

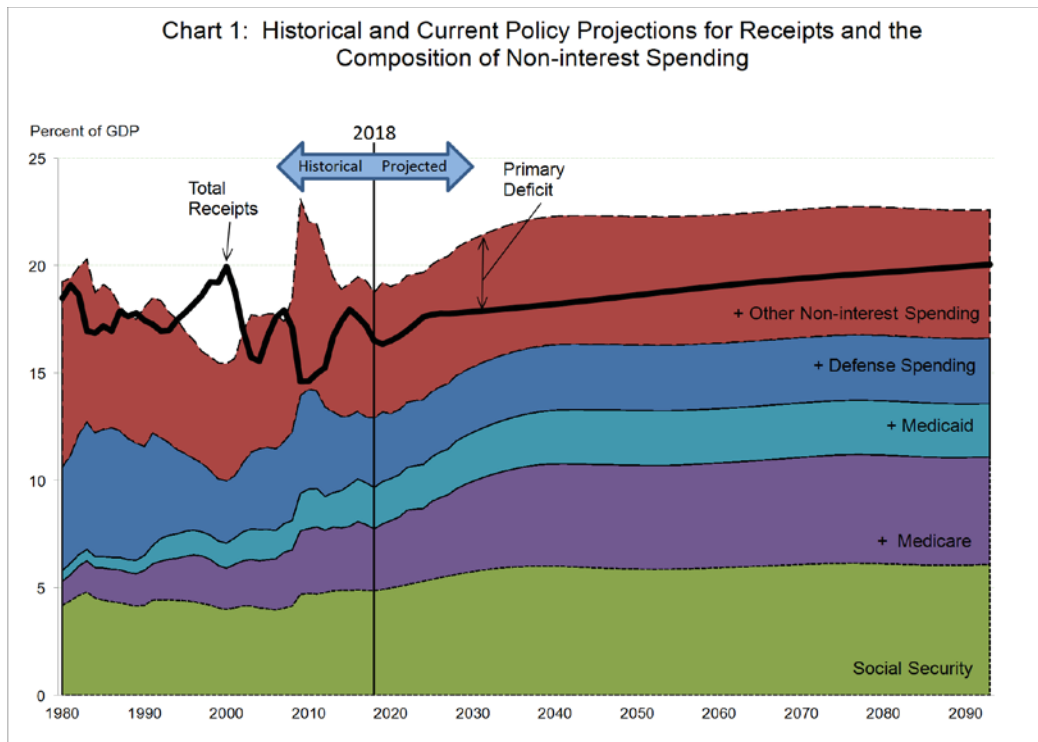
United States Government Required Supplementary Information (Unaudited) For the Fiscal Years Ended September 30, 2018, and 2017

The Sustainability of Fiscal Policy

One of the important purposes of the *Financial Report* is to help citizens and policymakers assess whether current fiscal policy is sustainable and, if it is not, the urgency and magnitude of policy reforms necessary to make fiscal policy sustainable. A sustainable policy is one where the ratio of debt held by the public to GDP (the debt-to-GDP ratio) is ultimately stable or declining.

As discussed below, the projections in this report indicate that current policy is not sustainable. If current policy is left unchanged, the projections show the debt-to-GDP ratio will rise from 78 percent in 2018 to 84 percent by 2022, to over 100 percent by 2030, and to 530 percent in 2093. For comparison, under the 2017 projections, the debt-to-GDP ratio fell about 4 percentage points between 2017 and 2023 before commencing a steady rise, exceeding its 2017 level by 2029, exceeding 100 percent by 2037, and reaching 297 percent in 2092.

These conclusions are rooted in the projected trends in receipts, spending, and deficits in the context of current law and policy, although, as described in the following pages, there is considerable uncertainty surrounding these projections. The projections are on the basis of policies currently in place and are neither forecasts nor predictions. Changes in policy – from repealing the ACA and increasing border security and infrastructure, to more routine developments such as changes in aggregate funding for discretionary program – could have a significant effect on eventual fiscal outcomes.



Current Policy Projections for Primary Deficits

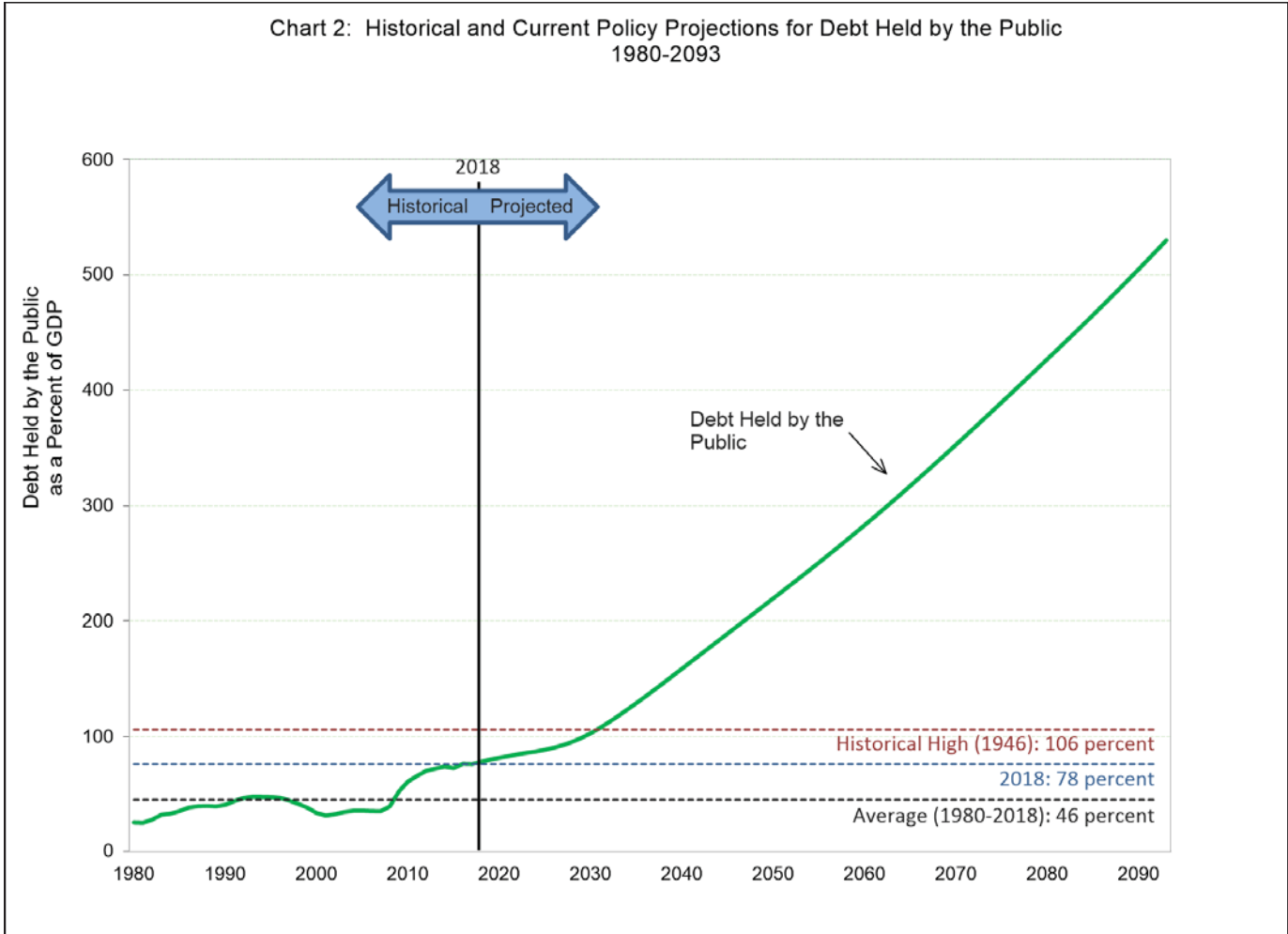
A key determinant of growth in the debt-to-GDP ratio and hence fiscal sustainability is the ratio of the primary deficit-to-GDP. The primary deficit is the difference between non-interest spending and receipts, and the primary deficit-to-GDP ratio is the primary deficit expressed as a percent of GDP. As shown in Chart 1, the primary deficit-to-GDP ratio spiked during 2009 through 2012 due to the 2008-09 financial crisis and the ensuing severe recession, as well as the increased spending and temporary tax reductions enacted to stimulate the economy and support recovery. These elevated primary deficits resulted in a sharp increase in the ratio of debt to GDP, which rose from 39 percent at the end of 2008 to 70 percent at the end of 2012. As an economic recovery took hold, the primary deficit ratio fell, averaging 1.9 percent of GDP over 2013 through 2018. This deficit level was still high enough that the debt held by the public increased further relative to GDP, ending 2018 at 78 percent. The primary deficit ratio is projected to rise to 2.9 percent in 2019 and then shrink slightly as the economy grows. After 2024, however, increased spending for Social Security and health programs due in part to the continued retirement of the baby boom generation is projected to result in increasing primary deficits that reach 3.0 percent of GDP in 2028. The primary deficit peaks at 4.1 percent of GDP in 2039, gradually decreases beyond that point as the aging of the population continues at a slower pace, and reaches 2.5 percent in 2093.

Trends in the primary deficit are heavily influenced by tax receipts. The receipt share of GDP was markedly depressed in 2009 through 2012 because of the recession and tax reductions enacted as part of the ARRA and the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*. The share subsequently increased to 18 percent of GDP by 2015 then decreased to 16.5 percent by 2018, after enactment of the TCJA of 2018 and below its 30-year average of 17.3 percent. Receipts are projected to grow slightly more rapidly than GDP over the projection period as increases in real (i.e., inflation-adjusted) incomes cause more taxpayers and a larger share of income to fall into the higher individual income tax brackets. Other possible paths for the receipts-to-GDP ratio and the implications for projected debt held by the public are analyzed in the “Alternative Scenarios” section.

On the spending side, the non-interest spending share of GDP is projected to rise gradually from 18.7 percent in 2018 to 21.0 percent of GDP in 2029 and ends at 22.6 percent in 2093, the end of the projection period. Beginning in 2020, these increases are principally due to faster growth in Medicare, Medicaid, and Social Security spending (see Chart 1). The aging of the baby boom generation over the next 25 years, among other factors, is projected to increase the Social Security, Medicare, and Medicaid spending shares of GDP by about 1.0 percentage points, 1.7 percentage points, and 0.6 percentage points, respectively. After 2035, the Social Security and Medicaid spending shares of GDP remain relatively stable, while the Medicare spending share of GDP continues to increase, albeit at a slower rate, due to projected increases in health care costs and population aging.

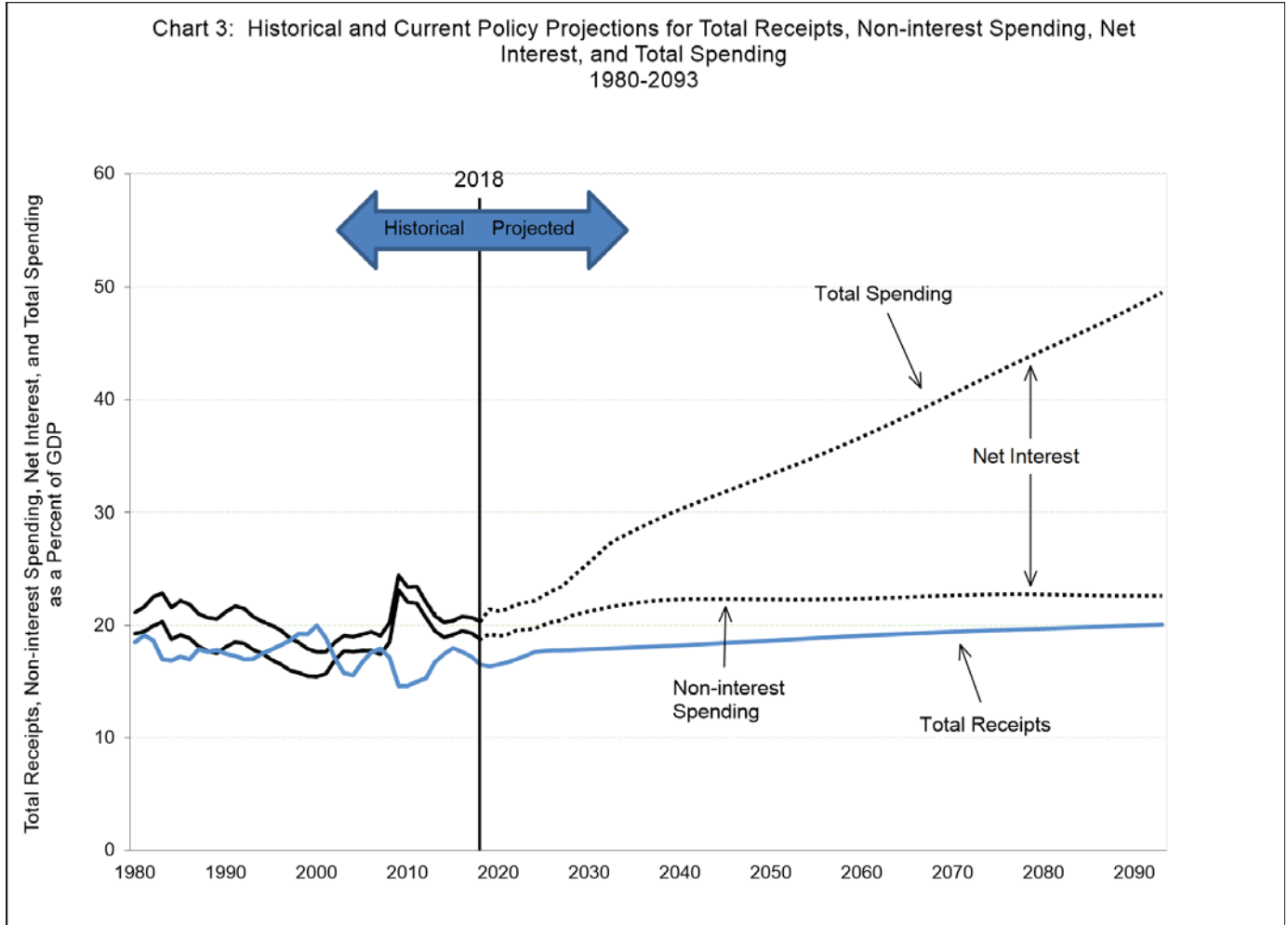
Current Policy Projections for Debt and Interest Payments

The primary deficit projections in Chart 1, along with projections for interest rates and GDP, determine the projections for the debt-to-GDP ratio shown in Chart 2. That ratio was 78 percent at the end of fiscal year 2018, and under current policy is projected to be 84 percent by 2022, over 100 percent by 2030, and 530 percent in 2093. The continuous rise of the debt-to-GDP ratio indicates that current policy is unsustainable.



The change in debt held by the public from one year to the next is approximately equal to the budget deficit, the difference between total spending and total receipts.¹ Total spending is non-interest spending plus interest spending. Chart 3 shows that the rapid rise in total spending and the unified deficit (Total Receipts less Total Spending) is almost entirely due to projected net interest, which results from the growing debt. As a percent of GDP, interest spending was 1.6 percent in 2018, and under current policy is projected to reach 7.4 percent in 2038 and 26.9 percent in 2093.

¹ The change in debt each year is also affected by certain transactions not included in the budget deficit, such as changes in Treasury’s cash balances and the non-budgetary activity of federal credit financing accounts. These transactions are assumed to hold constant at about 0.4 percent of GDP each year, with the same effect on debt as if the primary deficit was higher by that amount.



Another way of viewing the change in the financial outlook in this year's report relative to previous years' reports is in terms of the projected debt-to-GDP ratio in 2091, the last year of the 75-year projection period used in the fiscal year 2016 report. This ratio is projected to reach 513 percent in the fiscal year 2018 projections, which compares with 293 percent projected in the fiscal year 2017 projections and 252 percent projected in the fiscal year 2016 projections.²

The Cost of Delay in Closing the 75-Year Fiscal Gap

The longer policy action to close the fiscal gap³ is delayed, the larger the post-reform primary surpluses must be to achieve the target debt-to-GDP ratio at the end of the 75-year period. This can be illustrated by varying the years in which reforms closing the fiscal gap are initiated while holding the target ratio of debt to GDP in 2093 equal to the 2018 ratio (78 percent). Three timeframes for reforms are considered, each one beginning in a different year, and each one increasing the primary surplus relative to current policy by a fixed percent of GDP starting in the reform year. The analysis shows that the longer policy action is delayed, the larger the post-reform primary surplus must be to bring the debt-to-GDP ratio to 78 percent of GDP in 2093. Future generations are burdened by delays in policy changes because delay necessitates higher primary surpluses during their lifetimes, and those higher primary surpluses must be achieved through some combination of lower spending and higher taxes and other receipts.

As previously shown in Chart 1, under current policy, primary deficits occur throughout the projection period. Table 1 shows primary surplus changes necessary to make the debt-to-GDP ratio in 2093 equal to its level in 2018 under each of the three timeframes. If reform begins in 2019, then it is sufficient to raise the primary surplus share of GDP by 4.1 percentage

² For further information on changes from the 2016 projections, see the unaudited RSI in the 2017 *Financial Report*.

³ The fiscal gap reflects how much the primary surplus (receipts less non-interest spending) must increase to maintain the debt-to-GDP ratio at the 2018 level of 78 percent. See Note 23 for a more complete discussion of the fiscal gap.

points in every year between 2019 and 2093 in order for the debt-to-GDP ratio in 2093 to equal its level in 2018 (78 percent). This policy raises the average 2019-2093 primary surplus-to-GDP ratio from -3.5 percent to +0.8 percent.

Table 1
Costs of Delaying Fiscal Reform

| Timing of Reforms | Required Change in Average Primary Surplus |
|---------------------------------------|---|
| Reform in 2019 (No Delay) | 4.1 percent of GDP between 2019 and 2093 |
| Reform in 2029 (Ten-Year Delay) | 4.9 percent of GDP between 2029 and 2093 |
| Reform in 2039 (Twenty-Year Delay) . | 6.0 percent of GDP between 2039 and 2093 |

Note: Reforms taking place in 2018, 2028, and 2038 from the 2017 Financial Report were 2.0, 2.4, and 3.0 percent of GDP, respectively.

In contrast to a reform that begins immediately, if reform begins in 2029 or 2039, then the primary surpluses must be raised by 4.9 percent and 6.0 percent of GDP, respectively, in order for the debt-to-GDP ratio in 2093 to equal 78 percent. The difference between the primary surplus increase necessary if reform begins in 2029 or 2039 and the increase necessary if reform begins in 2019, an additional 0.8 and 1.9 percentage points, respectively, is a measure of the additional burden policy delay would impose on future generations. The costs of delay are due to the additional debt that accumulates between 2018 and the year reform is initiated, in comparison to the scenario in which reform begins immediately.

