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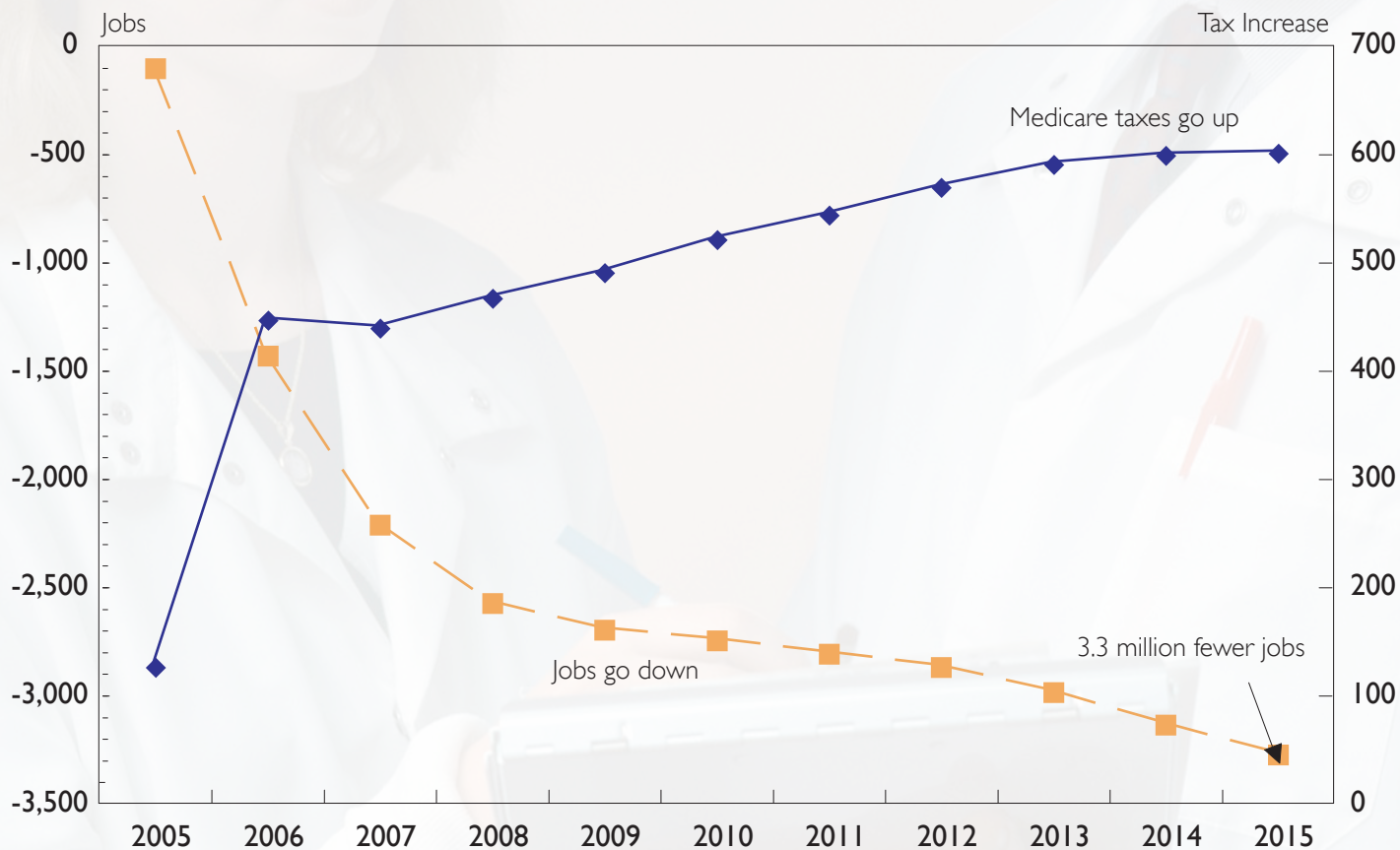
Center for Data Analysis

THE ECONOMIC AND FISCAL EFFECTS OF FINANCING MEDICARE'S UNFUNDED LIABILITIES

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Increasing Taxes to Fully Fund Medicare Cuts Job Growth (2005 through 2015)

A REPORT OF THE HERITAGE CENTER FOR DATA ANALYSIS

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THE ECONOMIC AND FISCAL EFFECTS OF FINANCING MEDICARE'S UNFUNDED LIABILITIES

TRACY L. FOERTSCH, PH.D., AND JOSEPH R. ANTOS, PH.D.

Social Security's looming financial crisis has received much attention over the past few months. However, Medicare, the other major program intended to ensure the well-being of older Americans, represents an equal if not greater threat to the long-term fiscal health of the federal government.

The numbers speak for themselves. Providing promised Medicare benefits is projected to require over \$2.7 trillion (in nominal dollars) in new tax revenues over just the next 10 years and a mind-boggling \$29.9 trillion (in 2005 dollars) over the next 75 years. Providing promised Social Security benefits is projected to cost much less. Combined annual Old-Age, Survivor, and Disability Insurance (OASDI) benefits are not expected to exceed OASDI income from payroll taxes and other sources until 2017, and unfunded OASDI obligations to America's seniors are expected to total roughly \$5.7 trillion (in 2005 dollars) over the next 75 years.¹

In other words, Medicare's financing problems will arise sooner and ultimately surpass Social Security's financing problems. They will also require difficult choices about both the size of public health-care spending for the elderly and the burden borne by future workers in paying for that care. For these reasons, Thomas R. Saving, a public trustee for the Medicare program and a senior fellow at the National Center for Policy Analysis, has argued that "the single biggest reason for Congress to reform Social Security is the existence of Medicare."²

This report focuses on the economic and budgetary effects of using higher taxes to finance promised Medicare benefits. It first looks at the effects of raising personal income and payroll tax rates to fund promised Medicare benefits through 2015. It then considers the effects of raising only payroll tax rates to finance promised Medicare benefits through 2079.

1. See Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees of the Hospital Insurance and the Supplementary Medical Insurance Trust Funds*, March 23, 2005, Table V.E2, at www.cms.hhs.gov/publications/trusteesreport/tr2005.pdf (August 23, 2005), and Social Security Administration, *The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, March 23, 2005, pp. 166-168, Table VI.F2 and Table VI.F3, at www.socialsecurity.gov/OACT/TR/TR05/tr05.pdf (August 23, 2005). All projections discussed here are consistent with the trustee reports' intermediate demographic and economic assumptions. Estimates from those projections were calculated from the "budget perspective," not from the "trust fund perspective" as is typically the case. That is, they include not just projected Medicare and Social Security trust fund deficits (as would be the case under the trust fund perspective), but also Medicare and Social Security trust fund holdings of special public-debt obligations and projected general revenue transfers to Medicare. (See Appendix A for additional details.) Under the trust fund perspective, public-debt obligations and general revenue transfers are counted as either an asset of or income into the trust funds. However, redeeming public-debt obligations and making good on revenue transfers requires that the federal government either raise taxes or cut spending and therefore represents an imbalance under the budget perspective.
2. See "Medicare Will Consume Almost All Income Taxes by 2075," *SeniorJournal.com*, February 18, 2005, at www.seniorjournal.com/NEWS/Medicare/5-02-18AllTaxes.htm (August 23, 2005). See also Thomas R. Saving, "Medicare Now and in the Future," testimony before the Committee on the Budget, U.S. Senate, February 17, 2005, at www.senate.gov/~budget/republican/hearingarchive/testimonies/2005/20050217-saving.pdf (August 23, 2005).

These policy changes were analyzed using Global Insight's short-term U.S. Macroeconomic Model.³ The results show that the economic costs of raising taxes to finance Medicare through even 2015 could be prohibitive. Assuming that new tax revenues are used to fund Medicare and not to offset higher spending elsewhere in the federal budget, between 2006 and 2015, total job losses could average almost 816,000 annually, and real (inflation-adjusted) gross domestic product (GDP) could be, on average, nearly \$87 billion lower per year.

Annual employment and output losses would be much greater if payroll taxes were raised sufficiently to finance all of the health-care benefits promised to Americans through 2079. Total job losses could average almost 2.7 million, and the drop in real GDP could approach an average of \$248 billion per year over the first 10 years that higher payroll tax rates are in place.

MEDICARE'S UNFUNDED LIABILITIES

The federal government faces huge unfunded liabilities because of the promised health-care benefits now available to current and future generations of older Americans. Those liabilities are a product of the Medicare program, which consists of two separate components: Hospital Insurance and Supplementary Medical Insurance (including the new prescription drug benefit).

Medicare's Hospital Insurance (HI) component, also known as Part A, helps to pay for the hospital, home health, nursing home, and hospice care of the elderly and disabled. HI benefits are financed primarily through a 2.9 percent payroll tax on the

earnings of all covered workers.⁴ Unlike contributions to Social Security's retirement program, the Medicare payroll tax has been applied to total covered wages, salaries, and self-employment income since 1994. In addition, taxes on the Social Security benefits of high-income individuals and interest income from the investment of past HI trust fund surpluses play a small role in funding HI benefits.⁵

The income flows from payroll tax and other revenues have exceeded Part A benefit payments in all but a handful of the past 40 years. As a result, the HI trust fund had accumulated surpluses totaling \$269.3 billion by the end of 2004.⁶ This amount is earmarked to fund the Part A benefits of future retirees.

However, there is little reason to be sanguine about the future of Medicare's HI trust fund. Today, the HI trust fund (aside from small cash balances) consists almost entirely of special public-debt obligations purchased using trust fund surplus dollars. Those special obligations are credited to the trust fund by the federal government and represent a claim on future tax revenues. In 2004, they totaled roughly the accumulated positive differences between payroll tax (and other) receipts and trust fund spending since the HI trust fund's inception in 1965.

Theoretically, payroll tax revenues in excess of current program needs could be used to reduce budget deficits. The subsequent decline in government borrowing would increase national saving and help to reduce the tax burden on future workers.⁷ Historically, however, rising payroll tax revenues and trust fund surpluses have not been accompanied by declining federal deficits.

3. Global Insight's short-term U.S. Macroeconomic Model was used to simulate the effects of financing Medicare's unfunded liabilities with higher payroll and personal income taxes. *Fortune* 500 companies and numerous government agencies use Global Insight's U.S. Macroeconomic Model to forecast how important changes in the economy and in public policy will likely affect hundreds of major economic indicators. The methodologies, assumptions, conclusions, and opinions presented here have not been endorsed by and do not necessarily reflect the views of the owners of the Global Insight model.
4. Covered workers include those currently under the OASDI program and the Railroad Retirement program. They also include certain government employees (federal, state, and local) who are currently exempt from OASDI. Employers and employees split the 2.9 percent payroll tax, each paying 1.45 percent of the employee's earnings. Self-employed workers pay the full 2.9 percent.
5. Up to 85 percent of OASDI benefits can be subject to personal income taxation at the federal level. Income tax revenue derived from the first 50 percent of OASDI benefits is credited to the OASI and DI trust funds. Income tax revenue derived from the remaining 35 percent of OASDI benefits is allocated to the HI trust fund. Other sources of HI trust fund income include Railroad Retirement account transfers, reimbursement for uninsured persons, premiums from voluntary enrollees, and payments for military wage credits. They comprised less than 1.6 percent of total HI income in 2004.
6. See Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, pp. 46–47, Table III.B4.
7. A reduction in government budget deficits is equivalent to an increase in government saving. The rise in national saving that would follow expands the wealth available to future retirees.

A number of researchers have attributed the buildup of public-debt obligations in the federal trust funds to the switch to a unified budget in 1970.⁸ Under unified budget accounting, trust fund income is combined with federal personal income taxes, corporate income taxes, and other federal receipts to arrive at unified federal revenues. Similarly, trust fund spending is lumped together with all other federal spending to arrive at unified federal expenditures.

The budget debate revolves around the unified budget balance. Until recently, payroll tax revenues (and other income) in excess of benefits have generated trust fund surpluses. Those surpluses have helped to offset increased federal spending by the rest of the government and the resulting on-budget and federal-funds deficits.⁹ In the late 1990s and early 2000s, they contributed greatly to unified budget surpluses.

