



Prior Commitments

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Most of us have at some point responded to an invitation with a sentence like this: “I regret that I will not be able to attend due to a prior commitment.” And if you have not responded in this way, you have probably received such a response to an invitation you have extended. Life is full of constraints both on our

time and on our resources.

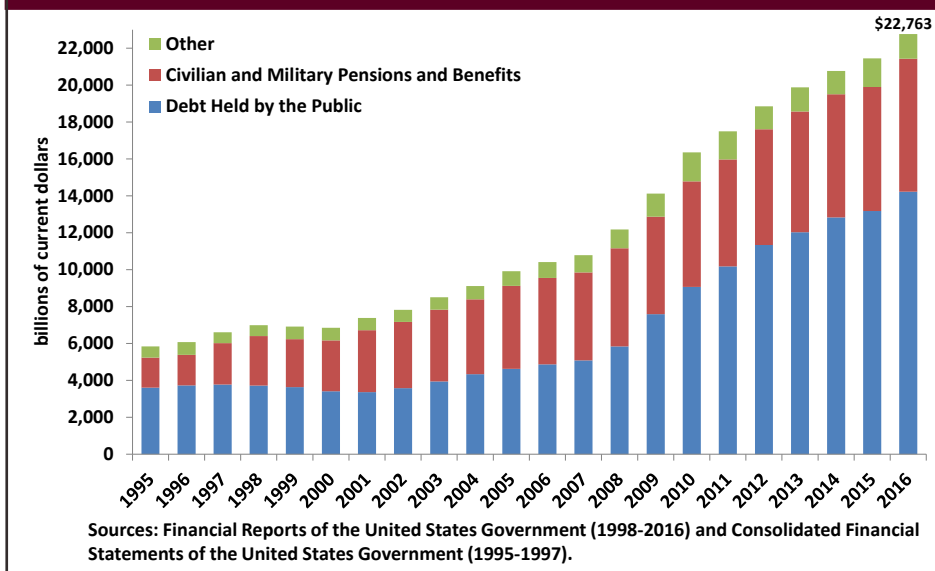
Prior actions constrain how much we can spend out of our paychecks each month. In addition to ongoing expenses like electric and gas bills, grocery purchases, and payments to the orthodontist, you may also have house or car payments. Your home provides you and your

family shelter and your car provides transportation services, and paying them off constrains how much you have left over for other purchases.

Similarly, paying off federal and state government liabilities constrain how much tax revenues are left over for other government spending. But, we may wonder whether these liabilities actually constrain spending. At the federal level, it seems that spending is not constrained by tax revenues, given the willingness to run deficits. The federal government has run a surplus in only five of the last 50 years. Over the past 9 years federal deficits have averaged more than \$900 billion per year and the debt held by the public now stands at \$14.2 trillion, equal to 77% of the nation’s gross domestic product (GDP).

The balance sheet of a firm should give its shareholders an honest picture of the firm’s commitments for the future. And a candid government’s balance sheet could and should perform the same function giving the government’s share-

Figure 1. Liabilities of the US Government



holders, taxpayers, a truthful picture of their future commitments. But is the reported \$14.2 trillion debt held by the public the best indicator of the accumulated commitments of the federal government based on its prior actions? If not, what are the alternatives?

One alternative is the gross federal debt, which includes bonds held in various trust funds – primarily the trust funds of the Social Security and Medicare programs. The gross federal debt is now approaching \$20 trillion, an amount equal to 105% of GDP. The gross debt is essentially equal to the debt subject to the debt limit. And recently, Treasury Secretary Steven Mnuchin expressed optimism that Congress will raise the debt limit in the next few months so that government can continue to run deficits.

Even the larger gross federal debt does not provide a complete picture of federal government commitments for the future. While the gross debt recognizes the bonds held in the trust funds as commitments of future resources, it underestimates just how many chits the federal government has out on the table.