Alternative Scenarios

The long-run projections are highly uncertain. This section illustrates this inherent uncertainty by presenting alternative scenarios for the growth rate of health care costs, interest rates, discretionary spending, and receipts. (Not considered here are the effects of alternative assumptions for long-run trends in birth rates, mortality, and immigration.)

The population is aging rapidly and will continue to do so over the next several decades, which puts pressure on programs such as Social Security, Medicare, and Medicaid. A shift in projected fertility, mortality, or immigration rates could have important effects on the long-run projections. Higher-than-projected immigration, fertility, or mortality rates would improve the long-term fiscal outlook. Conversely, lower-than-projected immigration, fertility, or mortality rates would result in deterioration in the long-term fiscal outlook.

Effect of Changes in Health Care Cost Growth

One of the most important assumptions underlying the projections is the future growth of health care costs. These future growth rates – both for health care costs in the economy generally and for federal health care programs such as Medicare, Medicaid, and ACA exchange subsidies – are highly uncertain. In particular, enactment of the ACA in 2010 and the MACRA in 2015 established cost controls for Medicare hospital and physician payments whose long-term effectiveness is still to be demonstrated. The Medicare spending projections in the long-term fiscal projections are based on the projections in the 2018 Medicare Trustees’ Report, which assume the ACA and MACRA cost control measures will be effective in producing a substantial slowdown in Medicare cost growth. As discussed in Note 22—Social Insurance, the Medicare projections are subject to much uncertainty about the ultimate effects of these provisions to reduce health care cost growth. For the long-term fiscal projections, that uncertainty also affects the projections for Medicaid and exchange subsidies, because the cost per beneficiary in these programs grows at the same reduced rate as Medicare cost growth per beneficiary.

As an illustration of the dramatic effect of variations in health care cost growth rates, Table 2 shows the effect on the size of reforms necessary to close the fiscal gap of per capita health care cost growth rates that are one percentage point higher or two percentage points higher than the growth rates in the base projection, as well as the effect of delaying closure of the fiscal gap.⁴ As indicated earlier, if reform is initiated in 2019, eliminating the fiscal gap requires that the 2019-2093 primary surplus increase by an average of 4.1 percent of GDP in the base case. However, that figure increases to 7.3 percent of GDP if per capita health cost growth is assumed to be 1.0 percentage point higher, and 12.5 percent of GDP if per capita

⁴ The base case health cost growth rates are derived from the projections in the 2018 Medicare trustees’ report. These projections are summarized and discussed in Note 22 (see Table 1B in particular) and the “Medicare Projections” section of the unaudited RSI for the SOSI.

health cost growth is 2.0 percentage points higher. The cost of delaying reform is also increased if health care cost growth is higher, due to the fact that debt accumulates more rapidly during the period of inaction. For example, the lower part of Table 2 shows that delaying reform initiation from 2019 to 2029 requires that 2029-2093 primary surpluses be higher by an average of 0.8 percent of GDP in the base case, 1.4 percent of GDP if per capita health cost growth is 1.0 percentage point higher, and 2.4 percent of GDP if per capita health cost growth is 2.0 percentage points higher. The dramatic deterioration of the long-run fiscal outlook caused by higher health care cost growth shows the critical importance of managing health care cost growth.

| Table 2 | | | |
|--|--|-------------|-------------|
| Impact of Alternative Health Cost Scenarios on Cost of Delaying Fiscal Reform | | | |
| Scenario | Primary Surplus Increase (% of GDP) | | |
| | Starting in: | | |
| | 2019 | 2029 | 2039 |
| Base Case..... | 4.1 | 4.9 | 6.0 |
| 1.0 p.p. higher per person health cost growth..... | 7.3 | 8.7 | 10.8 |
| 2.0 p.p. higher per person health cost growth..... | 12.5 | 14.9 | 18.6 |
| | Change in Primary Surplus Increase if Reform is Delayed From 2019 to: | | |
| | | 2029 | 2039 |
| Base Case..... | | 0.8 | 2.0 |
| 1.0 p.p. higher per person health cost growth..... | | 1.4 | 3.5 |
| 2.0 p.p. higher per person health cost growth..... | | 2.4 | 6.1 |

Note: Increments may not equal the subtracted difference of the components due to rounding. "p.p." means percentage point(s).

Effects of Changes in Interest Rates

A higher debt-to-GDP ratio is likely to increase the interest rate on government debt, making it more costly for the government to service its debt. Table 3 displays the effect of several alternative scenarios using different nominal (and real) interest rates than assumed in the base case on the size of reforms to close the fiscal gap as well as the effect of delaying closure of the fiscal gap. If reform is initiated in 2019, eliminating the fiscal gap requires that the 2019-2093 primary surplus increase by an average of 4.1 percent of GDP in the base case, 4.7 percent of GDP if the interest rate is 1.0 percentage point higher in every year, and 3.4 percent of GDP if the interest rate is 1.0 percentage point lower in every year. The cost of delaying reform is also increased if interest rates are higher, due to the fact that interest paid on debt accumulates more rapidly during the period of inaction. For example, the lower part of Table 3 shows that delaying reform initiation from 2019 to 2029 requires that 2029-2093 primary surpluses be higher by an average of 0.8 percent of GDP in the base case, 1.2 percent of GDP if the interest rate is 1.0 percentage point higher in every year, and 0.5 percent of GDP if the interest rate is 1.0 percentage point lower in every year.

Table 3
Impact of Alternative Interest Rate Scenarios on Cost of Delaying Fiscal Reform

| Scenario | Primary Surplus Increase (% of GDP) Starting in: | | |
|--|--|------|------|
| | 2019 | 2029 | 2039 |
| Base Case: Average of 5.0 percent over 75 years..... | 4.1 | 4.9 | 6.0 |
| 1.0 p.p. higher interest rate in each year..... | 4.7 | 5.9 | 7.9 |
| 1.0 p.p. lower interest rate in each year..... | 3.4 | 3.9 | 4.6 |
| | Change in Primary Surplus Increase if Reform is Delayed From 2019 to: | | |
| | 2029 | 2039 | |
| Base Case: Average of 5.0 percent over 75 years..... | 0.8 | 2.0 | |
| 1.0 p.p. higher interest rate in each year..... | 1.2 | 3.1 | |
| 1.0 p.p. lower interest rate in each year..... | 0.5 | 1.2 | |

Note: Increments may not equal the subtracted difference of the components due to rounding.

Effects of Changes in Discretionary Spending Growth

The growth of discretionary spending has a large impact on long-term fiscal sustainability. The current base projection for discretionary spending assumes that spending stays within the statutory caps that apply through 2019 under the BBA, grows with GDP from the cap level after that point, and remains subject to the reductions required by the Joint Committee⁵. The implications of two alternative scenarios are shown in Table 4. The first alternative scenario allows discretionary spending to grow with inflation and population after 2019 so as to hold discretionary spending constant on a real per capita basis. (This growth rate assumption is slower than growth with GDP but is still higher than the standard 10-year budget baseline assumption, which assumes that discretionary spending grows with inflation but not with population.) The second alternative scenario sets discretionary spending from 2019 onward to statutory cap levels prior to Joint Committee reductions and grows with GDP from that point forward. As shown in Table 4, if discretionary spending grows with inflation and population, eliminating the fiscal gap requires that the 2019-2093 primary surplus increase by an average of 1.9 percent of GDP. If discretionary spending rises to the levels prior to Joint Committee sequestration and grows with GDP, the fiscal gap increases to 4.4 percent of GDP. The cost of delaying reform is greater when discretionary spending levels are higher. Initiating reforms in 2029 requires that the primary surplus increase by an average of 0.9 percent of GDP per year in the base case, and increase by 0.9 percent of GDP if discretionary levels return to pre-Joint Committee sequestration levels in 2020. If delayed until 2039, the primary surplus must increase by an average of 2.0 percent of GDP in the base case, and increase by 2.1 percent of GDP at pre-sequestration levels.

⁵ The BCA of 2011 established statutory caps on discretionary spending for fiscal years 2012 through 2021 and established a Joint Committee tasked with identifying \$1.2 trillion in deficit reduction. The failure of the Joint Committee to propose and Congress to enact legislation sufficient to reduce the deficit triggers automatic spending reductions through adjustments to the discretionary spending limits and sequestration of mandatory spending. Mandatory sequestration has been extended in various statutes and currently extends through 2027. After 2027, the projections assume the automatic reductions continue as a constant share of projected GDP.

Table 4**Impact of Alternative Discretionary Spending Growth Scenarios on Cost of Delaying Fiscal Reform**

| Scenario | Primary Surplus Increase (% of GDP) Starting in: | | | |
|---|--|-------------|-------------|-----|
| | 2019 | 2029 | 2039 | |
| Base Case: Discretionary spending growth with GDP after 2019..... | 4.1 | 4.9 | 6.0 | |
| Growth with inflation and population after 2019..... | 1.9 | 2.3 | 2.8 | |
| Growth with GDP after 2019, pre-Joint Committee sequester levels..... | 4.4 | 5.2 | 6.5 | |
| | Change in Primary Surplus Increase if Reform is Delayed From 2019 to: | | | |
| | | | 2029 | |
| | | | 2039 | |
| Base Case: Discretionary spending growth with GDP after 2019..... | | | 0.8 | 2.0 |
| Growth with inflation and population after 2019..... | | | 0.4 | 0.9 |
| Growth with GDP after 2019, pre-Joint Committee sequester levels..... | | | 0.8 | 2.1 |

Note: Increments may not equal the subtracted difference of the components due to rounding.

Effects of Changes in Individual Income Receipt Growth

The growth rate of receipts, specifically individual income taxes, is another key determinant of long-term sustainability. The base projections assume growth in individual income taxes over time to account primarily for the slow shift of individuals into higher tax brackets due to real wage growth (“real bracket creep”). This assumption approximates the long-term historical growth in individual income taxes relative to wages and salaries and is consistent with current policy without change, as future legislation would be required to prevent real bracket creep. As an illustration of the effect of variations in individual income tax growth, Table 5 shows the effect on the size of reforms necessary to close the fiscal gap and the effect of delaying closure of the fiscal gap if long-term receipt growth as a share of wages and salaries is 0.1 percentage point higher than the base case, as well as 0.1 percentage point lower than the base case. If reform is initiated in 2019, eliminating the fiscal gap requires that the 2019-2093 primary surplus increase by an average of 4.1 percent of GDP in the base case, only 3.0 percent of GDP if receipt growth is 0.1 percentage point higher, but 5.2 percent of GDP if receipt growth is 0.1 percentage point lower. The cost of delaying reform is also affected if receipt growth assumptions change, much as was the case in the previous alternative scenarios.

Table 5
Impact of Alternative Revenue Growth Scenarios on Cost of Delaying Fiscal Reform

| Scenario | Primary Surplus Increase (% of GDP) Starting in: | | |
|---|--|------|------|
| | 2019 | 2029 | 2039 |
| Base Case: Individual income tax bracket creep of 0.1% of wages and salaries per year | 4.1 | 4.9 | 6.0 |
| 0.2% of wages and salaries per year after 2028 | 3.0 | 3.6 | 4.4 |
| 0.0% of wages and salaries per year after 2028 (no bracket creep) | 5.2 | 6.1 | 7.7 |
| | Change in Primary Surplus Increase if Reform is Delayed From 2019 to: | | |
| | 2029 | 2039 | |
| Base Case: Individual income tax bracket creep of 0.1% of wages and salaries per year | | 0.8 | 2.0 |
| 0.2% of wages and salaries per year after 2028 | | 0.6 | 1.4 |
| 0.0% of wages and salaries per year after 2028 (no bracket creep) | | 1.0 | 2.5 |

Note: Increments may not equal the subtracted difference of the components due to rounding.

Fiscal Projections in Context

In this report, a sustainable fiscal policy has been defined as one where the federal debt-to-GDP ratio is stable or declining. However, this definition does not indicate what a sustainable debt-to-GDP ratio might be. Any particular debt ratio is not the ultimate goal of fiscal policy. Rather, the goals of fiscal policy are many. They include financing public goods, such as infrastructure and government services; promoting a strong and growing economy; and managing the debt so that it is not a burden on future generations. These goals are interrelated, and readers should consider how policies intended to affect one might depend on or affect another.

This report shows that current policy is not sustainable. In evaluating policies that could make policy sustainable, note that debt may play roles in both facilitating and hindering a healthy economy. For example, government deficit spending supports demand and allows economies to emerge from recessions more quickly. Debt may also be a cost-effective means of financing capital investment that promotes future economic growth, which may in turn make future debt levels more manageable. However, economic theory also suggests that high levels of debt may contribute to higher interest rates, leading to lower private investment and a smaller capital stock which the economy can use to grow. Unfortunately, it is unclear what debt-to-GDP ratio would be sufficiently high to produce these negative outcomes, or whether the key concern is the level of debt per se, or a trend that shows debt increasing over time.

While several empirical studies have attempted to discern a definite relationship between debt and economic growth from the past experience of countries, the evidence is mixed. One study suggested that as advanced countries' debt-to-GDP ratios exceeded 90 percent it had significant negative consequences for real GDP growth through rising interest rates, crowding out of private investment, and reduced capital formation.⁶ Real GDP growth is generally lower by about 1 percent when the countries' debt-to-GDP ratios are above 90 percent relative to the times when they are below 90 percent.⁷ However,

⁶ Reinhart, Carmen M., and Kenneth S. Rogoff. 2010. "Growth in a Time of Debt." *American Economic Review*, 100(2): 573-78.

⁷ Errata: "Growth in a Time of Debt," Carmen M. Reinhart and Kenneth S. Rogoff. Harvard University, 2013.

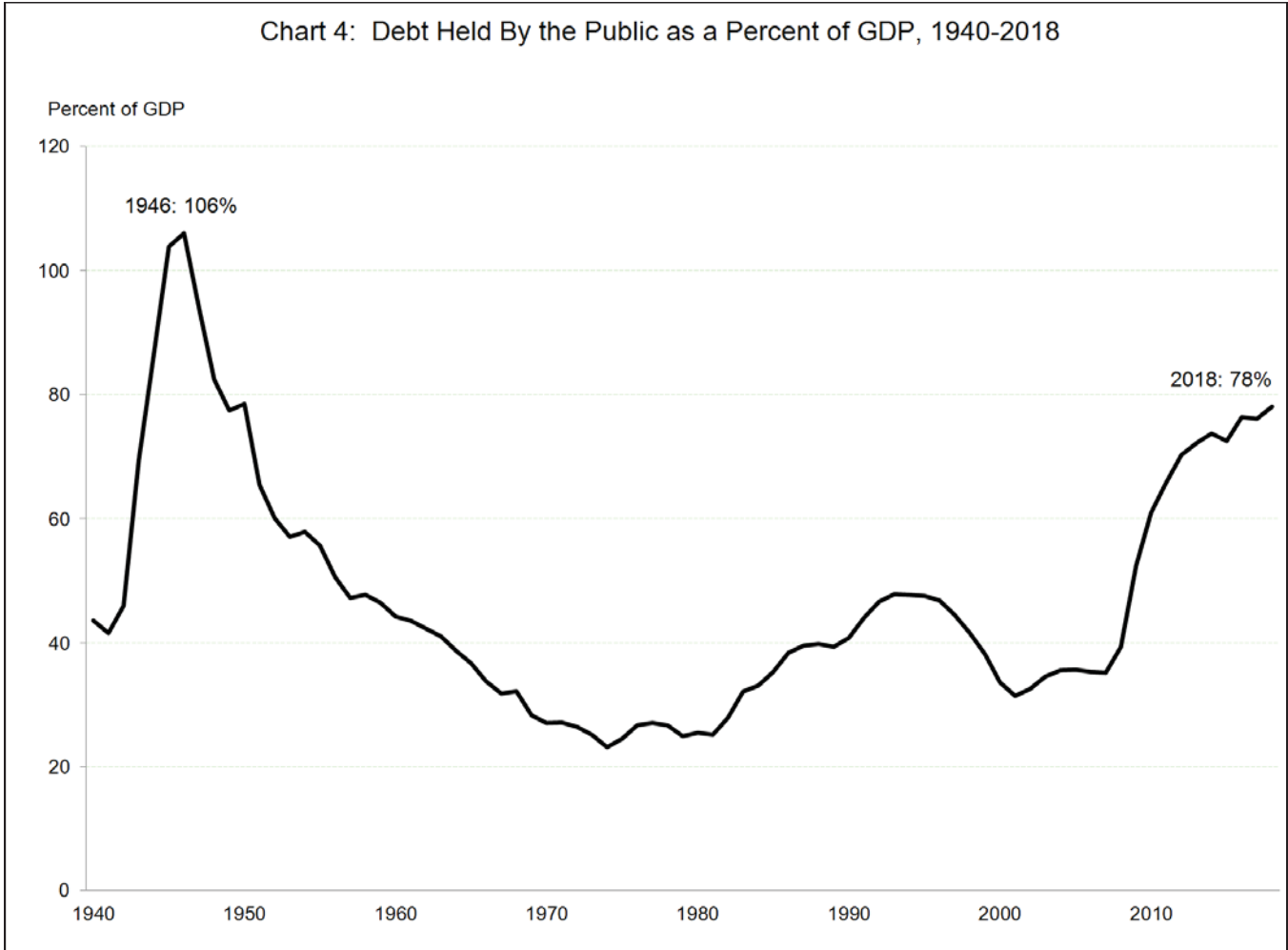
after removing sample countries with very high indebtedness – those with debt-to-GDP ratios of more than 120 percent – and very low indebtedness – those with debt-to-GDP ratios of less than 30 percent – the negative relationship between growth and debt is difficult to determine. Another study reports that differences in average GDP growth in countries with debt-to-GDP ratios between 30-60 percent, 60-90 percent, and 90-120 percent cannot be statistically distinguished.⁸ Some countries with high debt-to-GDP ratios have been observed to experience lower-than-average growth, while other countries with similarly high debt ratios have continued to enjoy robust growth. Analogously, low debt-to-GDP ratios are no guarantee of strong economic growth. Moreover, the direction of causality is unclear. High debt may undermine growth through increased interest rates and lower business confidence, or low growth may contribute to high debt by depressed tax revenues and increased deficit spending on social safety net programs.

Nevertheless, to put the current and projected debt-to-GDP ratios in context, it is instructive to examine how the United States experience compares with that of other countries. The U.S. government's debt as a percent of GDP is relatively large compared with central government debt of other countries, but far from the largest among developed countries. Based on historical data as reported by the International Monetary Fund (IMF) for 28 advanced economies, the debt-to-GDP ratio in 2016 ranged from 6.3 percent of GDP to 192.2 percent of GDP.⁹ The United States is not included in this set of statistics, which underscores the difficulty in calculating debt ratios under consistent definitions, but the projections in this report show the 2018 debt-to-GDP ratio as 78 percent. Despite using consistent definitions where available, these debt measures are not strictly comparable due to differences in the share of government debt that is debt of the central government, how government responsibilities are shared between central and local governments, how current policies compare with the past policies that determine the current level of debt, and how robustly each economy grows.

