

THE BUDGET AND ENTITLEMENTS: TIME TO TAKE ACTION

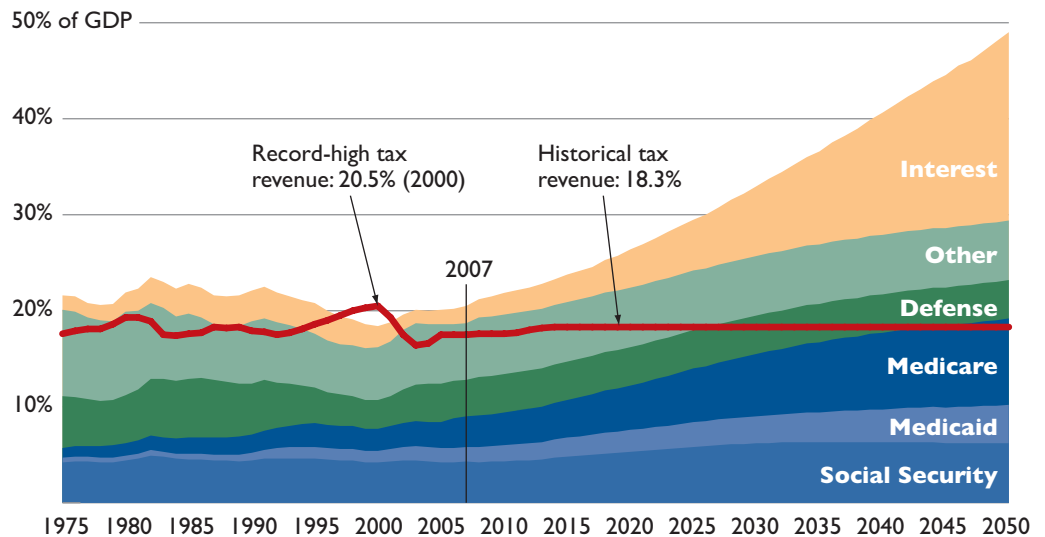
America faces an entitlement spending tsunami.

According to the Congressional Budget Office (CBO), spending on the big three entitlements—Medicare, Medicaid, and Social Security—is projected to rise from just over 8 percent of GDP today to almost 19 percent in 2050, when today's college graduates are nearing retirement.

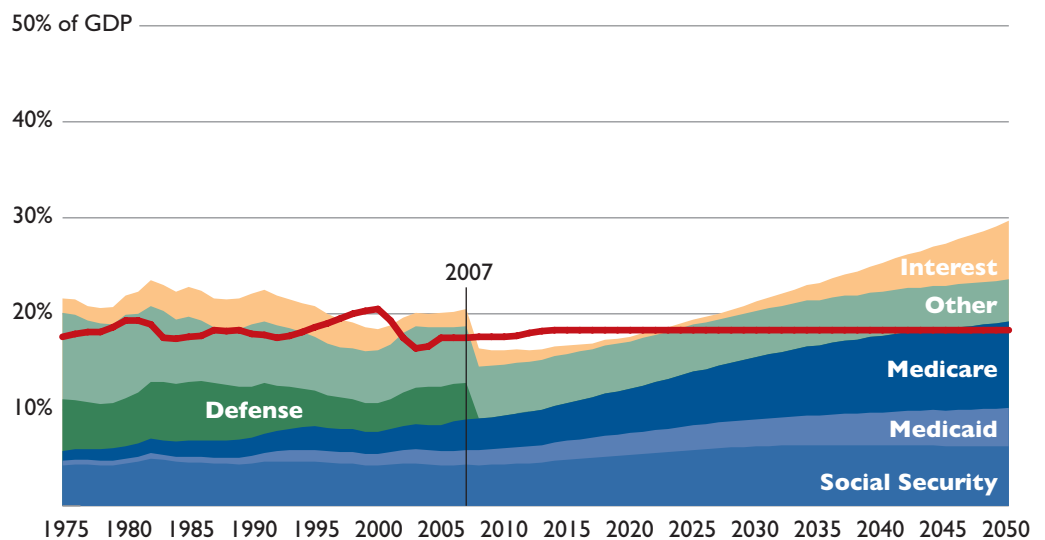
This entitlement-driven unfunded growth in spending will impose staggering financial burdens on our children and grandchildren. The total present value of unfunded federal obligations of the federal government is now \$53 trillion (\$41 trillion of which is due to Medicare and Social Security), according to the US Government Accountability Office. This translates into a financial burden of \$455,000 for every household or, put differently, a mortgage of \$175,000 placed in the crib of each and every baby born in America.

