



UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

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
Annual Public Policy Meeting
Washington, D.C.
February 14, 2008**

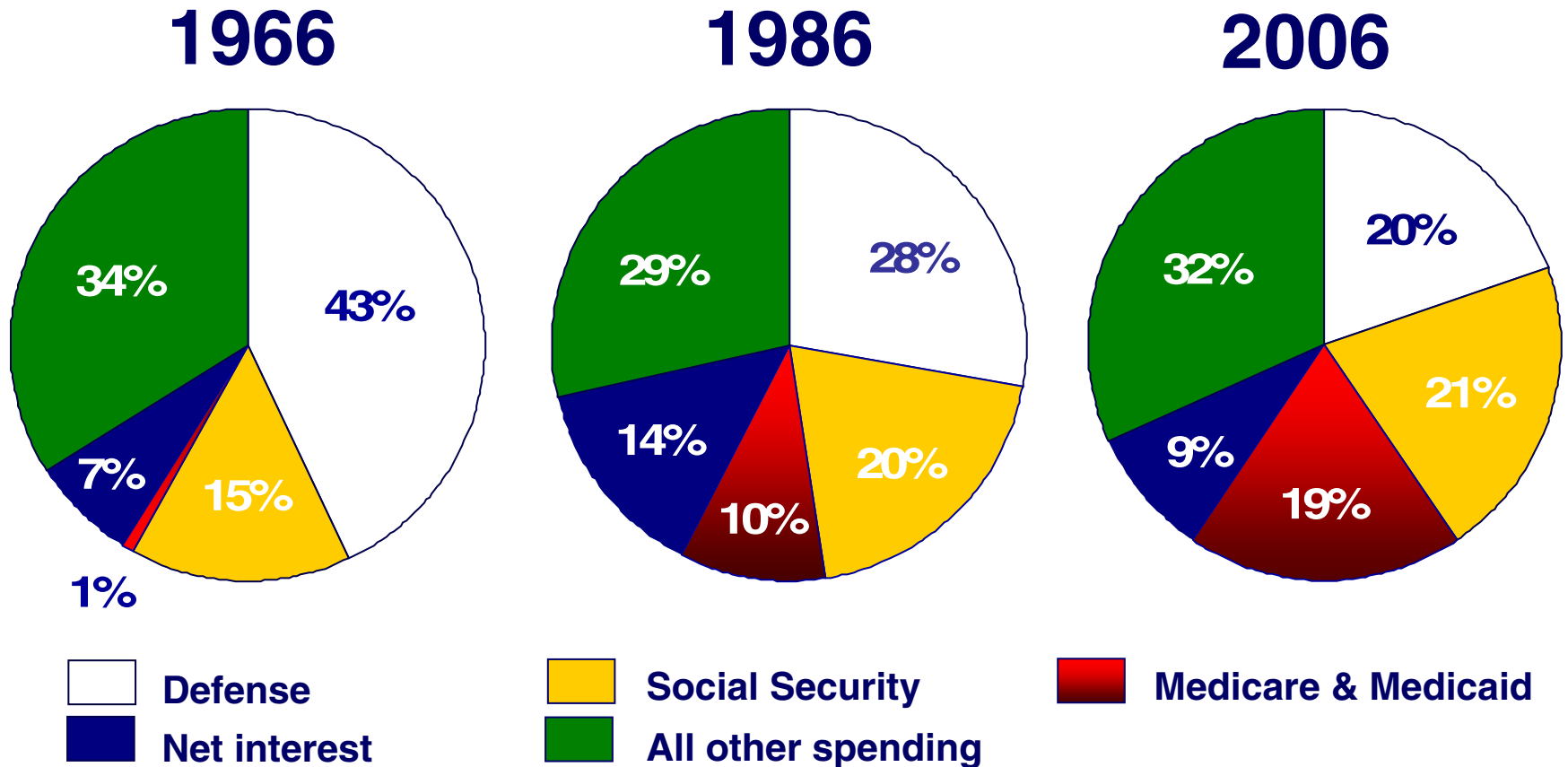


The Case for Change

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- Outdated federal organizational structures, policies, and practices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