The historical experience of the U.S. may also provide some perspective. As Chart 4 shows, the debt-to-GDP ratio was highest in the 1940s, following the debt buildup during World War II. In the projections in this report, the U.S. would reach the previous peak debt ratio in 2030. However, the origins of current and future federal debt are quite different from the wartime debt of the 1940s, which limits the pertinence of past experience.

⁸ Herndon, Thomas, Michael Ash, and Robert Pollard, "Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff," *Cambridge Journal of Economics*, 2013.

⁹ Government Finance Statistics Yearbook, Main Aggregates and Balances, available at <https://data.imf.org>. Data is for D1 debt liabilities for the central government, excluding social security funds, for Advanced Economies.



As the cross-country and historical comparisons suggest, there is a very imperfect relationship between the current level of central government debt and the sustainability of overall government policy. Past accrual of debt is certainly important, but current policies and their implications for future debt accumulation are as well.

Conclusion

The past 11 years saw debt held by the public nearly double as a share of GDP, bringing it to a level not seen since shortly after World War II. The projections in this *Financial Report* indicate that if policy remains unchanged, the debt-to-GDP ratio will steadily increase and soon far exceed historical levels, which implies current policy is not sustainable and must ultimately change. Subject to the important caveat that policy changes are not so abrupt that they slow economic growth, the sooner policies are put in place to avert these trends, the smaller are the adjustments necessary to return the nation to a sustainable fiscal path, and the lower the burden of the debt will be to future generations.

Social Insurance

The social insurance programs consisting of Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment Insurance (UI) were developed to provide income security and health care coverage to citizens under specific circumstances as a responsibility of the government. Because taxpayers rely on these programs in their long-term planning, social insurance program information should indicate whether the current statutory provisions of the programs can be sustained, and more generally what effect these provisions likely have on the government's financial condition. The resources needed to run these programs are raised through taxes and fees. Eligibility for benefits depends in part on earnings and time worked by the individuals. Social Security benefits are generally redistributed intentionally toward lower-wage workers (i.e., benefits are progressive). In addition, each social insurance program has a uniform set of eligibility events and schedules that apply to all participants.

Social Security and Medicare

Social Security

The OASI Trust Fund was established on January 1, 1940, as a separate account in the Treasury. The DI Trust Fund, another separate account in the Treasury, was established on August 1, 1956. The OASI fund pays cash retirement benefits to eligible retirees and their eligible dependents and survivors, and the much smaller DI fund pays cash benefits to eligible individuals who are unable to work because of medical conditions and certain family members of such eligible individuals. Though the events that trigger benefit payments are quite different, both trust funds have the same dedicated financing structure: primarily payroll taxes and income taxes on benefits. All financial operations of the OASI and DI Programs are handled through these respective funds. The two funds are often referred to as the combined OASDI Trust Funds. At the end of calendar year 2017, OASDI benefits were paid to approximately 62 million beneficiaries.

The primary financing source for these two funds are taxes paid by workers, their employers, and individuals with self-employment income, based on work covered by the OASDI Program. Currently, employers and employees each pay 6.2 percent of taxable earnings, and the self-employed pay 12.4 percent of taxable earnings. Payroll taxes are levied on wages and net earnings from self-employment up to a specified maximum annual amount, referred to as maximum taxable earnings (\$128,400 in 2018), that increases each year with economy-wide average wages.

Legislation passed in 1984 subjected up to half of OASDI benefits to income tax and allocated the revenue to the OASDI Trust Funds. In 1993 legislation increased the potentially taxed portion of benefits to 85 percent and allocated the additional revenue to the Medicare's HI Trust Fund.

Medicare

The Medicare Program, created in 1965, has two separate trust funds: the HI Trust Fund (otherwise known as Medicare Part A) and the SMI Trust Funds (which consists of the Medicare Part B and Part D¹⁰ accounts). HI helps pay for inpatient hospital stays, home health care following a hospital stay, and skilled nursing facility and hospice care. SMI helps pay for hospital outpatient services, physician services, and assorted other services and products through Part B and for prescription drugs through Part D.

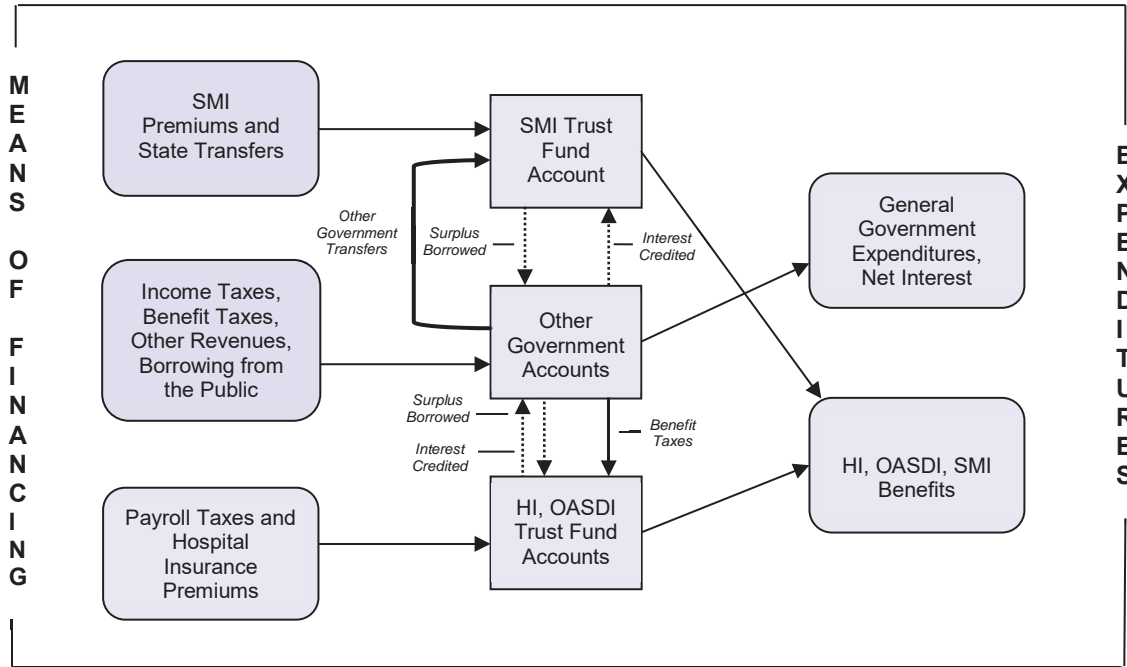
Though the events that trigger benefit payments are similar, HI and SMI have different dedicated financing structures. Similar to OASDI, HI is financed primarily by payroll contributions. Currently, employers and employees each pay 1.45 percent of earnings, while self-employed workers pay 2.9 percent of their net earnings. Beginning in 2013, employees and self-employed individuals with earnings above certain thresholds pay an additional HI tax of 0.9 percent on earnings above those thresholds. Other income to the HI Trust Fund includes a small amount of premium income from voluntary enrollees, a portion of the federal income taxes that beneficiaries pay on Social Security benefits (as explained above), and interest credited on Treasury securities held in the HI Trust Fund. As is explained in the next section, these Treasury securities and related interest have no effect on the consolidated statement of governmentwide finances.

For SMI, direct transfers from the General Fund financed 72 percent and 70 percent of 2018 program costs for Parts B and D, respectively. Premiums paid by beneficiaries and, for Part D state transfers, generally financed the remainder of

¹⁰ Medicare legislation in 2003 created the new Part D account in the SMI Trust Fund to track the finances of a new prescription drug benefit that began in 2006. As is the case for Medicare Part B, a little more than three-quarters of revenues to the Part D account will come from future transfers from the General Fund. Consequently, the nature of the relationship between the SMI Trust Fund and the Federal Budget described below is largely unaffected by the presence of the Part D account though the magnitude will be greater.

expenditures. For beneficiaries dually eligible for Medicare and Medicaid, states must pay the Part D account a portion of their estimated foregone drug costs for this population (referred to as state transfers). As with HI, interest received on Treasury securities held in the SMI Trust Fund is credited to the fund. These Treasury securities and related interest have no effect on the consolidated statement of governmentwide finances. See Note 22—Social Insurance, for additional information on Medicare program financing.

Figure 1
Social Security, Medicare, and Governmentwide Finances



Social Security, Medicare, and Governmentwide Finances

The current and future financial status of the separate OASDI, HI, and SMI Trust Funds is the focus of the Social Security and Medicare Trustees’ Reports, a focus that may appropriately be referred to as the “trust fund perspective.” In contrast, the government primarily uses the budget concept as the framework for budgetary analysis and presentation. It represents a comprehensive display of all federal activities, regardless of fund type or on- and off-budget status, and has a broader focus than the trust fund perspective that may appropriately be referred to as the “budget perspective” or the “governmentwide perspective.” Social Security and Medicare are among the largest expenditure categories of the U.S. federal budget. This section describes in detail the important relationship between the trust fund perspective and the governmentwide perspective.

Figure 1 is a simplified depiction of the interaction of the Social Security and Medicare Trust Funds with the rest of the federal budget.¹¹ The boxes on the left show sources of funding, those in the middle represent the trust funds and other government accounts, which include the General Fund into which that funding flows, and the boxes on the right show simplified expenditure categories. The figure is intended to illustrate how the various sources of program revenue flow through the budget to beneficiaries. The general approach is to group revenues and expenditures that are linked specifically to Social Security and/or Medicare separately from those for other government programs.

¹¹ The federal budget encompasses all government financing and is synonymous with a governmentwide perspective.

Each of the trust funds has its own sources and types of revenue. With the exception of General Fund transfers to SMI, each of these revenue sources represents revenue from the public that is dedicated specifically for the respective trust fund and cannot be used for other purposes. In contrast, personal and corporate income taxes as well as other revenue go into the General Fund and are drawn down for any government program for which Congress has approved spending.¹² The arrows from the boxes on the left represent the flow of the revenues into the trust funds and other government accounts.

The heavy line between the top two boxes in the middle of Figure 1 represents intragovernmental transfers to the SMI Trust Fund from other government accounts. The Medicare SMI Trust Fund is shown separately from the two Social Security Trust Funds (OASI and DI) and the Medicare HI Trust Fund to highlight the unique financing of SMI. Currently, SMI is the only one of the programs that is funded through transfers from the General Fund, which is part of the other government accounts (the SMI Part D account also receives transfers from the states). The direct transfers finance roughly three-fourths of SMI Program expenses. The transfers are automatic; their size depends on how much the program requires, not on how much revenue comes into the Treasury. If General Fund revenues become insufficient to cover both the mandated transfer to SMI and expenditures on other general government programs, Treasury has to borrow to make up the difference. In the longer run, if transfers to SMI increase beyond growth in general revenues—and as shown in the Medicare Trustees Report and Chart 5 later in this section, they are projected to increase significantly in coming years—then Congress must either raise taxes, cut other government spending, reduce SMI benefits, or borrow even more.

The dotted lines between the middle boxes of Figure 1 also represent intragovernmental transfers but those transfers arise in the form of “borrowing/lending” between the government accounts. Interest credited to the trust funds arises when the excess of program income over expenses is loaned to the General Fund. The vertical lines labeled *Surplus Borrowed* represent these flows from the trust funds to the other government accounts. These loans reduce the amount the General Fund has to borrow from the public to finance a deficit (or likewise increase the amount of debt paid off if there is a surplus). However, the General Fund has to credit interest on the loans from the trust fund programs, just as if it borrowed the money from the public. The credits lead to future obligations for the General Fund (which is part of the other government accounts). These transactions are indicated in Figure 1 by the vertical arrows labeled *Interest Credited*. The credits increase trust fund income exactly as much as they increase credits (future obligations) in the General Fund. From the governmentwide standpoint, at least in an accounting sense, these interest credits are a wash.

When the trust funds get the receipts that they loan to the General Fund, these receipts provide additional authority to spend on benefits and other program expenses. The General Fund, in turn, has taken on the obligation of paying interest on these loans every year and repaying the principal when trust fund income from other sources falls below expenditures.

How loans from the trust funds to the General Fund and later repayments of those loans affect tax income and expenditures of the General Fund is uncertain. Two extreme cases encompass the possibilities. At one extreme, each dollar the trust funds loan to the General Fund might reduce borrowing from the public by a dollar at the time the loan is extended, in which case the General Fund could repay all trust fund loans by borrowing from the public without raising the level of public debt above the level that would have occurred in the absence of the loans. At the other extreme, each dollar the trust funds loan to the General Fund might result in some combination of higher General Fund spending and lower General Fund revenues amounting to one dollar at the time the loans are extended, in which case General Fund loan repayments to the trust funds might initially be financed with borrowing from the public but must at some point be financed with a combination of higher General Fund taxes and lower General Fund spending than would have occurred in the absence of the loans. In this latter extreme, trust fund loans result in additional largess (i.e., higher spending and/or lower taxes) in General Fund programs at the time the loans are extended, but ultimately that additional largess is financed with additional austerity (i.e., lower spending and/or higher taxes) in General Fund programs at later dates. The actual impact of trust fund loans to the General Fund and their repayment on General Fund programs is at one of these two extremes or somewhere in between.

Actual dollar amounts roughly corresponding to the flows presented in Figure 1 are shown in Table 1 for fiscal year 2018. In Table 1, revenues from the public (left side of Figure 1) and expenditures to the public (right side of Figure 1) are shown separately from transfers between government accounts (middle of Figure 1). Note that the transfers (\$318.3 billion) and interest credits (\$93.5 billion) received by the trust funds appear as negative entries under “All Other” and are thus offsetting when summed for the total budget column. These two intragovernmental transfers are the key to the differences between the trust fund and budget perspectives.

From the governmentwide perspective, only revenues received from the public (and states in the case of Medicare, Part D) and expenditures made to the public are important for the final balance. Trust fund revenue from the public consists of

¹² Other programs also have dedicated revenues in the form of taxes and fees (and other forms of receipt) and there are a large number of dedicated trust funds in the federal budget. Total trust fund receipts account for about 40 percent of total government receipts with the Social Security and Medicare Trust Funds accounting for about two-thirds of trust fund receipts. For further discussion, see the report issued by the Government Accountability Office, *Federal Trust and Other Earmarked Funds*, GAO-01-199SP, January 2001. In the figure and the discussion that follows, all other programs, including these other dedicated trust fund programs, are grouped under “Other government Accounts” to simplify the description and maintain the focus on Social Security and Medicare.

payroll taxes, benefit taxes, and premiums. For HI, the difference between total expenditures made to the public (\$297.2 billion) and revenues (\$293.9 billion) was \$3.3 billion in 2018, indicating that HI had a relatively small negative effect on the overall budget outcome *in that year*. For the SMI account, revenues from the public (primarily premiums) fell short of total expenditures made to the public by \$291.6 billion in 2018, which resulted in a net draw on the overall budget balance in that year. For OASDI, the difference between total expenditures made to the public (\$988.0 billion) and revenues from the public (\$908.9 billion) was \$79.1 billion in 2018, indicating that OASDI had a negative effect on the overall budget outcome in that year. Combined OASDI payroll and benefit tax revenues were increased by \$3.5 billion in fiscal year 2018.

The trust fund perspective is captured in the bottom section of each of the three trust fund columns. For HI, total revenues exceeded total expenditures by \$5.7 billion in 2018, as shown at the bottom of the first column. For SMI, total revenues exceeded total expenditures by \$27.5 billion. The total revenue for SMI is \$441.6 billion (\$122.5 + \$319.1), which includes \$319.1 billion transferred from other government accounts (General Fund). Transfers to the SMI Program from other government accounts (the General Fund), amounting to about 76.5 percent of program costs, are obligated under current law and, therefore, appropriately viewed as revenue from the trust fund perspective. For OASDI, total revenues of \$992.7 billion (\$908.9 + \$83.8) exceeded total expenditures of \$988.0 billion by \$4.7 billion. Total revenues for OASDI included \$83.8 billion in transfers from the General Fund, made up of interest credits of \$83.8 billion.

Table 1
Revenues and Expenditures for Medicare and Social Security Trust Funds and the Total Federal Budget for the Fiscal Year ended September 30, 2018

| (In billions of dollars) | Trust Funds | | | | | Total ¹ |
|---|--------------|----------------|---------------|----------------|----------------|--------------------|
| | HI | SMI | OASDI | Total | All Other | |
| Payroll taxes and other public revenues: | | | | | | |
| Payroll and benefit taxes | 288.8 | - | 908.9 | 1,197.7 | - | 1,197.7 |
| Premiums..... | 5.1 | 106.7 | - | 111.8 | - | 111.8 |
| Other taxes and fees..... | - | 15.8 | - | 15.8 | 2,003.4 | 2,019.2 |
| Total | 293.9 | 122.5 | 908.9 | 1,325.3 | 2,003.4 | 3,328.7 |
| Total expenditures to the public ² | 297.2 | 414.1 | 988.0 | 1,699.3 | 2,408.4 | 4,107.7 |
| Net results for budget perspective³..... | (3.3) | (291.6) | (79.1) | (374.0) | (405.0) | (779.0) |
| Revenues from other Government accounts: | | | | | | |
| Transfers | 1.6 | 316.7 | - | 318.3 | (318.3) | |
| Interest credits..... | 7.3 | 2.4 | 83.8 | 93.5 | (93.5) | |
| Total | 9.0 | 319.1 | 83.8 | 411.8 | (411.8) | |
| Net results for trust fund perspective³ | 5.7 | 27.5 | 4.7 | 37.8 | N/A | N/A |

¹ This column is the sum of the preceding two columns and shows data for the total federal budget. The figure \$779 was the total federal deficit in fiscal year 2018.

² The OASDI figure includes \$4.9 billion transferred to the Railroad Retirement Board for benefit payments and is therefore an expenditure to the public.

³ Net results are computed as revenues less expenditures.

Notes: Totals may not equal the sum of components due to rounding.

"N/A" indicates not applicable.

