

United States Government Accountability Office

A LOOK AT



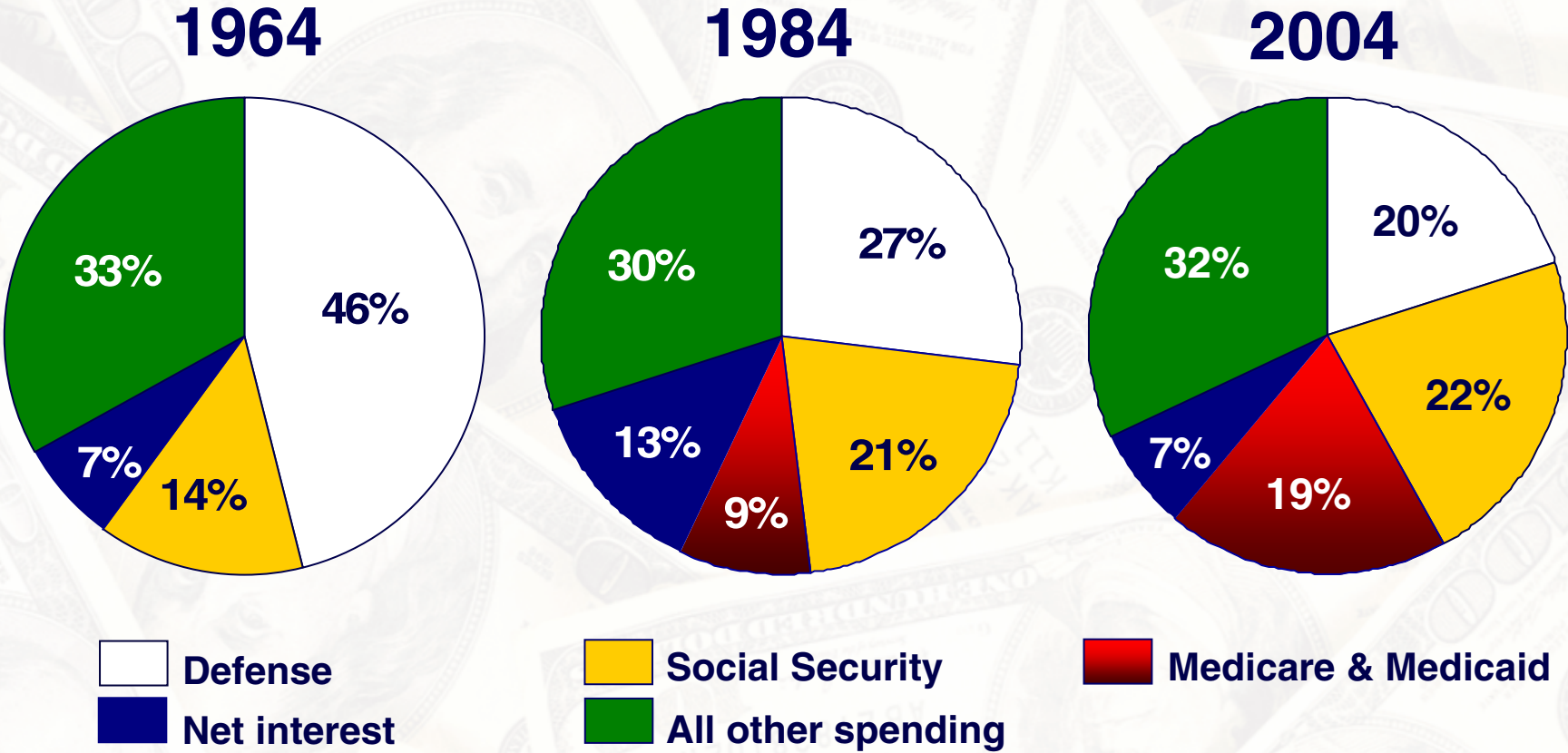
OUR
FUTURE:
WHEN BABY BOOMERS
RETIRE

2005 White House
Conference on Aging



The Honorable David M. Walker
Comptroller General of the United States
December 12, 2005

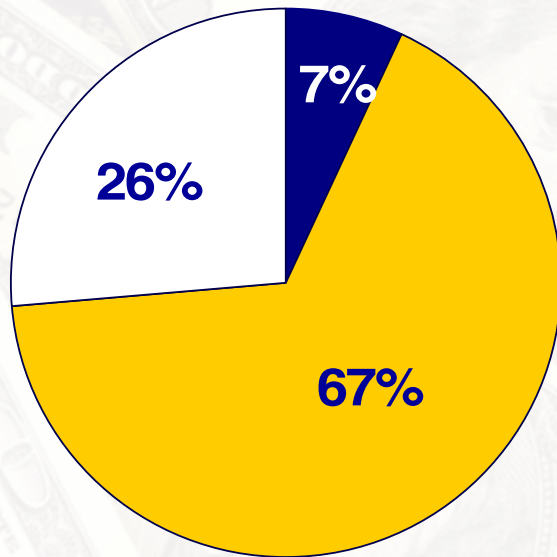
Composition of Federal Spending



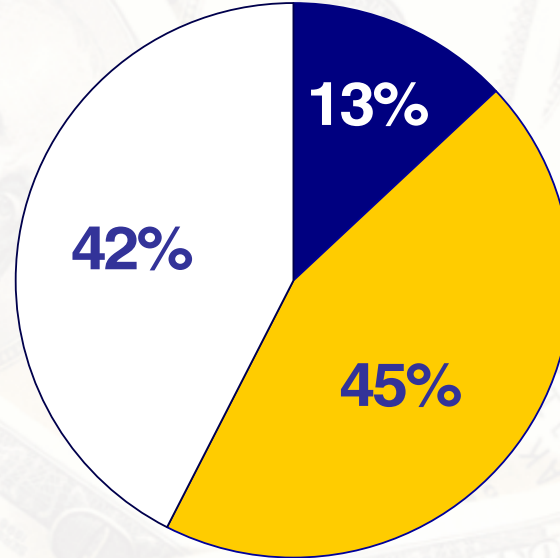
Source: Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs

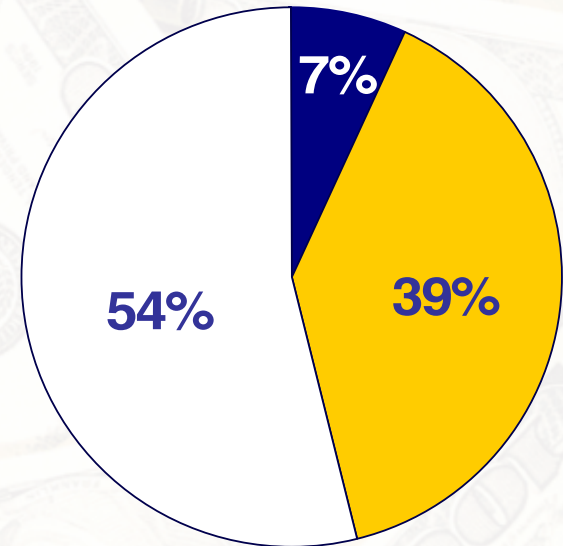
1964



1984



2004



 **Net Interest**

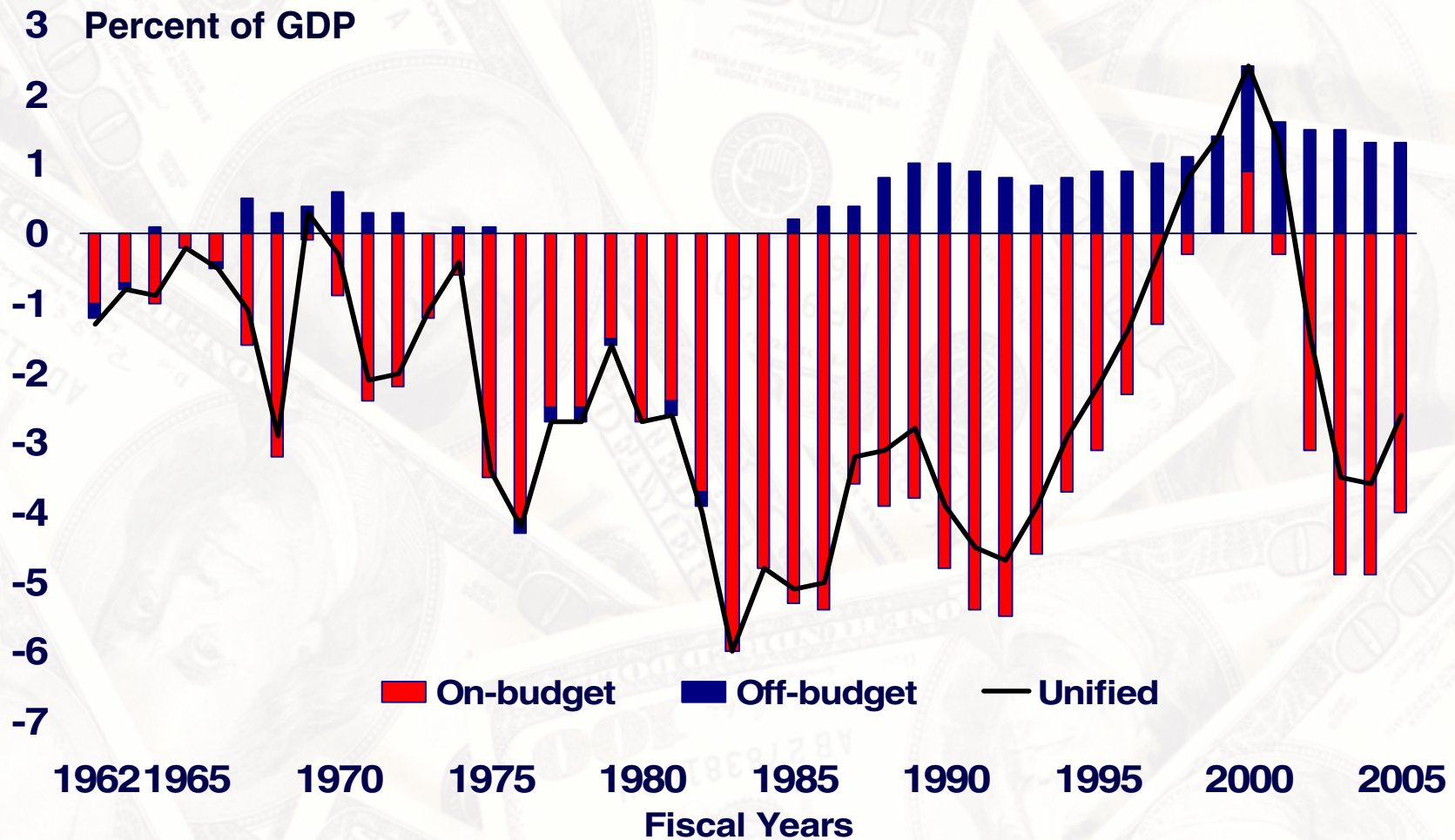
 **Discretionary**

 **Mandatory**

Source: Office of Management and Budget.

Surplus or Deficit as a Share of GDP

Fiscal Years 1962-2005



Source: Office of Management and Budget and Congressional Budget Office.

Fiscal Year 2004 and 2005 Deficits

	Fiscal Year 2004		Fiscal Year 2005	
	\$ Billion	% of GDP	\$ Billion	% of GDP
On-Budget Deficit	(567)	(4.9)	(494)	(4.0)
Off-Budget Surplus*	155	1.3	175	1.4
Unified Deficit	(412)	(3.6)	(319)	(2.6)

*Includes \$151 billion in fiscal year 2004 and \$173 billion in fiscal year 2005 in Social Security surpluses and \$4 billion in fiscal year 2004 and \$2 billion in fiscal year 2005 in Postal Service surpluses.

Estimated Fiscal Exposures

(in \$ trillions)

	2000	2002	2004
• Explicit liabilities	\$6.9	\$7.8	\$9.1
<ul style="list-style-type: none"> • Publicly held debt • Military & civilian pensions & retiree health • Other 			
• Commitments & Contingencies	0.5	0.8	0.9
<ul style="list-style-type: none"> • E.g., PBGC, undelivered orders 			
• Implicit exposures	13.0	17.8	33.3
<ul style="list-style-type: none"> • Future Social Security benefits 	3.8	4.6	5.2
<ul style="list-style-type: none"> • Future Medicare Part A benefits 	2.7	5.1	8.5
<ul style="list-style-type: none"> • Medicare Part B benefits 	6.5	8.1	11.4
<ul style="list-style-type: none"> • Medicare Part D benefits 	--	--	8.1
Total	\$20.4	\$26.4	\$43.3

Sources: Consolidated Financial Statements.

Note: Estimates for Social Security and Medicare are PV as of January 1 of each year as reported in the Consolidated Financial Statements and all other data are as of September 30. The 2005 Trustees Reports issued in March of this year show that the Social Security and Medicare exposures have increased as follows: Social Security increased to \$5.7 trillion, Medicare Part A increased to \$8.8 trillion, Medicare Part B increased to \$12.4 trillion and Part D increased to \$8.7 trillion. Totals may not add due to rounding.