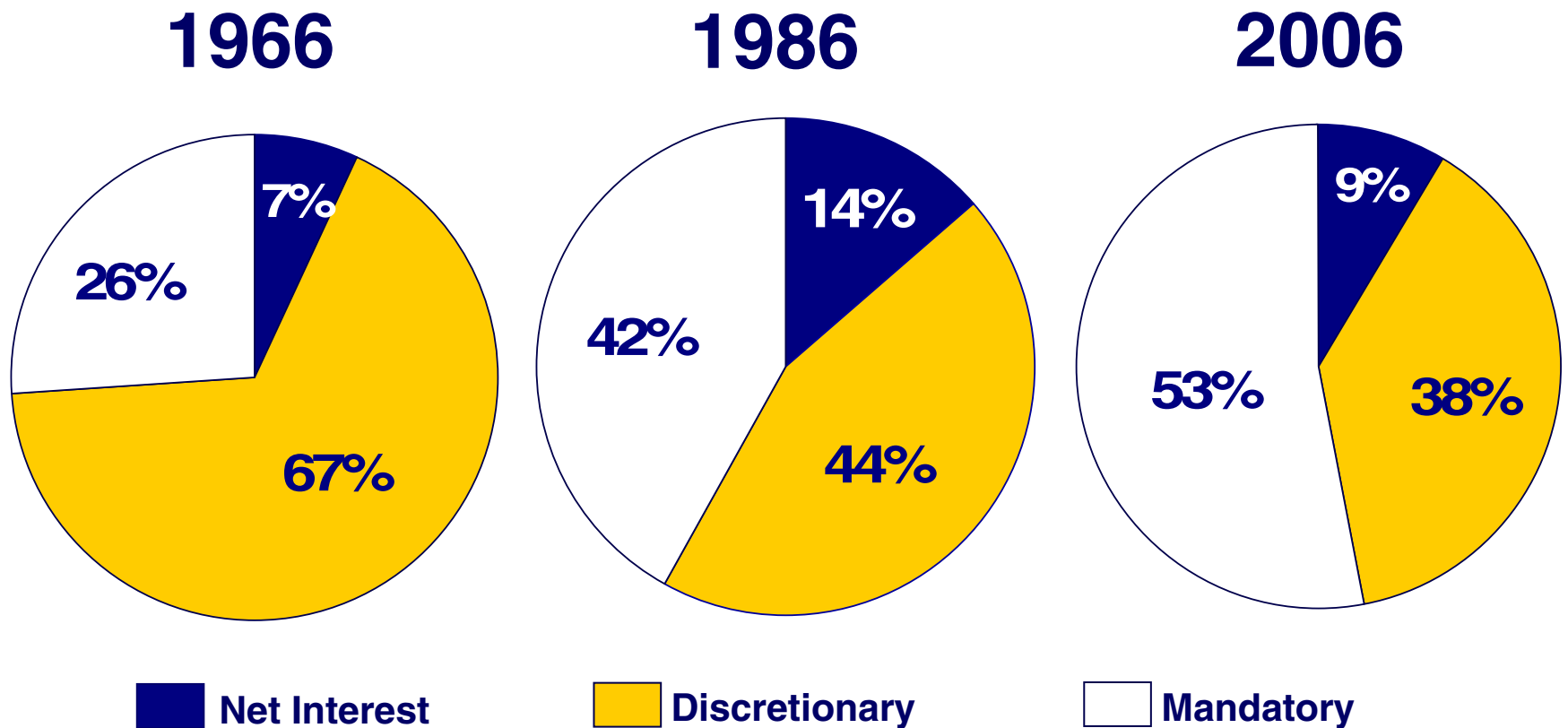
Composition of Federal Spending



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



Source: Office of Management and Budget.

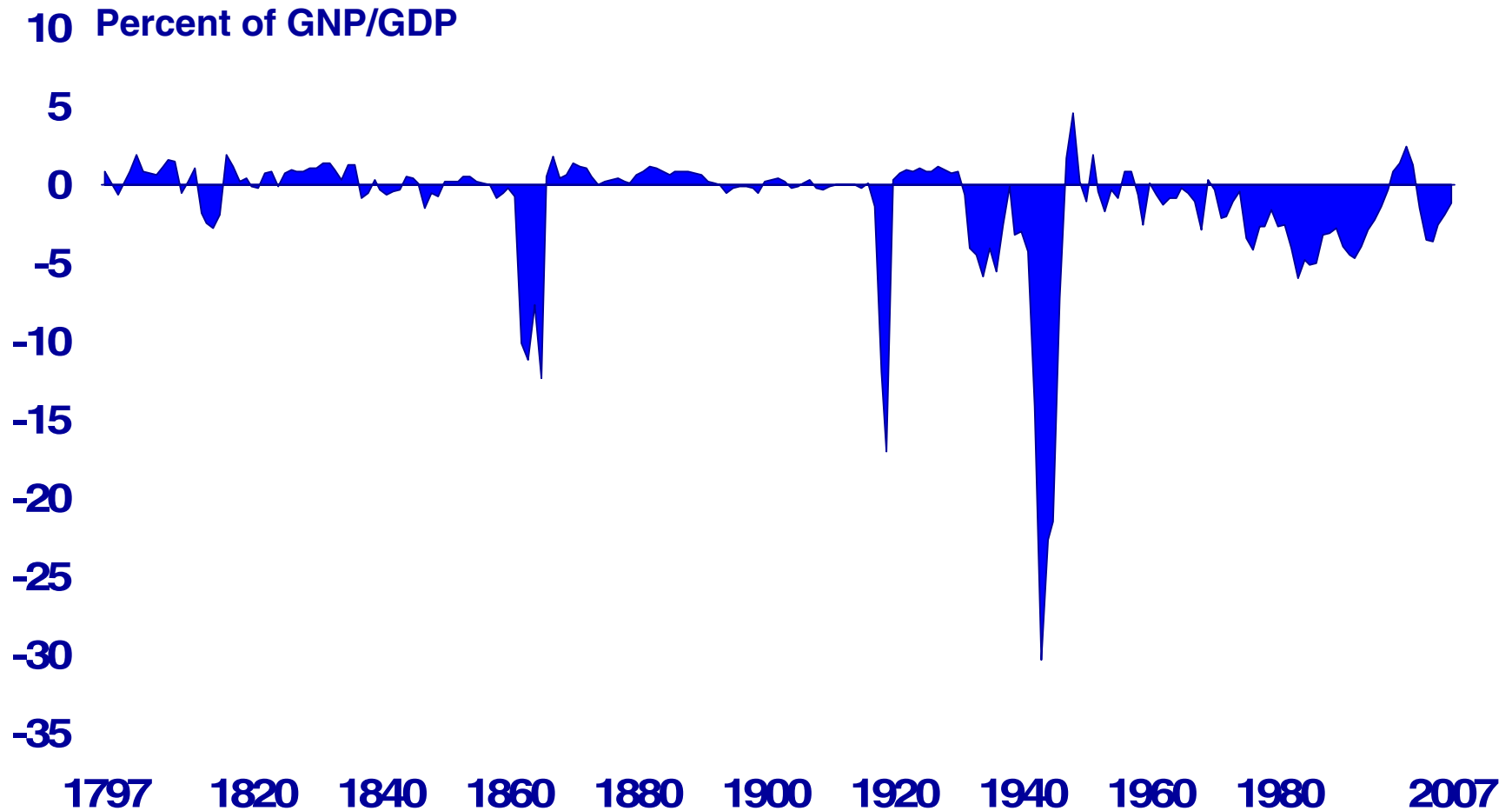
Fiscal Year 2006 and 2007 Deficits and Net Operating Costs