Cash Flow Projections

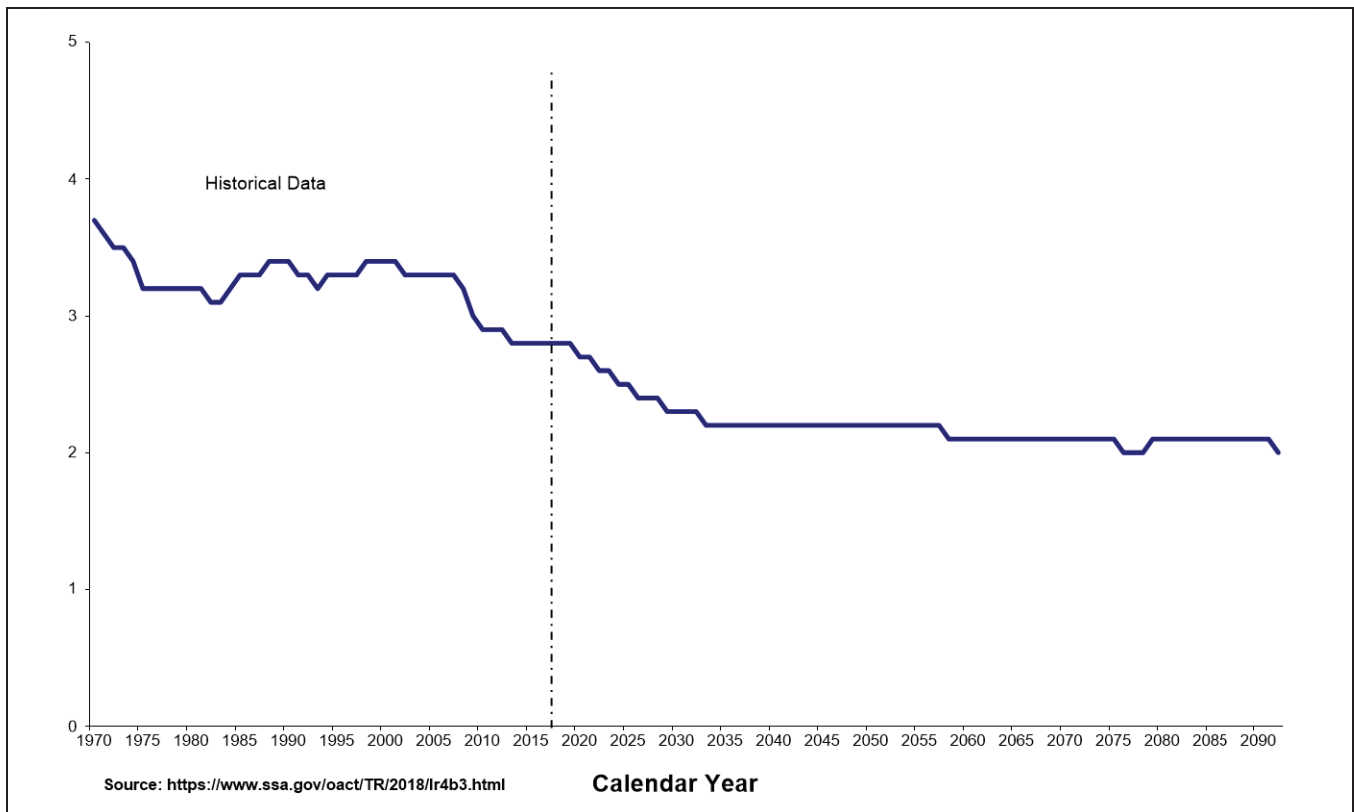
Background

Economic and Demographic Assumptions. The Boards of Trustees¹³ of the OASDI and Medicare Trust Funds provide in their annual reports to Congress short-range (10-year) and long-range (75-year) actuarial estimates of each trust fund. Because of the inherent uncertainty in estimates for 75 years into the future, the boards use three alternative sets of economic and demographic assumptions to show a range of possibilities. The economic and demographic assumptions used for the most recent set of intermediate projections for Social Security and Medicare are shown in the “Social Security” and “Medicare” sections of Note 22—Social Insurance.

¹³ There are six trustees: the Secretaries of the Treasury (managing trustee), Health and Human Services, and Labor; the Commissioner of the Social Security Administration; and two public trustees who are appointed by the President and confirmed by the Senate for a 4-year term. By law, the public trustees cannot both be members of the same political party.

Worker-to-Beneficiary Ratio. The expenditure projections for both the OASDI and Medicare Programs reflect the aging of the large baby-boom generation, born in the years 1946 to 1964, and its ultimate passing. Under the intermediate assumptions, cost rates are projected to rise rapidly between 2018 and 2035, primarily because the number of beneficiaries rises much more rapidly than the number of covered workers as the baby-boom generation retires. For the most part, current workers pay for current benefits. Due to the lower fertility rates of the baby-boom generation as compared to those of their parents' generation, and the expected low fertility rates of all future generations, there is a relatively smaller number of persons born after the baby boom who will then finance the retirement of the baby-boom generation. Chart 1 shows that in 2017, every OASDI beneficiary had 2.8 workers to pay for his or her benefit. In 2030, however, after the last baby boomer turns 65, there will be only about 2.3 workers per beneficiary. The projected ratio continues to decline until there are just 2.0 workers per beneficiary by 2092. A similar demographic pattern confronts the Medicare Program. The number of workers per HI beneficiary declines from 3.1 in 2017 to 2.4 in 2030, and continues to decline throughout the projection period to 2092, when there are just 2.1 workers per HI beneficiary.

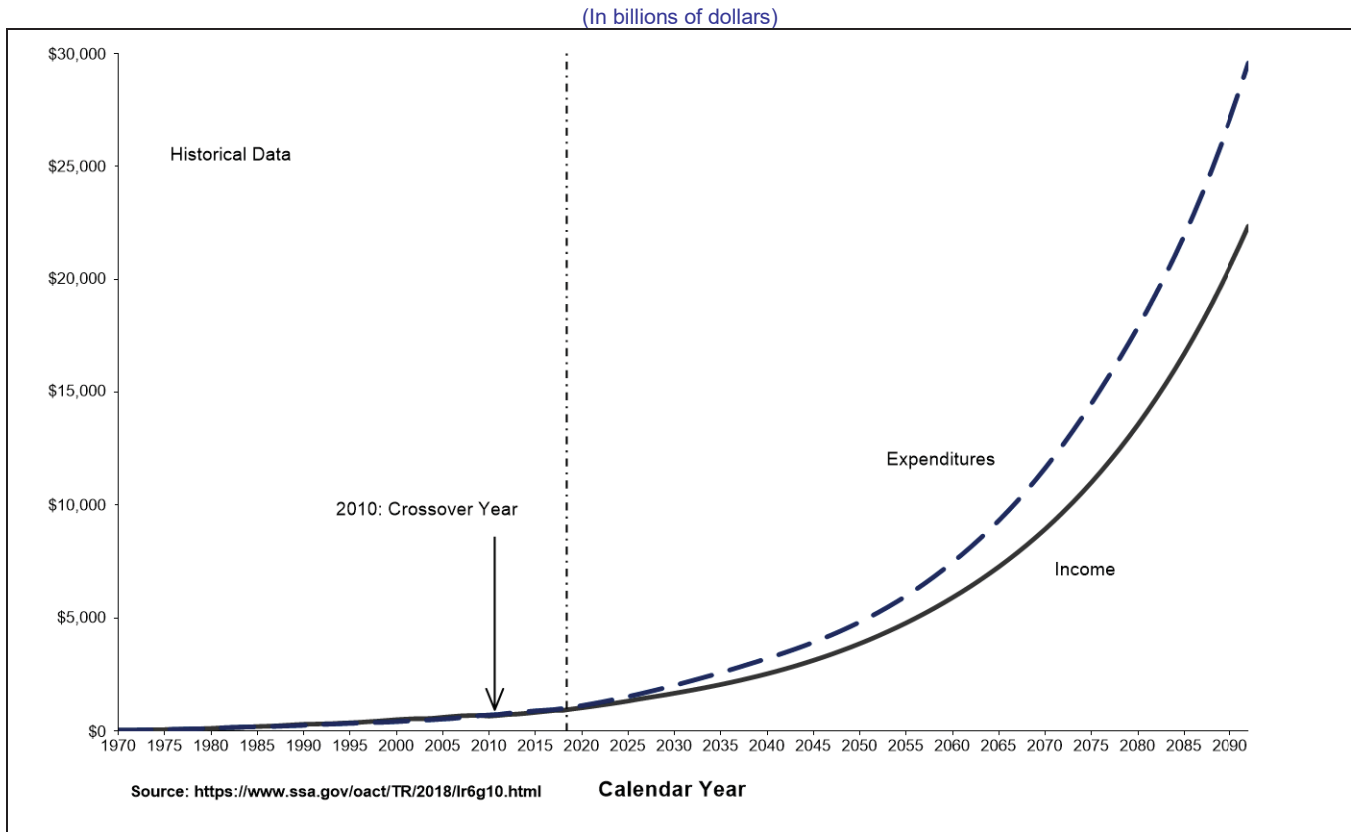
**Chart 1—Number of Covered Workers per OASDI Beneficiary
1970-2092**



Social Security Projections

Income and Expenditures. Chart 2 shows historical values and actuarial estimates of combined OASDI annual noninterest income and expenditures for 1970-2092. The estimates are for the open-group population of all workers and beneficiaries projected to be alive in each year. The expenditure projections in Chart 2 and all subsequent charts assume all scheduled benefits are paid regardless of whether the income and assets are available to finance them.

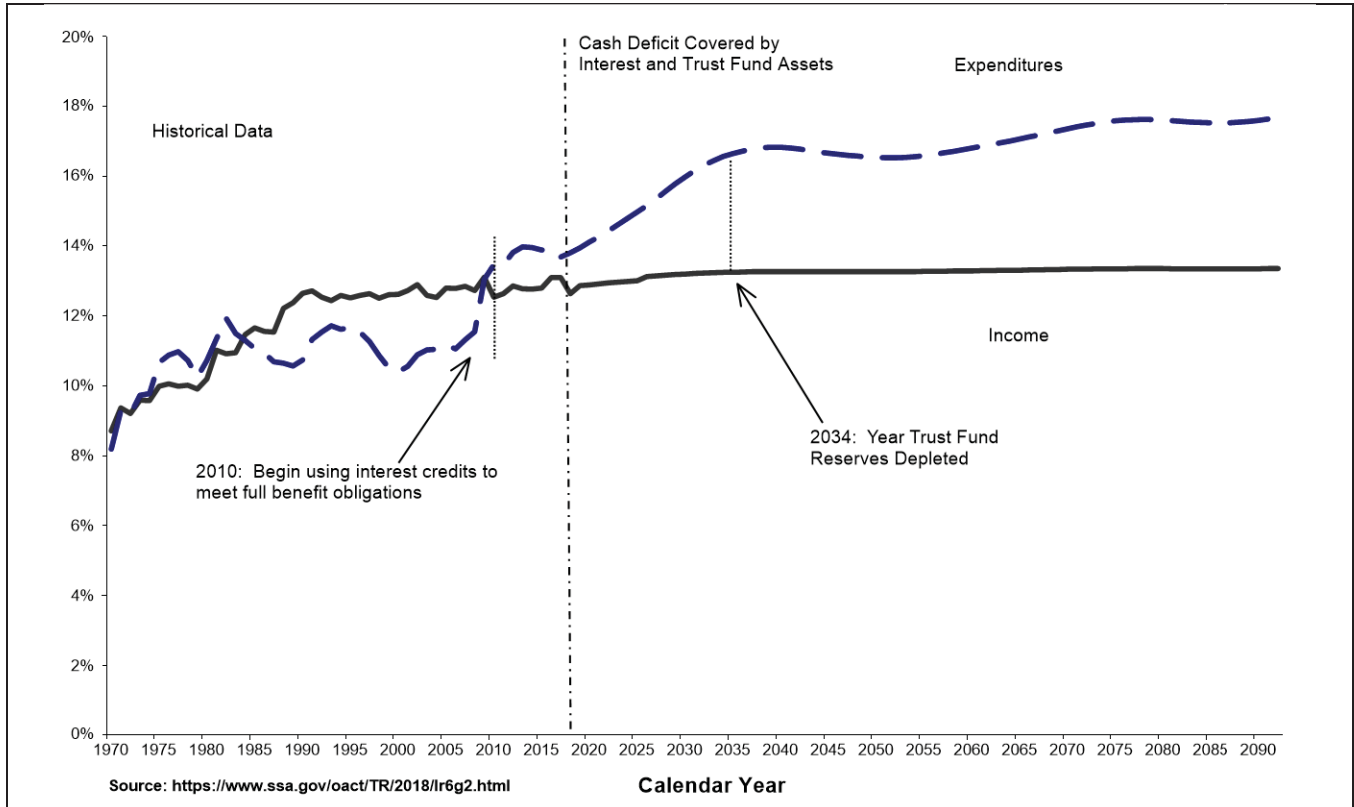
**Chart 2—OASDI Income (Excluding Interest) and Expenditures
1970-2092**



Annual OASDI cost exceeded noninterest income in 2010 for the first time since 1983. It is projected that cost will continue to exceed noninterest income throughout the 75-year valuation period. Projected OASDI cost increases more rapidly than projected noninterest income through 2039 primarily because the retirement of the baby-boom generation will increase the number of beneficiaries much faster than the number of covered workers increases, as subsequent lower-birth-rate generations replace the baby-boom generation at working ages. From 2040 to 2052, the cost rate (the ratio of program cost to taxable payroll) generally declines because the aging baby-boom generation is gradually replaced at retirement ages by subsequent low-birth-rate generations. Thereafter, increases in life expectancy cause OASDI cost to increase generally relative to noninterest income, but more slowly than between 2010 and 2039. Beginning in 2018, cost exceeds total income, and combined OASI and DI Trust Fund reserves diminish until they become depleted in 2034. After trust fund reserve depletion, continuing income is sufficient to support expenditures at a level of 79 percent of program cost for the rest of 2034, declining to 74 percent for 2092. To meet all OASDI cost on a timely basis, the combined OASI and DI Trust Funds will need to redeem Treasury securities. OASDI cost is projected to exceed total income (including interest) in 2018 for the first time since 1982, and remain higher throughout the 75-year valuation period. Therefore, the combined OASI and DI Trust Funds will be net borrowers from the General Fund going forward, rather than net lenders. The government could finance increased redemptions by increasing its borrowing from the public, raising taxes (other than OASDI payroll taxes), and/or reducing expenditures (other than OASDI cost).

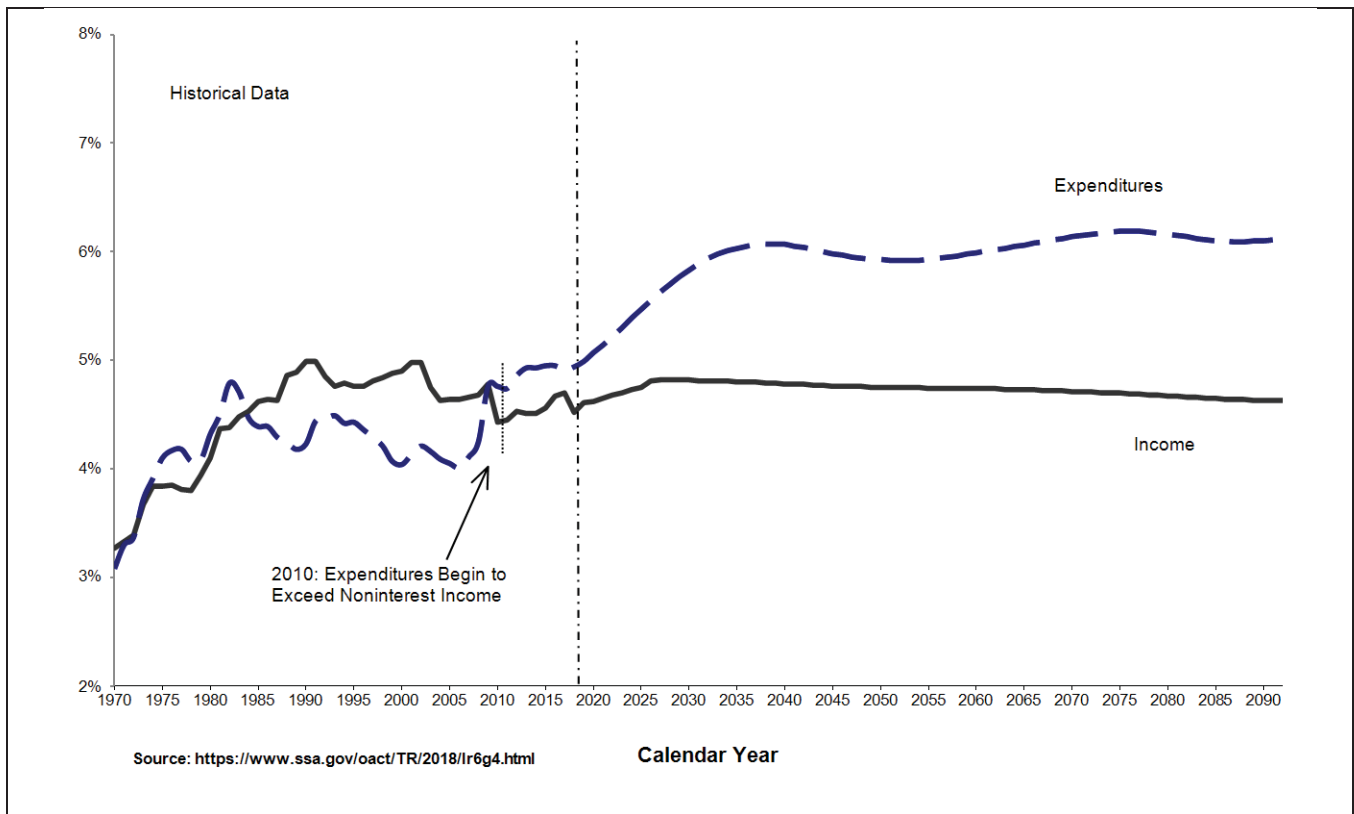
Income and Expenditures as a Percent of Taxable Payroll. Chart 3 shows annual noninterest income and expenditures expressed as percentages of taxable payroll, commonly referred to as the income rate and cost rate, respectively. Under the intermediate assumptions, demographic factors would by themselves cause the projected cost rate to rise rapidly for the next two decades before leveling off in about 2035. However, the recent recession temporarily depressed taxable earnings and increased the number of beneficiaries, which in turn sharply, but temporarily, increased the cost rate starting in 2009. From a peak in 2013, the cost rate generally declines through 2017 under the economic recovery and thereafter returns to a gradually rising trend. The projected income rate is stable at about 13 percent throughout the 75-year period.

Chart 3—OASDI Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2092



Income and Expenditures as a Percent of GDP. Chart 4 shows estimated annual noninterest income and expenditures, expressed as a percent of GDP, which is the total value of goods and services produced in the U.S. This alternative perspective shows the size of the OASDI Program in relation to the capacity of the national economy to sustain it. In calendar year 2017, OASDI cost was about \$952 billion, which was about 4.9 percent of GDP. The cost of the program (based on current law) rises rapidly to 6.1 by 2038, then declines to 5.9 percent by 2052, and then generally increases to 6.1 percent by 2092. The rapid increase from 2018 to 2035 is projected to occur as baby boomers become eligible for OASDI benefits, lower birth rates result in fewer workers per beneficiary, and beneficiaries continue to live longer. In 2092, expenditures are projected to exceed income by approximately 1.50 percent of GDP. Social Security’s noninterest income is projected to drop to 4.5 percent in 2018, then increase to about 4.8 percent of GDP by 2028. Thereafter, noninterest income as a percent of GDP declines gradually, to about 4.6 percent by 2092, because the Trustees expect the share of employee compensation provided as non-covered fringe benefits to increase gradually.

Chart 4—OASDI Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2092



Sensitivity Analysis. Projections of the future financial status of the OASDI program depend on many demographic and economic assumptions, including fertility, mortality, net immigration, average wages, inflation, and interest rates on Treasury securities. The income will depend on how these factors affect the size and composition of the working population and the level and distribution of wages and earnings. Similarly, the cost will depend on how these factors affect the size and composition of the beneficiary population and the general level of benefits.

