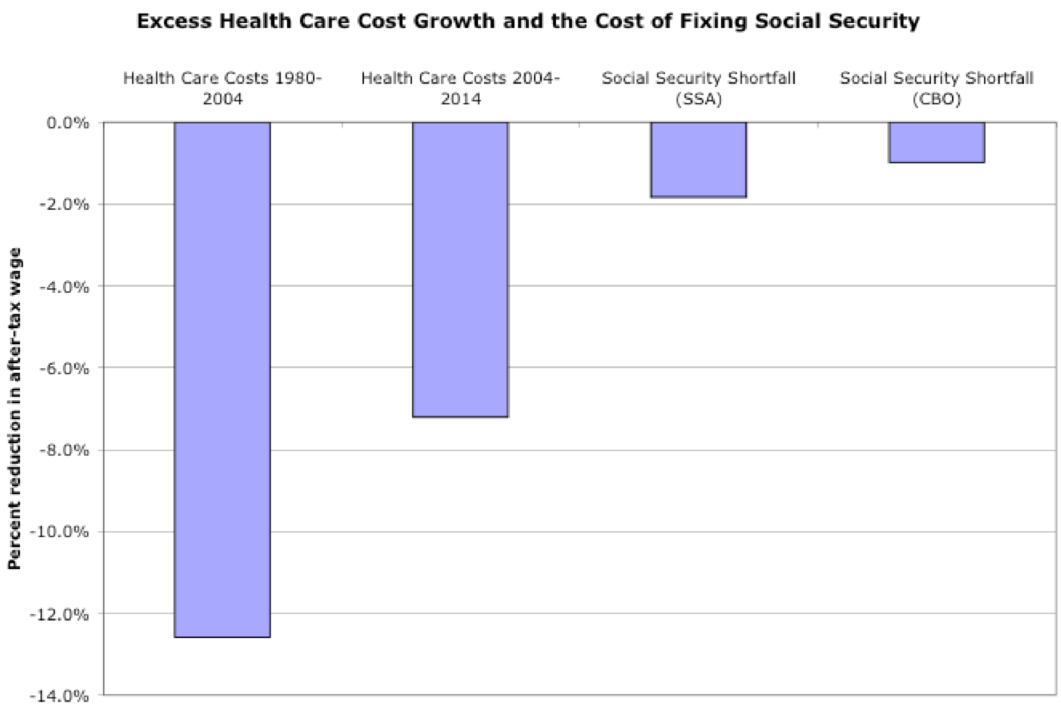
	Life Expectancy at Birth (1999)	**Per Capita Cost PPP - 2001**
Australia	79.0	$2,513
Austria	78.1	$2,191
Belgium	77.6	$2,490
Canada	79.0	$2,792
Denmark	76.6	$2,503
Finland	77.4	$1,841
France	78.8	$2,561
Germany	77.7	$2,808
Greece	78.1	$1,511
Iceland	79.6	$2,643
Italy	79.0	$2,212
Japan	80.6	$2,131
Netherlands	77.9	$2,626
New Zealand	78.3	$1,710
Norway	78.4	$2,920
Spain	78.6	$1,600
Sweden	79.5	$2,270
United Kingdom	77.4	$1,992
Non-U.S. Average	**78.4**	**$2,295**
United States	**76.7**	**$4,887**

Source: OECD Health Care Statistics, 2004.

The high costs and poor outcomes seem to stem from inefficiencies that are unique to the U.S. health care system. As long as politicians are unwilling to address these inefficiencies, the health care system will pose an ever greater burden on living standards for current and future generations of workers.

The burden posed by rising per person health care costs provides a useful comparison with the potential burden from the tax increases that may be needed to keep the Social Security system fully solvent in the future. Figure 1 compares the loss in wages available for non-health care spending due to excessive per person health care cost growth with the potential loss in take-home wages dues to Social Security tax increases.[3]

Figure 1



Source: CMS, CBO, and authors' calculations, see appendix.

As can be seen, excessive health care costs pose a much larger threat to wage growth than Social Security taxes. The loss of wages, net of health care spending, due to excessive health care costs over the period from 1980 to 2004 was 12.6 percent. This means that workers on average had 12.6 percent less money in 2004 to spend on non-health care items, than if health care costs had only risen in step with per capita GDP over this period. The Center for Medicare and Medicaid Services projects that health care costs