However, according to the Medicare trustees' report, promised HI benefits began to outstrip current payroll tax collections and other trust fund income (excluding interest income) beginning in 2004. Actuarial imbalances in the HI trust fund are expected to expand in every year thereafter as a result of the retirement of the baby-boom generation and the inflation of health-care costs, among other factors. To help fund current benefits, Medicare will begin to redeem the special public-debt obligations held in the HI trust fund. The 2005 Medicare trustees' report projects that Medicare will deplete those special obligations by 2020. However, the exact date matters little in one important sense. Both before and after 2020, ever larger transfers of federal corporate and personal income tax collections and other federal receipts will be needed to fund the gap between current HI income and promised benefits.

Such general revenue transfers already constitute the bulk of Supplementary Medical Insurance (SMI) trust fund financing. Medicare's SMI program consists of two separate components. Part B

covers physician, outpatient, home health, and other services for the elderly and disabled who are enrolled. Part D, a product of the Medicare Modernization Act of 2003, initially provides a prescription drug discount card to low-income Medicare beneficiaries. Beginning in 2006, the discount card will be replaced by subsidized drug insurance coverage that is available to all enrolled beneficiaries. Premium and cost-sharing subsidies will be available to all enrollees, with substantially larger subsidies for those with low incomes.

Part B and Part D benefits are funded out of two separate accounts within the SMI trust fund. Under law, each account is automatically in balance because benefits are financed using a combination of premiums paid by recipients and authorized general revenue transfers set to cover the next year's estimated fund expenditures. In fiscal year 2004, premiums accounted for roughly 25 percent of Part B trust fund income, and general revenue transfers from the Treasury accounted for the remaining 75 percent. Total funding for basic drug insurance coverage under Part D is calculated to follow a similar formula beginning in 2006.

The only revenues earmarked for financing the HI and SMI trust funds are those raised by the existing payroll tax, the tax on Social Security benefits, and premiums. Any gap between those earmarked revenues and expected benefit payments must be filled with transfers of federal personal and corporate income tax collections and other federal receipts. Assuming that the benefits promised to current and future retirees will be provided, that gap constitutes a staggering unfunded liability. (See Charts 1 and 2.)

Under the trustees' intermediate economic and demographic assumptions,¹⁰ the HI trust fund's actuarial imbalance is projected to exceed \$8.8 trillion (in 2005 dollars) over the next 75 years (2005–2079).¹¹ Over the same period, general revenue transfers to SMI Parts B and D are projected to total \$12.4 trillion and \$8.7 trillion, respectively.¹²

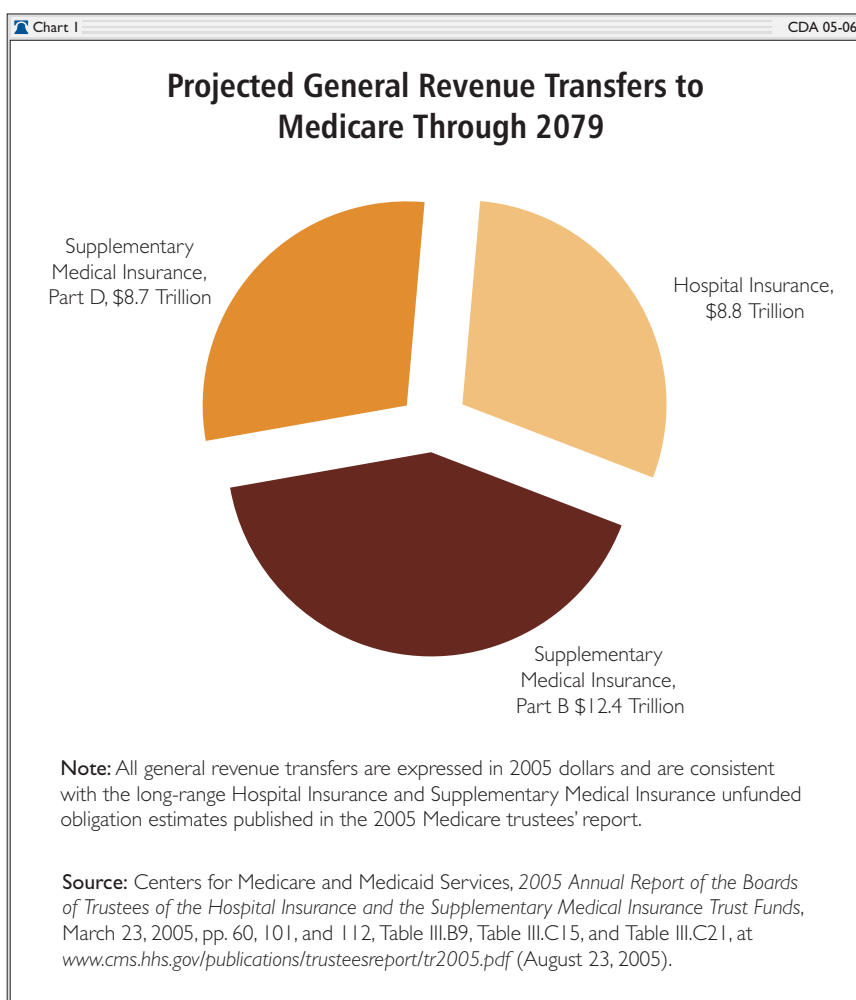
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8. For example, see Sita Nataraj and John B. Shoven, "Has the Unified Budget Undermined the Federal Government Trust Funds," National Bureau of Economic Research *Working Paper* No. 10953, December 2004, and Kent Smetters, "Is the Social Security Trust Fund Worth Anything?" National Bureau of Economic Research *Working Paper* No. 9845, July 2003. Nataraj and Shoven focus on the impact of increases in total federal trust fund surpluses on saving by the rest of the federal government. Smetters focuses more narrowly on the impact of Social Security trust fund surpluses on federal saving.
9. On-budget surpluses exclude surpluses in the Social Security trust funds and the net cash flow of the U.S. Postal Service. Federal funds surpluses exclude the surpluses in all federal trust funds, including those trust funds associated with Medicare.

To put those totals in perspective, fully funding the benefits promised to present and future beneficiaries through 2079 would require permanently and immediately increasing the Medicare payroll tax rate to roughly 13.4 percent of all wages, salaries, and self-employment income. (See Appendix A for the methodological details.)

Even funding the benefits promised to retirees over the next 10 years implies steep tax hikes. Closing HI trust fund imbalances through 2015 could require general revenue transfers totaling an estimated \$134 billion (in nominal dollars).¹³ More ominously, funding benefits promised under SMI Parts B and D over the same period could easily require total general revenue transfers approaching \$2.6 trillion.¹⁴ SMI Part D will likely account for nearly 40 percent of that \$2.6 trillion unfunded liability.¹⁵

FUNDING MEDICARE'S UNFUNDED LIABILITIES

Of course, estimating the economic and budgetary effects of putting Medicare on a firmer financial footing is difficult because of



the high degree of uncertainty surrounding long-term trends in life expectancy, birth rates, produc-

10. Under the Medicare trustees' intermediate assumptions, nominal per capita GDP is projected to expand at an annual rate of 4.1 percent, the average wage in covered employment at a rate of 3.9 percent, and the Consumer Price Index at a rate of 2.8 percent. The total fertility rate is projected to slip below replacement level to 1.95 children per woman. The long-run increase in average Medicare spending per beneficiary is expected to decline smoothly to 5.1 percent, or the growth in nominal per capita GDP plus 1 percent. See Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, p. 6, Table II.C1.
11. See Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, p. 60, Table III.B9. The present-value number given here indicates the amount of additional tax revenues that would have to be set aside today in an interest-bearing account to cover projected program expenditures over the next 75 years. The 75-year time horizon is a bit odd. It accounts for the unfunded liabilities implied by benefits promised to those who will be retired through 2079, but it ignores any unfunded liabilities arising from benefits promised to those who will be retired after 2079. An alternative would be to value, in perpetuity, the gap between Medicare's projected income and expenditures. The result would be the "infinite-horizon" liability discussed in the Medicare trustees' report.
12. See Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, pp. 101 and 112, Table III.C15 and Table III.C21.
13. Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, pp. 46–47, Table III.B4.
14. The forecast horizon for the current Global Insight model extends through 2015. However, the 2005 Medicare trustees' report projects Part B and Part D general revenue transfers only through 2014. In these simulations, general revenue transfers for 2015 are obtained by projecting forward using recent trends Part B and Part D general revenue transfers.

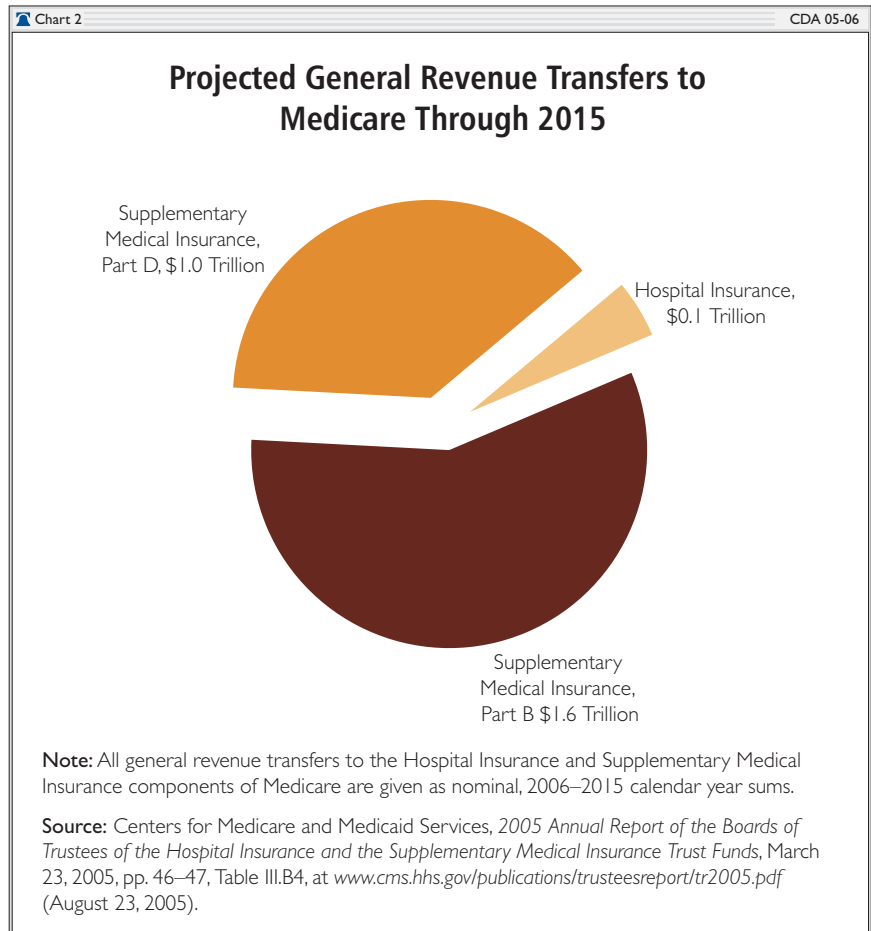
tivity, and wage growth. Trends in life expectancy and birth rates will determine the number of elderly and the pool of available workers to support them. Trends in productivity and wage growth will determine workers' ability to pay the taxes needed to fund promised benefits.

Similarly, there is no single approach that the federal government can take to fund Medicare's promised benefits. Some argue that the government can simply raise taxes with almost no effect on the economy. Others argue that tax increases would have beneficial effects on output and employment because they would reduce the need for federal borrowing and debt accumulation after the baby-boom generation retires.

