



Current and Emerging Challenges in Retirement Security

The Honorable David M. Walker
Comptroller General of the United States
Government Accountability Office
December 13, 2004

GAO's Strategic Plan

SERVING THE CONGRESS AND THE NATION GAO'S STRATEGIC PLAN FRAMEWORK

MISSION

GAO exists to support the Congress in meeting its constitutional responsibilities and to help improve the performance and ensure the accountability of the federal government for the benefit of the American people.

THEMES



Long-Term Fiscal Imbalance

National Security

Global Interdependence

Changing Economy

Demographics

Science and Technology

Quality of Life

Governance

GOALS & OBJECTIVES



Provide Timely, Quality Service to the Congress and the Federal Government to ...

Address Current and Emerging Challenges to the Well-Being and Financial Security of the American People *related to ...*

- Health care needs and financing
- Education and protection of children
- Work opportunities and worker protection
- Retirement income security
- Effective system of justice
- Viable communities
- Natural resources use and environmental protection
- Physical infrastructure

Respond to Changing Security Threats and the Challenges of Global Interdependence *involving ...*

- Emerging threats
- Military capabilities and readiness
- Advancement of U.S. interests
- Global market forces

Help Transform the Federal Government's Role and How It Does Business to Meet 21st Century Challenges *by assessing ...*

- Roles in achieving federal objectives
- Government transformation
- Key management challenges and program risks
- Fiscal position and financing of the government

Maximize the Value of GAO by Being a Model Federal Agency and a World-Class Professional Services Organization *in the areas of ...*


- Client and customer satisfaction
- Strategic leadership
- Institutional knowledge and experience
- Process improvement
- Employer of choice

CORE VALUES

Accountability

Integrity

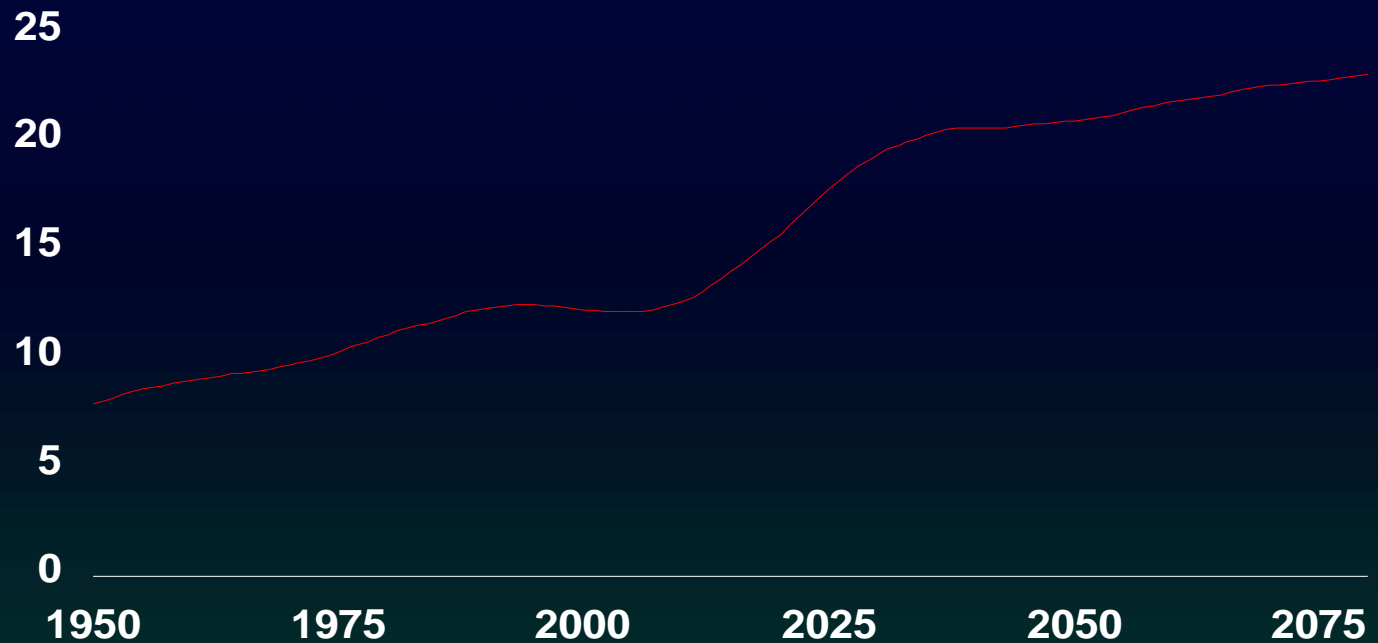
Reliability

The background of the slide features a vertical strip on the left side with a pattern of overlapping US dollar bills, including a \$100 bill and a \$20 bill, in shades of orange and yellow. The rest of the slide has a dark blue background.

Implications of Demographic Challenges

- **Fiscal challenges**
- **Potential adverse effects on real economic growth**
- **Potential adverse effects on overall living standards**

