Addressing Fiscal Sustainability and Fixing the Social Security System: Two Challenges Facing the Nation

The Honorable David M. Walker
Comptroller General of the United States

AARP Board of Directors
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The Case for Change

The federal government is on a “burning platform,” and the status quo way of doing business is unacceptable for a variety of reasons, including:

• Past fiscal trends and significant long-range challenges
• Selected trends and challenges having no boundaries
• Additional resource demands due to Iraq, Afghanistan, incremental homeland security needs, and recent natural disasters in the United States
• Numerous government performance/accountability and high risk challenges
• Outdated federal organizational structures, policies, and practices
• Rising public expectations for demonstrable results and enhanced responsiveness
Composition of Federal Spending

1966
- 34% Defense
- 7% Net interest
- 15% Social Security
- 1% All other spending

1986
- 29% Defense
- 14% Net interest
- 10% Social Security
- 28% All other spending

2006
- 32% Defense
- 9% Net interest
- 19% Social Security
- 21% All other spending

Sources: Office of Management and Budget and the Department of the Treasury.
Note: Numbers may not add to 100 percent due to rounding.
Federal Spending for Mandatory and Discretionary Programs

1966

- Net Interest: 7%
- Discretionary: 67%
- Mandatory: 26%

1986

- Net Interest: 14%
- Discretionary: 42%
- Mandatory: 44%

2006

- Net Interest: 9%
- Discretionary: 53%
- Mandatory: 38%

Source: Office of Management and Budget.
### Fiscal Year 2006 and 2007 Deficits and Net Operating Costs

<table>
<thead>
<tr>
<th></th>
<th>Fiscal Year 2006</th>
<th>Fiscal Year 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>($ Billion)</td>
<td>($ Billion)</td>
</tr>
<tr>
<td><strong>On-Budget Deficit</strong></td>
<td>(434)</td>
<td>(344)</td>
</tr>
<tr>
<td><strong>Unified Deficit</strong></td>
<td>(248)</td>
<td>(163)</td>
</tr>
<tr>
<td><strong>Net Operating Cost</strong></td>
<td>(450)</td>
<td>(276)</td>
</tr>
</tbody>
</table>

Sources: Office of Management and Budget and Department of the Treasury.

*a*Includes $185 billion in Social Security surpluses for fiscal year 2006 and $186 billion for fiscal year 2007; $1 billion in Postal Service surpluses for fiscal year 2006 and a $5 billion deficit for fiscal year 2007.
Surplus or Deficit as a Share of GDP (1797-2007)

Source: Department of Commerce, Office of Management and Budget, and Congressional Budget Office.
Note: Data until 1929 are shown as a percent of gross national product (GNP); data from 1930 to present are shown as a percent of GDP.
Debt Held by the Public as a Share of GDP (1797-2007)

Source: GAO analysis of data from the Department of Commerce, Office of Management and Budget, and Congressional Budget Office.

Note: Data until 1929 are shown as a percent of gross national product (GNP); data from 1930 to present are shown as a percent of GDP.
Foreign Ownership Share of Federal Debt Held by the Public Has Increased

1996
Total Debt Held by the Public: $3.73 trillion
62% Foreign and international investors
28% Domestic investors and state and local governments
10% Federal Reserve

2006
Total Debt Held by the Public: $4.87 trillion
40% Foreign and international investors
44% Domestic investors and state and local governments
16% Federal Reserve

Source: Department of the Treasury.
## Major Fiscal Exposures ($ trillions)

<table>
<thead>
<tr>
<th>Category</th>
<th>2000</th>
<th>2007</th>
<th>% Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explicit liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Publicly held debt</td>
<td>$6.9</td>
<td>$10.8</td>
<td>57</td>
</tr>
<tr>
<td>Military &amp; civilian pensions &amp; retiree health</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Explicit liabilities</strong></td>
<td>$6.9</td>
<td>$10.8</td>
<td>57</td>
</tr>
<tr>
<td><strong>Commitments &amp; contingencies</strong></td>
<td>0.5</td>
<td>1.1</td>
<td>97</td>
</tr>
<tr>
<td>E.g., PBGC, undelivered orders</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Commitments &amp; contingencies</strong></td>
<td>0.5</td>
<td>1.1</td>
<td>97</td>
</tr>
<tr>
<td><strong>Implicit exposures</strong></td>
<td>13.0</td>
<td>40.8</td>
<td>213</td>
</tr>
<tr>
<td>Future Social Security benefits</td>
<td>3.8</td>
<td>6.8</td>
<td></td>
</tr>
<tr>
<td>Future Medicare Part A benefits</td>
<td>2.7</td>
<td>12.3</td>
<td></td>
</tr>
<tr>
<td>Future Medicare Part B benefits</td>
<td>6.5</td>
<td>13.4</td>
<td></td>
</tr>
<tr>
<td>Future Medicare Part D benefits</td>
<td>--</td>
<td>8.4</td>
<td></td>
</tr>
<tr>
<td><strong>Total Implicit exposures</strong></td>
<td>$20.4</td>
<td>$52.7</td>
<td>158</td>
</tr>
</tbody>
</table>