How Big is Our Growing Fiscal Burden?

Our total fiscal burden can be translated and compared as follows:

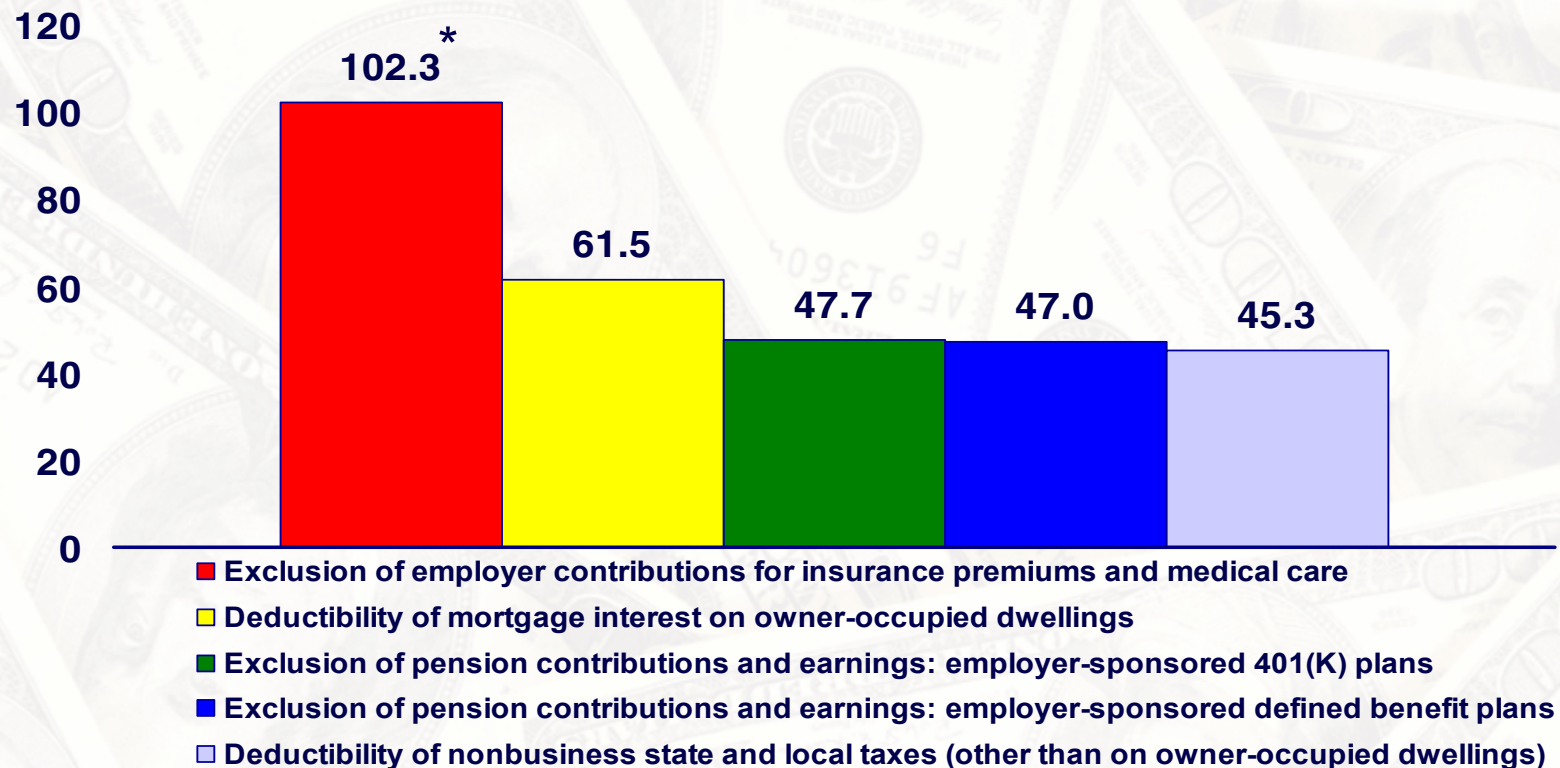
Total fiscal exposures	\$43.3 trillion
Total household net worth	\$48.5 trillion
Burden/Net worth ratio	89 percent
Burden	
Per person	\$147,000
Per full-time worker	\$350,000
Per household	\$383,000
Income	
Median household income	\$44,389
Disposable personal income per capita	\$29,475

Note: Net worth and income data are calendar year 2004 levels.

Sources: Federal Reserve Board for household net worth; Census Bureau for median household income; and the Bureau of Economic Analysis for disposable personal income per capita.

Health Care Is the Nation's Top Tax Expenditure in Fiscal Year 2004 (estimated)

