

SOURCES AND ASSUMPTIONS FOR PROJECTED OPTIONS

The following discussion sets out the sources and assumptions that Commission Staff relied on in projecting the effects of the options analyzed in this document. Those sources and assumptions fall into two general categories. The first two sections list certain baseline assumptions that affect the projections of all options. The remaining sections review the sources and assumptions on which the staff based its analysis of particular categories of options, such as changes to Social Security and Medicare or options to reduce tax expenditures.

BASELINE ASSUMPTIONS

Macroeconomic and Demographic Assumptions

— The macroeconomic and demographic assumptions that underlie staff projections were taken from the *1994 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (OASDI Trustees' Report), including annual unpublished data.

— In particular, the baseline levels of outlays and receipts are based on projections of gross domestic product (GDP), real growth in average wages, the consumer price index (CPI), interest rates, population, life expectancies, and other related variables drawn from the “intermediate assumptions” set out in the OASDI Trustees' Report, which are the Office of the Actuary in the Social Security Administration's (the SSA actuaries) “best estimates.”

Baseline Outlay and Revenue Assumptions

— Baseline projections are projections of outlays and receipts that would result in the future if current law is not changed.

— The baseline outlay and revenue assumptions are identical to those incorporated in the *Bipartisan Commission on Entitlement and Tax Reform: Interim Report to the President*, August 1994 (the Interim Report).

— In the Interim Report, Social Security, Medicare Part A-Hospital Insurance (HI), and Medicare Part B-Supplementary Medical Insurance (SMI) outlay assumptions were taken from the OASDI Trustees' Report, the *1994 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund*, and the *1994 Annual Report of the Board of Trustees of the Federal Supplementary Medical Insurance Trust Fund* (Medicare Trustees' Reports), respectively. Commission staff used the “intermediate projections” drawn from those sources.

— The projected baseline revenue assumptions for payroll taxes and premium receipts for Medicare were also drawn from the OASDI Trustees' Report and the Medicare Trustees' Reports. The

Medicare Trustees' Reports, in turn, based their projections of HI and SMI outlays and receipts on the Social Security Trustees' projections of macroeconomic variables. The Medicare Trustees' Reports based projected levels of Medicare outlays on the assumption that Medicare charges per enrollee would grow at the same rate as per capita GDP after 2018.

— For the years 1995 through 2004, baseline Medicaid outlay assumptions rely on Congressional Budget Office (CBO) projections in the CBO publication entitled *The Economic and Budget Outlook: Fiscal Years 1995-1999* (January 1994). For the years 2005 through 2030, the staff outlay assumptions are based on the OASDI Trustees' Report's projections of population and the Medicare Trustees' Reports' projections of per capita health care costs.

— Baseline revenue assumptions rely on the OASDI Trustees' Report's projected GDP and CPI levels for 1994 through 2070, the trend in revenues as a share of GDP projected by CBO in *The Economic and Budget Outlook: Fiscal Years 1995-1999* (January 1994) for the years 1994 through 1999, and the extrapolation of that trend for 2000 and thereafter.

OPTION ASSUMPTIONS³⁵

Macroeconomic and Demographic Assumptions for the Options

— The macroeconomic and demographic assumptions that underlie staff projections of Federal budget savings resulting from the options were taken from the OASDI Trustees' Report, including annual unpublished data.

— In particular, the effects of options on outlays and receipts are based on projections of gross domestic product (GDP), real growth in average wages, the consumer price index (CPI), interest rates, population, life expectancies, and other related variables drawn from the "intermediate assumptions" set out in the OASDI Trustees' Report.

Outlay and Revenue Assumptions under the Options

— The effects of options to change outlays and/or revenues are measured against the baseline projections of outlays and revenues. The projected effects of the options may not adequately capture changes in beneficiary and/or taxpayer behavior over a long period of time. (Except for options affecting Social Security, they are 35-year projections based on short-term (one- to five-year) estimates of options. In addition, interactions between proposals are not included in these projections. The interactions could be sizeable. *Budget Shadows*, the computer game, does include limited interactions between proposals.)

³⁵ See also Interim Report to the President, Bipartisan Commission on Entitlement and Tax Reform (August 1994), p. 20, for more detail on baseline assumptions.

— Social Security, Medicare Part A-Hospital Insurance (HI), and Medicare Part B-Supplementary Medical Insurance (SMI) outlay assumptions were taken from the OASDI Trustees' Report and the Medicare Trustees' Reports, respectively. Commission Staff used the "intermediate projections" drawn from those sources.

— The assumptions for payroll taxes and premium receipts for Medicare were also drawn from the OASDI Trustees' Report and the Medicare Trustees' Reports. The Medicare Trustees' Reports, in turn, based their projections on the Social Security Trustees' projections of macroeconomic variables. The Medicare Trustees' Reports based projected levels of Medicare outlays on the assumption that Medicare charges per enrollee would grow at the same rate as per capita GDP after 2018.

