

**“A Look at Our Future:
When Baby Boomers Retire”**

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In his poem “The Road Not Taken,” Robert Frost describes coming to a crossroads in the woods of New England. Frost chose the road less traveled, a choice that he says “made all the difference.”

The poem could be referring to man’s ability to choose and manage the consequences of those choices. As we all know, the right choice in life often isn’t easy or popular, and choosing it sometimes requires courage, effort, and persistence.

Today, America is at a similar crossroads. Things may seem fine at the moment, but when we look into the future our fiscal outlook isn’t pretty. We know that enormous challenges lie before us. With the retirement of the baby boomers and rising health care costs, we’re facing a fiscal challenge unprecedented in American history. This challenge is compounded by current deficit spending and relatively low federal revenues as a share of the economy.

Unfortunately, our public officials have done little to prepare us for this reality. Some policymakers are concerned, but so far there have been few calls for sacrifice or fundamental reform. Instead, the government’s continuing lack of fiscal discipline in recent years has made our long-term situation much worse. And yet, our demographic tsunami is on the horizon. It threatens to swamp the ship of state if we fail to act. In addition, unlike most natural

tsunamis, evacuation isn't an option with our demographic challenge. Tough choices will be required.

The United States confronts three interrelated deficits. The first is the federal budget deficit, which in 2004 reached a record \$412 billion on a unified basis. But the truth is that every dime of the Social Security and other trust fund surpluses went to government operating expenses, so the federal on-budget deficit for the year was actually closer to \$567 billion, of which less than \$100 billion related to Iraq, Afghanistan, and incremental homeland security costs. Even more troubling, the federal government's long-term liabilities and commitments rose by more than \$13 trillion in fiscal year 2004 alone to over \$43 trillion, largely because of the new Medicare prescription drug benefit. And these numbers don't even take into account the fiscal 2005 deficit or the future costs associated with Iraq and Hurricane Katrina.

In recent years, we've heard calls to relieve Americans of burdens like the so-called "death tax," but we need to talk more about the very real, very large, and ever increasing "birth burden." That's what I call the average amount of current federal liabilities and unfunded commitments that every American, including newborns, will at some point have to pay for. As of September 30, 2004, every new birth certificate came with a tab of nearly \$150,000, up from \$72,000 in just four years, and that tab is growing every day. It's no wonder that babies cry! But the federal budget deficit and our growing fiscal imbalance are only the beginning.

The second deficit is our savings deficit. Put quite simply, too many Americans – from individual consumers to elected officials – are spending today as if there's no tomorrow. At the same time, America has the lowest overall savings rate of any major industrialized nation.

The fact is that many Americans are saving next to nothing. The U.S. saving rate as a percentage of disposable personal income has fallen to 1.4 percent. By following their government's bad example, many Americans are living beyond their means and are deeply in debt. The average American household now carries a credit card balance of thousands of dollars. This trend is particularly alarming because personal savings are critical to an aging society such as our own. Those Americans who save more will certainly live better in retirement. Those who save less are rolling the dice, and the odds aren't in their favor, especially given the inevitability of entitlement reform.

So who's been underwriting America's recent spending spree? The answer is foreign investors. That brings me to the third deficit—our overall balance-of-payments deficit. America is spending more than it's producing. In 2004, the U.S. trade deficit hit a record \$618 billion, up \$121 billion from the year before. From cars to clothing, America is the world's largest single market for foreign goods.

Overseas money has been pouring into the United States. Many of these funds are coming from Asia, where U.S. treasury securities have been prized because of their safety. Thanks to the high savings rate in China, Japan, and elsewhere, it's relatively cheap for Americans to borrow. But there's a catch, and it's a big one. Increasingly, we're mortgaging our collective future, and some of our leading foreign lenders may not share our long-term economic, foreign policy, and national security interests. Imagine what would happen to the stock and bond markets if these foreign investors suddenly lost confidence in U.S. securities and decided not to buy or, worse yet, started to sell off their holdings.

From Rome and Babylon to the great powers of Europe, most civilizations have declined over time. Some nations are destroyed by wars, while others fall to disease and natural disasters. Today,

the greatest threat to America's future is our own unwillingness to make difficult but necessary policy choices, especially those that would help to restore fiscal responsibility. Unlike the nations of the past, we have the benefit of demographic projections and other sophisticated data whose meaning is clear and compelling. Unlike the nations of the past, it's fully within our power to make choices today that will help to ensure a better tomorrow. The key question is, will we?