	Fiscal Year 2006	Fiscal Year 2007
	(\$ Billion)	
On-Budget Deficit	(434)	(344)
Unified Deficit^a	(248)	(163)
Net Operating Cost	(450)	(276)

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

^aIncludes \$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)

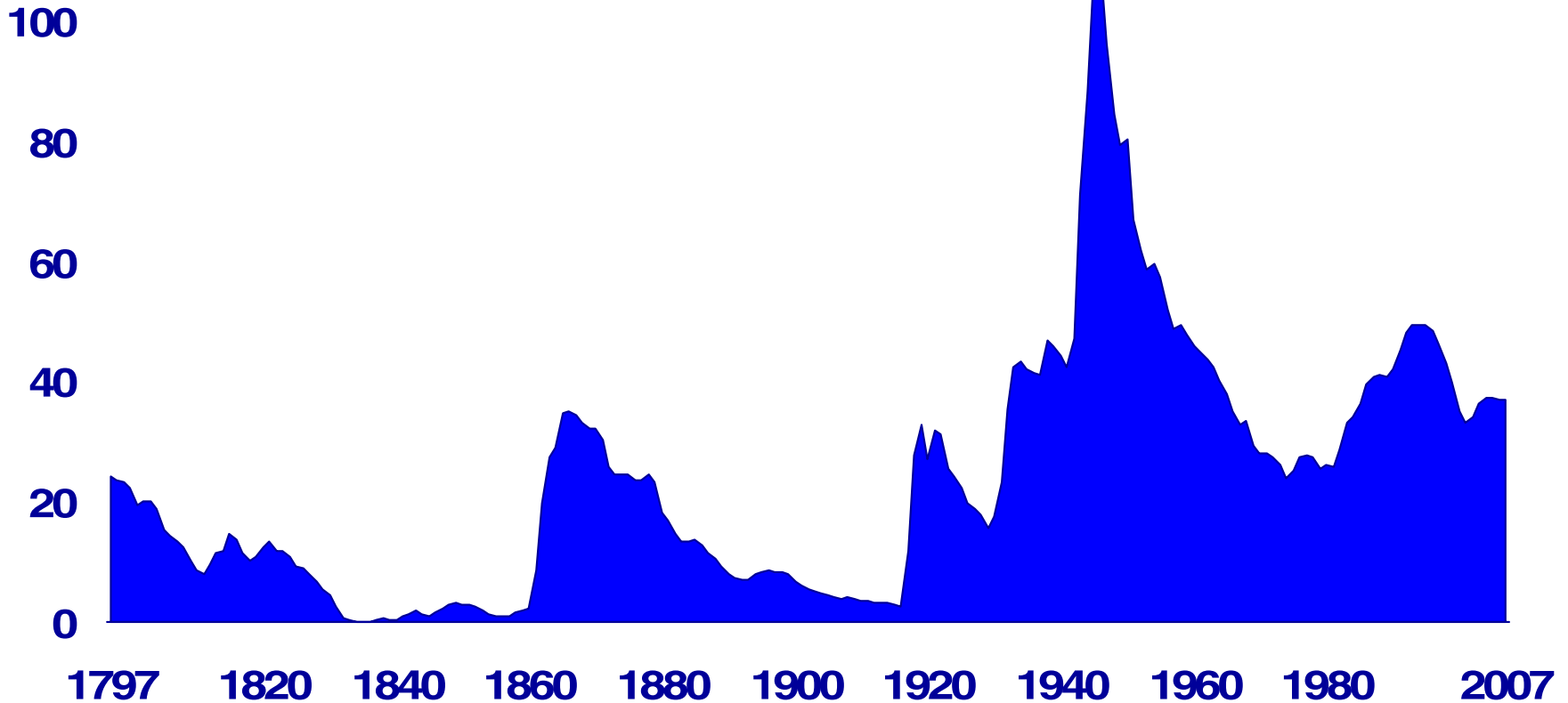


Source: Department of Commerce, Office of Management and Budget, and Congressional Budget Office.