— For the years 1995 through 2004, baseline Medicaid outlay assumptions rely on Congressional Budget Office (CBO) projections in the CBO publication entitled *The Economic and Budget Outlook: Fiscal Years 1995-1999* (January 1994). For the years 2005 through 2030, the Staff based outlay assumptions on the OASDI Trustees' Report's projections of population and the Medicare Trustees' Reports' projections of per capita health care costs.

— Baseline revenue assumptions rely on the OASDI Trustees' Report's projected GDP levels and the trend in revenues as a share of GDP projected by CBO in *The Economic and Budget Outlook: Fiscal Years 1995-1999* (January 1994).

Macroeconomic Effects of Options

— The Staff based the projected outlay and revenue effects on the assumption that net national savings and economic growth are not affected by the options. While Staff acknowledges the beneficial effects of lower deficits and reduced Federal borrowing on such factors, the magnitude of the change could not be projected with sufficient accuracy. Furthermore, Staff assumed that increases in payroll taxes do not change total compensation and, therefore, do not affect employment levels.

Federal Civil and Military Retirement Option Assumptions

— The Staff projected outlay reductions from options affecting civil retirement benefits based on information from the annual *Demographic Profile of the Federal Workforce* (September 30, 1992) and the *Civil Service Retirement and Disability Fund: An Annual Report to Comply with the Requirements of Public Law 95-595* (September 30, 1992), both published by the United States Office of Personnel Management (OPM).

— The Staff projected outlay reductions from options to reform military pensions based on the data in *Valuation of the Military Retirement System* (September 30, 1993), published by the Department of Defense's (DOD) Office of the Actuary, and supplementary information supplied by actuaries at OPM and DOD.

Federal Health Care Program Option Assumptions

— The Staff projected savings from options to reduce benefits and/or increase the standard monthly Medicare premiums based on a combination of (1) the program's baseline outlay and receipt assumptions incorporated in the Medicare Trustees' Reports, and (2) supplementary information on the distribution of per capita benefits drawn from the Bureau of the Census's *Current Population Survey* (CPS), which was tabulated by CBO.

— The Staff's projected Medicare savings include an offset for increased Medicaid outlays that would result from increases in premiums, deductibles, and/or coinsurance rates. Based on the assumptions: (1) that 15 percent of Medicare enrollees are eligible for Medicaid, and (2) that the Federal government's share of Medicaid expenditures averages 57 percent, the offset equals 8.55 percent of the Medicare savings otherwise generated by a particular option. The offset is the same as the one used by CBO for its estimates of Medicare reform options.

— The Staff based projected savings from options that index Medicare premiums or deductibles on projected per capita costs for aged enrollees on data drawn from the Medicare Trustees' Reports.

— Options that increase premiums and/or deductibles do not include behavioral effects that might reduce the level of medical services used by Medicare enrollees. These effects were not included because a large portion of current Medicare enrollees have medical insurance in addition to Medicare. In most cases, this insurance could provide first-dollar coverage for increased cost sharing under the options and would, therefore, not affect beneficiaries' use of medical services.

— Options requiring coinsurance for home health and clinical laboratory services equate to a marginal price increase for beneficiaries that the Staff assumes would result in beneficiaries reducing their use of these services. In addition, the Staff also assumed in projecting outlay reductions that health care providers are able to offset 10 percent of this reduction in services. These two adjustments, taken together, reduce services by about 8 percent compared to their baseline levels. These adjustments are the same ones that CBO uses when it estimates similar proposals.

— For the years 1995 through 1999, the Staff projected savings from options that would tax the insurance value of Medicare benefits based on Joint Committee on Tax (JCT) estimates. For the years 2000 through 2030, the Staff projected savings from these options as a share of GDP based on the trend in the 1995-1999 estimates. These projections were reviewed by CBO.

— For the years 1995 through 1999, the Staff obtained projections of outlay savings from CBO for options to reduce Medicare and Medicaid provider payments. For the years 2000 through 2030, the Staff projected outlay savings from these options based on methodology suggested by CBO analysts.

— The Staff projected the outlay effects of raising the Medicare eligibility age based on information obtained from the Health Care Financing Administration (HCFA) actuaries for the years 1995 through 2030. These projections include an offset in SMI premiums that result from the options. The projections incorporate the assumption that people affected by this option would defer seeking treatment for three months. These projections also assume that of the people affected by these options, 12 percent would become eligible for Disability Insurance and 31 percent would become eligible for Medicaid. Taken together, these assumptions reduce the projected savings by about 45 percent.

— The Staff projected increased revenues from options to increase the HI payroll tax rate based on information from HCFA's Office of the Actuary. Increases in payroll taxes reduce income tax revenues by lowering employer profits or by lowering workers' wages. This effect is known as the "payroll tax offset." The Staff took this effect into account by reducing the revenue effects of options that raise payroll taxes. The offset equals 10 percent for options affecting both the employer and employee. If the option affects only the employer, the offset equals 20 percent. The offset is a standard revenue estimating convention used by CBO, the JCT, and the Department of the Treasury's Office of Tax Analysis.