The Aged as a Share of Total U.S. Population Continues to Grow

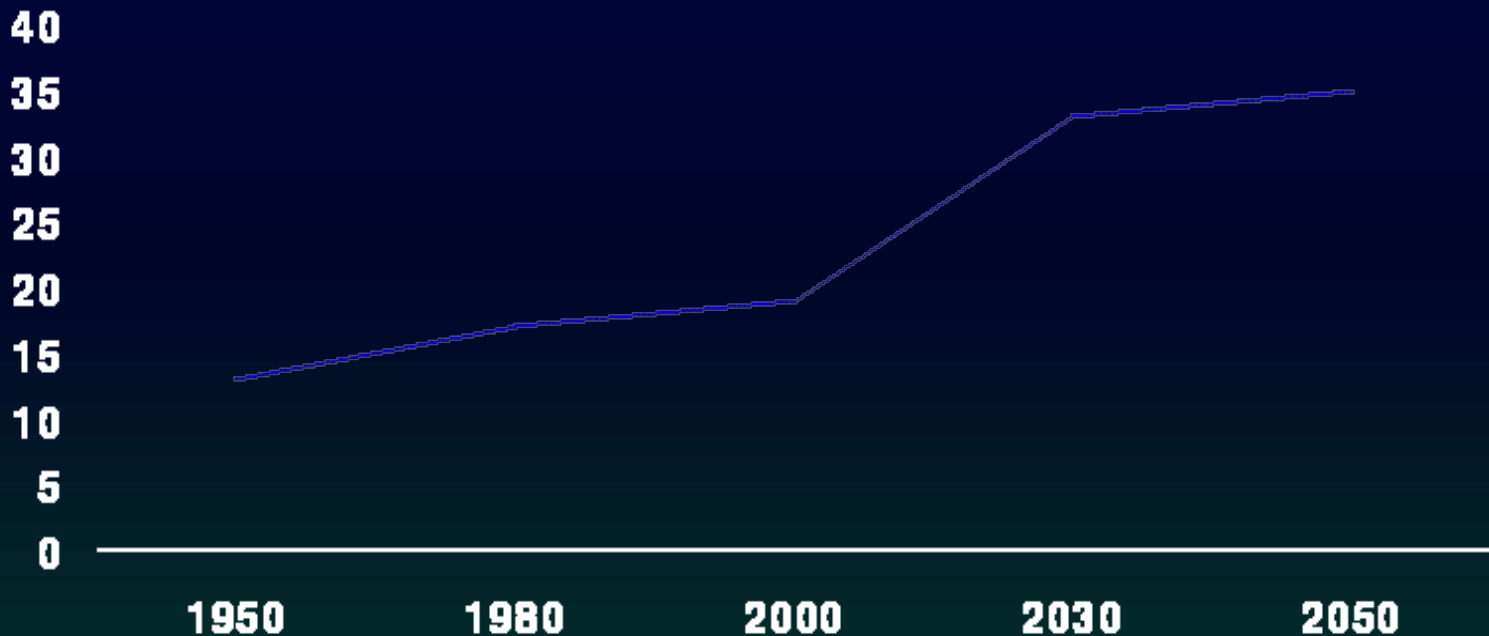


Source: Office of the Chief Actuary, Social Security Administration.

Note: Projections based on the intermediate assumptions of the 2004 Trustees' Reports.

U.S. Elderly Dependency Ratio Expected to Continue to Increase

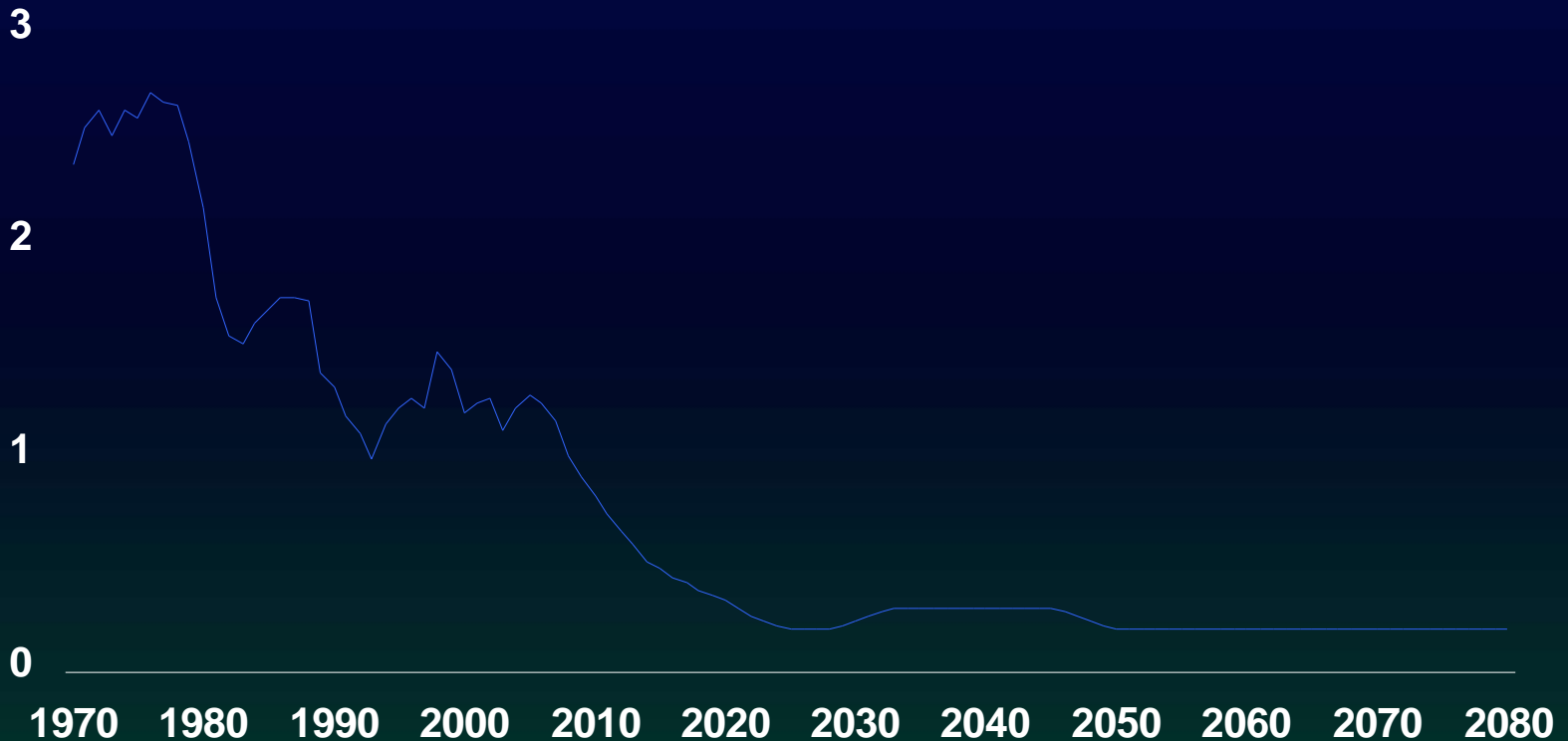
Elderly Dependency Ratio (in percent)



Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: 2000 Revision and World Urbanization Prospects: 2001 Revision. Data for 2030 - 2050 are projected.

U.S. Labor Force Growth Will Continue to Decline

Percentage change (5-yr moving average)

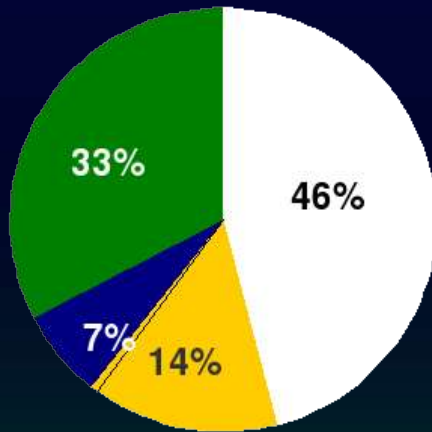


Note: Percentage change is calculated as a centered 5-yr moving average of projections based on the intermediate assumptions of the 2004 Trustees Reports.