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)

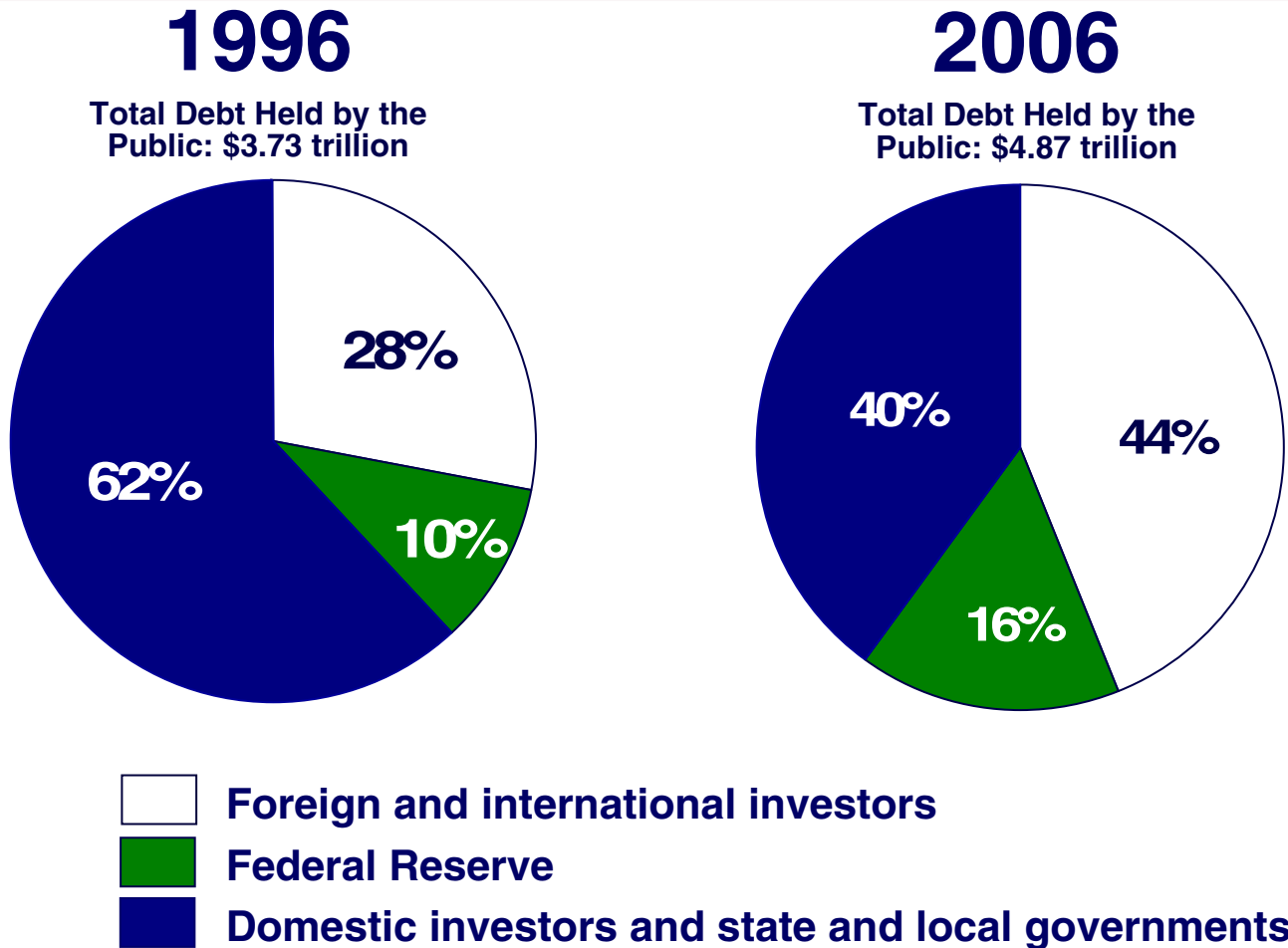
120 Percent of GNP/GDP



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



Source: Department of the Treasury.

Major Fiscal Exposures (\$ trillions)

	2000	2007	% Increase
• Explicit liabilities	\$6.9	\$10.8	57
<ul style="list-style-type: none"> • Publicly held debt • Military & civilian pensions & retiree health • Other 			
• Commitments & contingencies	0.5	1.1	97
<ul style="list-style-type: none"> • E.g., PBGC, undelivered orders 			
• Implicit exposures	13.0	40.8	213
<ul style="list-style-type: none"> • Future Social Security benefits 	3.8	6.8	
<ul style="list-style-type: none"> • Future Medicare Part A benefits 	2.7	12.3	
<ul style="list-style-type: none"> • Future Medicare Part B benefits 	6.5	13.4	
<ul style="list-style-type: none"> • Future Medicare Part D benefits 	--	8.4	
Total	\$20.4	\$52.7	158

Source: 2000 and 2007 Financial Report of the United States Government.

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:

Total –major fiscal exposures	\$52.7 trillion
Total household net worth¹	\$58.6 trillion
Burden/Net worth ratio	90 percent
Burden²	
Per person	\$175,000
Per full-time worker	\$410,000
Per household	\$455,000
Income	
Median household income³	\$48,201
Disposable personal income per capita⁴	\$33,253

Source: GAO analysis.