The 1993 Omnibus Budget Reconciliation Act (OBRA-93) is often used to bolster the case for higher taxes. OBRA-93, among other revenue-raising measures, put in place two new, higher marginal tax rates for individuals (36 percent and 39.6 percent) and repealed the wage cap on Medicare payroll taxes.¹⁶ In the five years following its passage, real GDP expanded at an annual average rate of almost 3.8 percent, and private-sector employment grew at an annual average rate of over 2.9 percent. At the time, the Clinton Administration credited the deficit reduction facilitated by OBRA-93 with setting the stage for economic expansion.¹⁷

However, there are reasons to be skeptical of such arguments. First, the tax increases needed to put Medicare on firmer financial footing would

be many orders of magnitude larger than those included in OBRA-93. In August 1993, the Joint Committee on Taxation (JCT) estimated that the revenue provisions in OBRA-93 would increase federal tax collections by almost \$241 billion over five years (1994–1998).¹⁸ As the Congressional Budget Office (CBO) noted at the time, the higher revenues were not even expected to alter “the underlying trends of deficits that, after falling from the high levels of the early 1990s, [would] rise steadily” as the decade neared its end.¹⁹ In comparison, funding all of Medicare's unfunded obligations through just 2015 would



15. The \$2.6 trillion unfunded liability is an undiscounted sum. Between 2005 and 2014, it is composed of undiscounted general revenue transfers to SMI Part B totaling just over \$1.5 trillion and undiscounted general revenue transfers to SMI Part D totaling \$853.5 billion. See Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, pp. 87 and 105, Table III.C8 and Table III.C17.
16. See Congressional Budget Office, “An Economic Analysis of the Revenue Provisions of OBRA-93,” *CBO Papers*, January 1994, at www.cbo.gov/ftpdocs/48xx/doc4832/doc03.pdf (August 23, 2005), and Joint Committee on Taxation, U.S. Congress, “Summary of the Revenue Provisions of the Omnibus Budget Reconciliation Act of 1993 (H.R. 2264),” August 23, 1993, at www.house.gov/jct/s-11-93.pdf (August 23, 2005).
17. Council of Economic Advisers, *Economic Report of the President* (Washington, D.C.: U.S. Government Printing Office, 1996), p. 3, at www.gpoaccess.gov/usbudget/fy97/pdf/erp.pdf (August 23, 2005).

require increasing tax collections by more than \$2.7 trillion.

Moreover, economic analysis of OBRA-93 has indicated that it potentially slowed rather than facilitated a nascent economic expansion. Beach *et al.* used the Washington University Macro Model (WUMM) to simulate U.S. economic performance assuming that Congress had not raised taxes in 1993.²⁰ Their comparison of OBRA-93 to a current-law baseline forecast (see Appendix A) concluded that the tax increase slowed the pace of economic growth and job creation and cut the growth in real disposable income and saving. As a result, the economy did not perform well when compared to similar points during previous economic expansions of similar length.

In this regard, continental Europe provides a cautionary tale. Since the 1970s, continental European countries have experienced declines—often dramatic declines—in employment rates, average annual hours worked, and the growth rates of real per capita GDP. As a result, European per capita GDP in 2000 remained fixed at roughly 70 percent of U.S.

per capita GDP (measured in terms of purchasing power parity), roughly its level in 1970. Over the same period, European taxes on labor income (income and payroll taxes) either have increased relative to or have remained persistently higher than the equivalent U.S. labor income taxes.²¹

Explanations for Europe's sluggish economic performance abound. Prescott and Cardia *et al.* recently argued that high labor taxes played a central role in driving down hours worked in Europe. Alesina *et al.* and Blanchard attributed the bulk of Europe's decline in hours worked to greater preferences for leisure among Europeans, but also allowed that high tax rates on labor income could explain at least part of the decline in annual average hours worked.

Looking into the future, Kotlikoff *et al.* estimate that U.S. payroll and income taxes would need to climb to almost 40 percent of wages to provide future retirees with promised health care and pension benefits.²² In their calculations, lower after-tax income to workers reduces hours worked, disposable income, and therefore personal saving. Over time, the implied decline in capital formation neg-

18. See Joint Committee on Taxation, U.S. Congress, "Summary of the Revenue Provisions of the Omnibus Budget Reconciliation Act of 1993 (H.R. 2264)," Appendix A, p. 40. Feldstein and Feenberg estimated that OBRA-93 increased 1993 personal income tax revenues by less than half of the amount originally estimated by the Department of the Treasury's Office of Tax Analysis (OTA). Carroll estimated that OBRA-93 may have increased personal income tax revenues by only 61 percent of OTA's original "static"—or no behavioral response—revenue estimate. In both cases, changes in behavior among high-income taxpayers in the 36 percent and 39.6 percent tax brackets account for the offset against OTA's original static revenue estimate. See Martin Feldstein and Daniel Feenberg, "The Effect of Increased Tax Rates on Taxable Income and Economic Efficiency: A Preliminary Analysis of the 1993 Tax Rate Increase," National Bureau of Economic Research *Working Paper* No. 5370, November 1995, and Robert Carroll, "Do Taxpayers Really Respond to Changes in Tax Rates? Evidence from the 1993 Tax Act," U.S. Department of the Treasury, Office of Tax Analysis *Working Paper* No. 79, November 1998, at www.treas.gov/offices/tax-policy/library/ota79.pdf (August 23, 2005).
19. See Congressional Budget Office, *Economic and Budget Outlook: An Update*, August 1994, p. xiii, at www.cbo.gov/ftpdocs/48xx/doc4847/doc43.pdf (August 23, 2005).
20. William W. Beach, Scott A. Hodge, John S. Barry, Mark Wilson, and Joe Cobb, "Is There a 'Clinton Crunch'? How the 1993 Budget Plan Affected the Economy," Heritage Foundation *Backgrounder* No. 1078, May 1996, at www.heritage.org/Research/Budget/BG1078.cfm.
21. See Edward Prescott, "Why Do Americans Work So Much More Than Europeans?" National Bureau of Economic Research *Working Paper* No. 10316, February 2004; Emanuela Cardia, Norma Kozhaya, and Francisco J. Ruge-Murcia, "Distortionary Taxes and Labor Supply," *Journal of Money, Credit and Banking*, Vol. 35, No. 3 (June 2003), pp. 351–373; Alberto Alesina, Edward Glaeser, and Bruce Sacerdote, "Work and Leisure in the US and Europe: Why So Different?" National Bureau of Economic Research *Working Paper* No. 11278, April 2005; Olivier Blanchard, "The Economic Future of Europe," National Bureau of Economic Research *Working Paper* No. 10310, February 2004; and Tine Dhont and Freddy Heylen, "Fiscal Policy, Employment, and Growth: Why Is Continental Europe Lagging Behind?" working paper presented at the EcoMod 2005 conference, Istanbul, June 29–July 1, 2005, at www.ecomod.net/conferences/ecomod2005/ecomod2005_papers/825.pdf (August 23, 2005).
22. See Laurence Kotlikoff, Hans Fehr, and Sabine Jokisch, "Aging, the World Economy, and the Coming Generational Storm," National Center for Policy Analysis *Policy Report* No. 273, February 2005, at www.ncpa.org/pub/st/st273 (August 24, 2005). Kotlikoff *et al.* use a dynamic intergenerational, interregional demographic life-cycle model to simulate the effects of financing old-age benefits in the United States.

actively affects labor productivity and wages. The result is an estimated 25 percent drop in the U.S. standard of living by 2030.

Clearly, any policy that reduces future job opportunities and economic growth will complicate the problem of providing future generations of older Americans with health-care benefits.

THE ECONOMIC AND BUDGETARY EFFECTS OF RAISING PAYROLL AND PERSONAL INCOME TAXES

This section focuses on the effects of raising taxes to finance Medicare's unfunded liabilities.²³ It first considers the economic and budgetary effects of immediately raising payroll tax rates and personal income tax rates to finance HI and SMI benefits through 2015. Payroll taxes would be increased to finance projected imbalances in the HI trust fund over only the next 10 years. Personal income taxes would be increased to cover general revenue transfers to the SMI trust fund over the same period.²⁴ It then looks at the economic and budgetary effects of raising payroll tax rates permanently and immediately to finance HI and SMI benefits through 2079.

Raising taxes to finance Medicare's unfunded liabilities over either the next 10 or the next 75 years would undoubtedly have economic and budgetary effects from the beginning. The size of those effects would depend largely on whether the new tax revenues are used to pay down debt or to finance higher spending elsewhere in the federal government's budget.

For example, raising payroll and personal income tax rates just enough to fund general revenue transfers to HI and SMI through 2015 (see Table 2 in Appendix B) could push real GDP an

average of \$105.5 billion below base levels between 2006 and 2010.²⁵ Private-sector employment over the same period would be reduced by an average of over 921,000 jobs per year, increasing the unemployment rate by an average of 0.4 percentage points over the five-year period.

Higher payroll and personal income taxes would continue to be a drag on the economy between 2011 and 2015. However, the magnitude of lost output and jobs would be moderate relative to the first five years. This is because, within any given budget year, the federal government is assumed to allocate new revenues earmarked for Medicare toward deficit reduction and not increased spending.²⁶

Thus, by 2015, the federal government's projected unified budget deficit would have become a substantial unified budget surplus, and privately held federal debt as a share of GDP would have dropped over 15 percentage points to 19.4 percent.

Reduced deficit spending, along with cuts in the federal funds rate by the Federal Reserve, would in time lower interest rates and the overall cost of capital to businesses. The result would be a temporary rebound in non-residential investment and an increase in capital formation. However, personal income and consumption would remain depressed, as would private-sector employment.²⁷ Higher taxes on labor would in turn contribute to a gradual decline in labor-force participation. As a result, by 2015, real GDP is estimated to be over \$116 billion lower than it would be without the tax increases.²⁸

The economic and budgetary effects would be much larger if the government raised payroll tax rates sufficiently to fund general revenue transfers to HI and SMI through 2079. (See Table 3 in Appendix B.) Raising the Medicare payroll tax rate

23. Version 9 of Global Insight's U.S. Macroeconomic Model was used to simulate the effects of financing Medicare's unfunded liabilities with higher payroll and personal income taxes.

24. SMI's unfunded liabilities far exceed HI's through 2015. As a result, new personal income tax revenues account for the vast majority of the total increase in tax revenues.

25. All results are expressed relative to a current-law baseline consistent with the Congressional Budget Office's August 2005 economic and budgetary assumptions and forecasts. See Appendix A for additional details.

26. In the Global Insight model, increased tax revenues contribute directly to deficit reduction unless new government spending is specified. In these simulations, such an approach is sensible if one assumes that baseline federal spending incorporates expected outlays for Medicare Parts A, B, and D, but that baseline federal tax revenues do not take account of the offsetting general revenue transfers needed to fund that spending (as projected by the Medicare trustees). See Appendix A for additional details.

27. Real GDP would fall even further below base levels were it not for an improvement from 2006 in U.S. net exports.

28. See Appendix A for a discussion of the adjustments made to the Global Insight model's labor supply variables.

Economic Effects of Raising Taxes to Fund Medicare's Unfunded Liabilities, Annual Averages 2007–2015

Government Uses New Tax Revenues to:

	Pay Down Debt		Finance Increased Spending
	Fund HI and SMI Benefits through 2015	Fund HI and SMI Benefits through 2079	Fund HI and SMI Benefits through 2079
Gross Domestic Product (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)			
Forecast	13,177.4	13,073.6	13,016.3
Baseline	13,264.2	13,264.2	13,264.2
Difference	-86.8	-190.6	-247.9
Total Employment (Thousands of Jobs)			
Forecast	140,771.0	139,287.3	138,913.7
Baseline	141,586.7	141,586.7	141,586.7
Difference	-815.7	-2,299.4	-2,673.0
Private Employment (Thousands of Jobs)			
Forecast	117,619.0	116,549.2	116,160.5
Baseline	118,396.9	118,396.9	118,396.9
Difference	-777.8	-1,847.6	-2,236.3

Notes: HI denotes the Hospital Insurance component of Medicare. SMI denotes the Supplementary Medical Insurance (including the new prescription drug benefit) component of Medicare. All summary results are presented as annual averages over a 10-year period. Some numbers may not add due to rounding.