This afternoon, I'm going to talk about where we are, where we're headed, and the steps that can and must be taken to avoid a long-term decline in America's position in the world and our standard of living here at home. I'm going to set the stage by discussing in more detail our nation's large and growing long-term fiscal imbalance. I'm then going to spend some time talking about two issues that will become increasingly important as the baby boomers retire. Those two issues are retirement income security and health care. Finally, I'm going to outline several specific steps that need to be taken, and taken soon, to secure America's continuing role as a superpower and to ensure an improved quality of life for our children and grandchildren.

Facing Financial Facts

Historically, Americans have shrugged off warnings about impending deficit and debt problems. Today, many people are in denial about the seriousness of our situation. After all, interest rates are low and inflation is modest. This false sense of security is reinforced by the government's financial statements and official budget projections, which fail to provide a full or fair view of our nation's current financial condition and long-term fiscal outlook. As the federal official who signs the audit report on the U.S. government's financial statement, I'm here to tell you that America's financial condition is worse than advertised.

In the past, particularly in the decades since World War II, America has been the world's engine of economic growth. We still are, but our long-term fiscal gap is so great now that there's no way we can simply grow our way out of the problem.

While the current deficit numbers are big and bad, I'm even more concerned about the decades of structural deficits that lie ahead. What do I mean by structural deficits? A structural deficit isn't caused by temporary economic cycles or one-time emergencies. Instead, a structural deficit is driven year after year by powerful underlying factors that affect both the spending and the revenue sides of the budget. As I mentioned earlier, these factors include known demographic trends, such as an aging population, longer life spans, and lower birth rates. Another key factor is the rising cost of health care. We also don't have enough revenue to pay our current bills or deliver on our future promises.

Obviously, one of the most important drivers of our structural deficits will be the cost to care for the aging baby boomers. The problem is that fewer and fewer working-age Americans will be around to support more and more retirees.

This trend is having and will continue to have a profound impact on government spending. The government now faces enormous expenses from its many liabilities and unfunded commitments. These include things like unfunded promises for Social Security and Medicare, military and civilian retirement benefits, and potential costly bailouts of government-sponsored entities like the Pension Benefit Guaranty Corporation. As I mentioned earlier, as of September 30, 2004, these items totaled over \$43 trillion, up \$13 trillion in one year alone, and that amount is growing daily.

Even with the recent run-up in housing prices, the combined net worth of every American, including Microsoft founder Bill Gates, stock market investor Warren Buffett, and other billionaires, is

only about \$48 trillion. That means that every American would have to give up around 90 percent of his or her net worth just to cover the government's current liabilities and unfunded promises for future spending.

Clearly, a crunch is coming, and eventually every federal department will feel its impact. Long-range budget simulations from my agency, the U.S. Government Accountability Office (GAO), show that, without meaningful changes, increasingly drastic actions on spending and taxes will be required to balance the budget. By 2040, if nothing is done, federal revenues may be barely adequate to pay interest on the national debt.

Absent timely and dramatic action, the real-life consequences of unchecked deficits are likely to become reality. If we continue as we have, higher interest rates are inevitable. It's only a matter of when and how high. As government is forced to borrow more and more money to finance its debt, less money will be available for companies to invest to innovate, improve, and stay competitive. Eventually, long-term economic growth will suffer, and along with it American jobs, purchasing power, America's international prestige, our overall standard of living, and even our long-term national security. A possible resurgence of inflation only adds to that worry.

So, despite what some say, deficits do matter—at least from an economic perspective. It also matters how a nation keeps score. After all, if our elected representatives don't have timely, comprehensive, and reliable information on the government's current finances and long-term fiscal outlook, how will they ever make the tough choices that will be required to help save our collective future?

The only thing scarier than incomplete and inaccurate financial projections is the possibility that we're seeing them through rose-colored glasses.

Reinventing Government

Beyond our growing fiscal imbalance, the United States also confronts a range of other emerging challenges. We're seeing globalization on many fronts. Markets, technologies, and businesses everywhere are increasingly linked, and geo-political borders are becoming less and less significant. And with today's international air travel, infectious diseases can spread from one continent to another literally overnight. This is one reason public health experts are so concerned about avian flu. Obviously, we also confront a range of new security threats.

To keep pace with these changes, our government must also change. It's time to ask a series of basic questions about what government does and how it does business. Nothing less than a top-to-bottom review of federal activities is needed to determine whether they are meeting their objectives and to free up resources.