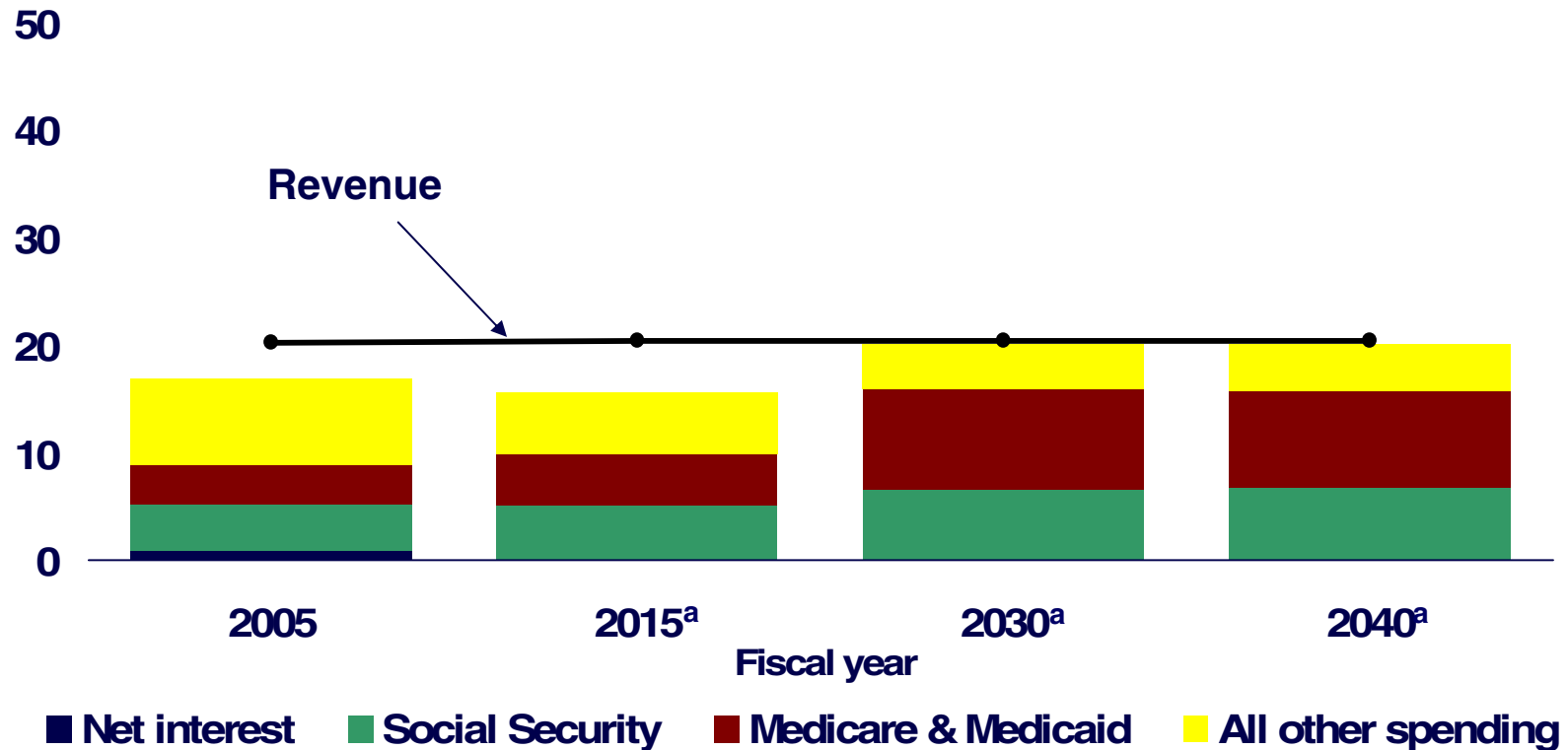
Notes: (1) Federal Reserve Board, Flow of Funds Accounts, Table B.100, 2007:Q3 (December 6, 2007); (2) Burdens are calculated using estimated total U.S. population as of 10/1/2007, from the U.S. Census Bureau; full-time workers reported by the Bureau of Economic Analysis, in NIPA table 6.5D (Aug. 1, 2007); and households reported by the U.S. Census Bureau, in Income, Poverty, and Health Insurance Coverage in the United States: 2006 (Aug. 2007); (3) U.S. Census Bureau, Income, Poverty, and Health Insurance Coverage in the United States: 2006 (Aug. 2007); and (4) Bureau of Economic Analysis, Personal Income and Outlays, table 2, (Nov. 29, 2007).

Potential Fiscal Outcomes

Under Baseline Extended (January 2001)

Revenues and Composition of Spending as a Share of GDP

Percent of GDP



Source: GAO's January 2001 analysis.