Because perfect long-range projections of these factors are impossible and actual experience is likely to differ from the estimated or assumed values of these factors, this section is included to illustrate the sensitivity of the long-range projections to changes in assumptions by analyzing six key assumptions: total fertility rate, average annual reduction in death rates, net immigration, real-wage differential, CPI change, and real interest rate. For this analysis, the intermediate assumptions are used as the reference point, and each selected assumption is varied individually. The variation used for each individual assumption reflects the levels used for that assumption in the low-cost (Alternative I) and high-cost (Alternative III) projections. For example, when analyzing sensitivity with respect to variation in real wages, income, and expenditure projections using the intermediate assumptions are compared to the outcome when projections are done by changing only the real wage assumption to either low-cost or high-cost alternatives.

The low-cost alternative is characterized by assumptions that improve the financial status of the program (relative to the intermediate assumption) such as slower improvement in mortality (beneficiaries die younger). In contrast, assumptions under the high-cost alternative worsen the financial outlook. All present values are calculated as of January 1, 2018 and are based on estimates of income and cost during the 75-year projection period 2018-2092.

Table 2 shows the effects of changing individual assumptions on the present value of estimated OASDI expenditures in excess of income (the *shortfall* of income relative to expenditures in present value terms). The assumptions are shown in parentheses. For example, if the annual reduction in death rates were changed from 0.77 percent, the intermediate assumption, to 0.41 percent, meaning that people die younger, the shortfall for the period of estimated OASDI income relative to cost would decrease to \$13,574 billion from \$16,057 billion; if the annual reduction were changed to 1.15 percent, meaning that people live longer, the shortfall would increase to \$18,761 billion.

A higher fertility rate means more workers relative to beneficiaries over the projection period, thereby lowering the shortfall relative to the intermediate assumption. Table 2 demonstrates that if the ultimate total fertility rate were changed from 2.0 children per woman, the intermediate assumption, to 1.8 children per woman, the shortfall for the period of estimated OASDI income relative to cost would increase to \$17,591 billion from \$16,057 billion; if the ultimate rate were changed to 2.2 children per woman, the shortfall would decrease to \$14,509 billion.

The annual real-wage differential is the difference between the percentage increases in: (1) the average annual wage in OASDI covered employment; and (2) the average annual CPI. Higher real wage growth results in faster income growth relative to expenditure growth. As shown in Table 2, if the ultimate real-wage differential were changed from 1.20 percentage points, the intermediate assumption, to 0.58 percentage points, the shortfall for the period of estimated OASDI income relative to cost would increase to \$18,489 billion from \$16,057 billion; if the ultimate real-wage differential were changed from 1.20 to 1.82 percentage points, the shortfall would decrease to \$12,378 billion.

Table 2 demonstrates that if the ultimate annual increase in the CPI were changed from 2.6 percent, the intermediate assumption, to 2.0 percent, the shortfall for the period of estimated OASDI income relative to cost would increase to \$16,535 billion from \$16,057 billion; if the ultimate annual increase in the CPI were changed to 3.2 percent, the shortfall would decrease to \$15,551 billion. The seemingly counter-intuitive result that higher CPI increases result in decreased shortfalls (and vice versa) is explained by the time lag between the effects of the CPI changes on taxable payroll and on benefit payments. The effect on taxable payroll due to a greater increase in average wages is experienced immediately, while the effect on benefits is experienced with a lag of about one year. For this reason, larger increases in the CPI cause earnings and income to increase sooner and, therefore, by more each year, than benefits and cost.

Immigration generally occurs at relatively young adult ages, so there is no significant effect on beneficiaries (and, therefore, on benefits) in the early years of the projection period, but the effect on the numbers of workers (and, therefore, on payroll tax income) is immediate. Therefore, even in the early years, the present values, year by year, are generally higher (less negative in later years) for higher net annual immigration. However, the increased payroll taxes for a given year are eventually offset by benefits paid in that year to earlier immigrant cohorts. Therefore, the present values based on the three assumptions about net annual immigration become more similar at the end of the projection period. Table 2 shows that if the intermediate immigration assumptions were changed so that the average level for the 75-year period decreased from 1,272,000 persons to 952,000 persons, the present value of the shortfall for the period of estimated OASDI income relative to cost would increase to \$16,914 billion from \$16,057 billion. If, instead, the immigration assumptions were changed so that net annual immigration would be expected to average 1,607,000 persons, the present value of the shortfall would decrease to \$15,274 billion.

Finally, Table 2 shows the sensitivity of the shortfall to variations in the real interest rate or, in present value terminology, the sensitivity to alternative discount rates assuming a higher discount rate results in a lower present value. If the ultimate real interest rate were changed from 2.7 percent, the intermediate assumption, to 2.2 percent, the shortfall for the

period of estimated OASDI income relative to cost, when measured in present-value terms would increase to \$18,999 billion from \$16,057 billion; if the ultimate annual real interest rate were changed to 3.2 percent, the present-value shortfall would decrease to \$13,713 billion.

Table 2
Present Values of Estimated OASDI Expenditures in Excess of Income
Under Various Assumptions, 2018-2092

(Dollar values in billions; values of assumptions shown in parentheses)

| Assumption | Financing Shortfall Range | | |
|---|---------------------------|-----------------------|---------------------|
| | Low | Intermediate | High |
| Average annual reduction in death rates | 13,574 (0.41) | 16,057 (0.77) | 18,761 (1.15) |
| Total fertility rate..... | 14,509 (2.2) | 16,057 (2.0) | 17,591 (1.8) |
| Real-wage differential | 12,378 (1.82) | 16,057 (1.20) | 18,489 (0.58) |
| CPI change..... | 15,551 (3.2) | 16,057 (2.6) | 16,535 (2.0) |
| Net immigration ¹ | 15,274 (1,607,000) | 16,057 (1,272,000) | 16,914 (952,000) |
| Real interest rate..... | 13,713 (3.2) | 16,057 (2.7) | 18,999 (2.2) |

¹ Amounts represent the average annual net immigration over the 75-year projection period.

Source: 2018 OASDI Trustees Report and SSA.

Medicare Projections

Medicare Legislation. The projections in this year's report include the enactment of the MACRA, which was enacted in 2015 and repealed the SGR formula that set physician fee schedule payments. While the physician payment updates and new incentives put in place by MACRA avoid the significant short-range physician payment issues that would have resulted from the SGR system approach, they nevertheless raise important long-range concerns. In particular, additional payments of \$500 million per year for one group of physicians and 5 percent annual bonuses for another group are scheduled to expire in 2025, resulting in a significant one-time payment reduction for most physicians. In addition, the law specifies the physician payment update amounts for all years in the future, and these amounts do not vary based on underlying economic conditions, nor are they expected to keep pace with the average rate of physician cost increases. The specified rate updates could be an issue in years when levels of inflation are high and would be problematic when the cumulative gap between the price updates and physician costs becomes large. The gap will continue to widen throughout the projection, and it is estimated that physician payment rates under current law will be lower than they would have been under the SGR formula by 2048. Absent a change in the delivery system or level of update by subsequent legislation, access to Medicare-participating physicians may become a significant issue in the long term under current law.

Incorporated in these projections is the sequestration of non-salary Medicare expenditures as required by the following laws:

- *Budget Control Act of 2011* (P.L. 112-25, enacted on August 2, 2011), as amended by the *American Taxpayer Relief Act of 2012* (P.L. 112-240, enacted on January 2, 2013);
- *Continuing Appropriations Resolution, 2014* (P.L. 113-67, enacted on December 26, 2013);
- Sections 1 and 3 of P.L. 113-82, enacted on February 15, 2014;
- *Protecting Access to Medicare Act of 2014* (P.L. 113-93, enacted on April 1, 2014);
- *BBA of 2015* (P.L. 114-74, enacted on November 2, 2015); and
- *BBA of 2018* (P.L. 115-123, enacted on February 9, 2018).

The sequestration reduces benefit payments by 2 percent from April 1, 2013 through March 31, 2027, and by 4 percent from April 1, 2027 through September 30, 2027. Due to sequestration, non-salary administrative expenses are reduced by an estimated 5 to 7 percent from March 1, 2013 through September 30, 2027.

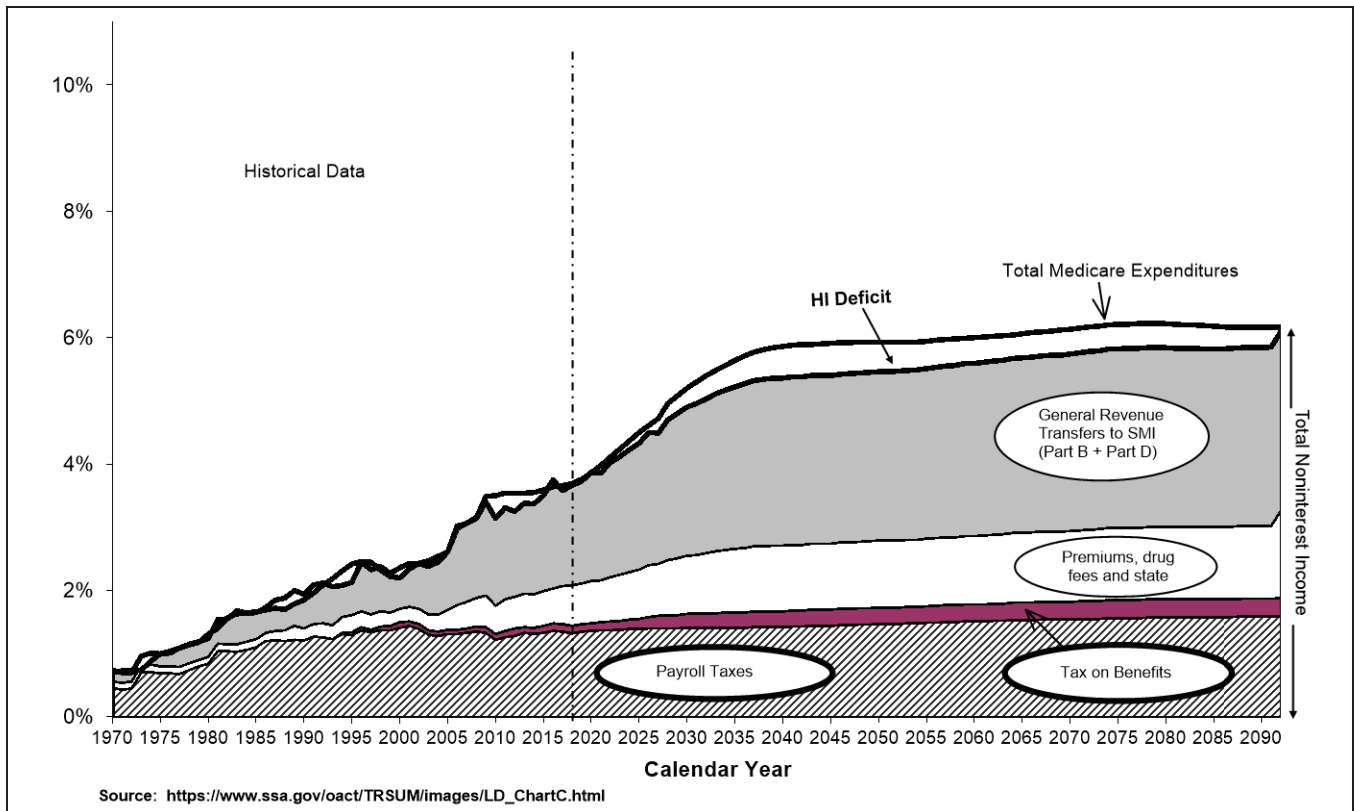
These projections also incorporate the effects of the *Patient Protection and Affordable Care Act*, as amended by the *HCERA of 2010*. This legislation, referred to collectively as the *Affordable Care Act* or ACA, was enacted in 2010 and contains roughly 165 provisions affecting the Medicare program by reducing costs, increasing revenues, improving benefits, combating fraud and abuse, and initiating a major program of R&D to identify alternative provider payment mechanisms, health care delivery systems, and other changes intended to improve the quality of health care and reduce costs.

The 2018 Medicare Trustees' Report warns that the financial projections for the Medicare program reflect substantial, but very uncertain, cost savings deriving from provisions of the ACA and MACRA that lower increases in Medicare payment rates to most categories of health care providers. Without fundamental change in the current delivery system, these adjustments would probably not be viable indefinitely. It is conceivable that providers could improve their productivity, reduce wasteful expenditures, and take other steps to keep their cost growth within the bounds imposed by the Medicare price limitations. For such efforts to be successful in the long range, however, providers would have to generate and sustain unprecedented levels of productivity gains—a very challenging and uncertain prospect. In view of the factors described above, it is important to note that Medicare's actual future costs are highly uncertain for reasons apart from the inherent challenges in projecting health care cost growth over time.

Changes in Projection Methods. The projections in this year's report, with one exception related to Part A, are based on current law; that is, it is assumed that laws on the books will be implemented and adhered to with respect to scheduled taxes, premium revenues, and payments to providers and health plans. The one exception is that the projections disregard payment reductions that would result from the projected depletion of the HI Trust Fund. Under current law, payments would be reduced to levels that could be covered by incoming tax and premium revenues when the HI Trust Fund was depleted.

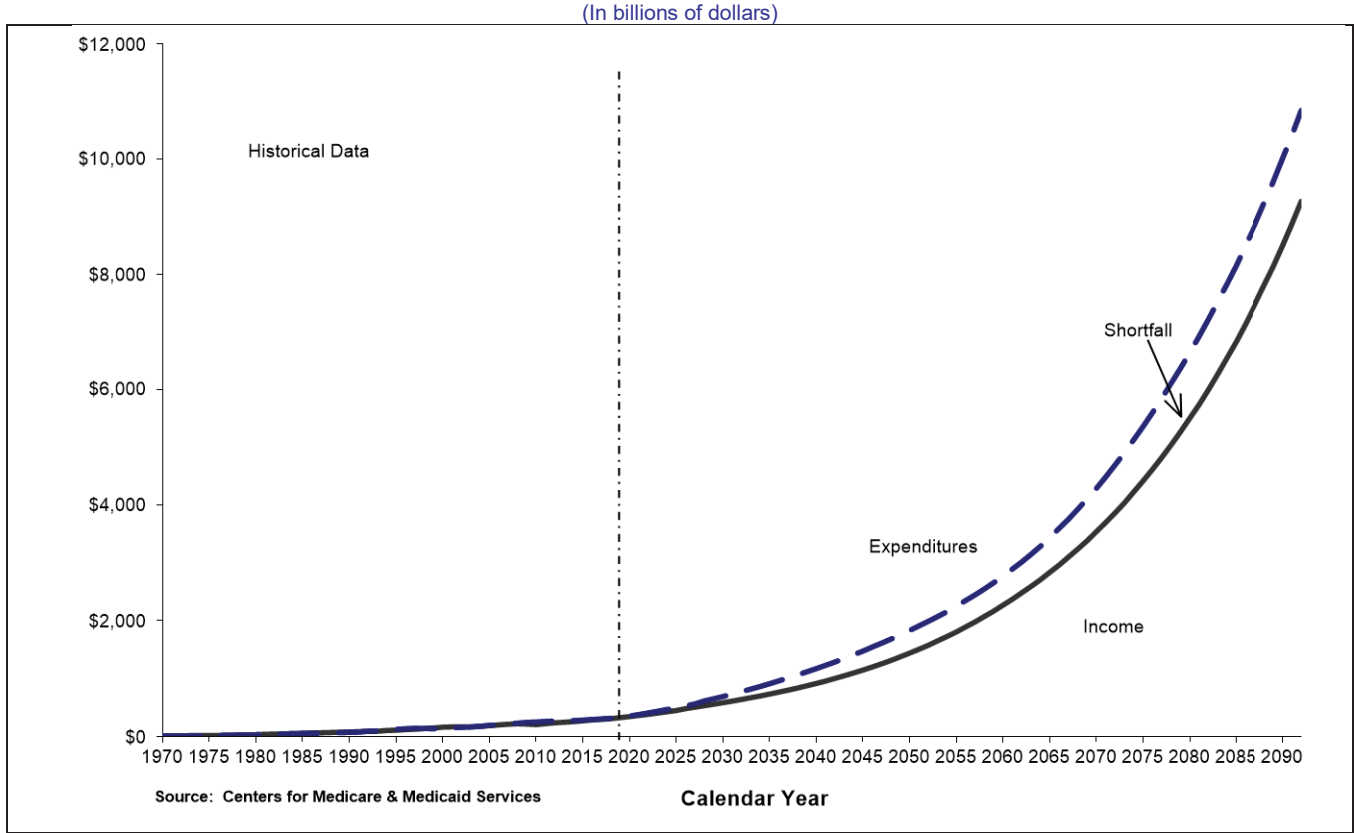
Total Medicare. Chart 5 shows expenditures and current-law noninterest revenue sources for HI and SMI combined as a percent of GDP. Under the ACA, beginning in 2013 the HI Trust Fund receives an additional 0.9 percent tax on earnings in excess of \$250,000 for joint tax return filers and \$200,000 for individual tax return filers. As a result of this provision, it is projected that payroll taxes will grow slightly faster than GDP. After 2018, HI revenue from income taxes on Social Security benefits will gradually increase as a share of GDP as the share of benefits subject to such taxes increases. Beginning in 2009, as HI payroll tax receipts declined due to the recession and general revenue transfers increased, the latter income source became the largest single source of income to the Medicare program as a whole. General revenue transfers to the Part B account increased significantly in 2016, as required by the BBA of 2015 to compensate for premium revenue that was not received in 2016 due to the hold harmless provision, which limited the Part B premium increase for a majority of beneficiaries. After decreasing from 2016 to 2017, general revenues will gradually increase as a share of Medicare financing from 2018 through 2032 and grow to about 49 percent, stabilizing thereafter. SMI premiums will also grow in proportion to general revenue transfers, placing a growing burden on beneficiaries. High-income beneficiaries have paid an income-related premium for Part B since 2007 and for Part D since 2011. SMI general revenues equal 1.5 percent of GDP in 2017 and will increase to an estimated 2.8 percent in 2092 under current law.