Dollars in billions



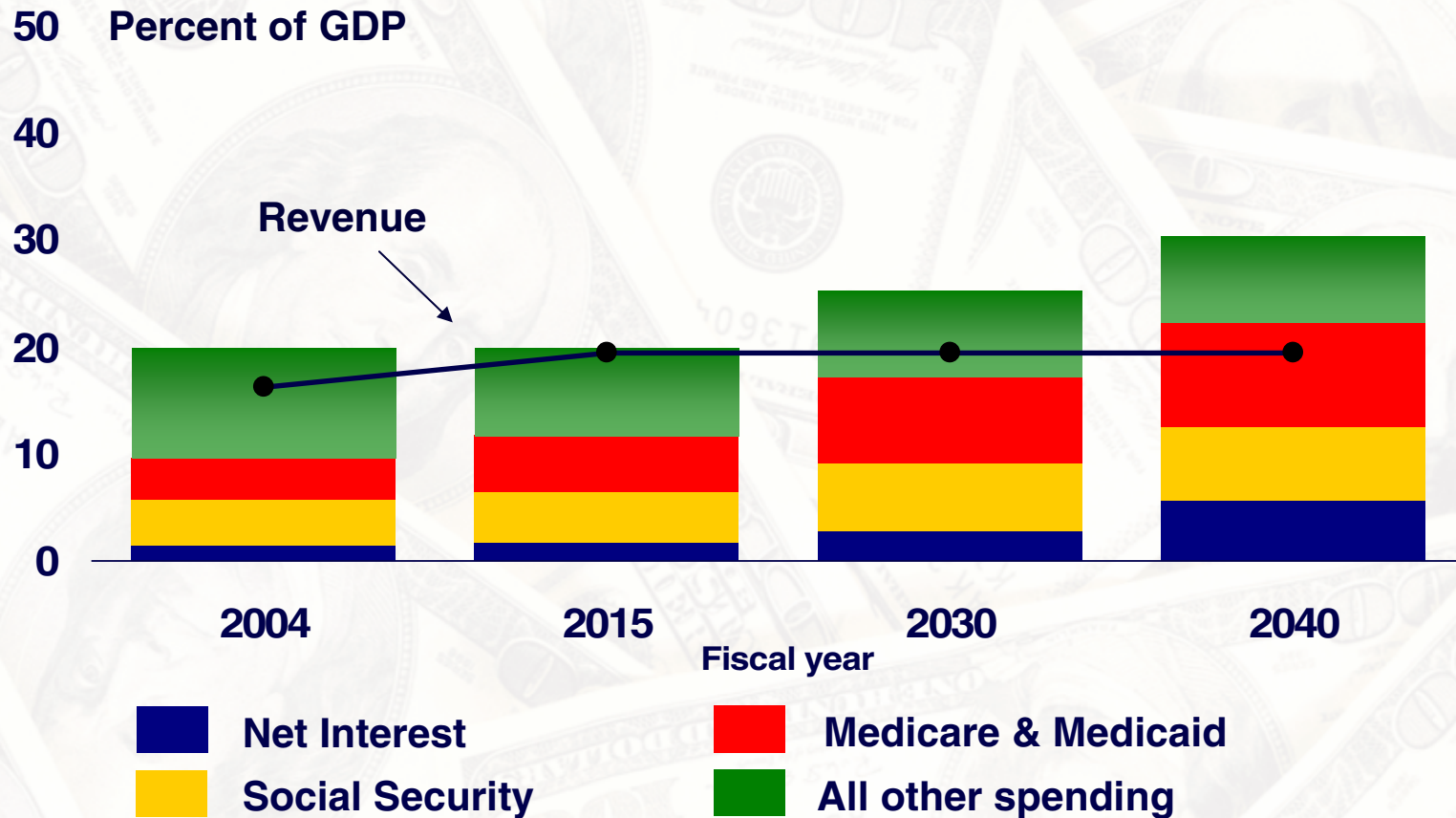
Note: "Tax expenditures" refers to the special tax provisions that are contained in the federal income taxes on individuals and corporations. OMB does not include forgone revenue from other federal taxes such as Social Security and Medicare payroll taxes.

* If the payroll tax exclusion were also counted here, the total tax expenditure for employer contributions for health insurance premiums would be about 50 percent higher or \$153.5 billion.

Source: Office of Management and Budget (OMB), *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2006*.

Composition of Spending as a Share of GDP

Under Baseline Extended

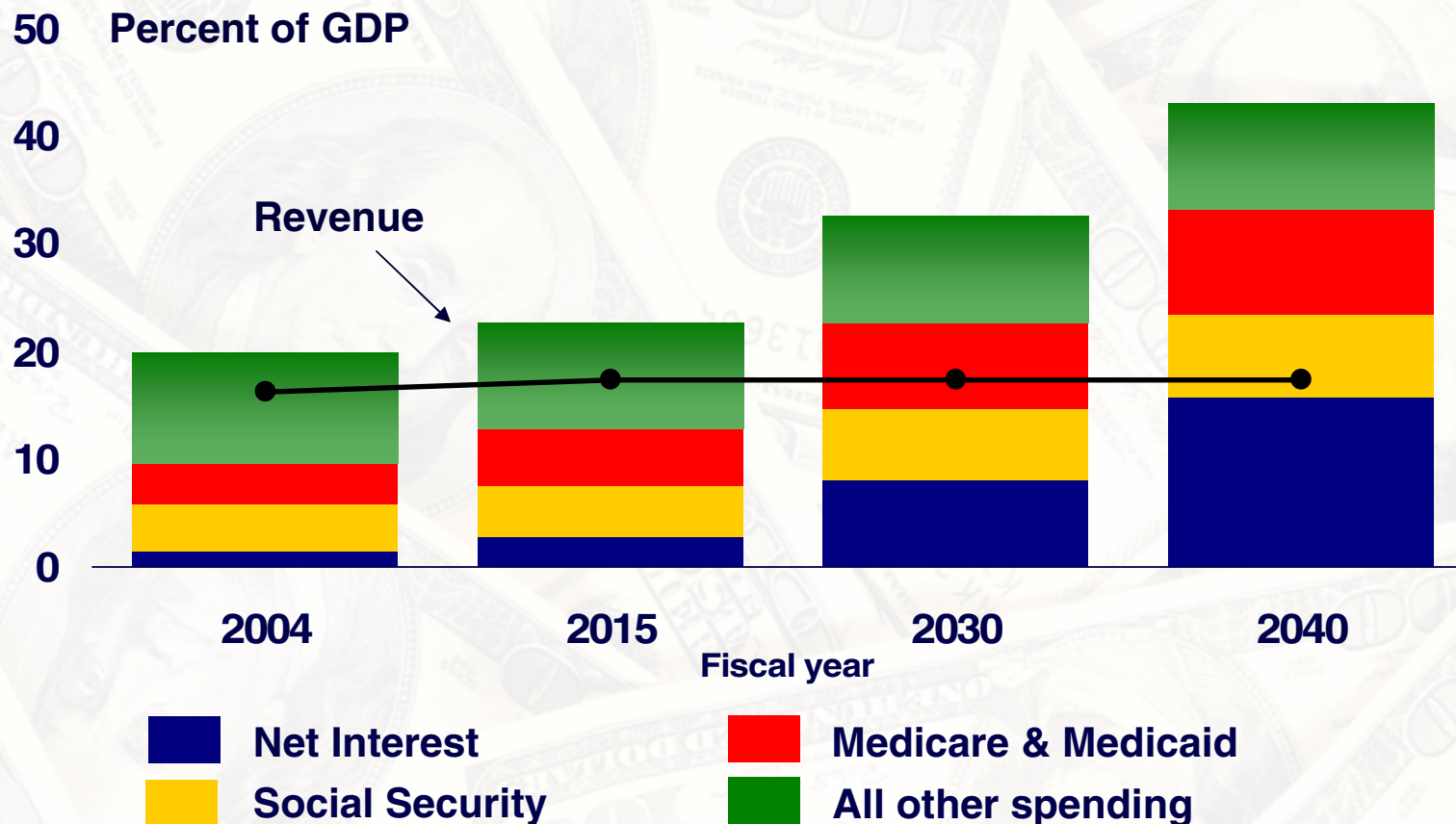


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

Source: GAO's August 2005 analysis.

Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP after 2005
and All Expiring Tax Provisions are Extended



Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

Source: GAO's August 2005 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 60 percent or
 - Raising taxes to 2.5 times today's level
- **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 Public Needs to Be Informed and Involved**

The Way Forward: Three Pronged Approach

Impose Budget Controls and Enhance Legislative Process

- Discretionary spending caps
- PAYGO rules on both sides of the ledger
- Mandatory spending triggers
- Automatic present value disclosures for legislative debate on major tax and spending bills
- Provide enhanced and integrated summaries of every key bill to Members before they vote on it, especially in connection with proposed new programs, policies, or activities

Improve Accounting and Reporting and Metrics:

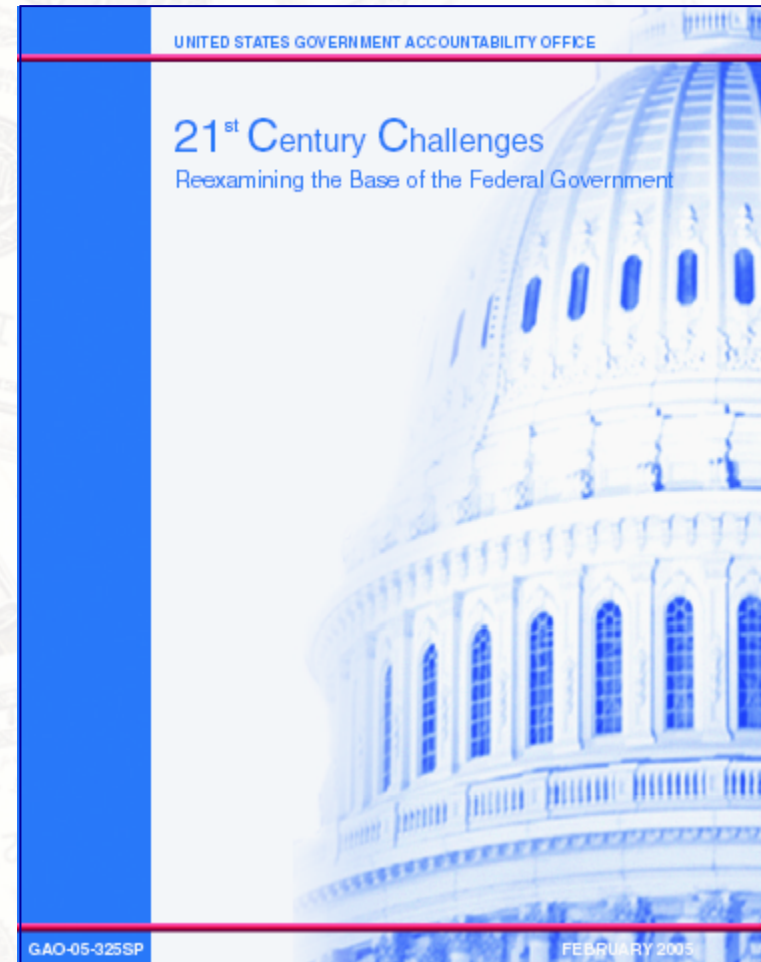
- Enhanced financial statement presentation (e.g. trust fund activity, intergenerational burdens)
- Develop key national (outcome-based) indicators

Re-examine Policies and Programs:

- Restructure existing entitlement programs
- Reexamine the base of discretionary and other spending
- Review and revise existing tax policy, including tax preferences and enforcement programs

21st Century Challenges Report

- Provides background, framework, and questions to assist in reexamining the base
- Covers entitlements & other mandatory spending, discretionary spending, and tax policies and programs
- Based on GAO's work for the Congress
- Issued February 16, 2005



Illustrative 21st Century Questions: Retirement and Disability Policy

- How should **Social Security** be reformed to provide for long-term program solvency and sustainability while also ensuring adequate benefits (for example, increase the retirement age, restructure benefits, increase taxes, and/or create individual accounts)?
- What changes should be made to enhance the retirement income security of workers while protecting the fiscal integrity of the **PBGC** insurance program (for example, increasing transparency in connection with underfunded plans, modifying PBGC's premium structure and insurance guarantees, reforming plan funding rules, or restricting benefit increases and the distribution of lump sum benefits in connection with certain underfunded plans)?
- How can existing policies be reformed to **encourage income preservation strategies** so that retirement income lasts an individual's entire life (for example, benefit annuitization)?
- How can existing policies and programs be reformed to **encourage older workers to work longer** and to facilitate phased retirement approaches to employment (for example, more flexible work schedules or receiving partial pensions while continuing to work)?