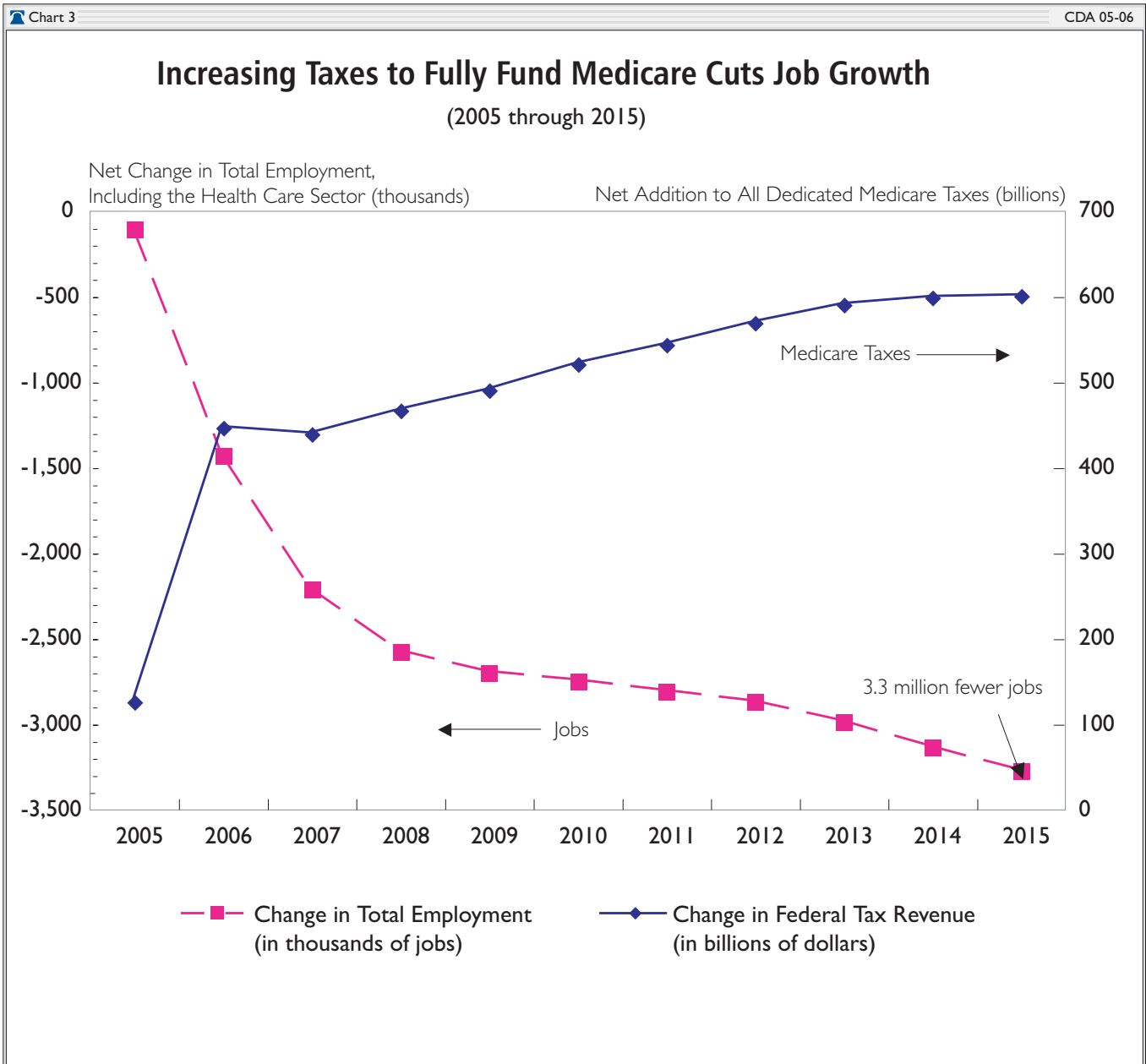
Source: Center for Data Analysis, The Heritage Foundation, using Global Insight's short-term U.S. Macroeconomic Model to simulate the effects of financing Medicare's unfunded liabilities with higher payroll and personal income taxes.

to the required 13.4 percent of all wages, salaries, and self-employment income would generate substantial amounts of new federal tax revenues. (See Appendix A.) Assuming that the new revenues are used to reduce deficits and pay down debt, the federal government's unified budget deficit would very quickly become a unified budget surplus, and privately held federal debt would drop below 10 percent of GDP before 2015. The ensuing lower interest rates would in time encourage higher non-residential capital spending and capital formation.

However, the unified budget surpluses would be the result of increased payroll tax revenues and lower interest payments on the federal debt. Both

personal and corporate incomes, and thus personal and corporate federal income tax collections, would fall below their base levels in every year between 2006 and 2015. Consistent with lower personal income, personal consumption expenditures would decline steadily, helping to push real GDP down an average of over \$204 billion per year between 2006 and 2010. Private-sector job losses would in turn average nearly 1.8 million annually over the same period.

The negative economic effects of raising payroll tax rates to fund HI and SMI through 2079 would be more pronounced if the federal government used new tax revenues to finance higher spending



instead of paying down debt. (See Table 4 in Appendix B.) This is because lower personal and corporate incomes would again give way to lower personal and corporate income tax collections, but increased payroll tax revenues, instead of offsetting declining federal income tax receipts, would offset greater spending elsewhere in the federal government's budget.

As a result, privately held federal debt would expand as a share of GDP, tending to make it more difficult for businesses to finance new capital spending. Non-residential investment and, ultimately, capital formation would still rebound, but

only because the Federal Reserve is assumed to lower the federal funds rate aggressively to offset rising unemployment rates. By 2015, real GDP would be over \$283 billion lower than it would be without tax increases, and almost 2.8 million private-sector jobs would have been lost because of higher payroll tax rates.

CONCLUSION

Today, Medicare is the less costly of the two major government programs intended to ensure the well-being of older Americans. However, an aging population and other factors will make it a primary concern of policymakers in the coming

years. How policymakers meet the long-term fiscal challenges of Medicare's unfunded liabilities could have profound economic and budgetary effects. Any policy that reduces future job opportunities and economic growth will compound the problem.

Simply raising taxes to finance promised Medicare benefits would likely prove counterproductive because the economic costs would be prohibitive, even assuming that policymakers are prudent and use new tax revenues to pay down deficits and debt. In the estimates presented in this report, raising payroll and personal income taxes to finance Medicare over just the next 10 years could reduce total employment by an average of nearly 816,000 jobs and depress real GDP by an average of almost

\$87 billion per year through 2015. (See Table 1 and Chart 3.)

The economic costs would increase if policymakers follow historical patterns of using new tax revenues to offset new federal spending. Under such circumstances, raising taxes to finance Medicare over the next 75 years could reduce total employment by close to 2.7 million jobs and real GDP by an average of almost \$248 billion over the first 10 years that higher payroll taxes are in place.

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APPENDIX A METHODOLOGY

A three-step procedure was followed in analyzing the economic and budgetary effects of raising taxes to finance Medicare's unfunded liabilities.

First, the static increases in payroll tax and personal income tax revenues needed to fund promised benefits were estimated. These estimates were based on data from the *2005 Annual Report of the Boards of Trustees of the Hospital Insurance and the Supplementary Medical Insurance Trust Funds* and the *2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*.

Second, version 9 of the Global Insight U.S. Macroeconomic Model was calibrated to the baseline economic and budgetary assumptions and forecasts published in the Congressional Budget Office's August 2005 *The Budget and Economic Outlook: An Update*.²⁹

Third, once calibrated, that model and its CBO-like baseline were used to simulate how the general economy would likely respond to the implied changes in federal tax and spending policies.³⁰

The Congressional Budget Office produces a current-law baseline. A current-law baseline includes projections of personal incomes, corporate profits, GDP, prices, employment, consumption, investment, etc. that are consistent with no changes in federal outlays and receipts other than those specified by laws that have already been enacted.³¹ For example, the CBO's current-law baseline assumes the expiration of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 and the Jobs and Growth Tax

Relief Reconciliation Act (JGTRRA) of 2003. However, it excludes any new legislation that would increase federal spending, even when such legislation is likely to be enacted.

The CBO's current-law baseline treats the outlays and receipts associated with Medicare somewhat differently. CBO federal spending projections include expected outlays for Medicare Parts B and D. However, its revenue projections do not include any offsetting general revenue transfers to the SMI trust funds. These transfers are instead captured residually in CBO projections of unified federal budget surpluses/deficits. From a modeling standpoint, this means that any simulated increases in revenues earmarked for Medicare will affect deficit reduction and not spending on federal health-care benefits.

Calculating Static Revenue Estimates

Two separate sets of static revenue estimates were made. Both are consistent with the intermediate economic and demographic assumptions outlined in the 2005 Medicare and the 2005 OASDI trustees' reports.³²

First, the additional payroll tax revenues needed from 2005 to fund HI and SMI benefits over the next 75 years were calculated using projections of taxable payroll taken from the 2005 OASDI trustees' report and estimates of payroll tax rate increases from the 2005 Medicare trustees' report. The calculated gains in payroll tax revenues were then translated into corresponding increases in the effective federal social insurance tax rate used in the Global Insight model.

29. See Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2005, at www.cbo.gov/ftpdocs/66xx/doc6609/08-15-OutlookUpdate.pdf (August 15, 2005). A CBO report released shortly after the August 2005 update gives projections for national income and product account (NIPA) federal receipts and expenditures. These NIPA projections were taken into account when calibrating the Global Insight model to the CBO baseline. See Frank Russek and Barry Bloom, "The Treatment of Federal Receipts and Expenditures in the National Income and Product Accounts," Congressional Budget Office Report, September 2005, at www.cbo.gov/ftpdocs/66xx/doc6625/09-02-NIPAs.pdf (September 12, 2005).

30. The methodologies, assumptions, conclusions, and opinions presented here have not been endorsed by and do not necessarily reflect the views of the owners of the Global Insight model. *Fortune* 500 companies and numerous government agencies use Global Insight's short-term U.S. Macroeconomic Model to forecast how important changes in the economy and in public policy are likely to affect hundreds of major economic indicators.

31. See Christopher Williams, "What Is a Current-Law Baseline?" Congressional Budget Office *Economic and Budget Issue Brief*, June 2005, at www.cbo.gov/ftpdocs/64xx/doc6403/EconomicBaseline.pdf (August 25, 2005).

32. For a description of the Medicare trustees' intermediate assumptions, see footnote 10.

- The 2005 Medicare trustees' report estimates the present value of HI's 75-year actuarial imbalance to be 3.09 percent of taxable payroll.³³ It then suggests that HI's "long-range financial imbalance could be addressed" by immediately and permanently raising the 2.9 percent payroll tax rate to 5.99 percent of all wages, salaries, and self-employment income.³⁴
 - The report estimates the present value of the general revenue transfers needed to fund Part B through 2079 to be 4.34 percent of taxable payroll.³⁵ It estimates the present value of the general revenue transfers needed to fund Part D over the same period to be 3.04 percent of taxable payroll.³⁶ Therefore, using payroll taxes to fund Parts B and D combined would imply an immediate and permanent jump in the Medicare payroll tax rate to roughly 10.3 percent of total wages and salaries. Combining the unfunded obligations of SMI Parts B and D with HI's actuarial imbalance would immediately push the Medicare payroll tax rate to an estimated 13.4 percent.
 - Static revenue estimates were obtained by multiplying OASDI projections of taxable payroll by the difference between that 13.4 percent and the current 2.9 percent Medicare payroll tax rate. Between 2006 and 2015, in calendar years, the result would be an increase in payroll tax revenues exceeding \$8.1 trillion. Obtaining the same increase in payroll tax revenues in the Global Insight model required a permanent 10.8 percentage point increase in the model's effective federal social insurance tax rate by the end of 2015.
- Second*, the increases in payroll tax and personal income tax revenues needed to pay promised HI and SMI benefits over just the next 10 years were calculated using data taken from the 2005 Medicare trustees' report.
- Beginning in 2005, payroll taxes were increased by the amount of HI's projected (nominal) annual deficits. These deficits are defined as the difference between HI income, excluding interest, and HI benefits payments.³⁷ They sum to almost \$134 billion between 2006 and 2015, implying an increase of more than 0.4 percentage point in the Global Insight model's effective federal social insurance tax rate by the end of 2015.
 - Beginning in 2005, federal personal income taxes were increased by the amount of (nominal) projected general revenue contributions to SMI Parts B and D.³⁸ Those projected general revenue contributions sum to nearly \$2.6 trillion between 2006 and 2015, implying a rise of more than 4.2 percentage points in the Global Insight model's average effective federal personal income tax rate by the end of 2015.

Simulating the Economic and Budgetary Effects of Financing Medicare's Unfunded Liabilities with Higher Taxes

Increases in payroll and personal income tax revenues were introduced into the Global Insight model by:

33. The 2005 Medicare trustees' report obtained this 3.09 percent of taxable payroll by dividing the estimated present value of the 75-year HI trust fund actuarial imbalance (\$8.8 trillion under the intermediate assumptions) by the estimated present value of taxable payroll (\$286 trillion). See Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, p. 60, Table III.B9.
34. See Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, p. 16. In the simulations, the federal social insurance tax rate was raised beginning in the third quarter of 2005.
35. The 2005 Medicare trustees' report obtained this 4.34 percent of taxable payroll by dividing the estimated present value of Part B general revenue transfers over 75 years (\$12.4 trillion) by the estimated present value of taxable payroll (\$286 trillion). See Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, Table III.B9. Similarly, it obtained this 3.04 percent of taxable payroll by dividing the estimated present value of Part D general revenue transfers (\$8.7 trillion) by the estimated present value of taxable payroll.
36. See Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, pp. 101–112, Table III.C15 and Table III.C21.
37. See Social Security Administration, *The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, pp. 183–184, Table VI.F9, and Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, pp. 46–47, Table III.B4.
38. See Centers for Medicare and Medicaid Services, *2005 Annual Report of the Boards of Trustees*, Table III.C1, and footnote 15.