Chart 5—Total Medicare (HI and SMI) Expenditures and Noninterest Income as a Percent of GDP 1970-2092



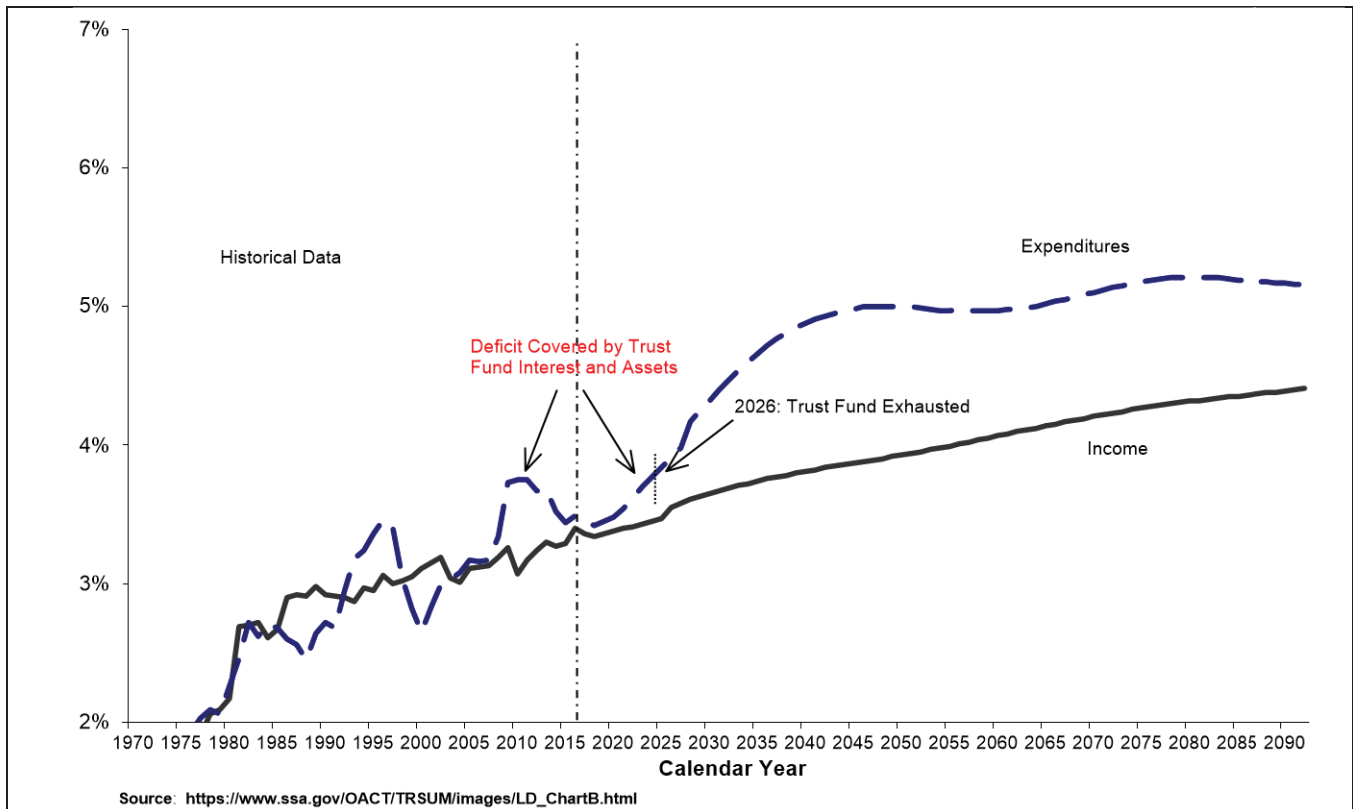
Medicare, Part A (Hospital Insurance)—Income and Expenditures. Chart 6 shows historical and actuarial estimates of HI annual income (excluding interest) and expenditures for 1970-2092 in nominal dollars. The estimates are for the open-group population.

**Chart 6—Medicare Part A Income (Excluding Interest) and Expenditures
1970-2092**



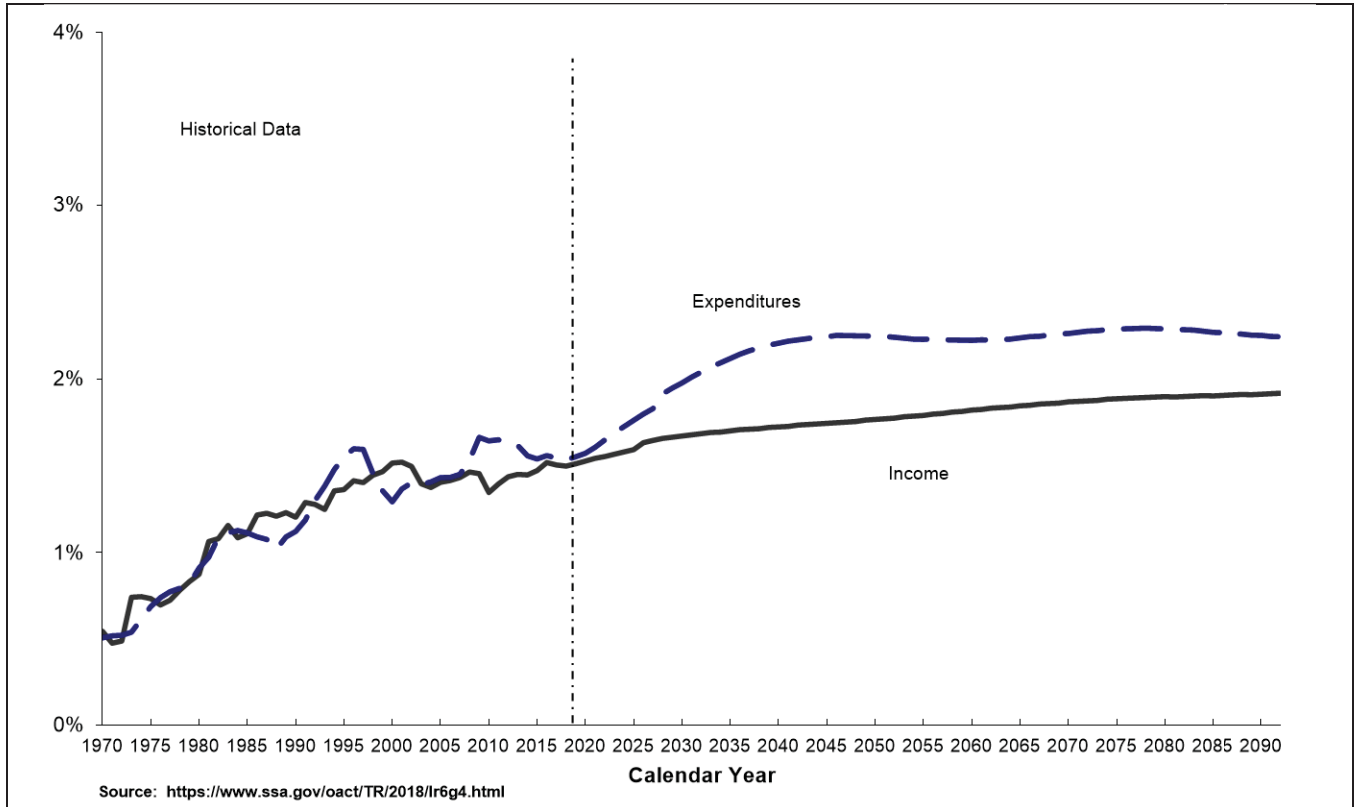
Medicare, Part A Income and Expenditures as a Percent of Taxable Payroll. Chart 7 illustrates income (excluding interest) and expenditures as a percentage of taxable payroll over the next 75 years. The projected HI cost rates shown in the 2018 report are higher than those from the 2017 report for all years largely due to higher spending and lower taxable payroll in all projected years. The standard HI payroll tax rate is scheduled to remain constant at 2.90 percent (for employees and employers, combined). In addition, starting in 2013, high-income workers pay an additional 0.9 percent of their earnings above \$200,000 (for single workers) or \$250,000 (for married couples filing joint income tax returns). Since these income thresholds are not indexed, over time an increasing proportion of workers and their earnings will become subject to the additional HI tax rate. (By the end of the long-range projection period, an estimated 79 percent of workers would be subject to this tax.) Thus, HI payroll tax revenues will increase steadily as a percentage of taxable payroll. Similarly, after 2019, HI income from taxation of Social Security benefits will also increase faster than taxable payroll because the income thresholds determining taxable benefits are not indexed for price inflation. The cost rate has mostly been declining since 2010, and it is projected to continue to decline in 2018, largely due to (i) expenditure growth that was constrained in part by low utilization and low payment updates, and (ii) a rebound of taxable payroll growth from 2007-2009 recession levels. After 2018 the cost rate is projected to rise primarily due to retirements of those in the baby-boom generation and partly due to a projected return to modest health services cost growth. This cost rate increase is moderated by the accumulating effect of the productivity adjustments to provider price updates, which are estimated to reduce annual HI per capita cost growth by an average of 0.8 percent through 2027 and 1.1 percent thereafter. The noninterest income is projected to decrease from 91 percent in 2026 to 78 percent in 2042, and then to increase to about 85 percent by the end of the projection period.

**Chart 7—Medicare Part A Income (Excluding Interest) and Expenditures
as a Percent of Taxable Payroll
1970-2092**



Medicare, Part A Income and Expenditures as a Percent of GDP. Chart 8 shows estimated annual noninterest income and expenditures, expressed as a percent of GDP, the total value of goods and services produced in the U.S. This alternative perspective shows the size of the HI Program in relation to the capacity of the national economy to sustain it. Under the intermediate and high-cost assumptions, the HI annual balance is negative for all years of the projection period. Under the intermediate assumptions, annual deficits generally increase through 2045, and then generally decline thereafter. The gap between expenditure and income shares of GDP widens to 0.50 percent in 2045, and then commences a slight decline, reaching 0.33 percent of GDP in 2092.

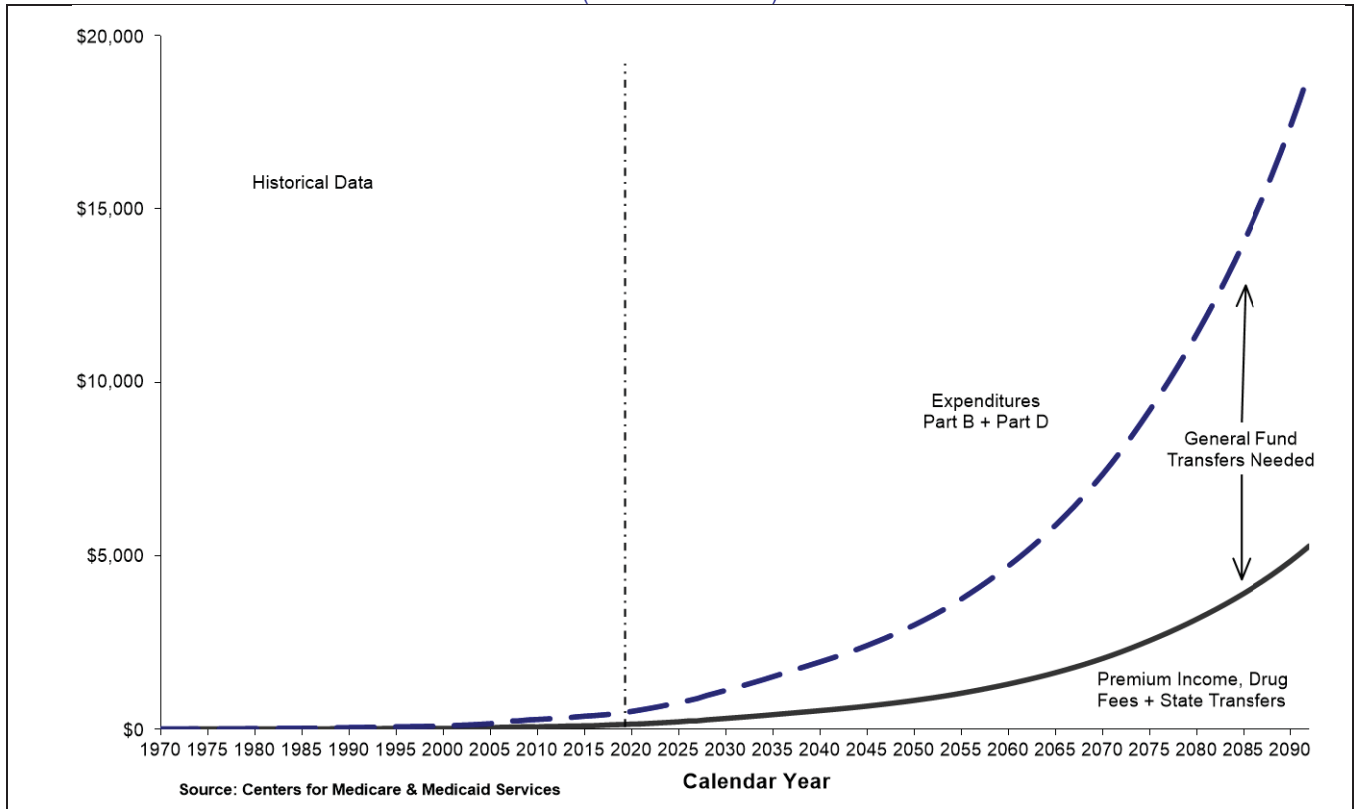
Chart 8—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2092



Medicare, Parts B and D SMI. Chart 9 shows historical and actuarial estimates of Medicare Part B and Part D premiums (and Part D state transfers) as well as expenditures for each of the next 75 years, in dollars. Beneficiary premiums and general revenue contributions for both Part B and Part D are established annually to cover the expected costs for the upcoming year. Should actual costs exceed those anticipated when the financing is determined, future financing rates can include adjustments to recover the shortfall. Likewise, should actual costs be less than those anticipated, the savings would result in lower future financing rates. The gap between program expenditures and revenues from premiums, drug fees, and state transfers grows throughout the projection period. This gap will need to be filled with general revenue transfers.

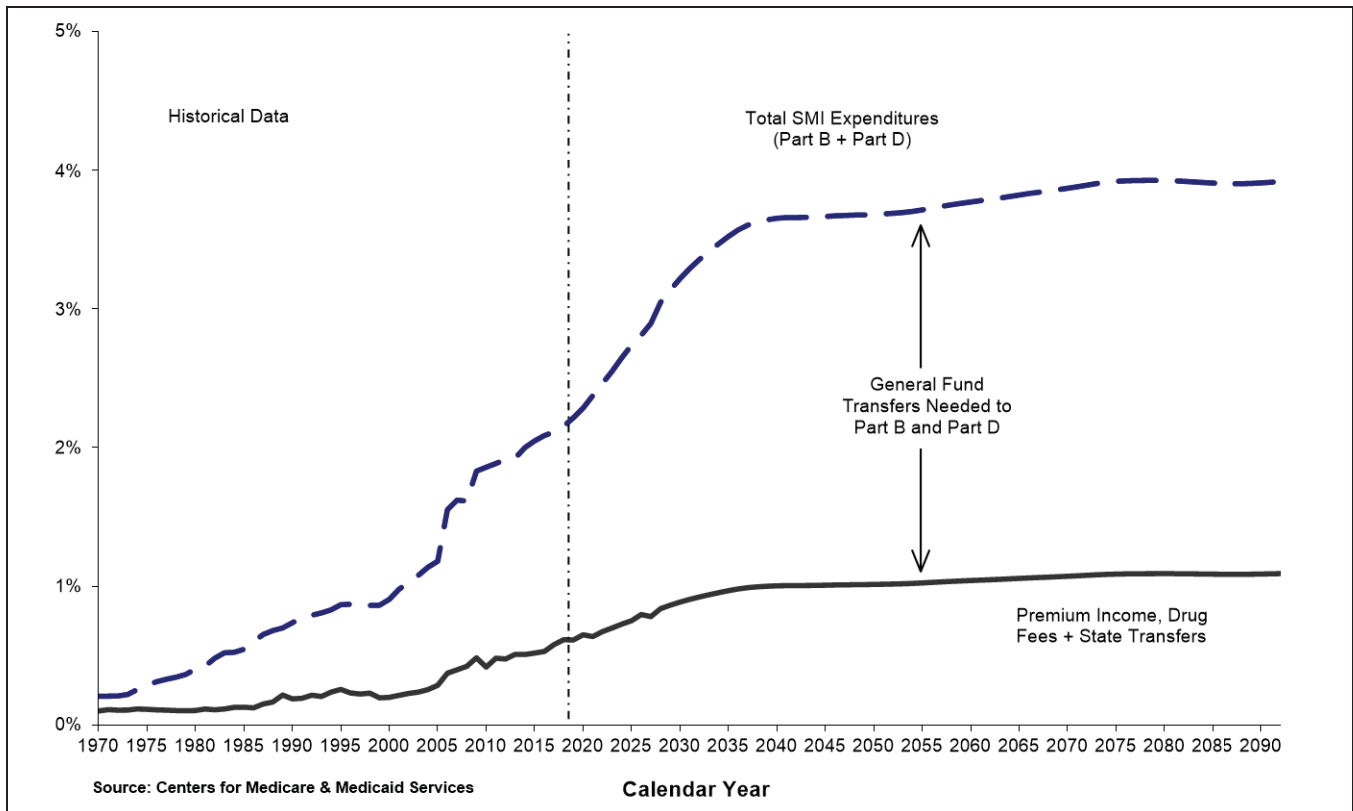
Chart 9—Medicare Part B and Part D Premium and State Transfer Income and Expenditures 1970-2092

(In billions of dollars)



Medicare Part B and Part D Premium as well as State Transfer Income and Expenditures as a Percent of GDP. Chart 10 shows expenditures for the SMI Program over the next 75 years expressed as a percent of GDP, providing a perspective on the size of the SMI Program in relation to the capacity of the national economy to sustain it. SMI costs are projected to continue to outpace growth in GDP but at a slower rate compared to the last 10 years. Total SMI expenditures amounted to 2.1 percent of GDP in 2017 and are projected to grow to about 3.7 percent of GDP within 25 years and to 3.9 percent by the end of the projection period. The relatively high growth during the period 2018-2027 is due to the continuing retirement of the baby-boom generation and modest increases in cost trends. Growth rates are projected to decline during the 2028-2042 period primarily as a result of a deceleration in beneficiary population growth. For the last 50 years of the projection period, cost growth moderates further due to the continued deceleration in beneficiary population growth and lower health care cost growth rate assumptions. To match the faster growth rates for SMI expenditures, beneficiary premiums, along with general revenue contributions, would increase more rapidly than GDP over time but at a slower rate compared to the last 10 years. Average per beneficiary costs for Part B and Part D benefits are projected to increase after 2017 by about 4.3 percent annually. The associated beneficiary premiums—and general revenue financing—would increase by approximately the same rate.

Chart 10—Medicare Part B and Part D Premium and State Transfer Income and Expenditures as a Percent of GDP 1970-2092



Medicare Sensitivity Analysis. This section illustrates the sensitivity of long-range cost and income estimates for the Medicare Program to changes in *selected individual assumptions*. As with the OASDI analysis, the intermediate assumption is used as a reference point, and each selected assumption is varied individually to produce three scenarios. The variation used for each individual assumption reflects the levels used for that assumption in the low-cost and high-cost projections (see description of sensitivity analysis for OASDI). All present values are calculated as of January 1, 2018 and are based on estimates of income and expenditures during the 75-year projection period.