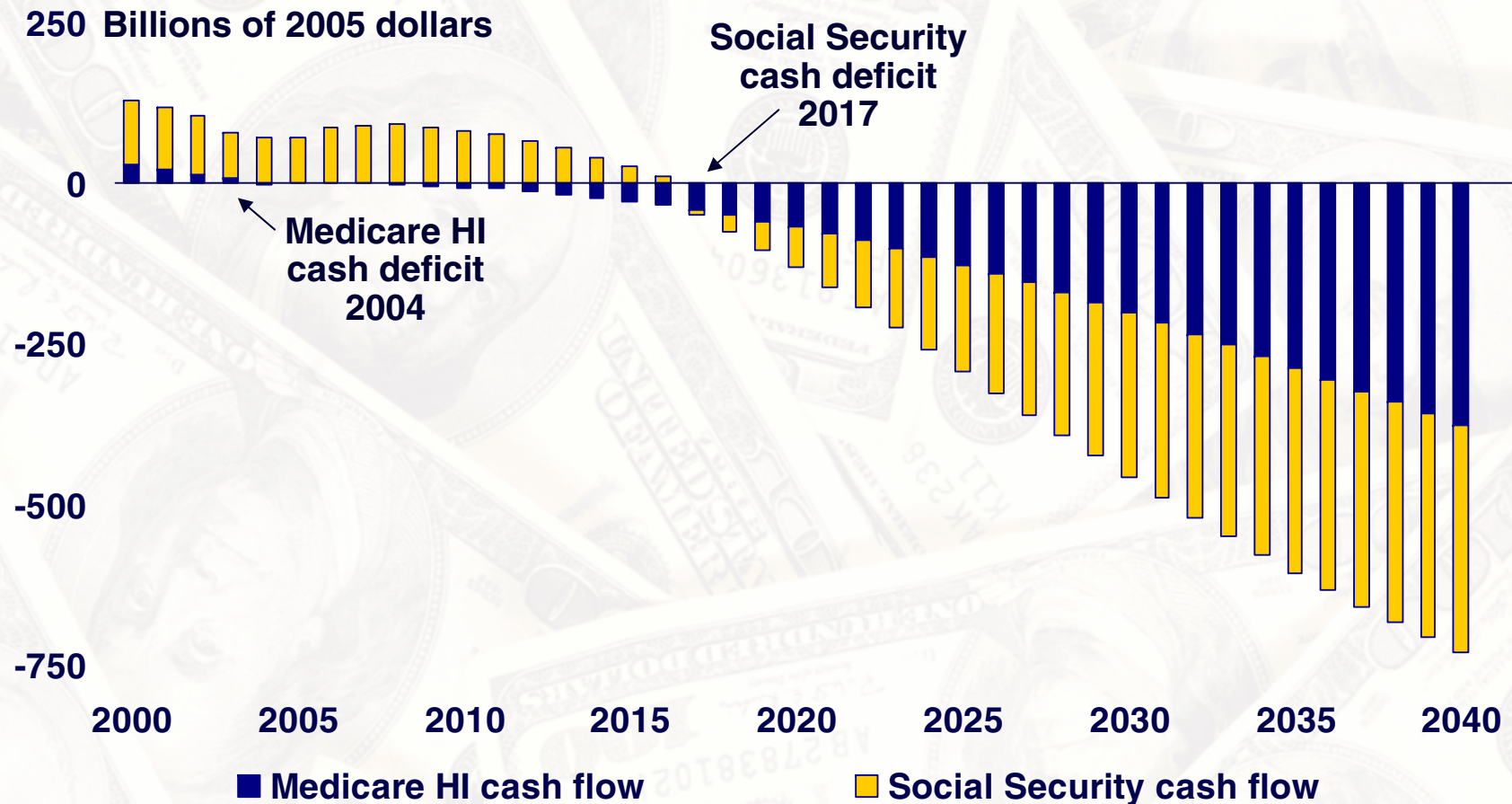
Illustrative 21st Century Questions: Health Care

- How can we make our current **Medicare and Medicaid** programs sustainable? For example, should the eligibility requirements (e.g., age, income requirements) for these programs be modified?
- How can we perform a **systematic reexamination of our current health care system**? For example, could public and private entities work jointly to establish formal reexamination processes that would (1) define and update as needed a minimum core of essential health care services, (2) ensure that all Americans have access to the defined minimum core services, (3) allocate responsibility for financing these services among such entities as government, employers, and individuals, and (4) provide the opportunity for individuals to obtain additional services at their discretion and cost?

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

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



Note: Projections based on the intermediate assumptions of the 2005 Trustees' Reports.
 Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration and Office of the Actuary, Centers for Medicare and Medicaid Services.

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

30 Percent of GDP

25

20

15

10

5

0

2000

2010

2020

2030

2040

2050

2060

2070

2080

Medicare

Medicaid

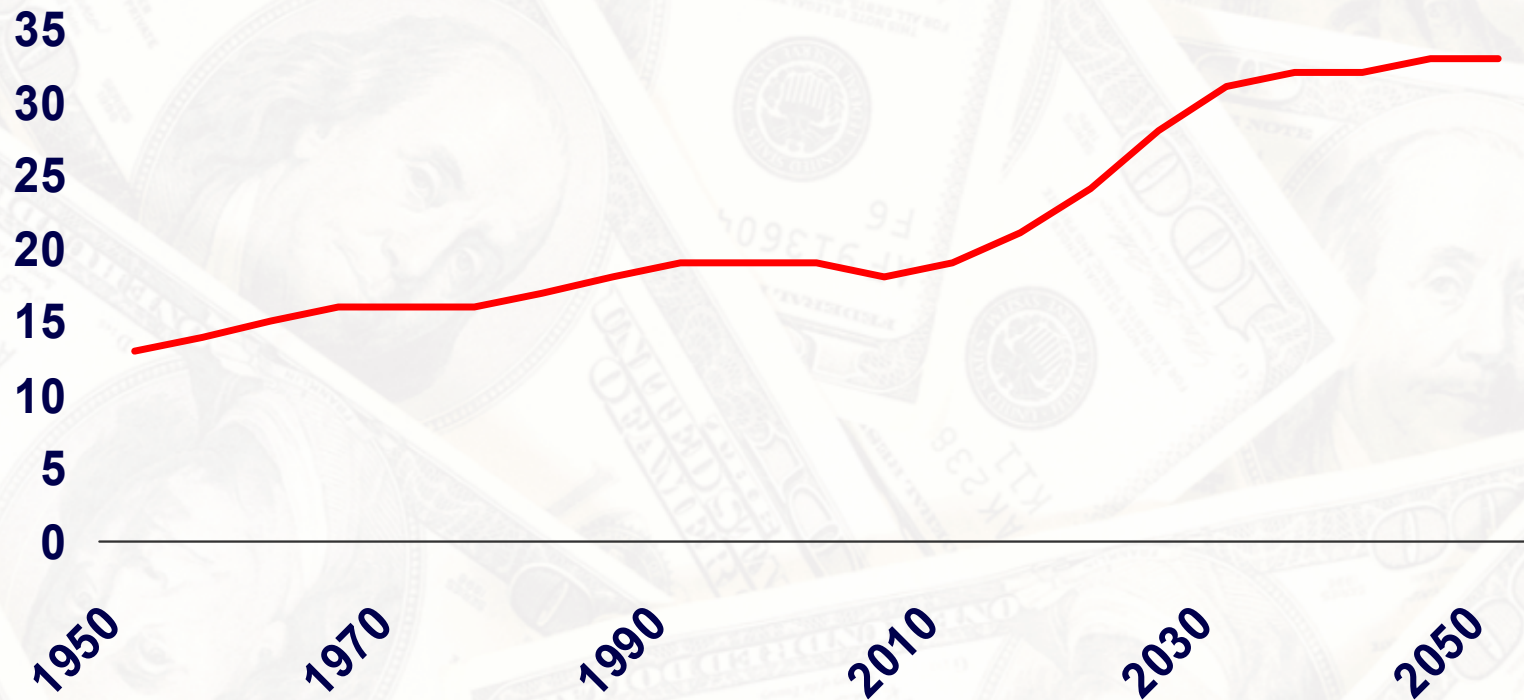
Social Security

Note: Social Security and Medicare projections based on the intermediate assumptions of the 2005 Trustees' Reports. Medicaid projections based on CBO's January 2005 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.

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: The 2004 Revision and World Urbanization Prospects: The 2003 Revision.