- Increasing the effective federal social insurance tax rate on wages and salaries and the effective federal personal income tax rate on the model's taxable personal income.
- Adjusting several of the model's labor supply variables to capture the potentially negative effects of higher payroll and personal income taxes on labor force participation and average weekly hours worked.³⁹ Those adjustments were relatively minor. For those 65 years old and older, a total wage elasticity between 0 and 0.3 was assumed.⁴⁰ This total wage elasticity includes a participation elasticity falling between 0.1 and 0.2 and an average-hours elasticity not exceeding 0.1. For those between 16 and 64 years old, a participation elasticity not exceeding 0.15 was assumed. The average number of hours worked was assumed to be unresponsive to changes in tax policy. A weighted average of these elasticities was used to determine the full-employment labor force's responsiveness to changes in tax rates. The weights applied equaled each age cohort's share of the total civilian labor force.⁴¹
- Assuming that the Federal Reserve Board follows historical behavior patterns when reacting to a change in either payroll or personal income tax rates. This assumption was implemented in the Global Insight model using an econometrically estimated reaction function that determines the effective interest rate on federal funds.
- Determining how sensitive the results are to using the new payroll tax revenues to pay down debt versus to finance higher spending.

The Global Insight model assumes that the federal government uses every additional dollar of higher payroll tax revenues to reduce debt. Increases in tax revenues negatively affect employment, income, and personal consumption. However, in the Global Insight model, reduced deficit spending pushes down interest rates and the cost of

capital, causing a “crowding-in” effect for non-residential investment. The result is an increase in the stock of non-residential capital and in the economy's capital-to-labor ratio.

However, historically, payroll tax revenues collected in excess of current benefits have not been used to fund future benefits. Rather, they have been used to offset higher spending elsewhere in the federal budget. In exchange for those revenues, the HI trust fund, like the Social Security trust fund, has been given special public-debt obligations.

Medicare has already begun to redeem those obligations and is expected to continue to do so over the next 10 years as benefits increasingly outstrip income from payroll tax and other revenues. Thus, future Congresses will be forced to borrow, cut spending elsewhere in the budget, raise taxes, or enact some combination of those policies to finance the benefits promised to today's workers.

The financing situation confronting Medicare's SMI is similar. SMI is composed of two separate trust fund accounts: one for Part B and one for Part D. Both accounts largely finance current benefit payments with premium income from beneficiaries and general revenue transfers from the Treasury. In any given year, premiums finance 25 percent of SMI's Part B benefits, and general revenue transfers finance the remaining 75 percent. Part D funding is expected to follow a similar formula beginning in 2006.

Two simulations were run to test the sensitivity of the results to assumptions about how the government uses higher payroll tax revenues. Both simulations assumed a permanent and immediate increase in payroll tax rates to fund general revenue transfers to the HI trust fund and the SMI trust fund through 2079.

The first simulation assumed that the government used new payroll tax revenues to pay down debt. The result was a drop in privately held debt as a share of GDP. The second assumed that the government used new payroll tax revenues to offset increases in other spending. The higher spending

39. The following labor supply variables in the Global Insight model were adjusted: NLFCFE (full-employment civilian labor force); NLFC16T64 (civilian labor force aged between 16 and 64 years); NLFC65A (civilian labor force aged 65 years or more); and HRNFPRIFE (full-employment average-hours worked). NLFCFE, NLFC16T64, and NLFC65A were adjusted in the simulations by replacing, not reducing, the baseline forecast levels.

40. See Frank Russek, “Labor Supply and Taxes,” Congressional Budget Office *Memorandum*, January 1996.

41. All labor supply elasticities were further multiplied by 0.25 to obtain a quarterly pattern. All implied reductions in labor force participation and average hours worked were phased in over the entire 10-year forecast horizon.

was matched by an offsetting increase in the model's variable for federal debt held by other government agencies, an approximation here for the special public-debt obligations currently held in the HI trust fund.

New government spending was introduced into the Global Insight model using a variable denoting

the difference between national income and product account federal outlays and unified budget federal outlays. The government spending represented by that variable has no short-run stimulative effects in the model. All other mandatory and discretionary federal spending in the model was kept at baseline levels.

APPENDIX B

THE EFFECTS OF RAISING TAXES TO FUND MEDICARE'S UNFUNDED LIABILITIES

Fiscal Year Average												Average, 2006-2015
Economic Indicators	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Gross Domestic Product (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	11,122.9	11,403.3	11,777.8	12,218.5	12,633.4	13,048.7	13,439.2	13,805.0	14,145.8	14,481.7	14,820.7	13,177.4
Baseline	11,136.6	11,527.7	11,919.3	12,328.8	12,725.3	13,108.3	13,477.6	13,843.0	14,204.2	14,570.5	14,937.1	13,264.2
Difference	-13.6	-124.4	-141.5	-110.3	-92.0	-59.5	-38.4	-38.1	-58.3	-88.9	-116.5	-86.8
Real GDP Growth Rate (Percent Change from Previous Year)												
Forecast	3.6	2.5	3.3	3.7	3.4	3.3	3.0	2.7	2.5	2.4	2.3	2.9
Baseline	3.7	3.5	3.4	3.4	3.2	3.0	2.8	2.7	2.6	2.6	2.5	3.0
Difference	-0.1	-1.0	-0.1	0.3	0.2	0.3	0.2	0.0	-0.1	-0.2	-0.2	-0.1
Total Employment (Thousands of Jobs)												
Forecast	133,025	134,487	135,913	137,762	139,513	141,084	142,345	143,340	144,004	144,478	144,782	140,771.0
Baseline	133,073	135,281	137,214	138,958	140,491	141,812	142,845	143,762	144,526	145,219	145,760	141,586.7
Difference	-47.5	-793.6	-1,300.7	-1,195.3	-977.4	-728.6	-499.2	-421.3	-521.2	-741.3	-978.0	-815.7
Private Employment (Thousands of Jobs)												
Forecast	111,275	112,274	113,466	115,068	116,553	117,853	119,010	119,791	120,366	120,754	121,057	117,619.0
Baseline	111,322	113,014	114,639	116,164	117,463	118,540	119,504	120,226	120,904	121,497	122,016	118,396.9
Difference	-47.5	-740.0	-1,172.8	-1,096.9	-910.5	-687.1	-494.2	-435.7	-538.1	-743.5	-959.6	-777.8
Unemployment Rate (Percent of Civilian Labor Force)												
Forecast	5.3	5.6	5.8	5.7	5.5	5.4	5.3	5.2	5.2	5.3	5.4	5.4
Baseline	5.3	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Difference	0.0	0.4	0.6	0.5	0.3	0.2	0.1	0.0	0.0	0.1	0.1	0.2
Disposable Personal Income (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	8,141.9	8,220.3	8,451.2	8,768.2	8,993.4	9,252.1	9,412.9	9,594.5	9,805.3	10,001.3	10,199.2	9,269.8
Baseline	8,181.9	8,483.5	8,776.4	9,096.7	9,346.5	9,596.8	9,764.4	9,964.4	10,213.8	10,464.7	10,718.6	9,642.6
Difference	-40.0	-263.3	-325.2	-328.5	-353.0	-344.7	-351.6	-369.9	-408.5	-463.4	-519.4	-372.8
Disposable Income Per Capita (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	27,495	27,510	28,032	28,831	29,315	29,898	30,158	30,479	30,885	31,237	31,589	29,793.4
Baseline	27,630	28,391	29,111	29,911	30,466	31,012	31,285	31,654	32,171	32,684	33,197	30,988.2
Difference	-135	-881	-1,079	-1,080	-1,151	-1,114	-1,126	-1,175	-1,287	-1,447	-1,609	-1,195
Difference for Family of Four	-540	-3,524	-4,315	-4,321	-4,603	-4,456	-4,505	-4,700	-5,147	-5,789	-6,435	-4,596
Personal Consumption Expenditures (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	7,822.2	7,947.4	8,192.1	8,445.9	8,703.5	8,959.6	9,181.7	9,400.5	9,598.4	9,781.2	9,970.8	9,018.1
Baseline	7,836.1	8,075.1	8,368.2	8,627.2	8,892.0	9,139.6	9,359.3	9,587.0	9,806.9	10,022.8	10,247.3	9,212.5
Difference	-13.9	-127.7	-176.2	-181.3	-188.5	-180.0	-177.6	-186.4	-208.5	-241.6	-276.5	-194.4
Gross Private Domestic Investment (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	1,961.2	2,020.8	2,056.2	2,180.2	2,273.4	2,363.7	2,457.5	2,516.3	2,582.8	2,662.3	2,742.4	2,385.5
Baseline	1,964.3	2,063.1	2,088.3	2,181.1	2,263.6	2,346.5	2,440.3	2,507.8	2,587.9	2,679.5	2,764.6	2,392.2
Difference	-3.1	-42.3	-32.1	-0.9	9.8	17.2	17.3	8.5	-5.1	-17.2	-22.3	-6.7
Non-Residential Investment (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	1,317.4	1,431.3	1,492.8	1,596.6	1,696.9	1,776.7	1,861.2	1,945.7	2,020.1	2,102.6	2,186.3	1,811.0
Baseline	1,318.0	1,451.3	1,519.3	1,602.1	1,688.7	1,765.1	1,850.4	1,940.8	2,025.2	2,117.7	2,206.3	1,816.7
Difference	-0.6	-20.0	-26.5	-5.5	8.2	11.6	10.7	4.9	-5.1	-15.1	-20.0	-5.7
Residential Investment (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	582.4	576.0	548.2	541.7	547.8	559.3	570.6	564.7	560.3	563.9	569.5	560.2
Baseline	583.1	580.0	550.8	543.8	548.3	557.6	568.1	562.2	558.7	563.4	569.9	560.3
Difference	-0.7	-4.0	-2.6	-2.1	-0.5	1.6	2.4	2.5	1.6	0.5	-0.3	-0.1

The Economic and Budgetary Effects of Raising Payroll and Personal Income Tax Rates to Fund HI and SMI Benefits through 2015, Government Uses New Tax Revenues to Pay Down Debt (cont.)