Note: Totals and percent increases may not add due to rounding. Estimates for Social Security and Medicare are at present value as of January 1 of each year and all other data are as of September 30.
### How Big is Our Growing Fiscal Burden?

This fiscal burden can be translated and compared as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total – major fiscal exposures</strong></td>
<td>$52.7 trillion</td>
</tr>
<tr>
<td><strong>Total household net worth</strong></td>
<td>$58.6 trillion</td>
</tr>
<tr>
<td><strong>Burden/Net worth ratio</strong></td>
<td>90 percent</td>
</tr>
<tr>
<td><strong>Burdens</strong></td>
<td></td>
</tr>
<tr>
<td>Per person</td>
<td>$175,000</td>
</tr>
<tr>
<td>Per full-time worker</td>
<td>$410,000</td>
</tr>
<tr>
<td>Per household</td>
<td>$455,000</td>
</tr>
<tr>
<td><strong>Income</strong></td>
<td></td>
</tr>
<tr>
<td>Median household income</td>
<td>$48,201</td>
</tr>
<tr>
<td>Disposable personal income per capita</td>
<td>$33,253</td>
</tr>
</tbody>
</table>

Source: GAO analysis.

Potential Fiscal Outcomes
Under Baseline Extended (January 2001)
Revenues and Composition of Spending as a Share of GDP

Source: GAO’s January 2001 analysis.

*All other spending is net of offsetting interest receipts.
Potential Fiscal Outcomes
Under Alternative Simulation
Revenues and Composition of Spending as a Share of GDP

Percent of GDP

Fiscal year

2006 2015 2030 2040

Revenue

Source: GAO's August 2007 analysis.

Notes: AMT exemption amount is retained at the 2006 level through 2017 and expiring tax provisions are extended. After 2017, revenue as a share of GDP returns to its historical level of 18.3 percent of GDP plus expected revenues from deferred taxes, i.e., taxes on withdrawals from retirement accounts. Medicare spending is based on the Trustees April 2007 projections adjusted for the Centers for Medicare and Medicaid Services alternative assumption that physician payments are not reduced as specified under current law.
Growth in Spending for Social Security, Medicare, and Medicaid Expected to Outpace Economic Growth

Growth in constant dollars 2007-2032

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.

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

Percent of GDP

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.

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 federal taxes to two times today's level

• **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
  • Closing the current long-term fiscal gap based on reasonable 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 Way Forward:
A Three-Pronged Approach

1. Improve Financial Reporting, Public Education, and Performance Metrics

2. Strengthen Budget and Legislative Processes and Controls

3. Fundamentally Reexamine & Transform for the 21st Century (i.e., entitlement programs, other spending, and tax policy)

Solutions Require Active Involvement from both the Executive and Legislative Branches
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)?
Key Elements for Economic Security in Retirement

- **Adequate retirement income**
  - Savings
  - Social Security
  - Pensions
  - 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
Personal Saving Rate Has Declined

Percent of disposable personal income

12.0
10.0
8.0
6.0
4.0
2.0
0.0


Source: Bureau of Economic Analysis.
Note: 2007 data available in April
Aged Population as a Share of Total U.S. Population Will Continue to Increase

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent of total population</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>5</td>
</tr>
<tr>
<td>1975</td>
<td>7</td>
</tr>
<tr>
<td>2000</td>
<td>10</td>
</tr>
<tr>
<td>2025</td>
<td>13</td>
</tr>
<tr>
<td>2050</td>
<td>16</td>
</tr>
<tr>
<td>2075</td>
<td>19</td>
</tr>
</tbody>
</table>

Source: Office of the Chief Actuary, Social Security Administration.
Note: Projections based on the intermediate assumptions of the 2007 Trustees’ Reports.
U.S. Labor Force Growth Will Continue to Decline

Percentage change (5-yr moving average)

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

Note: Percentage change is calculated as a centered 5-yr moving average of projections based on the intermediate assumptions of the 2007 Trustees Reports.
Social Security Workers Per Beneficiary Has Declined