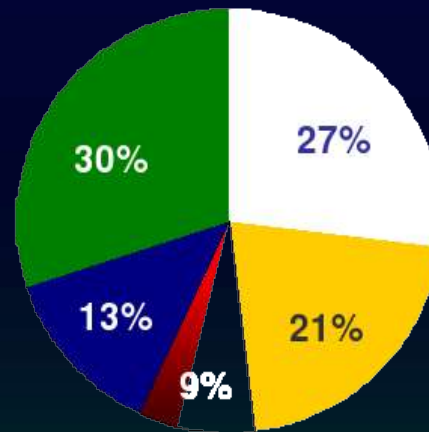
Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration.

Composition of Federal Spending

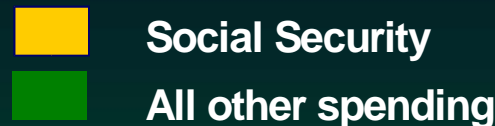
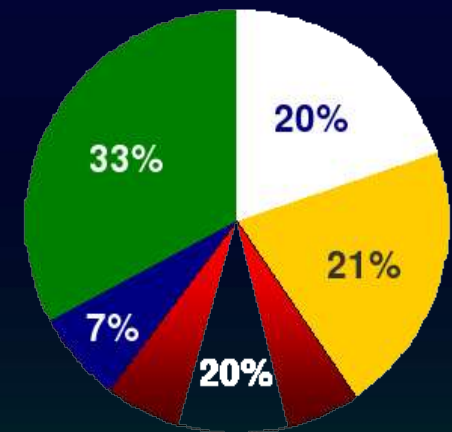
1964



1984



2004*

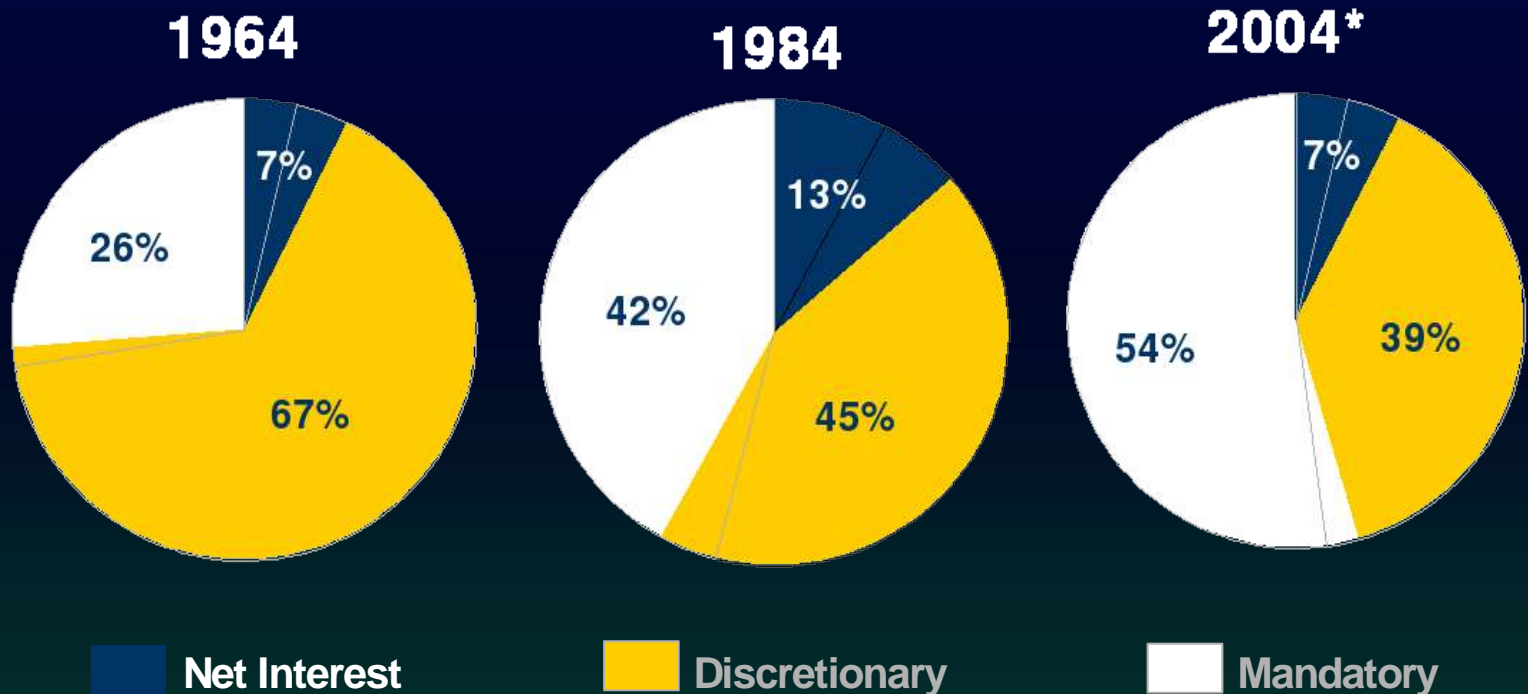


*Current services estimate.

Note: Numbers may not add to 100 percent due to rounding.

Source: *Budget of the United States Government, Fiscal Year 2005* (February 2004) and *Budget of the United States Government, Fiscal Year 2005, Mid-session Review* (July 2004), Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs



*Current services estimate.

Note: Numbers may not add to 100 percent due to rounding.

Source: *Budget of the United States Government, Fiscal Year 2005* (February 2004) and *Budget of the United States Government, Fiscal Year 2005, Mid-session Review* (July 2004), Office of Management and Budget.