Table 3 shows the net present value of cash flow during the 75-year projection period under three alternative assumptions for the annual growth rate in the aggregate cost of providing covered health care services to beneficiaries. These assumptions are that the ultimate annual growth rate in such costs, relative to taxable payroll, will be 1 percent slower than

the intermediate assumptions, the same as the intermediate assumptions, and 1 percent faster than the intermediate assumptions. The assumptions are shown in parentheses. The table demonstrates that if the ultimate growth rate assumption is 1 percentage point lower than the intermediate assumption, the deficit decreases by \$7,812 billion. On the other hand, if the ultimate growth rate assumption is 1 percentage point higher than the intermediate assumption, the deficit increases substantially by \$12,472 billion. This assumption has a dramatic impact on projected HI cash flow. The present value of the net cash flow under the ultimate growth rate assumption of 1 percentage point lower than the intermediate assumption actually becomes a surplus due to the improved financial outlook for the HI trust fund as a result of the ACA. Several factors, such as the utilization of services by beneficiaries or the relative complexity of services provided, can affect costs without affecting tax income. As the table indicates, the financial status of the HI Trust Fund is extremely sensitive to the relative growth rates for health care service costs.

The fertility rate assumption has a substantial impact on projected HI cash flows. As demonstrated by Table 3, for an increase of 0.2 in the assumed ultimate fertility rate, the projected present value of the HI deficit decreases by approximately \$562 billion, and for a decrease of 0.2 in the assumed ultimate fertility rate, the projected present value of the HI deficit increases by approximately \$557 billion. Under the higher fertility rate assumptions, there will be additional workers in the labor force after 20 years, and many will become subject to the additional HI tax, thereby lowering the deficit proportionately more on a present-value-dollar basis. On the other hand, under the lower fertility rate assumptions, there will be fewer workers in the workforce with a smaller number subject to the additional tax, in turn raising the HI deficit. It is important to point out that if a longer projection period were used, the impact of a fertility rate change would be more pronounced.

Relative to the intermediate case, for an increase in the ultimate real-wage differential assumption of 0.6 percentage points, the deficit—expressed in present-value dollars—decreases by approximately \$2,394 billion. Conversely, for a decrease in the ultimate real-wage differential assumption of 0.6 percentage points, the deficit increases by about \$1,271 billion. When expressed in present-value dollars, faster real-wage growth results in smaller HI cash flow deficits. A higher real-wage differential immediately increases both HI expenditures for health care and wages for all workers. There is a full effect on wages and payroll taxes, but the effect on benefits is only partial, since not all health care costs are wage-related. In practice, faster real-wage growth always improves the financial status of the HI trust fund, regardless of whether there is a small or large imbalance between income and expenditures.

As Table 3 indicates, the change in CPI inflation has an impact when the cash flow is expressed as present values. If the ultimate CPI-increase assumption is changed from 2.6 percent, the intermediate assumption, to 3.2 percent, the deficit decreases by \$1,060 billion. On the other hand, if the ultimate CPI-increase is changed from 2.6 percent, the intermediate assumption, to 2.0 percent, the deficit increases by \$1,375 billion. The projected present values of HI cash flow are relatively insensitive to the assumed level of general price inflation because price inflation has about the same proportionate effect on income as it does on costs. In present value terms, a smaller deficit results under high-inflation conditions because the present values of HI expenditures are not significantly different under the various CPI scenarios, but under high-inflation conditions the present value of HI income increases as more people become subject to the additional 0.9 percent HI tax rate required by the ACA for workers with earnings above \$200,000 or \$250,000 (for single and joint income-tax filers, respectively). Since the thresholds are not indexed, additional workers become subject to the additional tax more quickly under conditions of faster inflation, and vice versa.

Higher net immigration results in smaller HI cash flow deficits. Since immigration tends to occur most often among people at working ages, who work and pay taxes into the HI system, a change in the net immigration assumption affects revenues from payroll taxes almost immediately. However, the impact on expenditures occurs later as those individuals age and become beneficiaries.

Table 3 also shows that the present value of net HI expenditures is approximately 15 percent lower if the real interest rate is 3.2 percent rather than 2.7 percent, and approximately 18 percent higher if the real interest rate is 2.2 percent rather than 2.7 percent.

Table 3
Present Values of Estimated Medicare Part A Expenditures in Excess of Income
Under Various Assumptions, 2018-2092

(Dollar values in billions; values of assumptions shown in parentheses)

| Assumption ¹ | Financing Shortfall Range | | |
|--|---------------------------|----------------------|--------------------|
| | Low | Intermediate | High |
| Average annual growth in health costs ² | (3,104) (2.7) | 4,708 (3.7) | 17,180 (4.7) |
| Total fertility rate ³ | 4,146 (2.2) | 4,708 (2.0) | 5,265 (1.8) |
| Real wage differential | 2,314 (1.8) | 4,708 (1.2) | 5,979 (0.6) |
| CPI change | 3,648 (3.2) | 4,708 (2.6) | 6,083 (2.0) |
| Net immigration ⁴ | 4,503 (1,607,000) | 4,708 (1,272,000) | 4,973 (952,000) |
| Real interest rate | 4,018 (3.2) | 4,708 (2.7) | 5,542 (2.2) |

¹ The sensitivity of the projected HI net cash flow to variations in future mortality rates also is of interest. At this time, however, relatively little is known about the relationship between improvements in life expectancy and the associated changes in health status and per beneficiary health expenditures. As a result, it is not possible at present to prepare meaningful estimates of the Part A, mortality sensitivity.

² Annual growth rate is the aggregate cost of providing covered health care services to beneficiaries. The low-cost and high-cost alternatives assume that costs increase 1 percent slower or faster, respectively, than the intermediate assumption, relative to growth in taxable payroll.

³ The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year and if she were to survive the entire childbearing period.

⁴ Amount represents the average annual net immigration over the 75-year projection period.

Source: CMS

Table 4 shows the effects of various assumptions about the growth in health care costs on the present value of estimated SMI (Medicare Parts B and D) expenditures in excess of income. As with HI, net SMI expenditures are very sensitive to changes in the health care cost growth assumption. For the low-cost alternative, the slower assumed growth in health costs reduces the governmentwide resources needed for Part B from \$25,079 billion to \$18,175 billion and in Part D from \$7,902 billion to \$5,587 billion, about a 28 percent and 29 percent difference for Part B and Part D, respectively. The high-cost assumption increases governmentwide resources needed to \$35,846 billion for Part B and to \$11,585 billion for Part D, about a 43 percent and a 47 percent difference for Part B and Part D, respectively.

Table 4
Present Values of Estimated Medicare Parts B and D Future Expenditures
Less Premium Income and State Transfers Under Three Health Care Cost
Growth Assumptions, 2018-2092

(In billions of dollars)

| Medicare Program ¹ | Governmentwide Resources Needed | | |
|-------------------------------|---------------------------------|-----------------------|---------------|
| | Low (3.3) | Intermediate (4.3) | High (5.3) |
| Part B..... | 18,175 | 25,079 | 35,846 |
| Part D..... | 5,587 | 7,902 | 11,585 |

¹ Annual growth rate is the aggregate cost of providing covered health care services to beneficiaries. The low and high scenarios assume that costs increase one percent slower or faster, respectively, than the intermediate assumption.

Source: CMS

Sustainability of Social Security and Medicare

75-Year Horizon

According to the 2018 Medicare Trustees Report, the HI Trust Fund is projected to remain solvent until 2026 and, according to the 2018 Social Security Trustees Report, the OASI and DI Trust Funds are projected to have sufficient asset reserves to pay full benefits on time until 2034 and 2032, respectively. In each case, some general revenues must be used to satisfy the authorization of full benefit payments until the year of trust fund depletion. This occurs when the trust fund interest income and balances accumulated during prior years are needed to pay benefits, which leads to a transfer from general revenues to the trust funds. Moreover, under current law, General Fund transfers to the SMI Trust Fund will occur into the indefinite future and will continue to grow with the growth in health care expenditures.

The potential magnitude of future financial obligations under these three social insurance programs is, therefore, important from a budget perspective as well as for understanding generally the growing resource demands of the programs on the economy. A common way to present future cash flows is in terms of their *present value*. This approach recognizes that a dollar paid or collected next year is worth less than a dollar today because a dollar today could be saved and earn a year's worth of interest. From the 75-year budget perspective, the present value of the additional resources that would be necessary to meet projected expenditures, for the three programs combined, is \$53.7 trillion. To put this figure in perspective, it would represent 4.1 percent of the present value of projected GDP over the same period (\$1,298 trillion). These resource needs would be in addition to the payroll taxes, benefit taxes, and premium payments. Asset redemptions and SMI general revenue transfers represent formal budget commitments, but no provision exists for covering the HI and OASDI Trust Fund deficits once assets are depleted.

Table 5 shows the magnitudes of the primary expenditures and sources of financing for the three trust funds computed on an open-group basis for the next 75 years and expressed in present values. The data are consistent with the SOSI included in the principal financial statements. For HI, revenues from the public are projected to fall short of total expenditures by \$4,708 billion in present value terms which is the additional amount needed in order to pay scheduled benefits over the next 75 years.¹⁴ From the trust fund perspective, the amount needed is \$4,506 billion in present value after subtracting the value of the existing trust fund balances (an asset to the trust fund account but an intragovernmental transfer to the overall budget). For SMI, revenues from the public for Part B and D combined are estimated to be \$32,981 billion less than total expenditures for the two accounts, an amount that, from a budget perspective, will be needed to keep the SMI program solvent for the next 75 years. From the trust fund perspective, however, the present values of total revenues and total expenditures for the SMI Program are roughly equal due to the annual adjustment of revenue from other government accounts to meet program costs.¹⁵

¹⁴ Interest income is not a factor in this table as dollar amounts are in present value terms.

¹⁵ The SMI Trust Fund has \$88 billion of existing assets.

For OASDI, projected revenues from the public fall short of total expenditures by \$16,057 billion in present value dollars, and by \$13,166 billion from the trust fund perspective.

From the governmentwide perspective, the present value of the total resources needed for the Social Security and Medicare Programs over and above current-law funding sources (payroll taxes, benefit taxes, and premium payments from the public) is \$53,747 billion. From the trust fund perspective, which counts the trust funds (\$3,182 billion in present value) and the general revenue transfers to the SMI Program (\$32,981 billion in present value) as dedicated funding sources, additional resources needed to fund the programs are \$17,584 billion in present value.

Table 5
Present Values of Costs Less Revenues of 75-Year Open Group Obligations
HI, SMI, and OASDI

| (In billions of dollars, as of January 1, 2018) | HI | SMI | | OASDI | Total |
|---|--------|--------|--------|--------|---------|
| | | Part B | Part D | | |
| Revenues from the public: | | | | | |
| Taxes | 22,807 | - | - | 65,088 | 87,895 |
| Premiums and state transfers | - | 9,374 | 3,222 | - | 12,596 |
| Total | 22,807 | 9,374 | 3,222 | 65,088 | 100,491 |
| Total costs to the public | 27,515 | 34,453 | 11,124 | 81,146 | 154,238 |
| Net results - budget perspective ¹ | 4,708 | 25,079 | 7,902 | 16,057 | 53,746 |
| Revenues from other government accounts | - | 25,079 | 7,902 | - | 32,981 |
| Trust fund balances as of 1/1/2018 | 202 | 80 | 8 | 2,892 | 3,182 |
| Net results - trust fund perspective ¹ | 4,506 | (80) | (8) | 13,166 | 17,584 |

¹Net results are computed as costs less revenues and trust fund balances. Negative values are indicative of surpluses.

Note: Totals may not equal the sum of components due to rounding.

Source: 2018 OASDI and Medicare Trustees' Reports

Infinite Horizon

The 75-year horizon represented in Table 5 is consistent with the primary focus of the Social Security and Medicare Trustees' Reports. For the OASDI Program, for example, an additional \$16.1 trillion in present value will be needed above currently scheduled taxes to pay for scheduled benefits (\$13.2 trillion from the trust fund perspective). Experts have noted that limiting the projections to 75 years understates the magnitude of the long-range unfunded obligations because summary measures (such as the actuarial balance and open-group unfunded obligations) reflect the full amount of taxes paid by the next two or three generations of workers, but not the full amount of their benefits. One approach to addressing the limitations of 75-year summary measures is to extend the projection horizon indefinitely, so that the overall results reflect the projected costs and revenues after the first 75 years. Such extended projections can also help indicate whether the financial imbalance would be improving or continuing to worsen beyond the normal 75-year period. The open-group infinite horizon net obligation is the present value of all expected future program outlays less the present value of all expected future program tax and premium revenues. Such a measure is provided in Table 6 for the three trust funds represented in Table 5.

From the budget or governmentwide perspective, the values in line 1 plus the values in line 4 of Table 6 represent the value of resources needed to finance each of the programs into the infinite future. The sums are shown in the last line of the table (also equivalent to adding the values in the second and fifth lines). The total resources needed for all the programs sums to \$101.0 trillion in present value terms. This need can be satisfied only through increased borrowing, higher taxes, reduced program spending, or some combination.

The second line shows the value of the trust fund at the beginning of 2018. For the HI and OASDI Programs this represents, from the trust fund perspective, the extent to which the programs are funded. From that perspective, when the

trust fund is subtracted, an additional \$34.3 trillion is needed to sustain the OASDI program into the infinite future, while the HI program reflects a projected surplus of \$2.2 trillion over the infinite horizon. However, looking just at present values ignores timing differences in the underlying projected cash flows; the HI Trust Fund is projected to remain solvent only until 2029. As described above, from the trust fund perspective, the SMI Program is fully funded; from a governmentwide basis, the substantial gap that exists between premiums, state transfer revenue, and program expenditures in the SMI Program (\$46.3 trillion and \$19.3 trillion for Parts B and D, respectively) represents future general revenue obligations of the federal budget.

In comparison to the analogous 75-year number in Table 5, extending the calculations beyond 2092, captures the full lifetime benefits, plus taxes and premiums of all current and future participants. The shorter horizon understates the total financial needs by capturing relatively more of the revenues from current and future workers and not capturing all of the benefits that are scheduled to be paid to them.

Table 6
Present Values of Costs Less Tax, Premium and State Transfer Revenue
through the Infinite Horizon, HI, SMI, OASDI

| (in trillions of dollars as of January 1, 2018) | HI | SMI | | OASDI | Total |
|---|--------|--------|--------|-------|-------|
| | | Part B | Part D | | |
| Present value of future costs less future taxes, premiums, and state transfers for current participants | 11.8 | 21.0 | 5.8 | 35.3 | 73.9 |
| Less current trust fund balance | 0.2 | 0.1 | - | 2.9 | 3.2 |
| Equals net obligations for past and current participants | 11.6 | 20.9 | 5.8 | 32.4 | 70.7 |
| Plus net obligations for future participants | (13.7) | 25.4 | 13.5 | 1.9 | 27.1 |
| Equals net obligations through the infinite future for all participants | (2.2) | 46.3 | 19.3 | 34.3 | 97.7 |
| Present values of future costs less the present values of future income over the infinite horizon | (1.9) | 46.4 | 19.3 | 37.2 | 101.0 |

Note: Totals may not equal the sum of components due to rounding.

Source: 2018 OASDI and Medicare Trustees' Reports

Railroad Retirement, Black Lung, and Unemployment Insurance

Railroad Retirement

The RRB was created in the 1930s to establish a retirement benefit program for the nation's railroad workers. As the Social Security Program legislated in 1935 would not give railroad workers credit for service performed prior to 1937, legislation was enacted in 1934, 1935, and 1937 (collectively the Railroad Retirement Acts of the 1930s) to establish a railroad retirement system separate from the Social Security Program.

As was discussed previously in this report, railroad retirement pays full retirement annuities at age 60 to railroad workers with 30 years of service. The program pays disability annuities based on total or occupational disability. It also pays annuities to spouses, divorced spouses, widow(er)s, remarried widow(er)s, surviving divorced spouses, children, and parents of deceased railroad workers. Medicare covers qualified railroad retirement beneficiaries in the same way as it does Social Security beneficiaries.

Payroll taxes paid by railroad employers and their employees provide a primary source of income for the Railroad Retirement and Survivors' Benefit Program. Other sources of program income include: the RRB-SSA-CMS Financial Interchanges with the Social Security and Medicare Trust Funds, earnings on investments, federal income taxes on railroad retirement benefits, and appropriations.

For further detail related to Railroad Retirement Program financing and actuarial assumptions, see Note 22—Social Insurance.

Cash Flow Projections

Income and Expenditures. Railroad retirement cash flow projections are based on the intermediate set of assumptions used in the RRB's actuarial valuation of the program. The estimates are for the open-group population, which includes all persons projected to participate in the Railroad Retirement Program as railroad workers or beneficiaries during the period. Thus, the estimates include payments from, and on behalf of, those who will be employed by the railroads during the period as well as those already employed at the beginning of the period. They also include expenditures made to, and on behalf of, such workers during that period. Estimated railroad retirement expenditures are expected to exceed estimated income (excluding interest and financial interchange income), in dollars, for the entire projection period (2018-2092).

Sensitivity Analysis. The projections of the future financial status of the Railroad Retirement Program depend on many economic and demographic assumptions. For further information on the sensitivity of the long-range projections of the Railroad Retirement Program and how the projections are impacted by changes in certain key assumptions, refer to RRB's financial statements.

Sustainability of Railroad Retirement

Consistent with SOSI the primary expenditures and sources of financing for the Railroad Retirement Program are computed on an open-group basis for the next 75 years and are expressed in present values as of October 1, 2017. From a governmentwide perspective, revenues are expected to fall short of expenditures by approximately \$108.5 billion, which represents the present value of resources needed to sustain the Railroad Retirement Program. From a trust fund perspective, when the trust fund balance (\$27.9 billion) and the financial interchange and transfers (\$81.9 billion) are included, the combined balance of the NRRIT, the Railroad Retirement Account, and the SSEB Account show a slight surplus (\$1.3 billion). For further detail related to the sustainability of the Railroad Retirement Program, refer to RRB's financial statements.

Black Lung

The *Federal Coal Mine Health and Safety Act of 1969* created the Black Lung Disability Benefit Program to provide compensation, medical, and survivor benefits for eligible coal miners who are totally disabled due to pneumoconiosis (black lung disease) arising out of their coal mine employment and the BLDTF provides benefit payments when no RMO can be assigned the liability.

As was stated in the note to Social Insurance earlier in this report, black lung disability benefit payments are funded by excise taxes from coal mine operators based on the domestic sale of coal, as are the program's administrative costs. These taxes are collected by the IRS and transferred to the BLDTF.

P.L. 110-343, *Division B-Energy Improvement and Extension Act of 2008*, enacted on October 3, 2008, among other things, restructured the BLDTF debt by refinancing the outstanding high interest rate repayable advances with low interest rate discounted debt instruments similar in form to zero-coupon bonds, plus a one-time appropriation. This Act also allowed that any subsequent debt issued by the BLDTF may be used to make benefit payments, other authorized expenditures, or to repay debt and interest from the initial refinancing. For more information on Black Lung Disability Benefit Program financing and actuarial assumptions, see Note 22—Social Insurance.