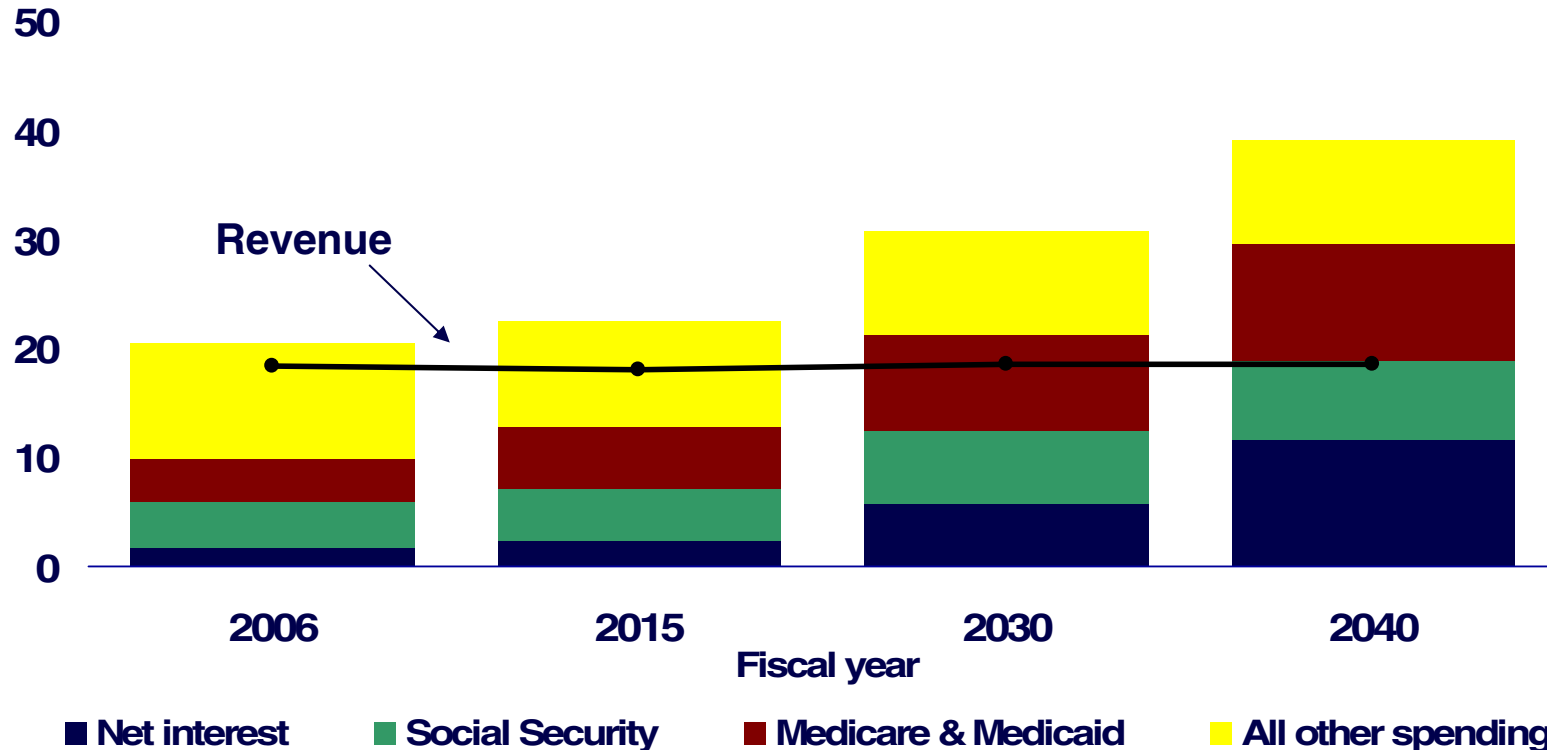
^aAll other spending is net of offsetting interest receipts.