Fiscal Year 2004 Deficit Numbers

	\$ Billion	% of GDP
On-Budget Deficit	(568)	(4.9)
Off-Budget Surplus	155*	1.3
Unified Deficit	(413)	(3.6)

*Includes the \$151 billion Social Security surplus and a \$4 billion surplus for the Postal Service

Selected Fiscal Exposures: Sources and Examples

(End of 2003)^a

Type	Example (dollars in billions)
Explicit Liabilities	Publicly held debt (\$3,913) Military and civilian pension and post-retirement health (\$2,857) Veterans benefits payable (\$955) Environmental and disposal liabilities (\$250) Loan guarantees (\$35)
Explicit Financial commitments	Undelivered orders (\$596) Long-term leases (\$47)
Financial contingencies	Unadjudicated claims (\$9) Pension Benefit Guaranty Corporation (\$86) Other national insurance programs (\$7) Government corporations e.g., Ginnie Mae
Exposures implied by current policies or the public's expectations about the role of government	Debt held by government accounts (\$2,859) ^b Future Social Security benefit payments (\$3,699) ^c Future Medicare Part A benefit payments (\$8,236) ^c Future Medicare Part B benefit payments (\$11,416) ^c Future Medicare Part D benefit payments (\$8,119) ^c Life cycle cost including deferred and future maintenance and operating costs (amount unknown) Government Sponsored Enterprises e.g., Fannie Mae and Freddie Mac

^a All figures are for end of fiscal year 2003, except Social Security and Medicare estimates, which are end of calendar year 2003.

^b This amount includes \$774 billion held by military and civilian pension funds that would offset the explicit liabilities reported by those funds.

^c Figures for Social Security and Medicare are net of debt held by the trust funds (\$1,531 billion for Social Security, \$256 billion for Medicare Part A, and \$24 billion for Medicare Part B) and represent net present value estimates over a 75-year period. Over an infinite horizon, the estimate for Social Security would be \$10.4 trillion, \$21.8 trillion for Medicare Part A, \$23.2 trillion for Medicare Part B, and \$16.5 trillion for Medicare Part D.

Source: GAO analysis of data from the Department of the Treasury, the Office of the Chief Actuary, Social Security Administration, and the Office of the Actuary, Centers for Medicare and Medicaid Services.

Updated 3/30/04.

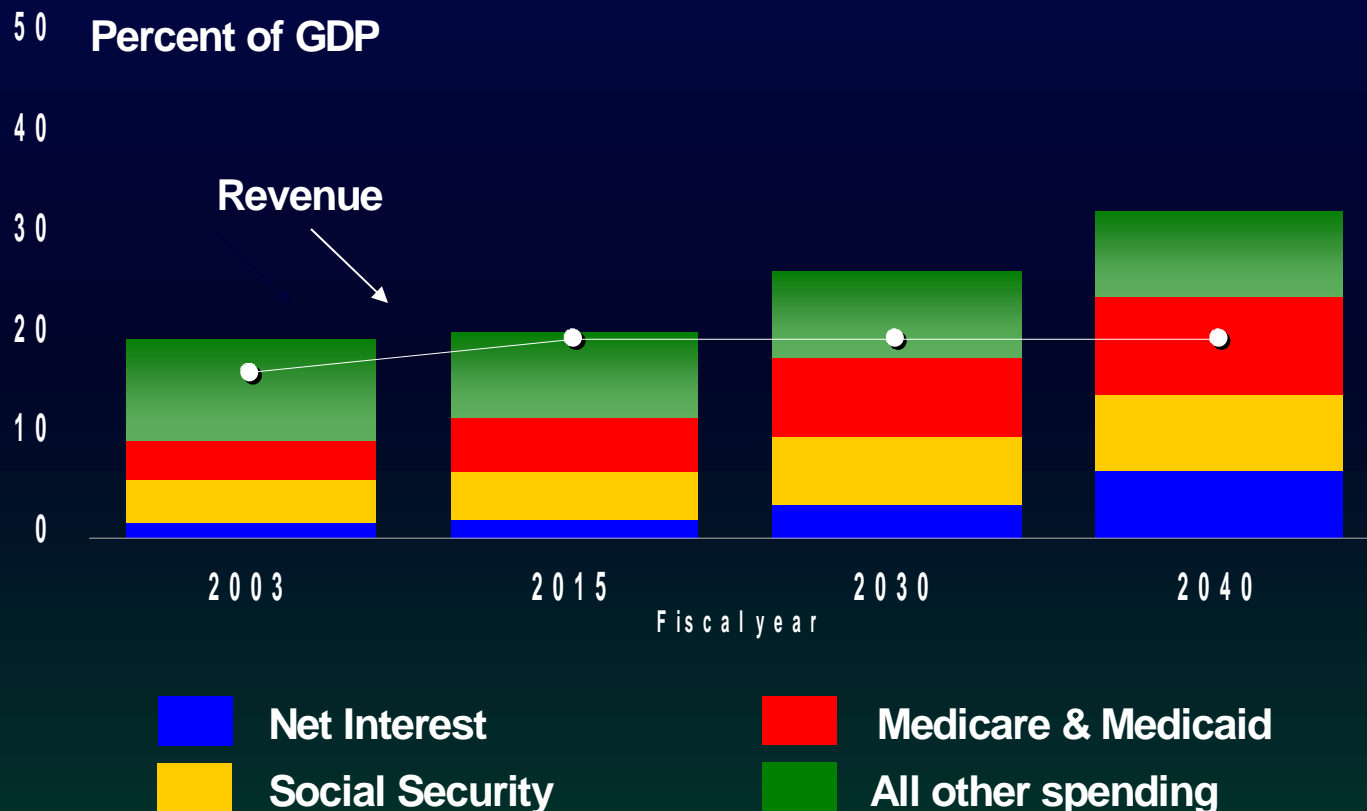
Another Way to Think About These Numbers

- Debt held by the public—\$3.9T
- Trust fund debt—\$2.9T
- Gross debt—\$6.8T
- Gross debt per person—about \$24,000
- If we add everything on the previous slide that is not included in gross debt, the burden rises to more than \$140,000, or about \$330,000 per full-time worker. Alternatively, it amounts to a total unfunded burden of more than \$40 trillion in current dollars, which is about 18 times the current annual federal budget or more than 3 ½ times the current annual GDP.

Note: The calculations only consider a 75-year horizon for Social Security and Medicare.