Cash Flow Projections

Projected Cash Inflows and Outflows, in Constant Dollars, for the Open Group. Effective for fiscal year 2017 reporting, DOL revised its projection period from a fixed terminus of fiscal year 2040 to a rolling 25-year period beginning on the valuation date. In order to be consistent with Executive Branch policy on regulations pursuant to the Clean Power Plan (CPP), DOL's estimates of future excise tax income were based on Energy Information Administration (EIA) projections of future coal production that do not reflect CPP regulation. The EIA projections reflect the continuing trend of lower coal production which would lead to lower future excise tax income. The projections, in constant dollars for the open group, made over the 25-year period ending September 30, 2043, indicate that cash outflows for benefit payments and administrative expenses will exceed cash inflows from excise taxes for all years in the projection period.

Sensitivity Analysis. For the projected cash inflows and outflows with sensitivity analysis, in constant dollars for the open group, the significant assumption for medical cost inflation was increased by one percent. For the sensitivity analysis, the other significant assumptions (coal excise tax revenue estimates, tax rate structure, number of beneficiaries, life expectancy, federal civilian pay raises, interest rate on new debt issued by the BLDTF, and CPI-U for goods and services) were left unchanged. Cash projections depend on the assumptions used and actual experience may differ materially from the projections. These projections with sensitivity analysis, in constant dollars for the open group, made over the 25-year period ending September 30, 2043, indicate cash outflows for benefit payments and administrative expenses will exceed cash inflows from excise taxes for all years in the projection period. For further information on the sensitivity of the projections of the Black Lung Disability Benefit Program and how the projections are impacted by changes in assumptions, refer to DOL's financial statements.

Sustainability of Black Lung

On September 30, 2018, total liabilities of the BLDTF exceeded assets by \$5.6 billion. This net position deficit represents the accumulated shortfall of excise taxes necessary to meet benefit payments, administrative costs, and interest expense incurred prior to and subsequent to the debt refinancing pursuant to P.L. 110-343. Prior to the enactment of P.L. 110-343, this shortfall was funded by repayable advances to the BLDTF, which were repayable with interest. Pursuant to P.L. 110-343, any shortfall will be financed with debt instruments similar in form to zero-coupon bonds, with a maturity date of one year and bear interest at the Treasury 1-year rate. For further detailed information on the sustainability of the Black Lung Disability Benefit Program, refer to DOL's financial statements.

Unemployment Insurance

The UI Program was created in 1935 to provide income assistance to unemployed workers who lose their jobs generally through no fault of their own, and are unemployed due to a lack of suitable work. The program protects workers during temporary periods of unemployment through the provision of unemployment compensation benefits. The program is administered through a unique system of federal and state partnerships established in federal law but executed through conforming state laws by state entities. The federal government provides broad policy guidance and program direction through the oversight of DOL, while program details are established through individual state UI statutes, administered through state UI entities.

The UI Program is financed through the collection of federal and state unemployment taxes levied on subject employers and deposited in the UTF and federal appropriations. The fund was established to account for the receipt, investment, and disbursement of unemployment pay taxes. Federal unemployment taxes are used to pay for the administrative costs of the UI

Program, including grants to each state to cover the costs of state UI operations and the federal share of extended UI benefits. Federal unemployment taxes are also used to fund an account within the UTF to make advances to state UI accounts when a state's UI account balance has been exhausted and the state is unable to make benefit payments.

The UI Program provides regular and extended benefit payments to eligible unemployed workers. Regular UI program benefits are established under state law and are payable for a period not to exceed a maximum duration. In 1970 federal law began to require states to extend this maximum period of benefit duration by 50 percent during periods of high unemployment. These extended benefit payments are paid equally from federal and state accounts.

Cash Flow Projections

The significant assumptions used in the cash flow projections of the UTF include total unemployment rates, civilian labor force levels, percent of unemployed receiving benefits, total wages, distribution of benefit payments by state, state tax rate structures, state taxable wage bases, interest rates on UTF investments, and the CPI-U for goods and services. Cash projections depend on the assumptions used and actual experience may differ materially from the projections. Under expected economic conditions, total cash inflows, excluding interest earnings, are projected to exceed total cash outflows through the end of the projection period.

Sensitivity Analysis. The effect on the accumulated UTF assets of projected total cash inflows and cash outflows of the UTF, in constant dollars, over the ten-year period ending September 30, 2028, are demonstrated in two sensitivity analyses. Each sensitivity analysis uses an open group, which includes current and future participants in the UI Program. Sensitivity Analysis I assumes higher rates of unemployment and Sensitivity Analysis II assumes even higher rates of unemployment compared to expected economic conditions. In Sensitivity Analysis I, which uses a higher unemployment rate of 5.5 percent beginning in fiscal year 2019, net cash inflows are negative in fiscal years 2019 through 2024, but become positive in fiscal year 2025, and continue to be positive through 2028. In Sensitivity Analysis II, net cash outflows, including interest earnings and expenses, are projected in fiscal years 2019 through 2024, but inflows exceed outflows in fiscal years 2025 through 2028. Net cash inflows are reestablished in fiscal year 2025 and peak in fiscal year 2027, with a drop in the unemployment rate to 8.3 percent in fiscal year 2023, and then steadily downward for fiscal years 2024 through 2028. The example of expected economic conditions and two sensitivity analyses, in constant dollars, demonstrate the counter cyclical nature of the UI Program, which experiences net cash inflows during periods of low unemployment that are depleted by net cash outflows during periods of increased unemployment. For further detail on the sensitivity of the projections of the UI Program, refer to DOL's financial statements.

Sustainability of Unemployment Insurance

The ability of the UI Program to meet a participant's future benefit payment needs depends on the availability of accumulated taxes and earnings within the UTF. The effect of projected benefit payments on the accumulated net assets of the UTF is measured, under an open group scenario, which includes current and future participants in the UI Program. As of September 30, 2018, total assets within the UTF exceeded total liabilities by \$72.5 billion. At the present time there is a surplus; any surplus of tax revenues and earnings on these revenues over benefit payment expenses is available to finance benefit payments in future periods when tax revenues may be insufficient. For more information on the sustainability of the UI Program, refer to DOL's financial statements.

Unemployment Trust Fund Solvency

Each state's accumulated UTF net assets or reserve balance should provide a defined level of benefit payments over a defined period. To be minimally solvent, a state's reserve balance should provide for one year's projected benefit payment needs based on the highest levels of benefit payments experienced by the state over the last 20 years. A ratio of 1.0 or greater indicates that the state UTF account balance is minimally solvent. States below this level are vulnerable to exhausting their funds in a recession. States exhausting their reserve balance must borrow funds from the Federal Unemployment Account (FUA) to make benefit payments. In fiscal year 2018, there were no FUA borrowings.

The results of DOL's state by state analysis indicate 23 state funds plus the fund of the Virgin Islands were below the minimal solvency ratio of 1.0 at September 30, 2018.

Deferred Maintenance and Repairs

Deferred maintenance and repairs result from maintenance not being performed on a timely basis and is the estimated cost to bring government-owned PP&E to an acceptable condition. Deferred maintenance and repairs exclude the cost of expanding the capacity of assets or upgrading them to serve needs different from those originally intended. The consequences of not performing regular maintenance and repairs could include increased safety hazards, poor service to the public, higher costs in the future, and inefficient operations. Estimated deferred maintenance and repairs costs are not accrued in the Statements of Net Cost or recognized as a liability on the Balance Sheets.

The amounts disclosed for deferred maintenance and repairs are allowed to be measured using one of the following three methods:

- Condition assessment surveys which are periodic inspections of government-owned property to determine the current condition and estimated cost to bring the property to an acceptable condition.
- Life-cycle cost forecast that is an acquisition or procurement technique that considers operation, maintenance, and other costs in addition to the acquisition cost of assets.
- Any other method of choice that is similar to the condition assessment survey or life-cycle costing methods.

The table below of deferred maintenance and repairs is presented as a single estimate in accordance with SFFAS No. 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29, and 32*. These amounts were all measured using the condition assessment survey method. Please refer to the individual financial statements of DOI, DOD, USDA, DOE, HHS, NASA, and VA for detailed significant information on deferred maintenance and repairs.

| Deferred Maintenance and Repairs as of September 30, 2018, and 2017 | | |
|--|--------------|--------------|
| (In billions of dollars) | 2018 | 2017 |
| Asset category: | | |
| General property, plant, and equipment | 147.3 | 151.6 |
| Heritage assets | 18.9 | 18.1 |
| Stewardship land..... | 0.4 | 0.5 |
| Total deferred maintenance and repairs | <u>166.6</u> | <u>170.2</u> |

Other Claims for Refunds

Management has estimated amounts that may be paid out as other claims for tax refunds. This estimate represents an amount (principal and interest) that may be paid for claims pending judicial review by the federal courts or, internally, by appeals. The total estimated payout (including principal and interest) for claims pending judicial review by the federal courts is \$11.1 billion and \$8.2 billion for fiscal years 2018 and 2017, respectively. For those under appeal, the estimated payout is \$1.8 billion and \$2.2 billion for fiscal years 2018 and 2017, respectively. Although these refund claims have been deemed to be probable, they do not meet the criteria in SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, for reporting the amounts in the Balance Sheets or for disclosure in the notes to the financial statements. However, they meet the criteria in SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, as amended, for inclusion as required supplementary information. To the extent judgments against the government for these claims prompt other similarly situated taxpayers to file similar refund claims, these amounts could become significantly greater.

Tax Assessments

The government is authorized and required to make inquiries, determinations, and assessments of all taxes that have not been duly paid. Unpaid assessments result from taxpayers filing returns without sufficient payment, as well as enforcement programs such as examination, under-reporter, substitute for return, and combined annual wage reporting. Under federal accounting standards, unpaid assessments are categorized as taxes receivable if taxpayers agree or a court has determined the assessments are owed. If neither of these conditions are met, the unpaid assessments are categorized as compliance assessments. Assessments with little or no future collection potential are called write-offs. Although compliance assessments and write-offs are not considered receivables under federal accounting standards, they represent legally enforceable claims of the government. There is, however, a significant difference in the collection potential between compliance assessments and receivables.

Compliance assessments and pre-assessment work in process are \$67.5 billion and \$75.8 billion for fiscal years 2018 and 2017, respectively. The amount of allowance for uncollectible amounts pertaining to compliance assessments cannot be reasonably estimated, and thus the net realizable value of the pre-assessment work-in-process cannot be determined. The amount of assessments that entities have statutory authority to collect at the end of the period but that have been written off and excluded from accounts receivable are \$115.0 billion and \$111.0 billion for fiscal years 2018 and 2017, respectively.

Federal Oil and Gas Resources

The DOI is responsible for managing the nation's oil and natural gas resources and the mineral revenues on federal lands, both onshore and on the Outer Continental Shelf. This management process can be broken down into six essential analysis components: pre-leasing, post-leasing and pre-production, production and post-production, revenue collection, fund disbursement, and compliance.

Federal Oil and Gas Resources as of September 30, 2018, and 2017

| (In billions of dollars) | Offshore | | Onshore | | Total | |
|--|-------------|-------------|-------------|-------------|-------------|-------------|
| | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| Oil and lease condensate..... | 20.9 | 23.7 | 11.6 | 12.2 | 32.5 | 35.9 |
| Natural gas, wet after lease separation..... | 1.9 | 1.8 | 11.3 | 9.3 | 13.2 | 11.1 |
| Total | <u>22.8</u> | <u>25.5</u> | <u>22.9</u> | <u>21.5</u> | <u>45.7</u> | <u>47.0</u> |

The above table presents the estimated present value of future federal royalty receipts on estimated proved reserves¹⁶ as of September 30, 2018 and 2017. The federal government's estimated petroleum royalties have as their basis the DOE's EIA estimates of proved reserves. The EIA provides such estimates directly for federal offshore areas and they are adjusted to extract the federal subset of onshore proved reserves. The federal proved reserves were then further adjusted to correspond with the effective date of the actual production for calendar year 2016, the most recently published EIA proved reserves report and then are projected, separately for oil and natural gas, over time to simulate a schedule of when the reserves would be produced. Future royalties are then calculated from these production streams by applying future price estimates by the OMB, and effective royalty rates, adjusted for transportation allowances and other allowable deductions. The valuation method used for gas captures royalties from three products—dry gas, wet gas, and natural gas liquids—which collectively are reported as natural gas, wet after lease separation. The present value of these royalties are then determined by discounting the revenue stream back to the effective date at a public discount rate assumed to be equal to the OMB's estimates of future 30-year Treasury bill rates. The 30-year rate was chosen because this maturity life most closely approximates the productive lives of the proved reserves estimates.

¹⁶ Per the EIA, lease condensate is a mixture consisting primarily of pentanes and heavier hydrocarbons which is recovered as a liquid from natural gas in lease separation facilities. This category excludes natural gas plant liquids, such as butane and propane, which are recovered at downstream natural gas processing plants or facilities. Also per the EIA, natural gas, wet after lease separation, is the volume of natural gas remaining after removal of lease condensate in lease and/or field separation facilities, if any, and after exclusion of nonhydrocarbon gases where they occur in sufficient quantity to render the gas unmarketable. Natural gas liquids may be recovered from volume of natural gas, wet after lease separation, and at natural gas processing plants (<https://www.eia.gov/naturalgas/data.cfm>).

**Estimated Federal Oil and Gas Petroleum Royalties (Proved Reserves)
As of September 30, 2018, and 2017**

| Petroleum Category | Quantity (in millions) | | Average Purchase Price (\$) | | Average Royalty Rate (%) | |
|---|------------------------|-----------------|-----------------------------|-------|--------------------------|-------|
| | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| Oil and lease condensate (Bbl): | | | | | | |
| Offshore | 3,491.3 | 4,022.4 | 65.41 | 46.86 | 12.96 | 13.06 |
| Onshore | 2,361.0 | 2,278.0 | 60.16 | 45.20 | 12.19 | 12.12 |
| Total | <u>5,852.3</u> | <u>6,300.4</u> | | | | |
| Natural gas, wet after lease separation (Mcf): | | | | | | |
| Offshore | 5,370.3 | 5,946.4 | 3.50 | 3.28 | 11.89 | 11.99 |
| Onshore | 37,828.7 | 39,877.7 | 2.94 | 3.07 | 10.36 | 10.58 |
| Total | <u>43,199.0</u> | <u>45,824.1</u> | | | | |

Bbl = barrels

Mcf = 1,000 cubic feet

The table above provides the estimated quantity, a weighted average purchase price, and a weighted average royalty rate by category of estimated federal petroleum royalties at the end of fiscal years 2018 and 2017.¹⁷ The estimated quantities, average purchase prices and royalty rates vary by region; the above table reflects an overall weighted average purchase price and royalty rate, and is not presented on a regional basis, but is instead calculated based on regional averages. The prices and royalty rates are based upon historical (or estimated) averages, excluding prior-period adjustments, if any, and are affected by such factors as accounting adjustments and transportation allowances, resulting in effective average prices and royalty rates. Prices are valued at the lease rather than at the market center, and differ from those used to compute the asset estimated present values, which are forecasted and discounted based upon OMB economic assumptions. For further details on federal oil and gas resources, refer to the financial statements of DOI. In addition to the oil and gas resources discussed above, the federal government also owns oil and gas resources that are not currently under lease.

¹⁷ Gulf of Mexico proved reserves are royalty bearing volumes. In the Gulf of Mexico, an additional 860.6 million Bbl for fiscal year 2018 and 689.7 million Bbl for fiscal year 2017 of proved oil reserves, and 739.9 million Mcf for fiscal year 2018 and 1,180.3 million Mcf for fiscal year 2017 of proved gas reserves are not reflected in these totals as they are estimated to be producible royalty free under various royalty relief provisions. The net present value of the royalty value of the royalty free proved reserves volumes in the Gulf of Mexico is estimated to be \$5.4 billion for fiscal year 2018 and \$4.4 billion for fiscal year 2017.

Federal Natural Resources Other than Oil and Gas

Federal Natural Resources Other than Oil and Gas as of September 30, 2018, and 2017

(in billions of dollars)

| Natural Resource Category | 2018 | 2017 |
|---------------------------|------|------|
| Coal royalties | 8.8 | 9.0 |
| Total | 8.8 | 9.0 |

The Office of Natural Resources Revenue (ONRR) within DOI is responsible for the management and collection of revenues associated with federal coal leases which are managed by the Bureau of Land Management (BLM) within DOI. The ONRR achieves optimal value by ensuring that all natural resource revenues are efficiently and accurately collected as well as disbursed to recipients in a timely manner by performing audit and revenue compliance activities.

The Mineral Leasing Act of 1920, as amended, and the *Mineral Leasing Act for Acquired Lands of 1947*, as amended, gives DOI the responsibility for coal leasing on approximately 700 million acres of federal mineral estate which includes 570 million of acres where coal development is allowed. The surface estate of these lands may be under the control of BLM, the U.S. Forest Service (within USDA), private or state land owners, or other federal entities.

Public lands are available for coal leasing after the lands have been evaluated through a multiple-use planning process. *The Mineral Leasing Act*, as amended by the *Federal Coal Leasing Amendments Act of 1976*, generally requires that coal be leased competitively and that the federal government must receive a fair market value for land leased for coal development. Once a lease is issued, federal coal leasing laws and lease terms determine the federal government's share of production from coal leasing operations.

DOI receives coal leasing revenues from a bonus paid at the time of the lease, an annual rent payment of \$3.00 per acre, and royalties paid on the value of the coal after it has been mined. A portion of the total federal coal royalties will be distributed to other non-federal entities. The royalty rate for surface-mining methods is 12.5 percent and is 8.0 percent for underground mining, and the BLM can approve reduced royalty rates based on maximum economic recovery. Regulations that govern BLM's coal leasing program are contained in Title 43, Groups 3000 and 3400 of the Code of Federal Regulations.

The above table presents the estimated present value of federal coal royalties under lease contract or other long-term arrangements as of September 30, 2018 and 2017. The federal government's estimated coal royalties have as their basis the DOI's BLM estimates of recoverable reserves. The federal recoverable reserves are then further adjusted to correspond with the effective date of the analysis and then are projected over time to simulate a schedule of when the reserves would be produced. Future royalties are then calculated by applying future price estimates and effective royalty rates, adjusted for transportation allowances and other allowable deductions. The present value of these royalties are then determined by discounting the revenue stream back to the effective date at a public discount rate assumed to be equal to the OMB's estimates of future 30-year Treasury bill rates. The 30-year rate was chosen because this maturity life most closely approximates the productive lives of the recoverable reserves estimates.

In addition to the coal resources discussed above, the federal government has other natural resources under lease contract whereby the lessee is required to pay royalties on the sale of the natural resource. These natural resources include soda ash, potash muriates of potash and langbeinite phosphate, lead concentrate, copper concentrate, and zinc concentrate. Soda ash and potash have the largest estimated present value of future royalties. The federal government also owns coal resources and certain other natural resources that are not currently under lease. For further details on federal natural resources-other than oil and gas, refer to the financial statements of DOI.