Social Security Option Assumptions

— With certain exceptions, the effects of various options affecting Social Security outlays and/or revenues were projected by the Office of the Actuary in the Social Security Administration (SSA actuaries). These projections take into account interactions between the Old Age and Survivors Insurance (OASDI) program and the Disability Insurance (DI) program. They do not take into account potential interactions with the other programs, such as Supplementary Security Income and Medicaid. *Budget Shadows* does not include interactions between options affecting OASDI and other government programs.

— The Commission Staff projected effects of the proposal to limit OASDI benefits for high-income benefit recipients based on the CPS, as tabulated by CBO. (The SSA actuaries projected the effects of means testing OASDI benefits under the Concord Coalition proposal.) The Staff projections assume that beneficiaries' real incomes increase at a 1 percent annual rate (the same assumption used by the SSA actuaries). The projected savings take into account the offsetting reduction in individual income tax revenues resulting from the taxation of Social Security benefits.

— The Commission Staff projected effects of options to reduce cost-of-living adjustments (COLAs) for OASDI benefits, as discussed in the Comprehensive Reform Option section below.

— The Staff projected increased revenues resulting from options that would raise Social Security payroll taxes based on information from the SSA actuaries. In making these projections, the Staff

assumed the “payroll tax offset” effect, as discussed in the Federal Health Care Program Option Assumptions section above.

— The Staff projected increases in payroll taxes for the options to tax all wages earned in covered OASDI employment (repeal the taxable maximum) based on the projected levels of effective taxable payroll from the Trustees’ Report and based on the projected ratios of covered wages to total wages for OASDI and HI and taxable wages to covered wages for OASDI contained in *Economic Projections for OASDHI Cost and Income Elasticities: 1992*, (Actuarial Study No.108), Office of the Actuary in the Social Security Administration.

— The Staff projected increases in payroll taxes for the option to treat a portion of employer-provided fringe benefits as wages for the purposes of the employer’s share of the Social Security payroll taxes based on projected levels of effective taxable payroll from the Trustees’ Report and based on the ratio of wages to compensation from Actuarial Study No. 108.

Comprehensive Reform Option Assumptions

COLAs

— The COLA options include reductions in Social Security, Railroad Retirement Tier I, Federal retirement programs and veterans’ compensation. Veterans’ pensions are excluded from these options along with other means-tested benefits.

— In projecting savings in Social Security from options to modify COLAs, the Staff based savings from reductions in Social Security benefit payments due to the COLA changes on information from the SSA Actuaries, consistent with their projections of the effect of reducing COLAs by 0.5 percentage points each year.

— For the years 1995 through 1999, Staff developed outlay reductions for Federal retirement programs and veterans’ compensation based on baseline benefit payments contained in the *Budget of the United States Government, Fiscal Year 1995*. The Staff adjusted these projections to make them consistent with the OASDI Trustees’ Report’s projections of the CPI.

— For the years 2000 through 2030, Staff based outlay reductions on the projected number of beneficiaries and projected real growth rates in benefits obtained from the Office of Management and Budget. The Staff adjusted these projections to make them consistent with the OASDI Trustees’ Report’s projections of the CPI.

Means Test Non-Means-Tested Benefits

— The Staff projected savings from options to means test benefits that are not currently means tested based on information from the CPS tabulated by CBO. These projections assume that real incomes of benefit recipients increase at a 1 percent annual rate (the same assumption used in the OASDI Trustees' Report). Because OASDI benefits and Railroad Retirement Tier I benefits are already taxed, the projected savings take into account an offset for reduced individual income tax revenues from the taxation of these benefits.

Taxation of Benefits

— The Staff projected increases in individual income tax revenues from taxing non-means-tested benefits based on information provided by the JCT, which included estimates for the years 1995 through 1999. Taxing non-means-tested benefits would affect Social Security, Medicare, and veterans' compensation benefits under this option. The projections assume that the increased revenue derived from taxing these benefits would yield 20 percent more revenue than the sum of revenue effects derived from taxing these benefits separately. This increase in projected revenues results from the potential effect of the accumulated additions to a taxpayer's adjusted gross income pushing the taxpayer into a higher tax bracket.

Cap Entitlements

— The Staff projected savings from comprehensive options to cap spending on entitlements, other than Social Security, Medicare, Medicaid, and Federal employee pensions, using the OASDI Trustees' Report's projections of the CPI and population growth to determine the cap. The options to reduce and cap entitlement spending use CBO projections of spending for 1999.

Tax Expenditure Option Assumptions

— For the years 1995 through 1999, the Staff projected increases in revenues from options that reduce or eliminate tax expenditures based on information provided by the JCT and from tax expenditure estimates contained in *Analytical Perspectives, Budget of the United States Government, Fiscal Year 1995*. For the years 2000 through 2030, the Staff based projected savings on trends measured against baseline individual income tax projections, which in turn are based on the OASDI Trustees' Report's projections of GDP.