Composition of Spending as a Share of GDP

Under Baseline Extended

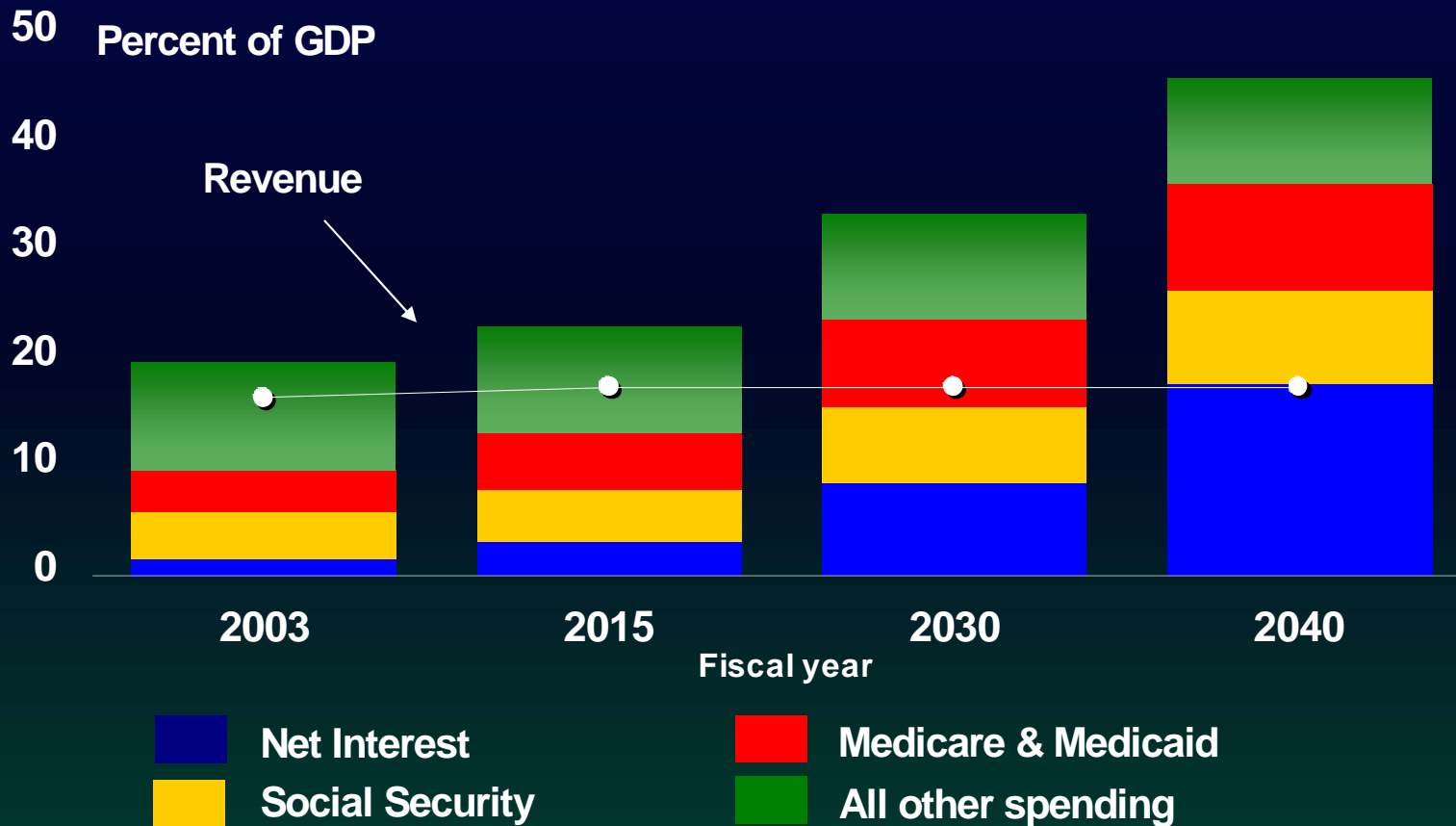


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant. Budgetary effects due to passage of the Working Families Tax Relief Act of 2004 are not reflected in this simulation.

Source: GAO's September 2004 analysis.

Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP after 2004 and All Expiring Tax Provisions are Extended



Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Source: GAO's September 2004 analysis.