Economic Indicators	Fiscal Year Average											Average, 2006-2015
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Change in the Stock of Business Inventories (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	54.8	16.7	26.8	62.1	55.4	58.7	61.9	51.3	56.6	57.8	56.3	50.4
Baseline	56.5	34.9	30.5	54.6	51.8	53.4	56.7	49.9	58.9	62.1	60.1	51.3
Difference	-1.7	-18.2	-3.6	7.5	3.6	5.4	5.2	1.4	-2.3	-4.3	-3.8	-0.9
Full-Employment Capital Stock (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	12,592.8	13,150.6	13,716.2	14,270.0	14,855.6	15,448.6	16,027.1	16,605.0	17,177.3	17,759.4	18,357.2	15,736.7
Baseline	12,593.0	13,162.9	13,742.6	14,289.8	14,859.2	15,438.8	16,010.8	16,590.7	17,170.8	17,763.8	18,370.5	15,740.0
Difference	-0.2	-12.3	-26.4	-19.8	-3.6	9.8	16.3	14.3	6.5	-4.4	-13.3	-3.3
Consumer Price Index (Percent Change from Previous Year)												
Forecast	3.2	2.6	2.1	2.0	2.0	2.0	2.0	2.1	2.1	2.1	2.1	2.1
Baseline	3.2	2.7	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.3
Difference	0.0	0.0	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1
Treasury Bill, 3 Month (Annualized Percent)												
Forecast	2.6	2.8	3.1	3.7	3.8	4.0	4.1	4.3	4.3	4.2	4.1	3.8
Baseline	2.7	3.6	4.3	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.5
Difference	-0.1	-0.8	-1.1	-1.0	-0.9	-0.7	-0.6	-0.5	-0.4	-0.5	-0.6	-0.7
Treasury Bond, 10 Year (Annualized Percent)												
Forecast	4.2	4.0	4.4	4.7	4.7	4.8	4.8	4.8	4.8	4.7	4.7	4.6
Baseline	4.3	4.6	5.2	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.3
Difference	0.0	-0.6	-0.8	-0.7	-0.7	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7	-0.7
Federal Funds Rate (Annualized Percent)												
Forecast	2.6	3.2	2.9	3.3	4.0	4.2	4.4	4.5	4.6	4.5	4.4	4.0
Baseline	2.7	4.0	4.1	4.4	4.9	5.0	5.0	5.0	5.0	5.0	5.0	4.7
Difference	-0.1	-0.8	-1.2	-1.1	-1.0	-0.8	-0.6	-0.5	-0.5	-0.5	-0.6	-0.8
Federal Budget												
Indicators	Fiscal Year Average											Total, 2006-2015
Unified Federal Tax Revenue (\$Billions, Not Adjusted for Inflation)												
Forecast	2,178.3	2,455.2	2,567.8	2,697.1	2,868.1	3,003.3	3,279.6	3,532.9	3,716.9	3,910.5	4,109.2	32,140.6
Baseline	2,141.8	2,281.1	2,397.4	2,527.5	2,676.7	2,818.8	3,076.8	3,313.9	3,483.0	3,662.1	3,850.2	30,087.5
Difference	36.5	174.1	170.5	169.6	191.5	184.5	202.8	219.0	233.9	248.4	259.0	2,053.1
Change in Unified Federal Tax Revenue (\$Billions, Not Adjusted for Inflation)												
Static Change												
to Tax Revenue	40.5	213.1	215.6	209.1	236.2	231.3	255.9	283.4	317.2	355.3	390.2	2,707.3
Dynamic Change												
to Tax Revenue	36.5	174.1	170.5	169.6	191.5	184.5	202.8	219.0	233.9	248.4	259.0	2,053.1
Revenue Feedback	-4.0	-39.0	-45.1	-39.5	-44.7	-46.9	-53.1	-64.4	-83.3	-106.9	-131.2	-654.2
Feedback Percent	-9.9%	-18.3%	-20.9%	-18.9%	-18.9%	-20.3%	-20.8%	-22.7%	-26.3%	-30.1%	-33.6%	-24.2%
Federal Personal Tax Collections (\$Billions, Not Adjusted for Inflation)												
Forecast	944.5	1,190.1	1,262.8	1,336.8	1,444.1	1,521.8	1,736.2	1,897.1	2,020.1	2,142.7	2,265.1	16,816.7
Baseline	905.0	992.0	1,070.0	1,150.0	1,235.0	1,323.0	1,520.0	1,664.0	1,769.0	1,873.0	1,983.0	14,579.0
Difference	39.5	198.1	192.8	186.8	209.1	198.8	216.2	233.1	251.1	269.7	282.1	2,237.7
Federal Payroll Tax Receipts (\$Billions, Not Adjusted for Inflation)												
Forecast	844.7	904.1	947.2	991.8	1,038.8	1,093.4	1,147.5	1,204.1	1,263.8	1,324.7	1,389.9	11,305.3
Baseline	845.0	911.0	961.0	1,008.0	1,056.0	1,110.0	1,164.0	1,220.0	1,279.0	1,340.0	1,404.0	11,453.0
Difference	-0.3	-6.9	-13.8	-16.2	-17.2	-16.6	-16.5	-16.0	-15.2	-15.3	-14.1	-147.7

Table 2c

CDA 05-06

The Economic and Budgetary Effects of Raising Payroll and Personal Income Tax Rates to Fund HI and SMI Benefits through 2015, Government Uses New Tax Revenues to Pay Down Debt (cont.)

Federal Budget Indicators	Fiscal Year Average											Total 2006-2015
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Unified Federal Spending (\$Billions, Not Adjusted for Inflation)												Total
Forecast	2,472.9	2,582.2	2,690.0	2,812.9	2,930.3	3,049.1	3,180.6	3,266.1	3,414.2	3,548.3	3,691.7	31,165.4
Baseline	2,473.1	2,593.0	2,720.0	2,860.0	2,996.0	3,134.0	3,284.0	3,389.0	3,562.0	3,727.0	3,905.0	32,170.0
Difference	-0.2	-10.8	-30.0	-47.1	-65.7	-84.9	-103.4	-122.9	-147.8	-178.7	-213.3	-1,004.7
Federal Net Interest Payments (\$Billions, Not Adjusted for Inflation)												Total
Forecast	225.6	240.3	252.8	276.6	293.5	309.2	319.1	321.2	310.7	294.5	273.7	2,891.6
Baseline	225.7	251.3	283.3	319.9	347.3	373.7	393.3	407.3	415.3	424.3	431.9	3,647.6
Difference	-0.2	-11.0	-30.5	-43.2	-53.8	-64.5	-74.2	-86.1	-104.6	-129.8	-158.2	-755.9
Unified Federal Surplus/Deficit (\$Billions, Not Adjusted for Inflation)												Total
Forecast	-294.6	-127.0	-122.1	-115.8	-62.2	-45.8	99.0	266.8	302.7	362.2	417.5	975.3
Baseline	-331.3	-311.9	-322.7	-332.5	-319.4	-315.2	-207.2	-75.1	-79.0	-64.9	-54.8	-2,082.5
Difference	36.7	184.9	200.5	216.7	257.1	269.4	306.2	341.9	381.7	427.1	472.3	3,057.8
Privately Held Federal Debt (\$Billions, Not Adjusted for Inflation, End of Third Quarter)												Average
Forecast	4,587.5	4,724.6	4,862.1	4,994.7	5,071.9	5,130.4	5,052.6	4,795.9	4,500.5	4,144.6	3,730.5	4,700.8
Baseline	4,621.0	4,943.0	5,281.0	5,630.0	5,964.0	6,292.0	6,520.0	6,605.0	6,691.0	6,762.0	6,820.0	6,150.8
Difference	-33.5	-218.4	-418.9	-635.3	-892.2	-1,161.6	-1,467.4	-1,809.1	-2,190.6	-2,617.4	-3,089.5	-1,450.0
Privately Held Federal Debt Share (Percent of GDP)												Average
Forecast	37.4	36.9	36.1	35.2	34.1	32.9	30.9	28.1	25.3	22.4	19.4	30.1
Baseline	37.7	38.1	38.7	39.2	39.5	39.7	39.3	38.1	36.9	35.8	34.6	38.0
Difference	-0.2	-1.3	-2.6	-3.9	-5.4	-6.9	-8.4	-10.0	-11.6	-13.3	-15.2	-7.8

Notes: HI denotes the Hospital Insurance component of Medicare; SMI denotes the Supplementary Medical Insurance (including the new prescription drug benefit) component of Medicare. Some numbers may not add due to rounding. The static change in unified federal tax revenues assumes no macroeconomic behavioral response to an increase in payroll and personal income tax rates. A dynamic change in revenues assumes a behavioral response at the macroeconomic level.

Source: Center for Data Analysis, The Heritage Foundation.

The Economic and Budgetary Effects of Raising Payroll Tax Rates to Fund HI and SMI Benefits Through 2079, Government Uses New Tax Revenues to Pay Down Debt

Economic Indicators	Fiscal Year Average											Average, 2006-2015
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Gross Domestic Product (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	11,107.9	11,331.4	11,710.6	12,108.9	12,517.2	12,919.1	13,308.2	13,686.4	14,039.0	14,386.3	14,729.2	13,073.6
Baseline	11,136.6	11,527.7	11,919.3	12,328.8	12,725.3	13,108.3	13,477.6	13,843.0	14,204.2	14,570.5	14,937.1	13,264.2
Difference	-28.6	-196.3	-208.7	-219.9	-208.1	-189.2	-169.4	-156.6	-165.2	-184.2	-207.9	-190.6
Real GDP Growth Rate (Percent Change from Previous Year)												
Forecast	3.4	2.0	3.4	3.4	3.4	3.2	3.0	2.8	2.6	2.5	2.4	2.9
Baseline	3.7	3.5	3.4	3.4	3.2	3.0	2.8	2.7	2.6	2.6	2.5	3.0
Difference	-0.3	-1.5	0.0	0.0	0.2	0.2	0.2	0.1	0.0	-0.1	-0.1	-0.1
Total Employment (Thousands of Jobs)												
Forecast	132,971	133,863	135,078	136,539	138,037	139,424	140,537	141,514	142,202	142,697	142,982	139,287.3
Baseline	133,073	135,281	137,214	138,958	140,491	141,812	142,845	143,762	144,526	145,219	145,760	141,586.7
Difference	-102.4	-1,417.7	-2,135.6	-2,419.0	-2,454.2	-2,388.1	-2,307.8	-2,247.8	-2,324.0	-2,522.2	-2,777.7	-2,299.4
Private Employment (Thousands of Jobs)												
Forecast	111,219	111,764	112,920	114,205	115,493	116,640	117,688	118,462	119,065	119,480	119,774	116,549.2
Baseline	111,322	113,014	114,639	116,164	117,463	118,540	119,504	120,226	120,904	121,497	122,016	118,396.9
Difference	-102.7	-1,249.9	-1,719.5	-1,959.9	-1,970.0	-1,899.8	-1,815.9	-1,763.9	-1,838.6	-2,017.1	-2,241.8	-1,847.6
Unemployment Rate (Percent of Civilian Labor Force)												
Forecast	5.3	5.9	6.1	6.0	5.9	5.7	5.5	5.4	5.3	5.2	5.2	5.6
Baseline	5.3	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Difference	0.0	0.7	0.8	0.8	0.7	0.5	0.3	0.1	0.0	0.0	0.0	0.4
Disposable Personal Income (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	8,099.6	8,146.0	8,380.2	8,608.2	8,792.1	8,980.1	9,099.3	9,257.1	9,454.7	9,650.8	9,851.2	9,022.0
Baseline	8,181.9	8,483.5	8,776.4	9,096.7	9,346.5	9,596.8	9,764.4	9,964.4	10,213.8	10,464.7	10,718.6	9,642.6
Difference	-82.3	-337.5	-396.2	-488.5	-554.4	-616.7	-665.1	-707.2	-759.1	-813.9	-867.3	-620.6
Disposable Income Per Capita (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	27,352	27,262	27,797	28,305	28,659	29,020	29,154	29,407	29,780	30,142	30,511	29,003.5
Baseline	27,630	28,391	29,111	29,911	30,466	31,012	31,285	31,654	32,171	32,684	33,197	30,988.2
Difference												
per Person	-278	-1,130	-1,314	-1,606	-1,807	-1,993	-2,131	-2,247	-2,391	-2,542	-2,686	-1,985
Difference for												
Family of Four	-1,111	-4,518	-5,257	-6,425	-7,228	-7,971	-8,524	-8,987	-9,564	-10,168	-10,745	-7,627
Personal Consumption Expenditures (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	7,807.1	7,887.0	8,133.4	8,337.9	8,571.7	8,794.3	8,992.7	9,200.7	9,391.9	9,573.7	9,762.7	8,864.6
Baseline	7,836.1	8,075.1	8,368.2	8,627.2	8,892.0	9,139.6	9,359.3	9,587.0	9,806.9	10,022.8	10,247.3	9,212.5
Difference	-29.1	-188.1	-234.8	-289.3	-320.3	-345.3	-366.6	-386.2	-415.0	-449.1	-484.6	-347.9
Gross Private Domestic Investment (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	1,957.8	1,991.4	2,050.1	2,166.5	2,271.8	2,370.8	2,472.8	2,545.3	2,618.3	2,701.3	2,779.7	2,396.8
Baseline	1,964.3	2,063.1	2,088.3	2,181.1	2,263.6	2,346.5	2,440.3	2,507.8	2,587.9	2,679.5	2,764.6	2,392.2
Difference	-6.6	-71.7	-38.1	-14.6	8.2	24.3	32.5	37.5	30.4	21.8	15.1	4.5
Non-Residential Investment (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	1,316.7	1,417.3	1,487.5	1,595.3	1,701.3	1,789.6	1,880.6	1,974.4	2,054.8	2,140.6	2,223.9	1,826.5
Baseline	1,318.0	1,451.3	1,519.3	1,602.1	1,688.7	1,765.1	1,850.4	1,940.8	2,025.2	2,117.7	2,206.3	1,816.7
Difference	-1.2	-33.9	-31.8	-6.8	12.6	24.5	30.1	33.6	29.6	22.9	17.6	9.9
Residential Investment (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	581.6	571.9	544.1	536.7	543.8	555.6	568.0	563.6	560.3	564.3	569.5	557.8
Baseline	583.1	580.0	550.8	543.8	548.3	557.6	568.1	562.2	558.7	563.4	569.9	560.3
Difference	-1.5	-8.1	-6.7	-7.1	-4.6	-2.0	-0.1	1.4	1.6	0.9	-0.4	-2.5

Table 3b

CDA 05-06

The Economic and Budgetary Effects of Raising Payroll Tax Rates to Fund HI and SMI Benefits Through 2079, Government Uses New Tax Revenues to Pay Down Debt (cont.)