Note: Data for 2005 through 2050 are projected.

Key Dates Highlight Long Term Challenges of the Social Security System

Date	Event
2009	Social Security cash surplus begins to decline
2017	Annual benefit costs exceed cash revenue from taxes
2027	Trust fund ceases to grow because even taxes plus interest fall short of benefits
2041 (SSA) 2052 (CBO)	Trust fund exhausted, annual revenues sufficient to pay about 74% – 78% of promised benefits

Sources: Social Security Administration, *The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*. Washington, DC, March 2005. Congressional Budget Office, *The Outlook for Social Security: Potential Range of Social Security Outlays and Revenues Under Current Law*. Washington, DC, June 2004 (updated April 2005).

GAO Criteria for Evaluating Social Security Reform Proposals

Reform proposals should be evaluated as packages that strike a balance among individual reform elements and important interactive effects.

Comprehensive proposals can be evaluated against three basic criteria:

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

Challenges Facing the Defined Benefit (DB) Pension System

- Large accumulated deficits for many active plans, the PBGC, and the U.S. Government
- Structural weaknesses in certain industries with large, underfunded DB plans
- PBGC has limited control over its risks
- Decline in the number of DB plans
- Changing demographics and workforce trends
- Legal and regulatory uncertainties
- Social Security reform initiatives

Broad Goals for Reform of the DB System

- Provide incentives and safeguards for plan sponsors to improve plan funding
- Hold plan sponsors accountable for adequately funding their plans
- Improve transparency and timeliness of plan financial information

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

- Strengthen funding rules applicable to poorly funded plans
- Consider additional tax deductible funding flexibility
- Limit lump sums in underfunded plans
- Modify program guarantees (e.g., phase-in rules)
- Raise and modify pension premiums (e.g., nature of risk related premiums)
- Eliminate floor/offset arrangements with significant investment concentrations in employer securities
- Increase transparency of current plan funding information
- Modify bankruptcy laws
- Address issues surrounding certain hybrid plans (e.g., cash balance plans)

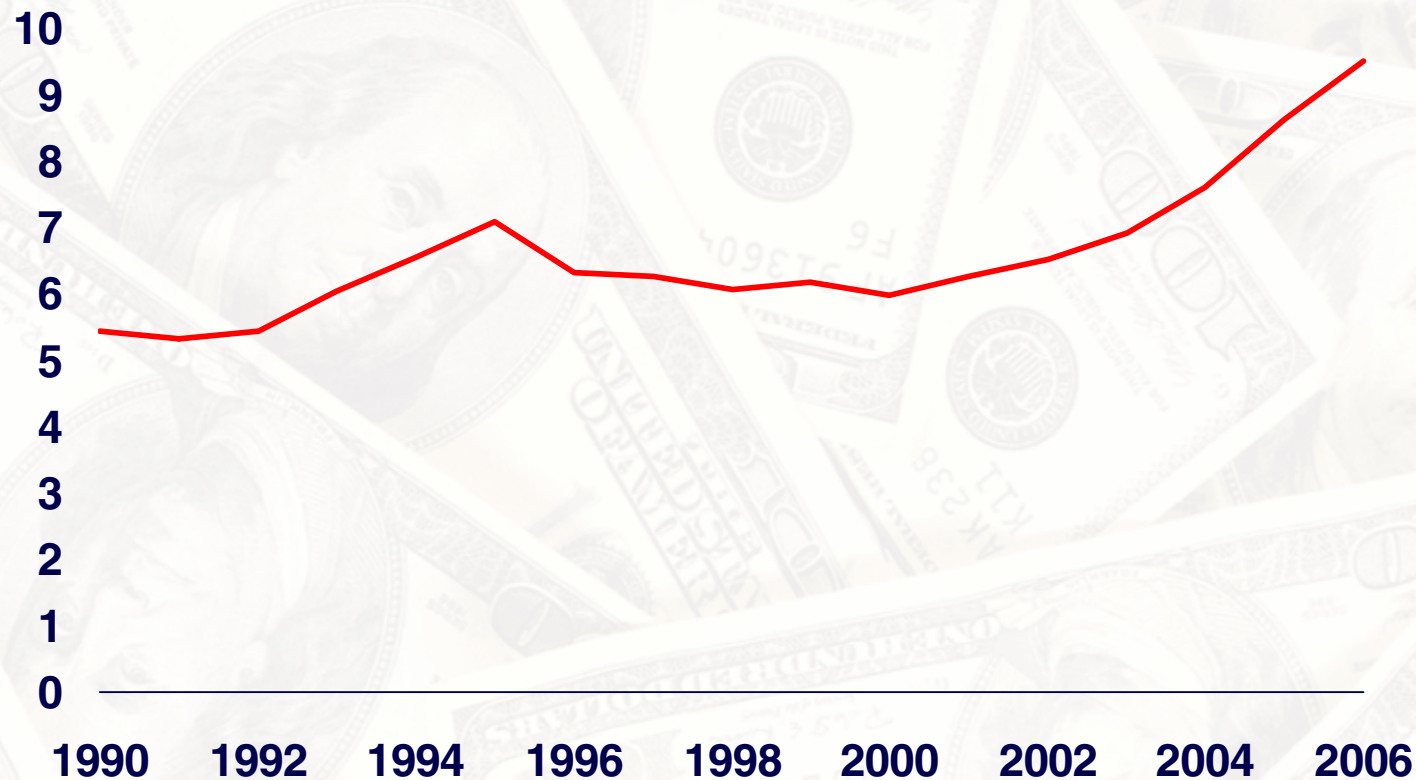
Key Dates Highlight Long Term Challenges of the Medicare Program

Date	Event
2004	HI outlays exceed cash income
2007	Estimated trigger date for “Medicare funding warning”
2012	Projected date that annual “general revenue funding” will exceed 45 percent of total Medicare outlays
2020	HI (Part A) trust fund exhausted, annual income sufficient to pay about 79% of HI promised benefits

Source: 2005 Annual Report of The Boards of Trustees of The Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds Washington, DC, March 2005

SMI Premium as Share of Average Social Security (OASI) Benefit

Percent of average OASI benefit



Note: Data for 2006 are based on the announced SMI monthly premium of \$88.50 and do not include the Medicare Prescription Drug premium. In August, the Centers for Medicare & Medicaid Services estimated that the national average monthly premium for prescription drug coverage equivalent to the Medicare standard coverage would be \$32.20.

Source: CMS, Office of the Actuary.