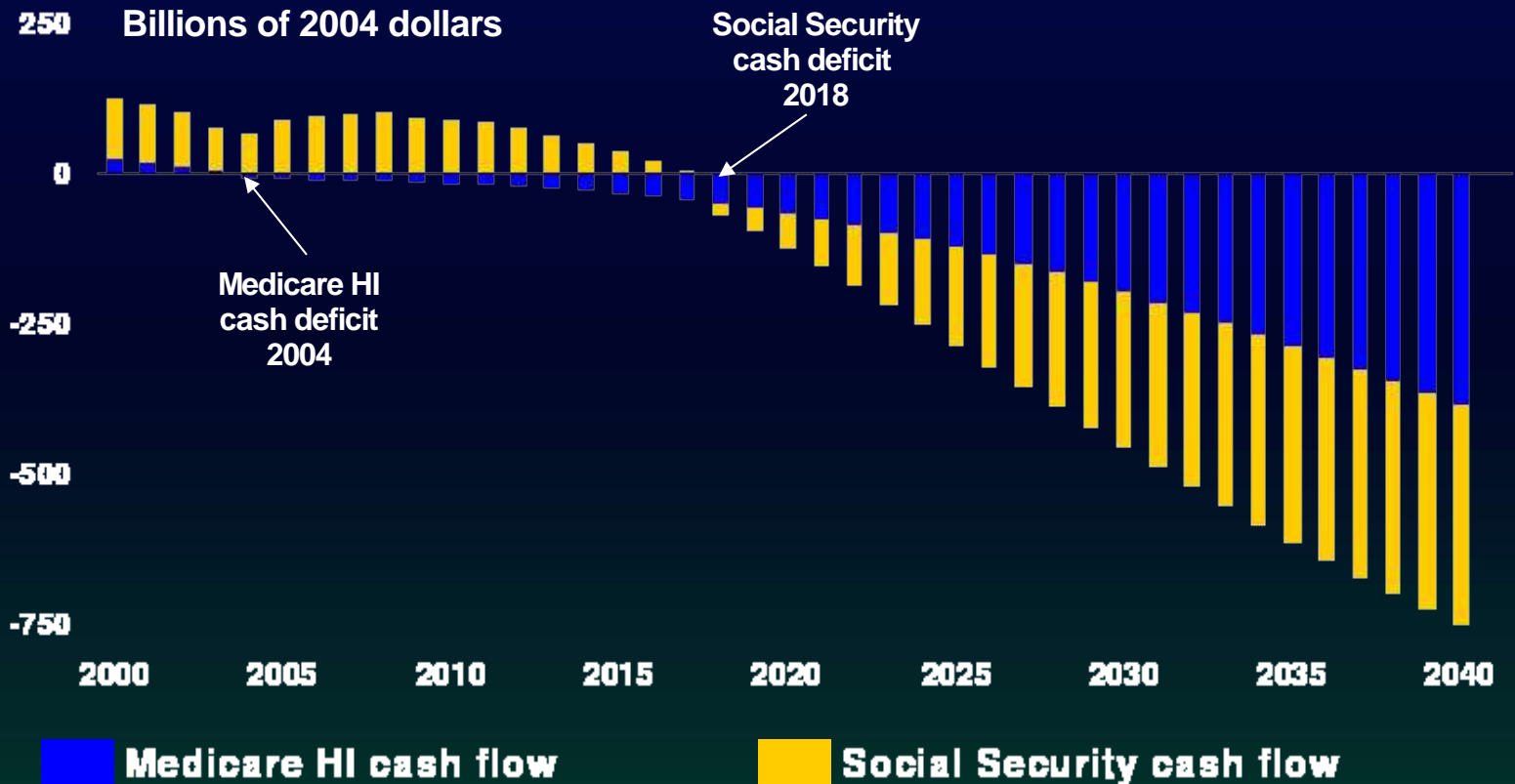
Current Fiscal Policy Is Unsustainable

- **The “Status Quo” is Not an Option**
 - We face large and growing structural deficits largely due to known demographic trends and rising health care costs.
 - GAO’s simulations show that balancing the budget in 2040 could require actions as large as
 - Cutting total federal spending by about 60 percent or
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
 - Closing the current long-term fiscal gap based on responsible assumptions would require real average annual economic growth in the double digit range every year for the next 75 years.
 - During the 1990s, the economy grew at an average 3.2 percent per year.
 - As a result, we cannot simply grow our way out of this problem. Tough choices will be required.
- **The Sooner We Get Started, the Better**
 - Less change would be needed, and there would be more time to make adjustments.
 - The miracle of compounding would work with us rather than against us.
 - Our demographic changes will serve to make reform more difficult over time.

The Way Forward

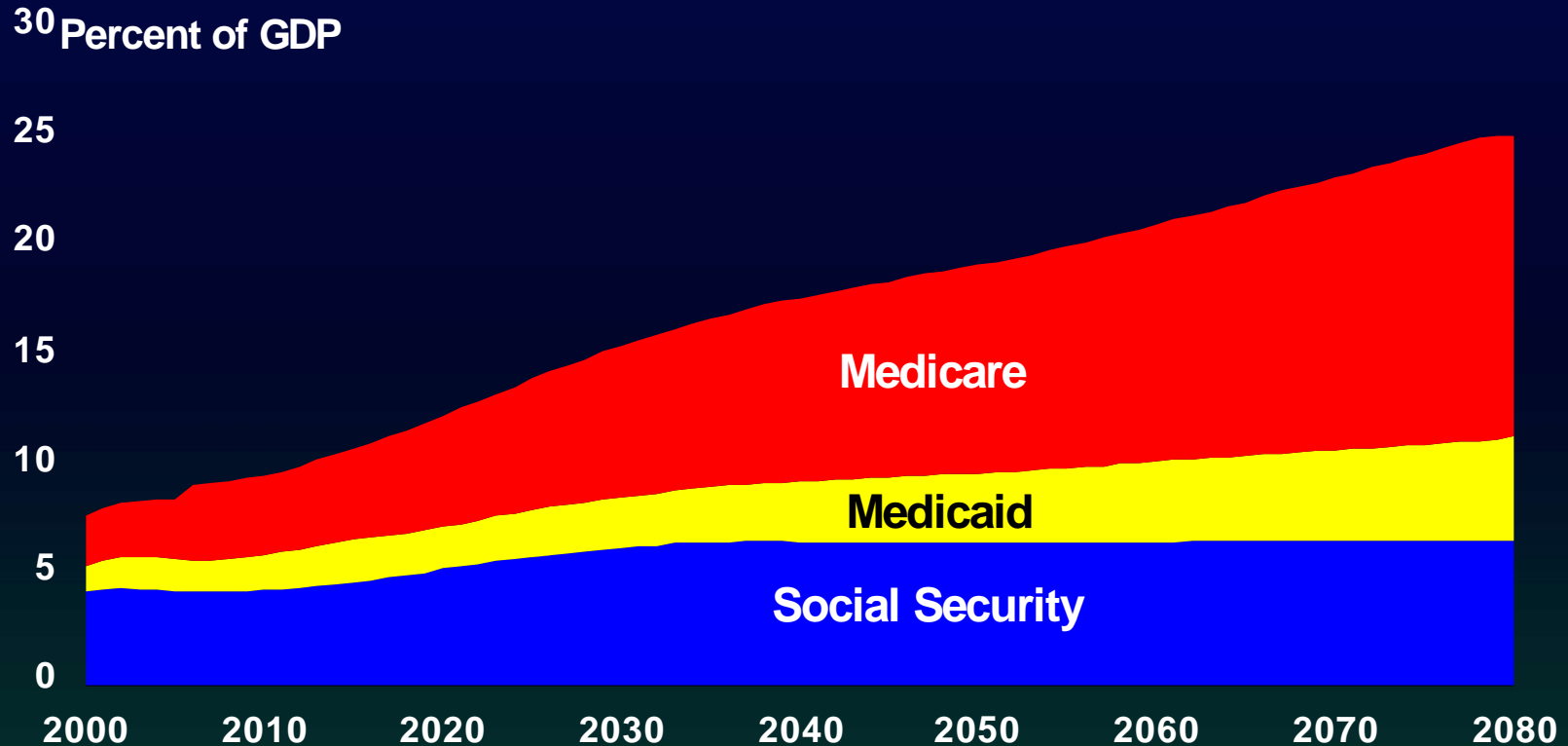
- Implement new accounting and reporting approaches and new budget control mechanisms for considering the impact of spending and tax policies and decisions over the long term
- Develop new metrics for measuring the impact of policies and decisions over the long term (e.g., key national indicators to measure our Nation's position and progress over time and in relation to other countries)
- Reexamine the base—question existing programs, policies and activities

Social Security and Medicare's Hospital Insurance Trust Funds Face Cash Deficits



Source: GAO analysis based on the intermediate assumptions of *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and the Federal Disability Insurance Trust Funds* and *The 2004 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*. The above excludes Medicare Part B and the newly enacted Medicare Part D benefit.