Even eliminating the National Endowment for the Arts, NASA, all foreign aid, all pork barrel spending, and the entire Department of Defense would not curb spending enough to balance the budget. Entitlement spending must be tackled.

Entitlements, now nearly half of the federal budget, will swamp budget in two generations



Cutting other spending alone won't solve the problem *Eliminating NEA + NASA + Foreign aid + Pork + Defense*

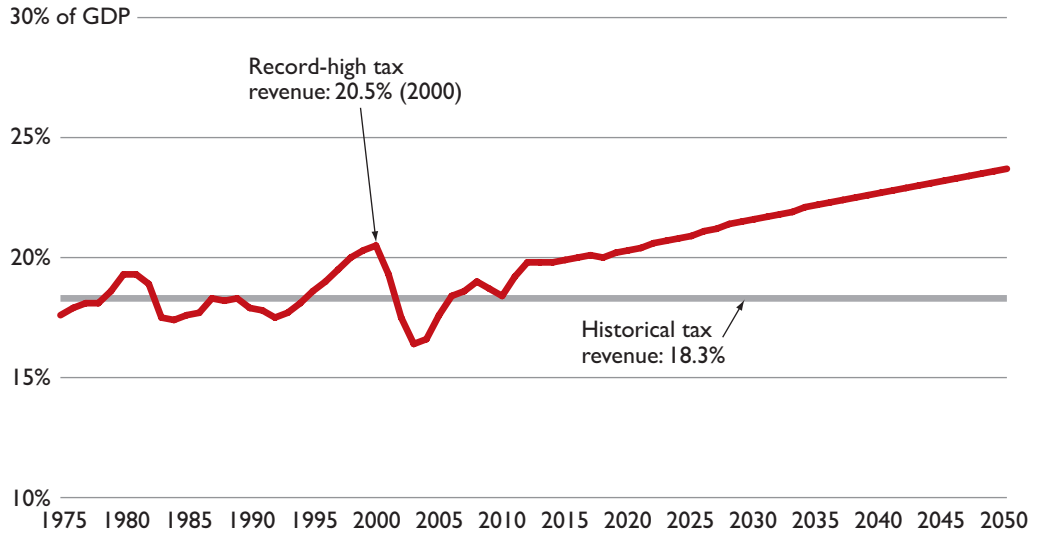


The Federal Government is not suffering from a dearth of tax revenues.