To move to a comprehensive balance sheet, let’s begin with the definition of liabilities from the annual Financial Report of the US Government (FRUSG): liabilities are obligations of the Government resulting from prior actions that will require future financial resources.

With this definition, the tally of liabilities reported in the 2016 FRUSG came to \$22.8 trillion. These liabilities include the debt held by the public of \$14.2 trillion

along with \$7.2 trillion in accrued pensions and benefits payable to military and civilian employees, and \$1.3 trillion in other liabilities. Figure 1 presents the Federal government’s liabilities from 1995 to 2016. The uptick in the debt held by the public due to the great recession is evident from this figure.

In consolidating across the entire federal government, the inter-governmental debts, such as the Social Security and Medicare Trust Funds, cancel each other out as the Trust Funds are assets to the programs but are liabilities of the federal government. When consolidated in the FRUSG they offset each other. However, this consolidation does not make the commitments to pay benefits to current retirees go away.

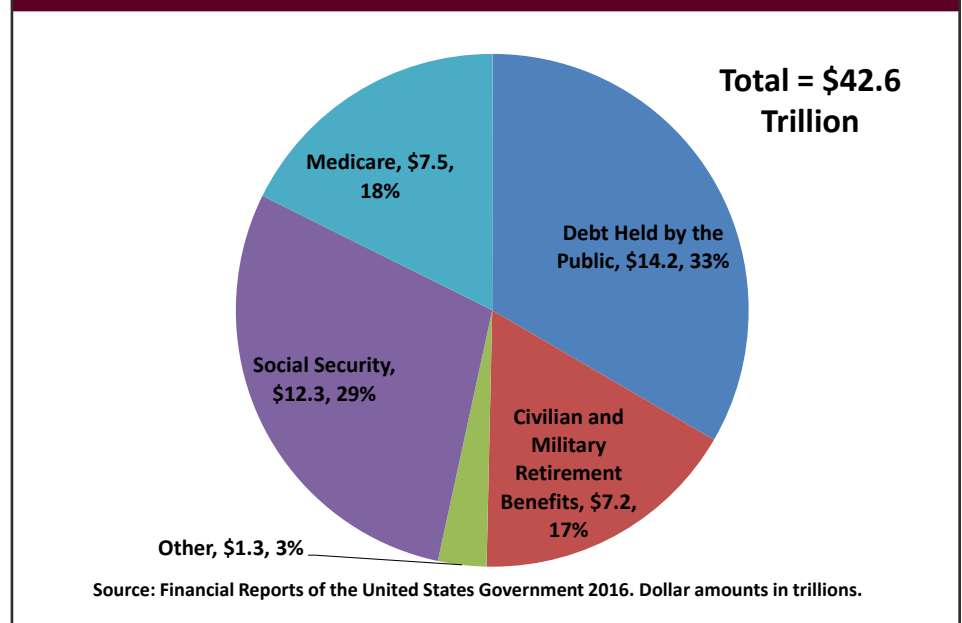
We propose a more complete statement of future taxpayer com-

mitments that recognizes that current retirees are likely to receive their accrued Social Security and Medicare benefits in full.

The logic is as follows. First, these accrued benefits meet the definition of liabilities – they are based on prior actions that require future financial resources. Second, the accrued amounts are comparable to accrued civilian and military pensions and benefits that are already included as federal liabilities. Third, reporting these liabilities provides a more complete picture of future taxpayer commitments. Fourth, while program reforms are possible, the accrued benefits of current retirees are not substantially reduced by most reforms currently under discussion.

The FRUSG does not ignore the financial status of the Social Security and Medicare programs but they

Figure 2. Composition of Federal Liabilities Including Accrued Social Security and Medicare Benefits Payable to Participants Who Have Attained Eligibility Age, 2016





are separately reported in the Statement of Social Insurance (SOSI). Convenient for our purposes, the SOSI reports benefits payable to participants who have reached the programs' eligibility ages. Given that they are conceptually comparable to the accrued retirement benefits payable to civilian and military personnel it makes sense to consider adding them to the other liabilities.