Potential Fiscal Outcomes

Under Alternative Simulation

Revenues and Composition of Spending as a Share of GDP

Percent of GDP

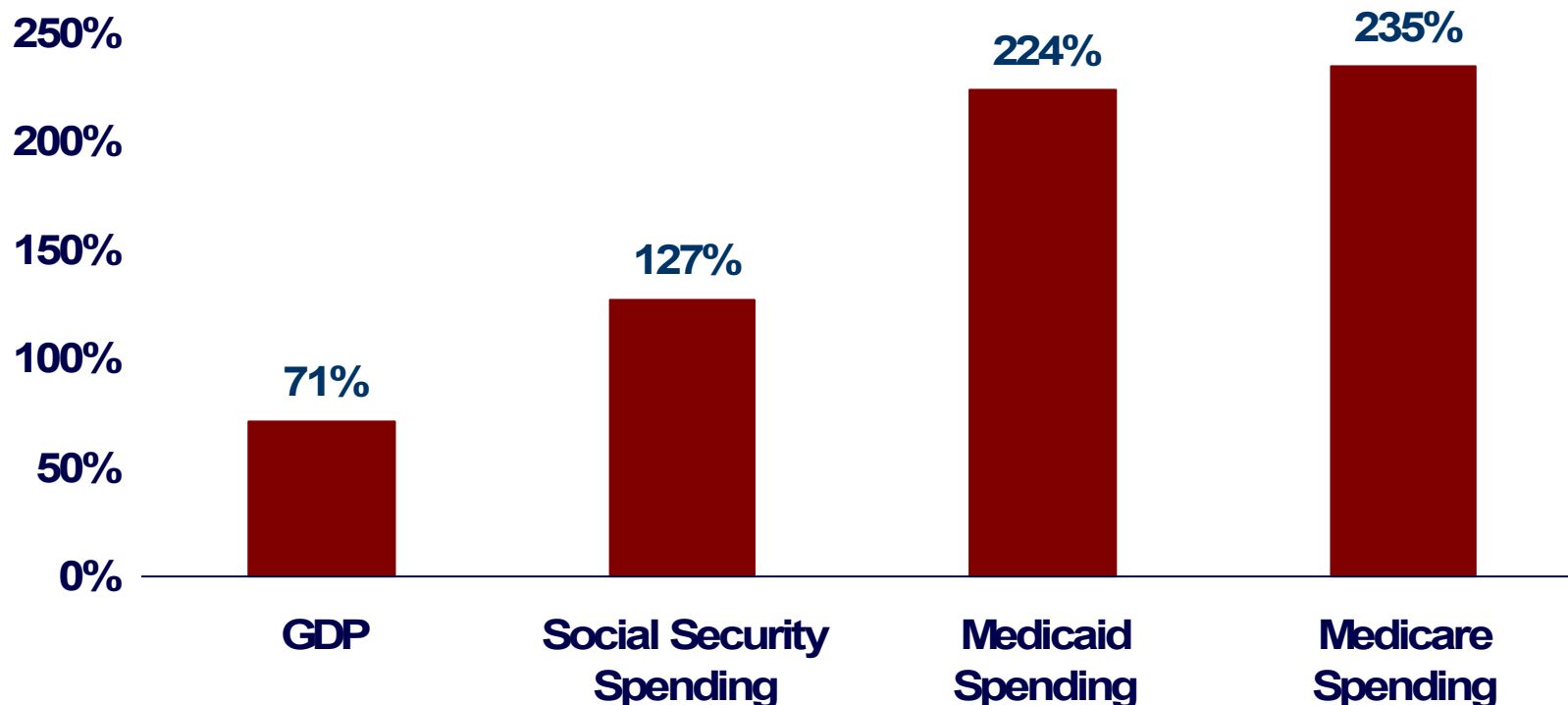


Source: GAO's August 2007 analysis.

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

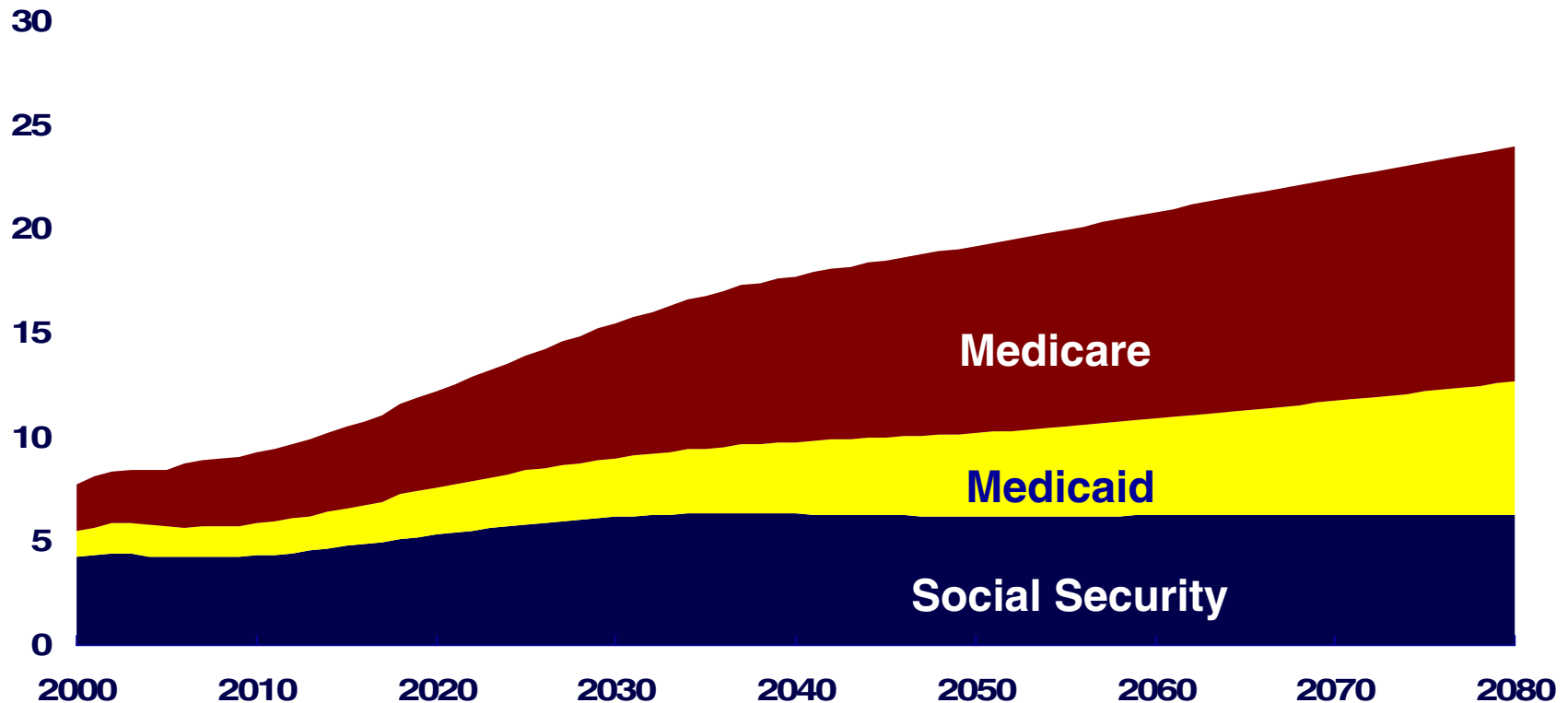


Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration; Office of the Actuary, Centers for Medicare and Medicaid Services; and the Congressional Budget Office.