To help in this effort, GAO recently published an unprecedented report that asks a series of basic questions about both mandatory and discretionary spending and tax policy. GAO's report is called "21st Century Challenges: Reexamining the Base of the Federal Government," and you can find it on our website at www.gao.gov. I should stress that while GAO doesn't make policy, decades of experience and expertise put GAO in a unique position to pose a range of thought-provoking questions for policy makers to consider. These questions address issues ranging from entitlement programs and mandatory and discretionary spending to tax policy and overall government operations. They also include a range of economic, health, and retirement security

questions. Any of these questions would make an excellent research topic for any student or faculty member here at The American College or any other school.

As I mentioned previously, our fiscal gap is now so great that, unlike the past, there is no way we can count on economic growth to bail us out. In the end, policymakers will need to reform entitlement programs, restructure the base of federal spending, and reexamine all existing tax policies to determine whether they remain relevant and appropriate for the 21st century. GAO's new report on tax expenditures, which we released last Friday, recommends that policymakers take a hard look at whether the costs of specific tax preferences outweigh the benefits.

My hope is that policymakers and the public will begin to think more strategically about where we are; where we're headed; and, more importantly, what we need to do to get back on a more prudent and sustainable path. But the time to start is now. There's a real payoff for prompt action. By making tough choices sooner rather than later, we can minimize the need for drastic measures down the road and we can give everyone time to adjust to any changes. We can make the miracle of compounding work for us rather than against us, as it is now. We can avoid a dangerous upward spiral of debt and inflation. Importantly, we can also fulfill our stewardship obligation to our children, grandchildren, and future generations of Americans.

Retirement Security

One of the many areas we need to reexamine and reprioritize is retirement security. Let's talk a little about what happens when the baby boomers start to leave the U.S. workforce in large numbers. Just to be clear, when I refer to the baby boomers, I'm talking about the generation born in the two decades after World

War II. Specifically, if you were born between 1946 and 1964, you're a baby boomer—like me.

We know that the boomers are living longer than past generations, yet many expect to retire just as early or earlier than their parents did. Obviously, that's going to put huge strains on both our public and private retirement systems. Longer retirements also underscore the importance of growing our future workforce.

As most of you know, a secure retirement has traditionally included several key elements, including Social Security, Medicare, private pension and health benefits, and personal savings. But some of these elements may not be as reliable in the future as they were in the past.

For example, take Social Security. In 1950, and I should point out that the system wasn't fully mature then, more than 16 workers were paying into the system for every retiree drawing benefits. Today, that ratio is a little more than three to one. By 2040, it'll be about two to one. Soon afterward, the Social Security trust funds are expected to be exhausted. At that point, there will only be enough revenue from payroll taxes to pay about seventy-four cents of every dollar of promised benefits.

So far, Social Security has been taking in more than it's been paying out. Frankly, the Social Security cash surpluses have been helping to finance the rest of government. But we know this is coming to end in the not-too-distant future. The Social Security cash surplus will begin to shrink within the next five years and it will disappear entirely by 2017. At that point, the Social Security trust fund will have to start redeeming its Treasury securities. The government will be forced to raise taxes, cut other spending, increase public borrowing, or some combination of these measures to raise the cash needed to pay Social Security benefits.

Importantly, Social Security isn't our biggest problem. Medicare is in much worse financial shape and is a far more complex and controversial challenge. The government's fiscal exposure to health care is a time bomb that's ticking ever more loudly. Combine all of them, and the picture is bleak indeed.

Today, federal spending for Social Security, Medicare, and Medicaid is about eight percent of the gross domestic product. By 2055, it could be 20 percent. That means that one in five dollars out of our entire economy would go to these three federal programs. I'll get back to this issue in a moment, but it's clear that the boomers, along with their children and grandchildren, have good reason to be worried about their promised public retirement benefits.

At the same time, we're seeing erosion in the benefits offered to American workers. This trend can be traced partly to changes in the nation's private pension system. The percentage of workers covered by an employer pension remains more or less at 1980 levels, or about half the workforce. But the type of benefits being offered has changed dramatically.

