



Federal Liabilities: They're Bigger than You May Think

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Tracking the federal debt has never been easier. Websites, apps, and billboards provide instantaneous updates. Most of these venues track both the debt held by the public, currently \$12.8 trillion, as well as the gross debt outstanding, currently \$17.8 trillion. The latter includes intergovernmental holdings – primarily comprised of the Social Security Trust Fund. But, most Americans have a hard time making sense of the sheer size of these numbers or determining which of the numbers provides the best indication of the federal government debt.

Among economists there is limited agreement on whether current federal debt is too big or on the best way to talk about federal indebtedness in the first place. Let's begin with the \$12.8 trillion current debt held by the public. In historical context the current debt as a share of the nation's economy, at 74%, is at its highest level in the post-war period.

Recent projections from the Congressional Budget Office suggest that the debt will remain at about this share of GDP for the next ten years.

Is this a problem? It will be if the cost of servicing the debt increases significantly. Even though the debt to GDP ratio is at historical highs the federal government's real borrowing rate is at historical lows making debt serving manageable. However, even a modest rise in the real interest rate will result in a substantial increase in interest expenses. Beyond the expense of servicing the debt, there are other less tangible, but just as important economic costs associated with rising federal debt. These economic costs are primarily in the form of foregone investment. Government bond holders could have invested in productive capital.

Further, the debt held by the public is just the tip of the feder-

al liability iceberg. To see this we must distinguish between traditional liabilities, or commitments arising from past governmental actions, and commitments that result from actions that may be taken in the future. For example, the debt held by the public is definitely a liability because it arises from past deficits and will require future resources. But often actions taken by Congress have no immediate effect on federal deficits so do not increase the debt held by the public, but will have effects on future deficits.

An example is federal employees' accrued, but not yet paid retirement benefits – both accrued pension benefits and accrued health care benefits – and several other smaller categories. And, as we suggest here, the federal governments' liabilities should also include some portion of accrued Medicare and Social Security benefits.

The "official" liabilities of the

federal government are presented each year in the Financial Report of the United States Government (FRUSG). The liabilities reported in the FRUSG at this time last year included \$12 trillion in debt held by the public, \$6.5 trillion in federal civilian and military employees' accrued pension benefits and other retirement and disability benefits, and \$1.3 trillion in other liabilities, producing total liabilities of \$19.9 trillion.

It is important to note that the federal employees' accrued retirement benefits and other liabilities are equal to 65 percent of the more familiar debt held by the public. Thus, the official liabilities are significantly bigger than the debt held by the public, but this measure still does not include a comparable measure of accrued Social Security and Medicare benefits.

Accounting for the intergenerational burdens of Social Security and Medicare has evolved over time. One possible accounting is the use of the aforementioned \$17.8 trillion gross federal debt rather than the debt held by the public because it includes the intergovernmental debts in the trust funds. However, though the intergovernmental debts are part of the gross debt measure they are not included as liabilities when the federal accounts are consolidated. The securities in these accounts are assets of the respective programs, but are also liabilities to the Treasury, and offset each other in the consolidated financial statements.

Alternatively, most reporting of the intergenerational burdens of Social Security and Medicare relies on estimates of the programs' unfunded obligations. These measures are definitely warranted and provide a comprehensive understanding of the resources necessary to cover the government's future commitments assuming the continuation of current policies.

In each case, the unfunded obligation begins with the difference between the present values of future expenditures and future revenues for a particular time horizon, 75 years or the infinite horizon. The current value for the Trust Fund partially offsets this amount, producing the unfunded obligation.

The calculation of the unfunded obligation is subject to the assumptions made about future economic conditions, demographic changes, and in the case of Medicare the all-important rate of per capita health care spending growth and its relation to per capita income growth. Further, these calculations assume that the programs continue into the indefinite future and thus include projected payments and revenues to and from current and future participants.

Our emphasis is much simpler and less controversial. We focus on accrued Social Security and Medicare benefits payable to current retirees because they conform to the definition of a liability and are comparable in nature to federal employees' accrued retirement benefits. Importantly, the estimates are