Covered workers per OASDI beneficiary

Source: Office of the Chief Actuary, Social Security Administration.
Note: Projections based on the intermediate assumptions of the 2007 Trustees’ Reports.
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
<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>OASI</td>
<td>DI</td>
</tr>
<tr>
<td>2009</td>
<td>--</td>
</tr>
<tr>
<td>2018</td>
<td>2005</td>
</tr>
<tr>
<td>2028</td>
<td>2013</td>
</tr>
<tr>
<td>2042</td>
<td>2026</td>
</tr>
</tbody>
</table>

- **Cash surplus begins to decline** in 2009.
- **Annual benefit costs exceed cash revenue from taxes** in 2018.
- **Trust fund ceases to grow because even taxes plus interest fall short of benefits** in 2028.
- **Trust fund exhausted** in 2042.

Possible Way Forward on Social Security Retirement System Reform

Make little or no changes to those who are near retirement or already retired and make a number of adjustments that would affect younger workers:

- Phase-in an increase in the **normal** retirement age and index it to life expectancy
- Consider phasing-in an increase in the **early** retirement age and index it to life expectancy with a modified disability access provision
- Modify income replacement and/or indexing formulas for middle and upper income earners
- Strengthen the minimum benefit
- Consider a modest adjustment to the COLA formula
- Increase the taxable wage base, if necessary
- Consider supplemental individual accounts and mandatory individual savings on a payroll deduction basis (e.g., a minimum 2 percent payroll contribution and a program designed much like the Federal Thrift Savings Plan with a real trust fund and real investments)
Disability Concepts Have Become Outmoded

- SSA and VA currently equate presence of medical conditions with an incapacity to work

- At the same time, difficult measurement and conceptual issues complicate the use of medical condition as basis for decisions on work incapacity
Advancements Have Mitigated the Effects of Medical Conditions on Work Capacity

- Medical advancements
- Assistive technologies
- Labor market shift from manufacturing to service- and knowledge-based industries
- Americans with Disabilities Act
Agencies Have Difficulty Managing Disability Programs

- Lengthy claims processing times
- Appealed claims further lengthen processing timeframes
- Limited assurance of accuracy and consistency of disability decisions
- Disability criteria have not been fully updated to reflect scientific advances and labor market changes
Growth in Size of Larger Disability Programs Elevates Need to Modernize

Number of VA, SSI, and SSDI Beneficiaries 1996 and 2006

 Millions of Beneficiaries

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>VA Compensation and Pension</th>
<th>SSI (blind and disabled)</th>
<th>SSDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>14.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>18.1</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

0 10 15 20 25

14.5 18.1

Millions of Beneficiaries
Growth in Costs of Larger Disability Programs Elevates Need to Modernize

VA, SSI, and SSDI Total Cash Benefits 1996 and 2006

Cash benefit (billions)

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>1996</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>VA Compensation and Pension</td>
<td>25.0</td>
<td>25.0</td>
</tr>
<tr>
<td>SSI (blind and disabled)</td>
<td>30.0</td>
<td>30.0</td>
</tr>
<tr>
<td>SSDI</td>
<td>28.2</td>
<td>98.0</td>
</tr>
</tbody>
</table>

Total: 83.2 billion in 1996, 158 billion in 2006.
Longer-Lasting Impairment Types

- Proportion of SSA beneficiaries with longer-lasting impairments (such as mental impairments) has grown over past two decades

- For example, since 1999, number of veterans receiving disability compensation for PTSD has more than doubled
Several Factors Could Impact Program Size in Future

**SSA**
- Growth in general population
- Baby Boom generation entering prime disability years
- Historically low termination rates due to medical improvement and earnings (about 2 percent or less) may continue

**VA**
- Global War on Terrorism
Key Factors to Consider in Transforming Disability Programs for the 21st Century

- **Program Design**: eligibility criteria (including definition of disability); effective work supports; timing issues; coordination; flexibility

- **Fiscal Implications**: short and long-term costs; financial benefits; fiscal impact on states and localities

- **Feasibility of Transformation**: standards applied accurately and consistently; capable personnel; timely determinations; program integrity controls; strategic information systems
The sooner we get started, the better
  - The miracle of compounding is currently working against us
  - Less change would be needed, and there would be more time to make adjustments

Our demographic changes will serve to make reform more difficult over time

Need public education, discussion, and debate
  - The role of government in the 21st century
  - Which programs and policies should be changed and how
  - How government should be financed
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