For years, defined benefit pensions were standard at many U.S. companies. Under this type of pension plan, the employer provided a retiree with a stated monthly income for life. In recent decades, the Pension Benefit Guaranty Corporation, or PBGC as it's commonly known, has insured all or part of these benefits. But the PBGC has gone from a \$9.7 billion surplus in 2000 to a \$23 billion deficit as of last year. Interestingly, the PBGC has suffered the same financial reversal as the overall federal government! In addition, the PBGC estimates that the nation's single-employer plans are now underfunded by more than \$450 billion. The recent bankruptcy filings by Delta and Northwest Airlines serve to underscore the seriousness of the situation. I should point out

that in 2003, GAO added PBGC's single-employer insurance program to our high-risk list.

Several basic changes could make a difference in PBGC's long-term outlook. For example, we need to strengthen the rules applicable to poorly funded plans. We need to raise and modify the PBGC's premiums to better reflect risk. We also need to limit lump sum payments from underfunded plans, provide better information on plan funding, and further reform the nation's bankruptcy laws.

The baby boomers will be the first generation to depend largely on uninsured defined contribution plans, which include 401(k) plans. Under this type of retirement plan, employers generally match all or part of worker contributions up to stated limits. As a result, it's increasingly up to the worker to plan, save, and invest for retirement.

Growing evidence shows that many workers are falling short in accumulating the large sums needed for a comfortable retirement. A recent survey by the human resources consulting firm Watson-Wyatt found that one in four eligible employees isn't participating in their 401(k) plan. And among those workers who did participate, not even one in 10 contributed the maximum.

The funds in the old defined benefit pensions were off limits until retirement. But today, employees can dip into their 401(k) balances before retirement—and apparently many workers are doing just that. When you also consider the growing problem of under-funded defined benefit plans and their troubling implications for both PBGC and individual retirees, it's becoming clear that some baby boomers won't have enough money to last them through retirement.

There's no question that defined contribution plans are very popular with employers and employees. These plans do have many positive features. In a world in which the average worker will change jobs seven times during a career, portability of benefits is a huge advantage. Unlike many defined benefit plans, 401(k)'s can follow a worker from job to job.

However, given current trends, many boomers may also need to work longer, or work part-time, if they want to maintain their standard of living into their 60s, 70s, and beyond. In the coming decades, with the slowing of growth in the U.S. labor market, America's seniors will play a more important role in the workforce. And in a knowledge-based economy such as ours, older workers can bring valuable skills and experience to a job. Hopefully, fewer workers will retire outright, and more and more workers will transition from full-time jobs to part-time work before retiring.

This trend will be particularly important given the inevitability of entitlement reform. Americans can no longer take for granted that the Social Security, Medicare, and Medicaid programs will continue in their present form. All of us are going to have to take more responsibility for our own financial futures. Americans will need to plan better, save more, and invest wisely for their retirement years. More Americans will also need to make provisions for one of the most expensive realities of growing old, and that's the need for long-term care. Financial advisors like the ones trained here at The American College can play an important role to help ensure that Americans do the right thing for themselves and their families.

It's also time to revisit a number of federal labor and tax policies in order to encourage people to work longer. The benefits from this trend are two-fold. First, the longer people work, the less the government is going to have to pay out in Social Security and other

benefits. The government will also be taking in more revenue. Second, continuing employment will not only put more money in the pockets of older Americans but it may also mean a significant difference in their quality of life and, according to authoritative research, could even lengthen their lives.

A saying that's equally true for government and for the individual is that if you fail to plan, you're likely to fail. The longer public officials and individuals postpone needed planning and necessary actions, the worse our options become and the more dramatic and potentially disruptive those changes will be.

As I said before, entitlement reform is essential and inevitable. We need to restructure Social Security and Medicare and put them on a sound footing for future generations. Actually, the problems with Social Security aren't that difficult to solve. Meaningful reform doesn't require breaking the bank or the back of the taxpayer. With a few thoughtful modifications to the program, we can exceed the expectations of every generation of Americans, whether they're retiring in 30 days or 30 years. Unfortunately, we're off to a bad start. Even so, the greatest challenge to retirement security isn't Social Security, it's the cost of health care.

Health Care

In recent decades, health care costs have generally outpaced U.S. economic growth, and this trend is likely to continue. Rising costs have already led to the disappearance of many employer-sponsored health care plans for retirees. As recently as 1997, one out of five companies provided their retirees with some form of subsidized health insurance. By 2002, that number had dropped to 13 percent and it's continuing to fall. Obviously, more and more baby boomers will be turning to Medicare and Medicaid to meet their health care needs in retirement. So how are we going to make these programs sustainable over the long run?