As of 2016, accrued Social Security benefits payable to retirees were \$12.3 trillion and net Medicare benefits were \$7.5 trillion. These combined accrued retirement benefits totaled \$19.8 trillion, 40% higher than the debt held by the public and an amount that is 87% the size of the official liabilities. The relative size of the accrued retirement benefits, in conjunction with the official liabilities, are shown in Figure 2. Altogether, the official liabilities and these proposed additions came to

\$42.6 trillion.

Figure 3 depicts the liabilities of the federal government combined with current retirees' accrued Medicare and Social Security benefits as percentages of GDP from 2000 to 2016. Clear from the figure is the growth in these "prior" commitments as a percentage of GDP, especially since the start of the great recession. They were equal to 145% of GDP as of 2007, and rose to 229% of GDP by 2016.

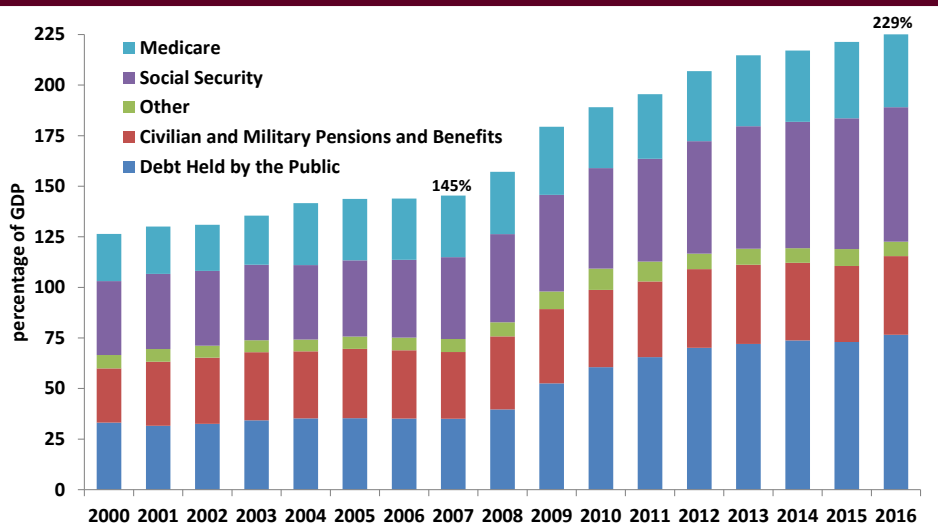
The primary opposition to including accrued Medicare and Social Security benefits as liabilities of the federal government is that workers and retirees do not have a legal claim to the receipt of the benefits. For a number of years, *Analytical Perspectives*, a companion document to the annual federal budget, stated that "the Government has unilaterally decreased as well as increased these benefits in the past, and future

reforms could alter them again," and "There is no bright line dividing Medicare, Medicaid, and Social Security from other programs that promise benefits to people, and all the Government programs that do so should be accounted for similarly."¹

The bright line we propose to draw is between the Social Security and Medicare benefits that are already expected by and being paid to current retirees and the benefits that are expected by all other current as well as future participants in the programs. Accrued benefits of current workers are not included in our proposed Social Security and Medicare liability. Their expected benefits, while based on prior actions, may be affected by future reforms.

In sum, net Social Security and Medicare benefits payable to retirees deserve added attention. Combined with the officially recognized liabilities, they provide a more comprehensive understanding the commitments already made based on prior actions. Because they are unlikely to be substantially reduced by reforms, they give policy makers a complete picture of the liabilities that are already on the federal government's books.

Figure 3. Composition of Federal Liabilities Including 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 (2000-2016). GDP from the Bureau of Economic Analysis.

¹*Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2010*, 186.





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