Social Security, Medicare, and Medicaid Spending as a Percent of GDP



Note: Social Security and Medicare projections based on the intermediate assumptions of the 2004 Trustees' Reports. Medicaid projections based on CBO's January 2004 short-term Medicaid estimates and CBO's December 2003 long-term Medicaid projections under mid-range assumptions.

Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration, Office of the Actuary, Centers for Medicare and Medicaid Services, and the Congressional Budget Office.

Key Elements for Economic Security in Retirement

- Adequate retirement income
 - Social Security
 - Pensions
 - Savings
 - Earnings from continued employment (e.g., part-time)
- Affordable health care
 - Medicare
 - Retiree health care
- Long-term care (a hybrid)
- Major Players
 - Employers
 - Government
 - Individuals
 - Family
 - Community

Selected 21st Century Questions

- **How should Social Security be reformed to make it both solvent and sustainable while better aligning it with 21st Century economic, demographic and fiscal realities?**
- **What changes should be made to existing pension laws in order to enhance the retirement income security of workers and help assure the financial integrity of the Pension Benefit Guaranty Corporation?**
- **How should federal programs and policies be revised to encourage people to work longer and to facilitate phased retirement approaches?**

Selected 21st Century Questions

- **How should our overall health care system be reformed to make it more successful and sustainable over time (e.g., focusing on certain defined needs versus unlimited wants; addressing the division of responsibilities between levels of government, employers, and individuals; and facilitating individual choice, cost control and quality improvement)?**
- **Which tax incentives and preferences need to be reconsidered given their costs and effects, failure to achieve goals intended by Congress, or their unintended consequences? For example, can adequate health care coverage be achieved at less cost and greater distributional equity through a fundamental redesign of the current health tax preferences, or through their elimination and the use of other means to provide for coverage?**

Social Security Reform Elements

Reform proposals should be evaluated as packages that strike a balance among individual reform elements and important interactive effects, including consideration of both funded and promised benefit levels.

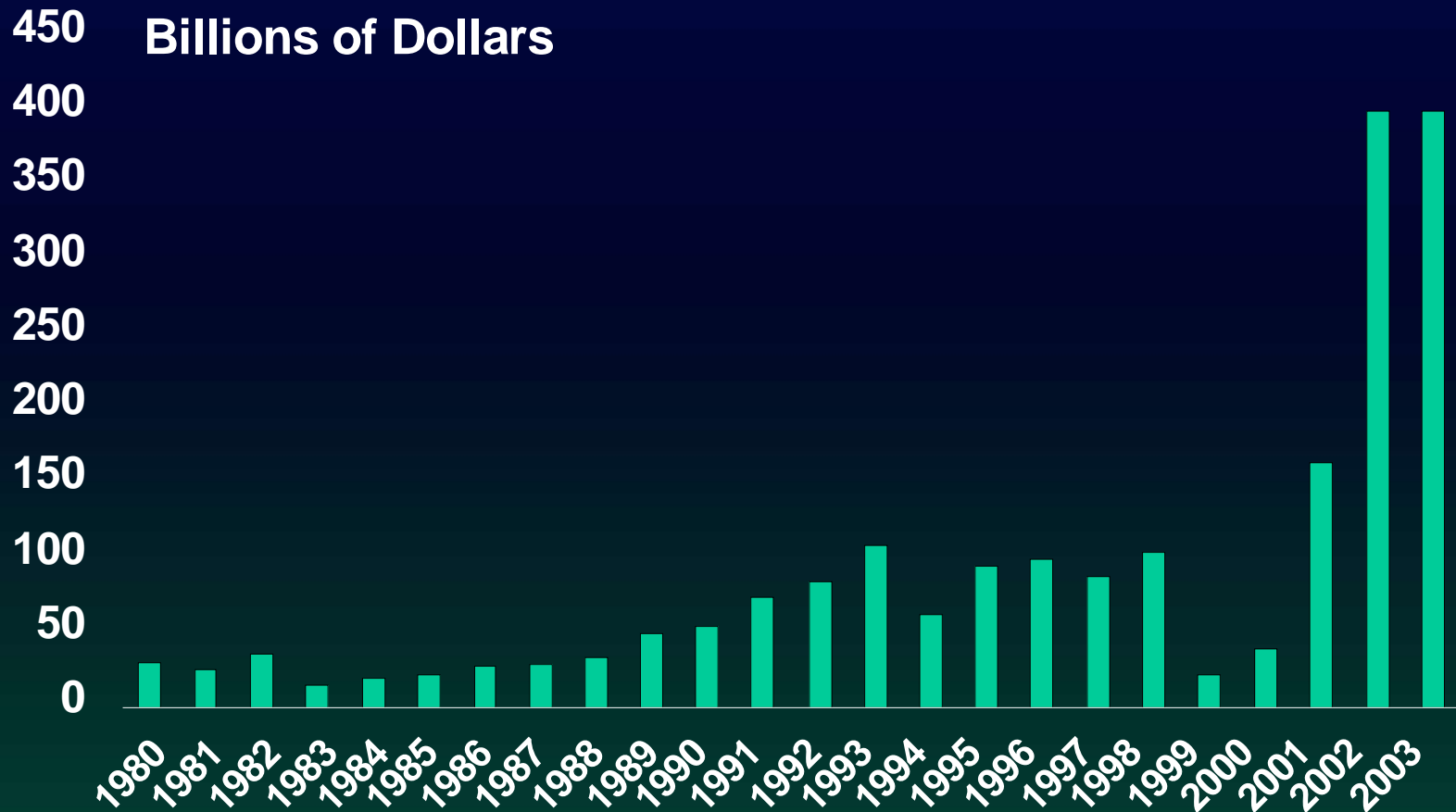
Comprehensive proposals can be evaluated against three basic criteria:

- Financing sustainable solvency**
- Balancing adequacy and equity in the benefits structure**
- Implementing and administering reforms**

Private Pension System Faces Variety of Challenges

- In total, only about half the private labor force covered by pensions
- Defined Benefit System
 - Long term decline in number of plans, active participants
 - Recent large plan terminations by bankrupt sponsors threaten solvency of Pension Benefit Guaranty Corporation, the federal agency insuring benefits
 - Stock market, interest rate declines reduced plan funding
 - Demographics, industry restructuring (steel, airlines) have contributed to both plan and corporate weakness

Total Underfunding in Single-Employer Program Plans, 1980 – 2003



Source: PBGC.