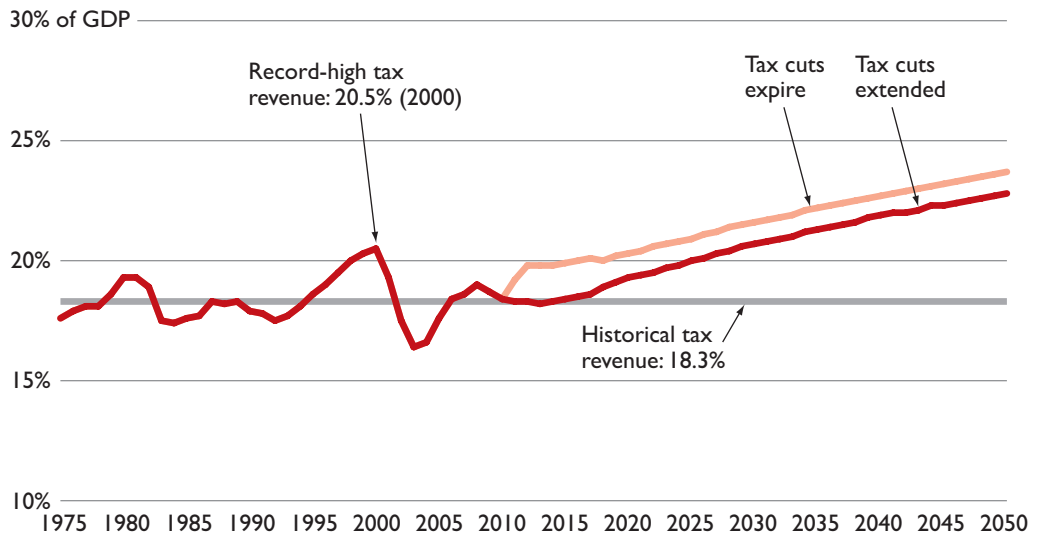
The nation's fiscal problems are not the result of inadequate taxation. Federal tax revenues are surging into the Treasury, and the tax burden is already scheduled to increase under current law. Taxes are now at 18.8 percent of the economy—above the modern historical average of 18.3 percent of GDP.

Under current law, the 2001 and 2003 tax cuts are scheduled to expire. Along with the alternative minimum tax, this will cause the tax burden to reach a record high in 2026 and continue to rise thereafter. Even if the tax cuts are made permanent, taxes will continue to rise sharply. In either case, taxes will exceed the record high of 20.5 percent experienced only two times in our nation's history—2000 and 1944.

