



ENTITLEMENT REFORM 101

America's entitlement programs are on a doomed course.
How did we get here? How big is the problem?
And, most important, how can we fix them?

The Basics

The three major programs that make up America's entitlement system include Social Security, Medicare, and Medicaid. They were created to ensure a strong social safety net, which all Americans support. However, our nation must keep its commitment to all its citizens in a responsible, sustainable way.

Social Security is a social insurance program created in 1935 that supplements retirement income and provides additional security for workers with disabilities. It is based on the seemingly simple premise that workers who pay into the system through payroll taxes will be able to draw benefits when they retire or if a disability disrupts employment. Though the program has been amended and reformed over the years, the underlying policy remains the same today. It has failed to keep up with changing demographics and growing life expectancies, creating a massive unfunded liability and threatening the security of future generations.

Medicare and Medicaid were created in 1965 to provide health insurance for seniors, people with disabilities, and low-income Americans. The federal government spends more on health care than on anything else. And as health care costs continue to soar, they will increasingly crowd out investment in virtually everything else.

The Demographic Shift

Due to changing demographics and the retirement of baby boomers, there are more Americans drawing benefits and fewer paying into the system. In Social Security's early years, there were 16 workers for every retiree. By 2035, the worker to retiree ratio will fall to 2-1.

Meanwhile, Americans are living longer than ever. It won't be long before one-third of all Americans will be retired and will spend one-third of their lives in retirement.

The technology and health advances that enable us to live longer lives are welcome—but they are also costly and will continue to drive federal health care spending.

An Unsustainable Path

Major components of our entitlement programs are headed for bankruptcy.

The Social Security Disability Trust Fund will be depleted by the end of 2016. Without a change in policy, disability payments for 11 million beneficiaries will be slashed by 19%.

The Social Security Trust Fund will be insolvent in 2033. If nothing is done, 67 million retirees could see a 23% cut in benefits.

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The Medicare Hospital Insurance Trust Fund, which pays for hospital services, will be exhausted by 2030. This could result in a 15% reduction in benefit payments impacting 81 million beneficiaries.

Driving the Debt and Robbing Investment

Over the next 10 years, Social Security, Medicare, and Medicaid will grow by \$780 billion. The total price will soar to \$3.2 trillion a year.

Spending to support these programs is mandatory, meaning it is automatically funded each year without requiring Congress or the president to approve it. Mandatory spending—which includes entitlements and debt service payments—already gobbles up every dollar of federal income tax revenues collected— and then some.

That means we have to borrow money and increase debt to pay for everything else.

Some have equated this to “generational theft.” Not only will future generations be left holding the bag, but they will suffer the consequences of decreased investment in education, innovation, infrastructure, and other national priorities critical to long-term prosperity and competitiveness.

Why Reform Is Necessary and Soon

We must reform these programs to save them now and for future generations.

But in the public debate over entitlement reform, there are some who deny that the problem exists or continually delay addressing it. Many leaders are unwilling to touch it because it's politically risky and there are powerful forces in Washington that want to maintain the status quo. But the status quo won't protect our entitlement programs—it will guarantee their insolvency.

There are others who acknowledge the problem, but believe that the solution is to sharply raise taxes. It would take a \$40 trillion tax hike to shore up the programs for just 75 years—an economy-crushing price that would suffocate the growth we need to sustain a social safety net. That's not a solution.

The longer our leaders wait to truly reform our entitlement programs, the more severe the inevitable reforms will be.

How Can It Be Done?

Entitlement reform can be undertaken without cutting baseline benefits or otherwise breaking our commitment to provide a stable social safety net.

There are any number of adjustments that can be made to restrain the costs and growth of these programs. Small, phased-in adjustments can be made in payments, benefits, eligibility, administration, coverage options, and program efficiencies. The sooner we begin to pursue these kinds of reforms, the less painful they will ultimately be.

The most important thing is that our nation's leaders acknowledge the problem so that they can begin considering the solutions.

The better Americans understand the issue, the more effective they can be at pushing their leaders to act on it. The sustainability of our entitlement programs will impact all of us in one way or another, so we must work together. And quickly.