Issues to Consider in Examining Cost, Access, and Quality Challenges

- In reforming our health care system, the public needs to be educated about the differences between **wants**, **needs**, **affordability**, and **sustainability** at both the individual and aggregate level.
- Ideally, health care reform proposals will
 - 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.

Selected Potential Health Care Reform Approaches

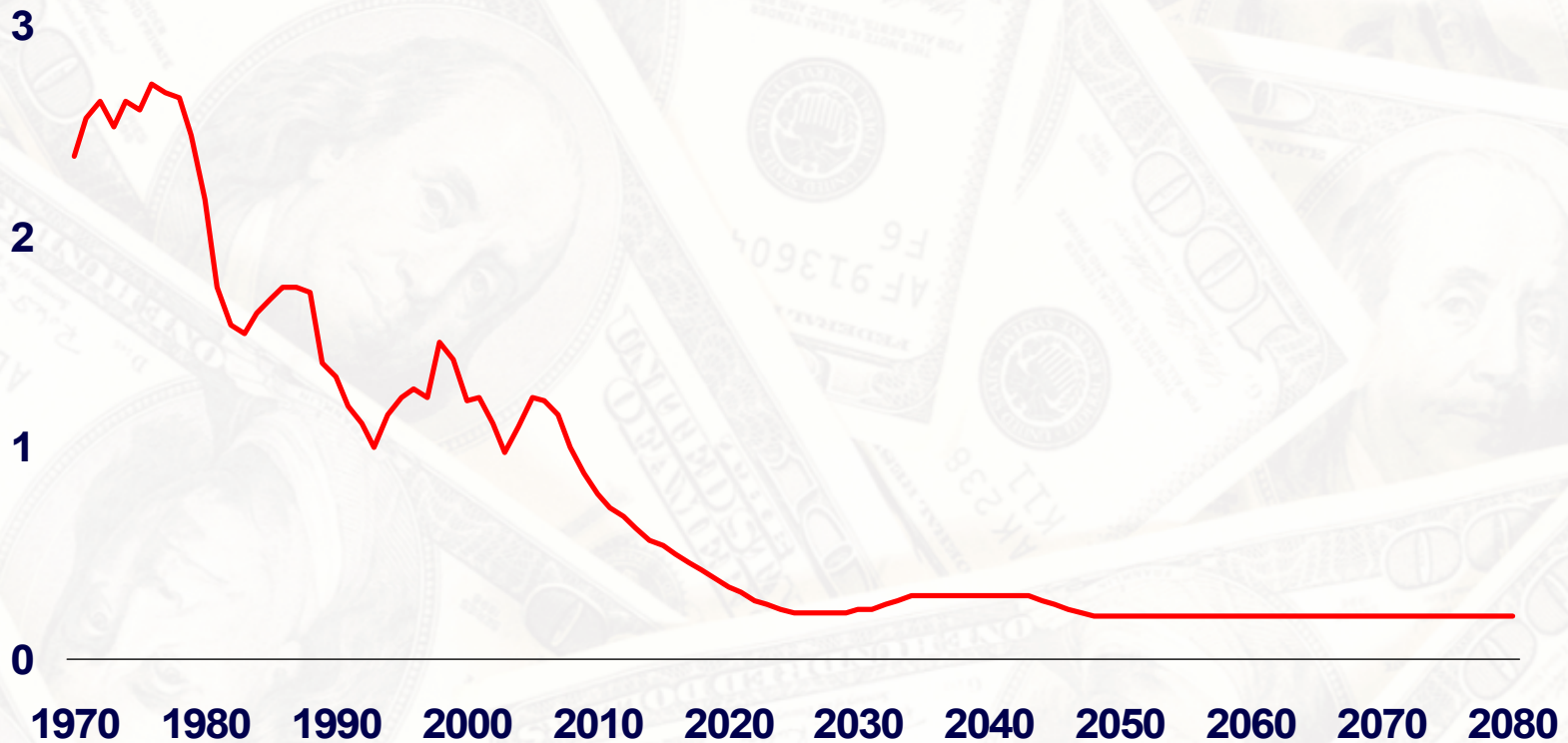
- Provide more transparency in connection with health care costs and outcomes.
- Employ case management approaches for people with expensive acute and chronic conditions to improve the quality and efficiency of care delivered and avoid inappropriate care.
- Leverage the government's purchasing authority to foster value-based purchasing for health care products and services.
- Foster the use of information technology to increase consistency, transparency, and accountability in health care.
- Provide additional cost sharing mechanisms for individuals.
- Develop a set of national practice standards to help avoid unnecessary care, improve outcomes, and reduce litigation.

Selected Potential Health Care Reform Approaches

- Revise certain federal tax preferences for health care to encourage the efficient use of appropriate care.
- Limit spending growth for government-sponsored health care programs (e.g., percentage of the budget and/or the economy).
- Pursue multinational approaches to investing in health care R&D.
- Develop a core set of basic and essential services with supplemental coverage being available as an option but at a cost. Use the Federal Employees Health Benefits Program (FEHBP) model as a possible means to experiment and see the way forward.
- Create insurance pools for alternative levels of coverage, as necessary.

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 2005 Trustees Reports.

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

Working Longer May Help Address the Challenges of an Aging Population

- **Impact on the Economy**
 - Larger labor force
 - Additional economic growth
- **Impact on the Federal Budget**
 - Additional tax revenue
 - Reduced expenditures: Social Security & Medicare
- **Impact on Individuals**
 - Enhanced retirement security and quality of life

Why Older Americans Don't Work Longer

- **Cultural Expectation to Retire in Mid-60s**
 - Social Security early retirement age is 62
 - Many private pensions have similar or lower eligibility ages
- **Older Americans Perceive Few Opportunities**
 - Few older workers felt they had opportunities for partial retirement
 - Most older workers and retirees saw low wage, low skilled jobs as their primary employment opportunities
- **Most Employers Do Not Make a Special Effort to Hire and Retain Older Workers**
 - Many employers say they are willing to implement policies to recruit and retain older workers, but few have actually done so
 - Employers cite barriers, such as federal pension regulations, to flexible employment options for older workers

Everyone Needs to Plan for the Aging of the Workforce

- Increase public awareness—both employers and employees need to understand the problem
- Encourage employers and employees to take an active role in meeting the challenges of an aging population
- Remove barriers and create opportunities for continued employment, such as phased retirement

GAO

United States Government Accountability Office
Report to Congressional Committees

December 2005

OLDER WORKERS

Labor Can Help
Employers and
Employees Plan Better
for the Future



GAO-06-80

Three Key Ingredients Needed for These Challenging and Changing Times

- ***Courage***
- ***Integrity***
- ***Innovation***

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