Defined Benefit Plan Weaknesses Have Serious Implications for National Retirement Policy

- **Current Issue:**
 - Protect the benefits of workers affected by terminated plans
 - Address PBGC financial exposure
 - Improve funding of DB plans generally
- **Broader Issue: what is role of DB plans in ensuring retirement security?**
 - Revitalized DB system vs smoother transition to all DC world
 - Impact of Social Security reform on the private DB and DC system and personal savings arrangements

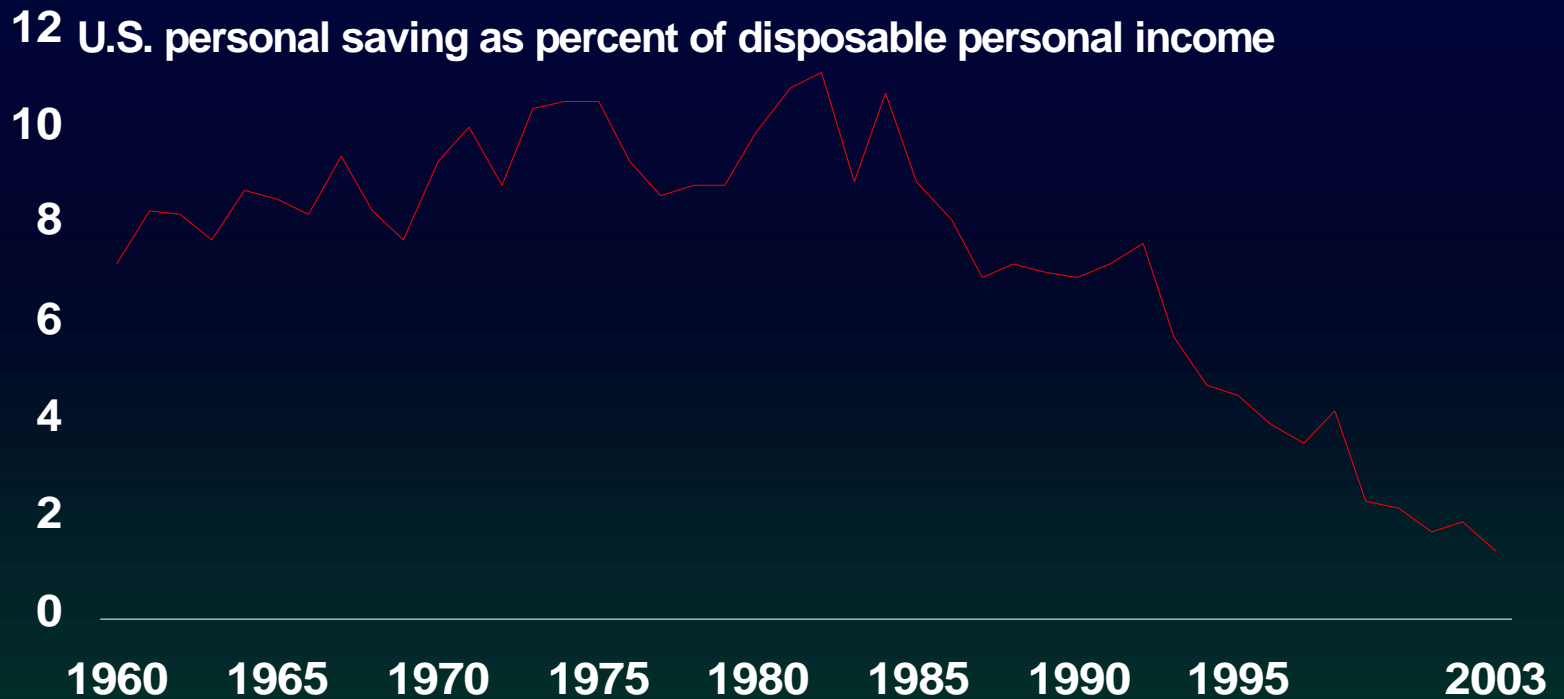
Defined Contribution Pension Plans Also Face Challenges

- **Increasingly widespread DC plans also pose problems for retirement security:**
 - Lack of reliable information and adequate education for many participants
 - Emphasis on lump sum features
 - Many covered workers do not participate
 - High fees may reduce returns

Many U.S. Workers Have Low Levels of Savings

- **U.S. continues to have a low personal saving rate**
- **Hard to know exactly but it appears that many workers are not saving enough for retirement**
 - For example, participation in individual retirement accounts (IRA's) not widespread, with less than 3 percent of tax filers reporting contributions to IRAs in 2001

U.S. Personal Saving Rate Fell from 10.8 Percent in 1984 to 1.8 percent in 2001 and 1.4 percent in 2003



Source: Bureau of Economic Analysis, Department of Commerce.

Several Reforms Might Improve Plan Funding and Reduce the Risks to PBGC's Long-term Viability

- Increase transparency of plan information
- Strengthen funding rules applicable to poorly funded plans
- Limit lump sums in underfunded plans
- Modify program guarantees (e.g., phase-in rules)
- Modify pension premiums (e.g., nature of risk related premiums)
- Eliminate floor/offset arrangements with significant investment concentrations in employer securities
- Modify bankruptcy laws?
- Other (e.g., pension leakage, cash balance plans, Social Security reform impacts)

Health Care System Key Questions

- **What is the difference between health care wants, needs, affordability and sustainability?**
- **What is an appropriate division of responsibility between individuals, government, employers, family and others?**

Health Care System Reform Elements

Incentives, Transparency, and Accountability

- Align **incentives** for providers and consumers to make prudent choices about health insurance coverage and prudent decisions about the use of medical services,
- Foster **transparency** with respect to the value and costs of care, and
- Ensure **accountability** from health plans and providers to meet standards for appropriate use and quality.

The background is a complex collage. On the left, there's a vertical strip with a warm, golden-yellow glow, showing a person in a white lab coat leaning over a desk. The rest of the background is a dark blue gradient with various elements: scattered US dollar bills (including a \$100 bill), a stack of colorful coins, and a faint, curved banner that says "SOCIAL SECURITY".

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