Economic Indicators	Fiscal Year Average											Average, 2006-2015
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Change in the Stock of Business Inventories (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	53.0	5.6	30.8	55.8	54.8	58.6	62.6	55.4	60.5	61.6	59.1	50.5
Baseline	56.5	34.9	30.5	54.6	51.8	53.4	56.7	49.9	58.9	62.1	60.1	51.3
Difference	-3.5	-29.3	0.4	1.2	3.0	5.2	5.8	5.6	1.5	-0.5	-1.1	-0.8
Full-Employment Capital Stock (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	12,592.6	13,141.0	13,705.5	14,267.1	14,866.8	15,483.6	16,087.0	16,694.9	17,297.9	17,907.5	18,528.6	15,798.0
Baseline	12,593.0	13,162.9	13,742.6	14,289.8	14,859.2	15,438.8	16,010.8	16,590.7	17,170.8	17,763.8	18,370.5	15,740.0
Difference	-0.4	-21.9	-37.2	-22.7	7.6	44.8	76.2	104.2	127.1	143.7	158.1	58.0
Consumer Price Index (Percent Change from Previous Year)												
Forecast	3.2	3.0	2.3	2.1	2.0	1.9	1.9	2.0	2.0	2.0	2.0	2.1
Baseline	3.2	2.7	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.3
Difference	0.0	0.3	0.1	-0.1	-0.2	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.1
Treasury Bill, 3 Month (Annualized Percent)												
Forecast	2.6	2.5	3.0	3.5	3.6	3.7	3.8	3.9	4.1	4.2	4.3	3.6
Baseline	2.7	3.6	4.3	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.5
Difference	-0.1	-1.1	-1.3	-1.2	-1.2	-1.0	-0.9	-0.8	-0.6	-0.5	-0.4	-0.9
Treasury Bond, 10 Year (Annualized Percent)												
Forecast	4.2	3.7	4.2	4.3	4.2	4.2	4.2	4.3	4.3	4.3	4.3	4.2
Baseline	4.3	4.6	5.2	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.3
Difference	-0.1	-0.9	-1.1	-1.1	-1.2	-1.2	-1.2	-1.2	-1.1	-1.1	-1.1	-1.1
Federal Funds Rate (Annualized Percent)												
Forecast	2.6	2.8	2.7	3.1	3.6	3.9	4.0	4.2	4.4	4.5	4.6	3.8
Baseline	2.7	4.0	4.1	4.4	4.9	5.0	5.0	5.0	5.0	5.0	5.0	4.7
Difference	-0.1	-1.2	-1.4	-1.4	-1.3	-1.1	-1.0	-0.8	-0.6	-0.5	-0.4	-1.0
Federal Budget												
	Fiscal Year Average											Total,
Indicators	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006-2015
Unified Federal Tax Revenue (\$Billions, Not Adjusted for Inflation)												
Forecast	2,268.1	2,726.7	2,835.6	2,992.8	3,167.0	3,344.5	3,634.3	3,907.2	4,105.3	4,299.9	4,494.1	35,507.3
Baseline	2,141.8	2,281.1	2,397.4	2,527.5	2,676.7	2,818.8	3,076.8	3,313.9	3,483.0	3,662.1	3,850.2	30,087.5
Difference	126.4	445.6	438.2	465.3	490.4	525.7	557.5	593.3	622.3	637.8	643.9	5,419.8
Change in Unified Federal Tax Revenue (\$Billions, Not Adjusted for Inflation)												
Static Change												
to Tax Revenue	152.6	633.6	670.0	704.8	740.5	777.7	816.7	856.3	895.9	936.9	977.5	8,009.8
Dynamic Change												
to Tax Revenue	126.4	445.6	438.2	465.3	490.4	525.7	557.5	593.3	622.3	637.8	643.9	5,419.8
Revenue Feedback	-26.2	-188.0	-231.8	-239.5	-250.1	-252.0	-259.2	-263.1	-273.6	-299.1	-333.6	-2,590.0
Feedback Percent	-17.2%	-29.7%	-34.6%	-34.0%	-33.8%	-32.4%	-31.7%	-30.7%	-30.5%	-31.9%	-34.1%	-32.3%
Federal Personal Tax Collections (\$Billions, Not Adjusted for Inflation)												
Forecast	902.6	959.6	1,023.0	1,103.3	1,190.3	1,285.3	1,488.0	1,643.1	1,758.5	1,860.3	1,961.2	14,272.7
Baseline	905.0	992.0	1,070.0	1,150.0	1,235.0	1,323.0	1,520.0	1,664.0	1,769.0	1,873.0	1,983.0	14,579.0
Difference	-2.4	-32.4	-47.0	-46.7	-44.7	-37.7	-32.0	-20.9	-10.5	-12.7	-21.8	-306.4
Federal Payroll Tax Receipts (\$Billions, Not Adjusted for Inflation)												
Forecast	995.6	1,518.2	1,591.3	1,662.7	1,737.4	1,819.4	1,902.6	1,988.5	2,075.8	2,165.2	2,256.8	18,717.9
Baseline	845.0	911.0	961.0	1,008.0	1,056.0	1,110.0	1,164.0	1,220.0	1,279.0	1,340.0	1,404.0	11,453.0
Difference	150.6	607.2	630.3	654.7	681.4	709.4	738.6	768.5	796.8	825.2	852.8	7,264.9

Table 3c CDA 05-06

The Economic and Budgetary Effects of Raising Payroll Tax Rates to Fund HI and SMI Benefits Through 2079, Government Uses New Tax Revenues to Pay Down Debt (cont.)

Federal Budget Indicators	Fiscal Year Average											Total, 2006-2015
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Unified Federal Spending (\$Billions, Not Adjusted for Inflation)												Total
Forecast	2,473.8	2,580.1	2,685.7	2,799.9	2,905.4	3,010.3	3,125.1	3,192.8	3,320.7	3,435.1	3,554.9	30,609.9
Baseline	2,473.1	2,593.0	2,720.0	2,860.0	2,996.0	3,134.0	3,284.0	3,389.0	3,562.0	3,727.0	3,905.0	32,170.0
Difference	0.7	-12.9	-34.3	-60.1	-90.7	-123.8	-158.9	-196.2	-241.3	-291.9	-350.1	-1,560.1
Federal Net Interest Payments (\$Billions, Not Adjusted for Inflation)												Total
Forecast	225.5	228.9	231.9	243.9	247.0	249.2	244.2	231.4	203.9	170.3	127.2	2,178.0
Baseline	225.7	251.3	283.3	319.9	347.3	373.7	393.3	407.3	415.3	424.3	431.9	3,647.6
Difference	-0.3	-22.4	-51.4	-76.0	-100.3	-124.5	-149.1	-175.9	-211.4	-254.0	-304.7	-1,469.6
Unified Federal Surplus/Deficit (\$Billions, Not Adjusted for Inflation)												Total
Forecast	-205.6	146.6	149.9	192.9	261.7	334.2	509.2	714.4	784.6	864.8	939.1	4,897.4
Baseline	-331.3	-311.9	-322.7	-332.5	-319.4	-315.2	-207.2	-75.1	-79.0	-64.9	-54.8	-2,082.5
Difference	125.7	458.5	472.5	525.4	581.0	649.4	716.4	789.4	863.6	929.7	993.9	6,979.9
Privately Held Federal Debt (\$Billions, Not Adjusted for Inflation, End of Third Quarter)												Average
Forecast	4,506.2	4,366.1	4,232.5	4,056.8	3,810.6	3,489.9	3,002.3	2,298.6	1,521.6	663.2	-272.4	2,716.9
Baseline	4,621.0	4,943.0	5,281.0	5,630.0	5,964.0	6,292.0	6,520.0	6,605.0	6,691.0	6,762.0	6,820.0	6,150.8
Difference	-114.8	-576.9	-1,048.5	-1,573.2	-2,153.4	-2,802.1	-3,517.7	-4,306.4	-5,169.4	-6,098.8	-7,092.4	-3,433.9
Privately Held Federal Debt Share (Percent of GDP)												Average
Forecast	36.8	34.1	31.4	28.7	25.7	22.5	18.5	13.5	8.6	3.6	-1.4	18.5
Baseline	37.7	38.1	38.7	39.2	39.5	39.7	39.3	38.1	36.9	35.8	34.6	38.0
Difference	-0.9	-4.0	-7.3	-10.5	-13.8	-17.3	-20.9	-24.6	-28.3	-32.2	-36.0	-19.5

Notes: HI denotes the Hospital Insurance component of Medicare; SMI denotes the Supplementary Medical Insurance (including the new prescription drug benefit) component of Medicare. Some numbers may not add due to rounding. The static change in unified federal tax revenues assumes no macroeconomic behavioral response to an increase in payroll tax rates. A dynamic change in revenues assumes a behavioral response at the macroeconomic level.

Source: Center for Data Analysis, The Heritage Foundation.

Table 4a

CDA 05-06

The Economic and Budgetary Effects of Raising Payroll Tax Rates to Fund HI and SMI Benefits Through 2079, Government Uses New Tax Revenues to Finance Increased Spending