If we hope to provide an acceptable level of health care to the baby boomers, we're going to need to fundamentally rethink how we define, deliver, and finance health care in this country. That's true for both the public and the private sectors. For example, our current system does little to encourage informed discussions and decisions about the costs and value of various health care services. That's particularly important when it comes to cutting-edge drugs and medical technologies, which can be incredibly expensive but only marginally better than other alternatives. We're going to need to weigh unlimited individual wants against broader societal needs and decide how responsibility for financing health care should be divided among employers, individuals, and government.

Ultimately, we may need to define a set of basic and essential health care services that would be guaranteed to every American. Individuals wanting additional coverage might be required to allocate resources to pay for it. Clearly, such a dramatic change would require an appropriate transition period.

For now, we need to take interim steps to establish uniform standards of practice, promote cost-effective care for people with chronic illnesses, modify existing cost-sharing arrangements, better leverage the government's purchasing power, increase transparency on the costs and quality of health care, introduce reconsideration triggers to help contain growth in health care costs, and rethink the existing tax exclusion for employer-provided and employer-paid health insurance. I'm convinced that in time, our health care crisis can be cured. But what we need now is a sound prescription for progress and a bold first step forward. Ultimate success is essential, nothing less than the fiscal future of the country, the global competitiveness of American business and the health security of Americans is at stake.

Leading the Way Forward

So where do we go from here? At the federal level, we must have more fiscal discipline and we need to change our current accounting and reporting model and budgeting systems to better reflect the government's true financial condition and long-term fiscal outlook. In my view, our elected representatives need more explicit information on the long-term costs of major spending and tax bills—before they vote on them. The time has also come to reinstate budget controls, such as spending caps and “pay-as-you-go” rules that would require any new spending increases or tax cuts to be paid for by equivalent tax increases or spending cuts. Likewise, we need to establish additional reconsideration triggers over mandatory spending.

As I said earlier, America is at a critical crossroads. The choices that policymakers make or fail to make in the next 5 to 10 years will have profound implications for the future of our country and all Americans. To help us make the right choice, we need more leaders with three key attributes. Those attributes are courage, integrity, and the ability to innovate. We need leaders who have the courage to speak the truth, to do the right thing, and to put the needs of the next generation ahead of the next election cycle. We need leaders who have the integrity to lead by example, to practice what they preach, and who understand the law is the floor of acceptable behavior and who live by higher standards. We need leaders who can see new ways to address our many challenges and who can help show others the way forward.

Recent history provides two examples of countries whose leaders took them down two very different fiscal paths. Before World War II, Argentina was one of the most prosperous nations in Latin America.

Today, due largely to the road not taken, Argentina is an economic basket case. In 2001, Argentina experienced the largest public debt default in history.

On the other hand, there's the example of New Zealand. Like the United States, New Zealand has an aging population. Unlike the United States, New Zealand has taken steps to deal with the growing burden associated with its pension system and other government programs. New Zealand is a work in progress, but at least its leaders have acknowledged their country's challenges and have begun to address them.

I don't want you to go away thinking that things here at home are hopeless. That's far from true. America has risen to greater challenges in the past. What we need to do now is to take steps that will put us on a path closer to that of New Zealand rather than Argentina. But unlike New Zealand, we shouldn't wait to act until we're on the brink of a disaster. After all, the facts about our own future are clear and compelling.

We need to overcome our myopia and look past the present to consider the future. We also need to educate ourselves about the issues that really matter and hold our government accountable for fiscal prudence, enhanced performance, real results, and appropriate stewardship.

Leadership is important, but "we the people" need to be part of the solution. My hope is that when you leave here today, you will spread the word among your friends and colleagues and start demanding the facts and insisting on action. If you and I remain silent, meaningful change is unlikely. After all, why should any elected official stick his or her neck out on difficult issues that no one seems to care about?

In closing, lately, I've been studying the life of George Washington, particularly his two terms as President. What's often overlooked is that George Washington was a great believer in fiscal discipline. In his farewell address in 1796, Washington spoke to the issue of public debt. He urged the new nation to avoid "ungenerously throwing upon posterity the burden which we ourselves ought to bear." This advice is as sound today as it was over 200 years ago. By ignoring George Washington's words of wisdom and postponing difficult policy decisions, our government is, in fact, making a choice—a choice with unacceptable fiscal and ethical consequences.

We can and must do better than the path of least resistance. The road less traveled won't always be easy, but it's a journey that our children, grandchildren, and future generations of Americans will thank us for taking. I hope you'll join with me in stating the facts, speaking the truth, and acting to help save our collective future.