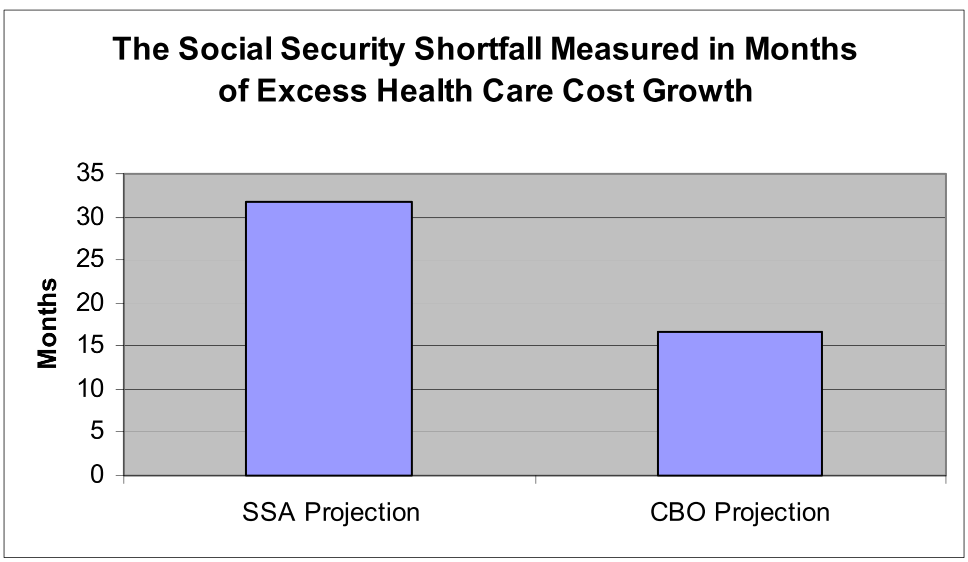
[3] Excessive health care cost growth is defined as the growth in costs in excess of GDP growth, implying a counterfactual of a constant share of GDP going to health care costs. While the aging of the population would be expected to raise the share of GDP going to health care costs, aging would not have been a major factor in the years from 1980 to 2004, when the baby boom cohort was still all under age 60. Aging will be more of a factor raising costs in coming decades, but the impact is still dwarfed by the impact of rising per person costs at every age. Other rich countries have substantially older populations than the United States and have not experienced a comparable increase in the share of GDP going to pay health care costs. Most of this wage loss takes the form of the increased cost of employer provided health insurance, but it would also include higher taxes needed to finance government provided health care, as well as additional costs borne out of wage income, such as premiums for individual insurance policies or deductibles and co-pays on all policies.

will continue to grow far more rapidly than per capita GDP. Its projections imply that this excess health care cost growth over the next decade will reduce the amount of money workers have available for non-health items in 2014 by an additional 7.2 percent.

These losses are an order of magnitude larger than the potential losses in wages due to higher Social Security taxes. The loss due to rising health care costs since 1980 is almost 7 times as large as the tax increase that the Social Security trustees project would be needed to keep the program fully solvent and 13 times as large as the tax increase that CBO projects would be needed. The projected loss over the next decade is 4 times as large as the tax increase projected by the trustees and 7 times as large as the tax increase projected by CBO. Of course, health care costs are projected to continue to rise more rapidly than per capita GDP even after 2104, so the long-run impact of the failure to fix the country's health care system on the living standards of future generations of workers is even greater than indicated in this chart.

Put another way, according to the Social Security trustees projections, the excessive growth in health care costs over the next 30 months will have the same impact on wages as the tax increase needed to keep the Social Security system fully solvent for the next seventy five years. According to the CBO projections, the excessive growth in health care costs over the next 16 months will be equal to tax increase needed to sustain Social Security's solvency over its planning horizon. This is shown in figure 2.

Figure 2



Source: CMS, CBO, SSA and authors' calculations, see appendix.

The inefficiencies of the U.S. health care system pose a large and growing burden for the country's workers. This impact of this burden on the living standards of the nation's workers dwarfs the impact of potential Social Security tax increases. If the latter are seen as posing a crisis, then the burden of rising health care costs must be viewed as an even more cataclysmic event. Politicians and commentators who claim to be concerned about the living standards of future generations of workers seem to be misdirecting their energy by focusing on the comparatively minor problem of Social Security. Clearly the inefficiency of the U.S. health care system poses a far larger and more immediate danger to the livings standards of our children and grandchildren.

Appendix

Figure 1 -- The impact of excess health spending from 1980 to 2004 on wages was calculated by taking the difference between the increase in health care spending shown in the Center for Medicare and Medicaid Services (CMS) estimates (National Health Expenditures, Table 1) and the increase in nominal GDP over this period. This figure was divided by wage income, net of Social Security taxes, as shown in the National Income Product Accounts, Table 2.1, line 3 (multiplied by 0.938 to adjust for employee side Social Security taxes). The impact of the projected increase in health care spending over the period from 2004 to 2014 on wages is calculated by using the difference between the CMS projected increase in health care spending and the projected increase in GDP over this period (National Health Care Expenditure Projections: 2004-2014, table 1) divided by total wages in 2014 (as projected by CBO), net of Social Security taxes. The measures of the Social Security shortfall are taken from the 2005 Social Security trustees report and the Congressional Budget Office's analysis of Social Security.

Figure 2 – The numbers of months of excess health cost growth that is equal to the tax increases needed to keep the Social Security trust fund solvent over its 75-year planning horizon is calculated by dividing the SSA measures of the projected Social Security shortfall by the projected 10 year excess health care cost growth calculated in Figure 1. This fraction is then multiplied by 120 months.