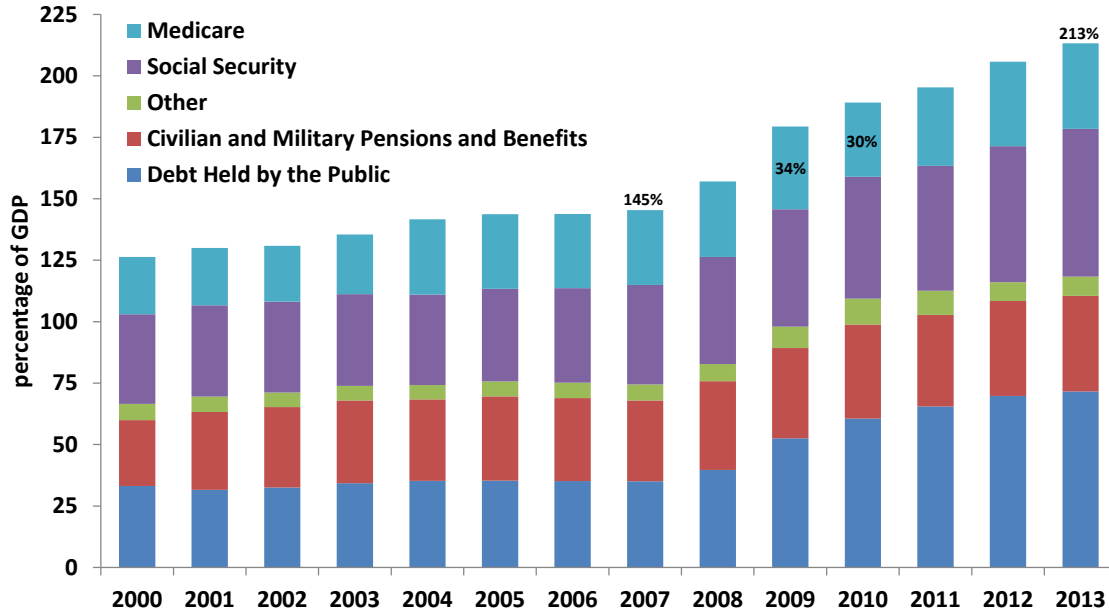
available each year in the FRUSG's Statement of Social Insurance.

The accrued Social Security and Medicare benefits payable to current retirees are modestly affected by major reforms, partly because the changes are phased in over a period of years. These accrued benefits, like the accrued retirement benefits of federal workers, represent liabilities that arise from prior actions and are likely to be paid. Most Social Security and Medicare reform proposals do not affect current beneficiaries and even the sizable reduction in the long run Medicare unfunded obligations that resulted with the scoring of the Affordable Care Act (ACA), did not substantially reduce the accrued Medicare benefits expected by current retirees.

The adjacent figure illustrates the proposed total federal liabilities measure as a percent of GDP for the years 2000 to 2013. The fact that retirees' accrued Medicare benefits only declined from 34% to 30% of GDP between 2009 and 2010 with the passage of the ACA illustrates the modest responsiveness of these liabilities after a major reform. In contrast, Medicare's Part A 75-year unfunded obligation dropped substantially from \$13.4 to \$2.4 trillion between 2009 and 2010!

The figure also indicates that prior to the recession the combined liabilities were 145% of GDP and rose to 213%. The increase in the debt held by the public accounts for 54% of the growth in the share of GDP from 2007 to 2013 and the accrued Social Security benefits of

Federal Liabilities and Accrued Social Security and Medicare Benefits Payable to Participants Who Have Attained Eligibility Age as a Percentage of GDP



Sources: Financial Reports of the United States Government (2000-2013). GDP from the Bureau of Economic Analysis.

retirees account for 29%.

These liabilities can also be thought of in terms of the tax revenues necessary to pay them off. It would take more than a dozen years to retire the liabilities assuming that federal tax revenues remain at 17.3% of GDP – their 50-year average.

The FRUSG identified liabilities totaling \$19.9 trillion as of September 30, 2013. Adding the \$16 trillion in accrued Social Security and Medicare benefits payable to current retirees produces a total of \$35.8 trillion in federal liabilities based on prior actions. The Social Security and Medicare benefits payable to current retirees are larger than the debt held by the public and are 45% of the total liabilities that include them.

We have argued that the Social

Security and Medicare benefits accrued by current retirees provide a conservative estimate of the programs’ liabilities. They are definitely obligations of the government resulting from prior actions that will require financial resources. These accrued benefits were modestly affected by past reforms and current proposals targeting long-run solvency will have limited impact on the size of the liabilities.

They are also large. Together they exceed the debt held by the public and are 80% the size of the official federal liabilities reported in the FRUSG. Finally, they are relevant to policy makers and the public. These are the benefits on which retirees rely and retirees are politically motivated to assure that their benefits are not reduced.

The accrued benefits appear in

the FRUSG’s Statement of Social Insurance but they deserve added attention. The added attention of reporting them as liabilities complements the forward-looking unfunded obligation measures by distinguishing between the obligations that retirees are already receiving and those that are payable to future retirees that are more susceptible to future reforms.

Access the full study “Federal Liabilities: Past Actions with Future Consequences” on PERC’s webpage at perc.tamu.edu/perc/Publication/policybrief/report_5_2014.pdf





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