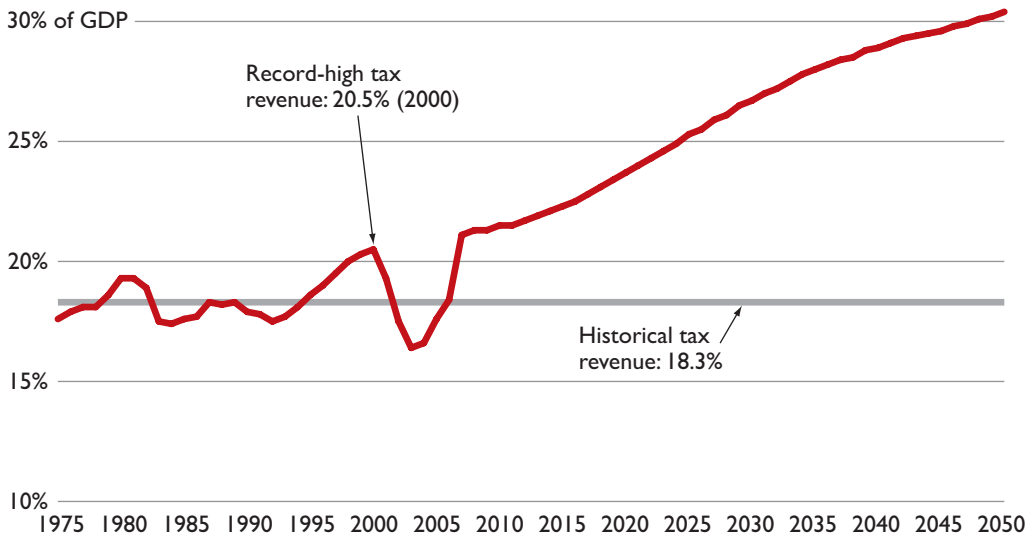
Tax cuts set to expire



Revenues still rise if tax cuts are extended



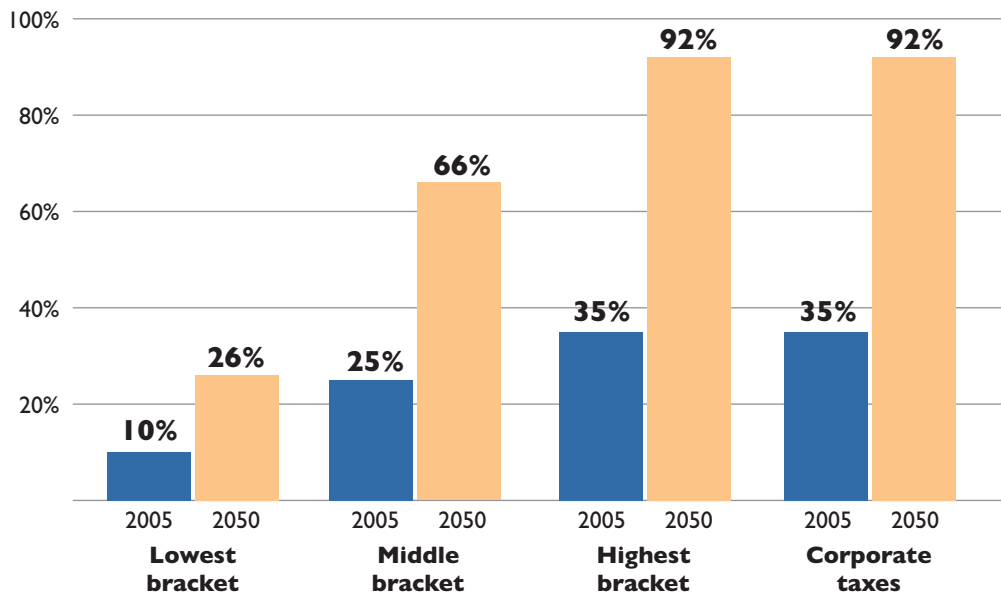
Taxes would have to rise to astronomical levels to balance the budget



Balancing this problem solely through taxes would put America well on the way to European-level taxes, causing European-style economic stagnation, slow income growth, and unemployment.

If the budget were balanced with tax increases alone, marginal tax rates would climb dramatically for all Americans, according to the Congressional Budget Office. Rather than add new taxes, Congress should focus on curbing the projected growth of taxes and crafting a serious strategy to reform and constrain entitlements.

Projected tax rates



It's time to rethink entitlements.

Fix the way Washington spends your money. The federal budget uses arbitrary one, five and ten-year budget windows. This enables the long-term cost of existing entitlements to be ignored in the annual budget cycle and makes it easier to add new ones. In addition, entitlement spending is mandatory, which means that benefits are paid without Congress having to budget for their costs. This arrangement preempts other budget priorities.

The long term budgetary implications of proposals to expand or reduce entitlement programs should be included in the budget, along with a requirement that Congress go on record each year with a vote agreeing to an increase or decline in that long-term measure. In addition, entitlements should be converted into 30-year budgeted discretionary programs that must be reviewed and re-authorized by Congress every five years.

Make retirement programs fair but affordable. Progressive indexation preserves the principle of social insurance for workers of every income level, but importantly it also recognizes that this principle is unsustainable for these programs. Benefits should be targeted to those who need them

the most. For Social Security, a good way to accomplish this would be to change the Social Security benefit formula so that the benefits of lower income workers grow at a faster rate than those for upper income workers. For Medicare, good steps would be to income adjust Part D (for drug benefits) and Part B premiums (for outpatient services), with the most affluent seniors paying a higher percentage of their premiums. Today many Americans expect to live 1/3 of their adult lives in retirement. Congress ought to recognize that this increasing longevity should lead to additional increases in the age retirees can qualify for benefits.

Encourage more savings and insurance for middle income workers. Too many Americans reach retirement age without a nest egg adequate to meet their needs. Social Security, pensions, and retirement accounts should work together to help Americans build the savings necessary to provide income security in retirement, without burdening future generations. Workers should be encouraged to enroll in automatic savings plans and purchase private long-term care insurance to help support themselves during retirement.

For an interactive presentation, go to www.heritage.org/research/Budget/FWUT.cfm

Chart sources: Congressional Budget Office, Social Security and Medicare Trustees, Budget and Economic Outlook, Heritage Foundation calculations