Economic Indicators	Fiscal Year Average											Average, 2006-2015
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Gross Domestic Product (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	11,107.9	11,328.7	11,697.1	12,084.6	12,478.1	12,860.9	13,228.7	13,592.1	13,941.9	14,296.6	14,654.0	13,016.3
Baseline	11,136.6	11,527.7	11,919.3	12,328.8	12,725.3	13,108.3	13,477.6	13,843.0	14,204.2	14,570.5	14,937.1	13,264.2
Difference	-28.7	-199.0	-222.2	-244.2	-247.2	-247.4	-248.9	-251.0	-262.3	-273.9	-283.2	-247.9
Real GDP Growth Rate (Percent Change from Previous Year)												
Forecast	3.4	2.0	3.3	3.3	3.3	3.1	2.9	2.8	2.6	2.5	2.5	2.8
Baseline	3.7	3.5	3.4	3.4	3.2	3.0	2.8	2.7	2.6	2.6	2.5	3.0
Difference	-0.3	-1.5	-0.2	-0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	-0.2
Total Employment (Thousands of Jobs)												
Forecast	132,970	133,851	135,001	136,384	137,794	139,067	140,036	140,892	141,540	142,085	142,488	138,913.7
Baseline	133,073	135,281	137,214	138,958	140,491	141,812	142,845	143,762	144,526	145,219	145,760	141,586.7
Difference	-102.5	-1,429.9	-2,213.0	-2,573.6	-2,696.4	-2,745.6	-2,809.1	-2,870.2	-2,985.8	-3,134.3	-3,272.3	-2,673.0
Private Employment (Thousands of Jobs)												
Forecast	111,219	111,751	112,838	114,044	115,240	116,270	117,177	117,833	118,391	118,839	119,223	116,160.5
Baseline	111,322	113,014	114,639	116,164	117,463	118,540	119,504	120,226	120,904	121,497	122,016	118,396.9
Difference	-102.9	-1,263.4	-1,800.8	-2,120.4	-2,223.0	-2,269.6	-2,327.3	-2,393.7	-2,513.0	-2,658.4	-2,793.6	-2,236.3
Unemployment Rate (Percent of Civilian Labor Force)												
Forecast	5.3	5.9	6.1	6.1	6.0	5.9	5.8	5.6	5.5	5.4	5.4	5.8
Baseline	5.3	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Difference	0.0	0.7	0.9	0.9	0.8	0.7	0.6	0.4	0.3	0.3	0.2	0.6
Disposable Personal Income (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	8,099.6	8,152.8	8,399.1	8,644.1	8,846.2	9,049.6	9,181.8	9,353.1	9,569.3	9,791.2	10,025.7	9,101.3
Baseline	8,181.9	8,483.5	8,776.4	9,096.7	9,346.5	9,596.8	9,764.4	9,964.4	10,213.8	10,464.7	10,718.6	9,642.6
Difference	-82.3	-330.8	-377.3	-452.6	-500.3	-547.2	-582.7	-611.2	-644.5	-673.5	-692.9	-541.3
Disposable Income Per Capita (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	27,352	27,284	27,860	28,423	28,835	29,244	29,418	29,712	30,141	30,581	31,051	29,254.9
Baseline	27,630	28,391	29,111	29,911	30,466	31,012	31,285	31,654	32,171	32,684	33,197	30,988.2
Difference												
per Person	-278	-1,107	-1,251	-1,488	-1,631	-1,768	-1,867	-1,942	-2,030	-2,103	-2,146	-1,733
Difference for												
Family of Four	-1,111	-4,428	-5,006	-5,952	-6,523	-7,073	-7,467	-7,767	-8,121	-8,414	-8,584	-6,750
Personal Consumption Expenditures (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	7,807.1	7,888.7	8,138.6	8,349.3	8,591.2	8,822.1	9,028.9	9,247.1	9,453.1	9,655.0	9,868.6	8,904.2
Baseline	7,836.1	8,075.1	8,368.2	8,627.2	8,892.0	9,139.6	9,359.3	9,587.0	9,806.9	10,022.8	10,247.3	9,212.5
Difference	-29.1	-186.4	-229.6	-277.8	-300.9	-317.5	-330.4	-339.9	-353.8	-367.9	-378.7	-308.3
Gross Private Domestic Investment (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	1,957.7	1,986.9	2,032.8	2,140.4	2,237.3	2,330.5	2,429.6	2,504.0	2,584.5	2,676.8	2,763.6	2,368.6
Baseline	1,964.3	2,063.1	2,088.3	2,181.1	2,263.6	2,346.5	2,440.3	2,507.8	2,587.9	2,679.5	2,764.6	2,392.2
Difference	-6.6	-76.2	-55.5	-40.7	-26.3	-16.0	-10.7	-3.8	-3.3	-2.7	-1.0	-23.6
Non-Residential Investment (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	1,316.7	1,416.1	1,481.7	1,584.5	1,684.5	1,768.3	1,857.1	1,951.5	2,036.4	2,129.0	2,218.8	1,812.8
Baseline	1,318.0	1,451.3	1,519.3	1,602.1	1,688.7	1,765.1	1,850.4	1,940.8	2,025.2	2,117.7	2,206.3	1,816.7
Difference	-1.2	-35.1	-37.7	-17.6	-4.1	3.2	6.6	10.7	11.3	11.3	12.5	-3.9
Residential Investment (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	581.5	569.5	535.5	524.4	529.9	541.3	553.9	550.4	548.3	553.5	560.0	546.7
Baseline	583.1	580.0	550.8	543.8	548.3	557.6	568.1	562.2	558.7	563.4	569.9	560.3
Difference	-1.6	-10.6	-15.3	-19.4	-18.4	-16.3	-14.2	-11.8	-10.4	-9.8	-9.9	-13.6

The Economic and Budgetary Effects of Raising Payroll Tax Rates to Fund HI and SMI Benefits Through 2079, Government Uses New Tax Revenues to Finance Increased Spending (cont.)

Economic Indicators	Fiscal Year Average											Average, 2006-2015
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Change in the Stock of Business Inventories (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	53.0	5.1	128.9	54.1	52.1	54.8	57.7	151.1	158.2	61.3	60.1	48.3
Baseline	56.5	34.9	30.5	54.6	51.8	53.4	56.7	49.9	58.9	62.1	60.1	51.3
Difference	-3.5	-29.7	-1.6	-0.5	0.3	1.4	0.9	1.2	-0.7	-0.8	0.0	-3.0
Full-Employment Capital Stock (\$Billions, Inflation-Adjusted, Indexed to the 2000 Price Level)												
Forecast	12,592.6	13,139.1	13,690.6	14,230.7	14,806.4	15,399.4	15,983.5	16,577.2	17,171.3	17,776.0	18,393.8	15,716.8
Baseline	12,593.0	13,162.9	13,742.6	14,289.8	14,859.2	15,438.8	16,010.8	16,590.7	17,170.8	17,763.8	18,370.5	15,740.0
Difference	-0.4	-23.8	-52.0	-59.1	-52.8	-39.4	-27.3	-13.5	0.5	12.2	23.3	-23.2
Consumer Price Index (Percent Change from Previous Year)												
Forecast	3.2	3.0	2.3	2.1	1.9	1.8	1.7	1.7	1.7	1.7	1.7	2.0
Baseline	3.2	2.7	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.3
Difference	0.0	0.3	0.1	-0.1	-0.3	-0.4	-0.5	-0.5	-0.5	-0.5	-0.5	-0.3
Treasury Bill, 3 Month (Annualized Percent)												
Forecast	2.6	2.5	2.9	3.3	3.4	3.4	3.4	3.4	3.4	3.5	3.5	3.3
Baseline	2.7	3.6	4.3	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.5
Difference	-0.1	-1.1	-1.3	-1.3	-1.4	-1.3	-1.3	-1.3	-1.3	-1.3	-1.2	-1.3
Treasury Bond, 10 Year (Annualized Percent)												
Forecast	4.2	4.0	4.8	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	4.9
Baseline	4.3	4.6	5.2	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.3
Difference	-0.1	-0.6	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Federal Funds Rate (Annualized Percent)												
Forecast	2.6	2.8	2.6	2.9	3.4	3.5	3.6	3.6	3.6	3.7	3.8	3.4
Baseline	2.7	4.0	4.1	4.4	4.9	5.0	5.0	5.0	5.0	5.0	5.0	4.7
Difference	-0.1	-1.2	-1.5	-1.5	-1.5	-1.5	-1.4	-1.4	-1.4	-1.3	-1.2	-1.4
Federal Budget												
Indicators	Fiscal Year Average											Total, 2006-2015
Unified Federal Tax Revenue (\$Billions, Not Adjusted for Inflation)												
Forecast	2,268.1	2,728.1	2,837.0	2,994.5	3,167.2	3,339.7	3,620.7	3,883.6	4,073.4	4,261.0	4,451.0	35,356.1
Baseline	2,141.8	2,281.1	2,397.4	2,527.5	2,676.7	2,818.8	3,076.8	3,313.9	3,483.0	3,662.1	3,850.2	30,087.5
Difference	126.3	447.0	439.6	466.9	490.5	520.9	543.8	569.7	590.4	598.9	600.8	5,268.6
Change in Unified Federal Tax Revenue (\$Billions, Not Adjusted for Inflation)												
Static Change												
to Tax Revenue	152.6	633.6	670.0	704.8	740.5	777.7	816.7	856.3	895.9	936.9	977.5	8,009.8
Dynamic Change												
to Tax Revenue	126.3	447.0	439.6	466.9	490.5	520.9	543.8	569.7	590.4	598.9	600.8	5,268.6
Revenue Feedback	-26.2	-186.7	-230.4	-237.8	-250.0	-256.7	-272.8	-286.7	-305.5	-338.0	-376.7	-2,741.2
Feedback Percent	-17.2%	-29.5%	-34.4%	-33.7%	-33.8%	-33.0%	-33.4%	-33.5%	-34.1%	-36.1%	-38.5%	-34.2%
Federal Personal Tax Collections (\$Billions, Not Adjusted for Inflation)												
Forecast	902.6	959.8	1,023.1	1,103.2	1,189.7	1,283.3	1,483.3	1,635.2	1,748.1	1,847.6	1,946.6	14,219.9
Baseline	905.0	992.0	1,070.0	1,150.0	1,235.0	1,323.0	1,520.0	1,664.0	1,769.0	1,873.0	1,983.0	14,579.0
Difference	-2.4	-32.2	-46.9	-46.8	-45.3	-39.7	-36.7	-28.8	-20.9	-25.4	-36.4	-359.2
Federal Payroll Tax Receipts (\$Billions, Not Adjusted for Inflation)												
Forecast	995.6	1,518.0	1,589.9	1,659.4	1,731.3	1,808.9	1,885.7	1,963.3	2,041.6	2,121.4	2,203.2	18,522.7
Baseline	845.0	911.0	961.0	1,008.0	1,056.0	1,110.0	1,164.0	1,220.0	1,279.0	1,340.0	1,404.0	11,453.0
Difference	150.6	607.0	628.9	651.4	675.3	698.9	721.7	743.3	762.6	781.4	799.2	7,069.7

Table 4c

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The Economic and Budgetary Effects of Raising Payroll Tax Rates to Fund HI and SMI Benefits Through 2079, Government Uses New Tax Revenues to Finance Increased Spending (cont.)

Federal Budget Indicators	Fiscal Year Average											Total, 2006-2015
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Unified Federal Spending (\$Billions, Not Adjusted for Inflation)												Total
Forecast	2,626.3	3,229.5	3,399.6	3,580.9	3,754.5	3,926.7	4,108.3	4,243.2	4,440.4	4,629.4	4,836.6	40,149.0
Baseline	2,473.1	2,593.0	2,720.0	2,860.0	2,996.0	3,134.0	3,284.0	3,389.0	3,562.0	3,727.0	3,905.0	32,170.0
Difference	153.3	636.5	679.6	720.9	758.5	792.7	824.3	854.2	878.4	902.4	931.6	7,979.0
Federal Net Interest Payments (\$Billions, Not Adjusted for Inflation)												Total
Forecast	225.5	244.7	275.9	320.9	357.6	392.7	420.0	441.8	454.2	467.2	486.3	3,861.4
Baseline	225.7	251.3	283.3	319.9	347.3	373.7	393.3	407.3	415.3	424.3	431.9	3,647.6
Difference	-0.3	-6.6	-7.4	1.0	10.3	19.0	26.7	34.5	38.9	42.9	54.4	213.8
Unified Federal Surplus/Deficit (\$Billions, Not Adjusted for Inflation)												Total
Forecast	-358.2	-501.4	-562.6	-586.5	-587.4	-587.0	-487.6	-359.6	-366.9	-368.4	-385.6	-4,792.9
Baseline	-331.3	-311.9	-322.7	-332.5	-319.4	-315.2	-207.2	-75.1	-79.0	-64.9	-54.8	-2,082.5
Difference	-26.9	-189.5	-239.9	-254.0	-268.0	-271.8	-280.5	-284.5	-288.0	-303.5	-330.8	-2,710.4
Privately Held Federal Debt (\$Billions, Not Adjusted for Inflation, End of Third Quarter)												Average
Forecast	4,645.6	5,155.7	5,733.4	6,336.0	6,937.6	7,536.9	8,044.7	8,413.4	8,786.3	9,159.4	9,546.3	7,565.0
Baseline	4,621.0	4,943.0	5,281.0	5,630.0	5,964.0	6,292.0	6,520.0	6,605.0	6,691.0	6,762.0	6,820.0	6,150.8
Difference	24.6	212.7	452.4	706.0	973.6	1,244.9	1,524.7	1,808.4	2,095.3	2,397.4	2,726.3	1,414.2
Privately Held Federal Debt Share (Percent of GDP)												Average
Forecast	37.9	40.3	42.6	44.9	46.9	48.8	49.9	50.2	50.5	50.7	50.9	47.6
Baseline	37.7	38.1	38.7	39.2	39.5	39.7	39.3	38.1	36.9	35.8	34.6	38.0
Difference	0.3	2.2	3.9	5.7	7.4	9.0	10.6	12.1	13.5	14.9	16.3	9.6

Notes: HI denotes the Hospital Insurance component of Medicare; SMI denotes the Supplementary Medical Insurance (including the new prescription drug benefit) component of Medicare. Some numbers may not add due to rounding. The static change in unified federal tax revenues assumes no macroeconomic behavioral response to an increase in payroll tax rates. A dynamic change in revenues assumes a behavioral response at the macroeconomic level.

Source: Center for Data Analysis, The Heritage Foundation.

The Heritage Center for Data Analysis

The CDA has created one of the largest collections of privately held public policy databases in the United States, which the Center employs to analyze policy changes ranging from taxes to welfare. The Center constructs these databases largely from publicly available federal data on important economic, social, and cultural aspects of American life. These databases frequently are used to estimate the likely effects of policy changes on such key dimensions of everyday life as marriage rates, income growth, educational attainment, and retirement decisions.

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