Notes: Social Security and Medicare projections based on the intermediate assumptions of the 2007 Trustees' Reports. Medicaid projections based on CBO's August 2007 short-term Medicaid estimates and CBO's December 2005 long-term Medicaid projections under mid-range assumptions.

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.

Note: Social Security and Medicare projections based on the intermediate assumptions of the 2007 Trustees' Reports. Medicaid projections based on CBO's August 2007 short-term Medicaid estimates and CBO's December 2005 long-term Medicaid projections under mid-range assumptions.

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

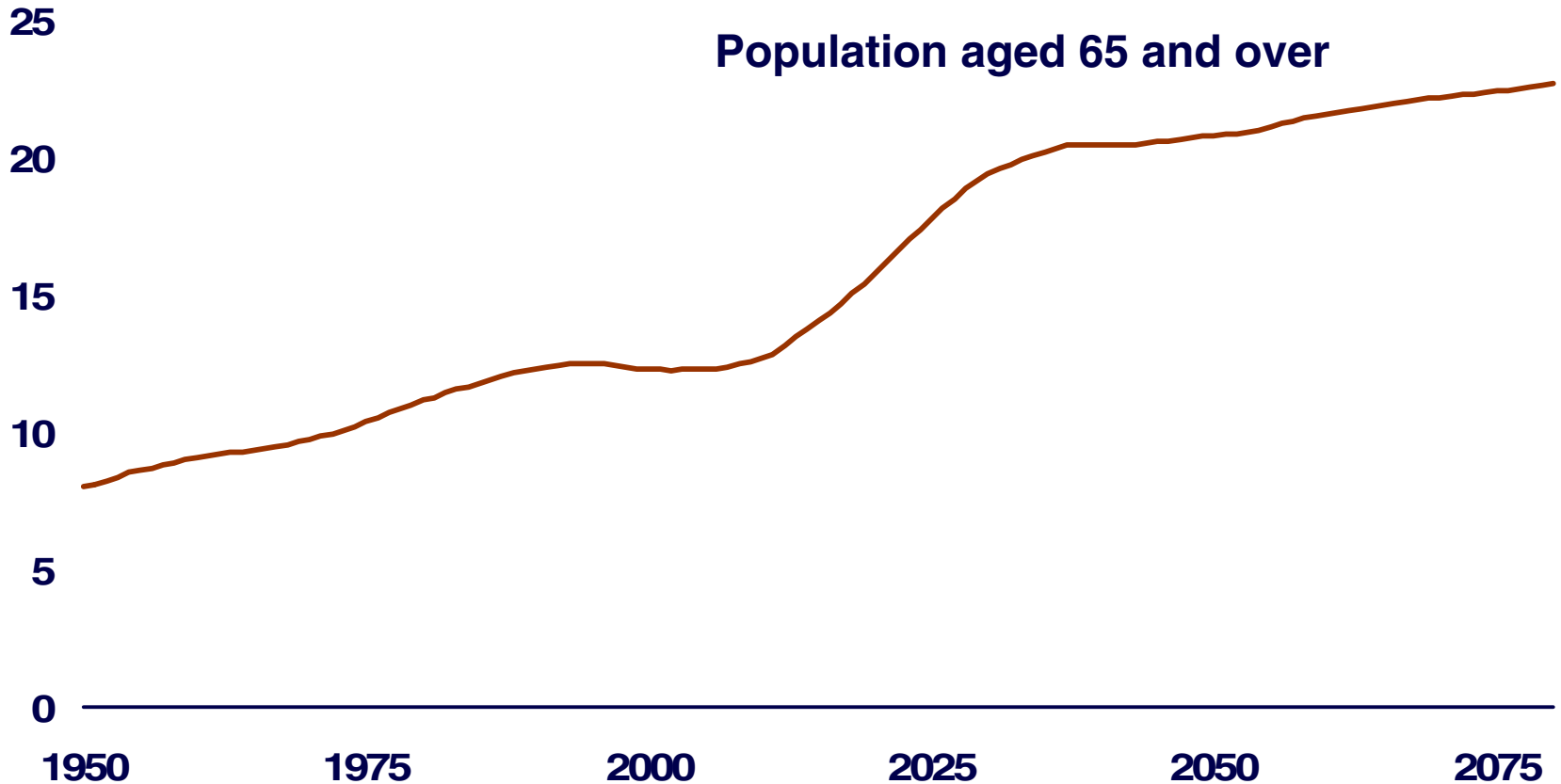


Source: Bureau of Economic Analysis.

Note: 2007 data available in April

Aged Population as a Share of Total U.S. Population Will Continue to Increase

Percent of total population

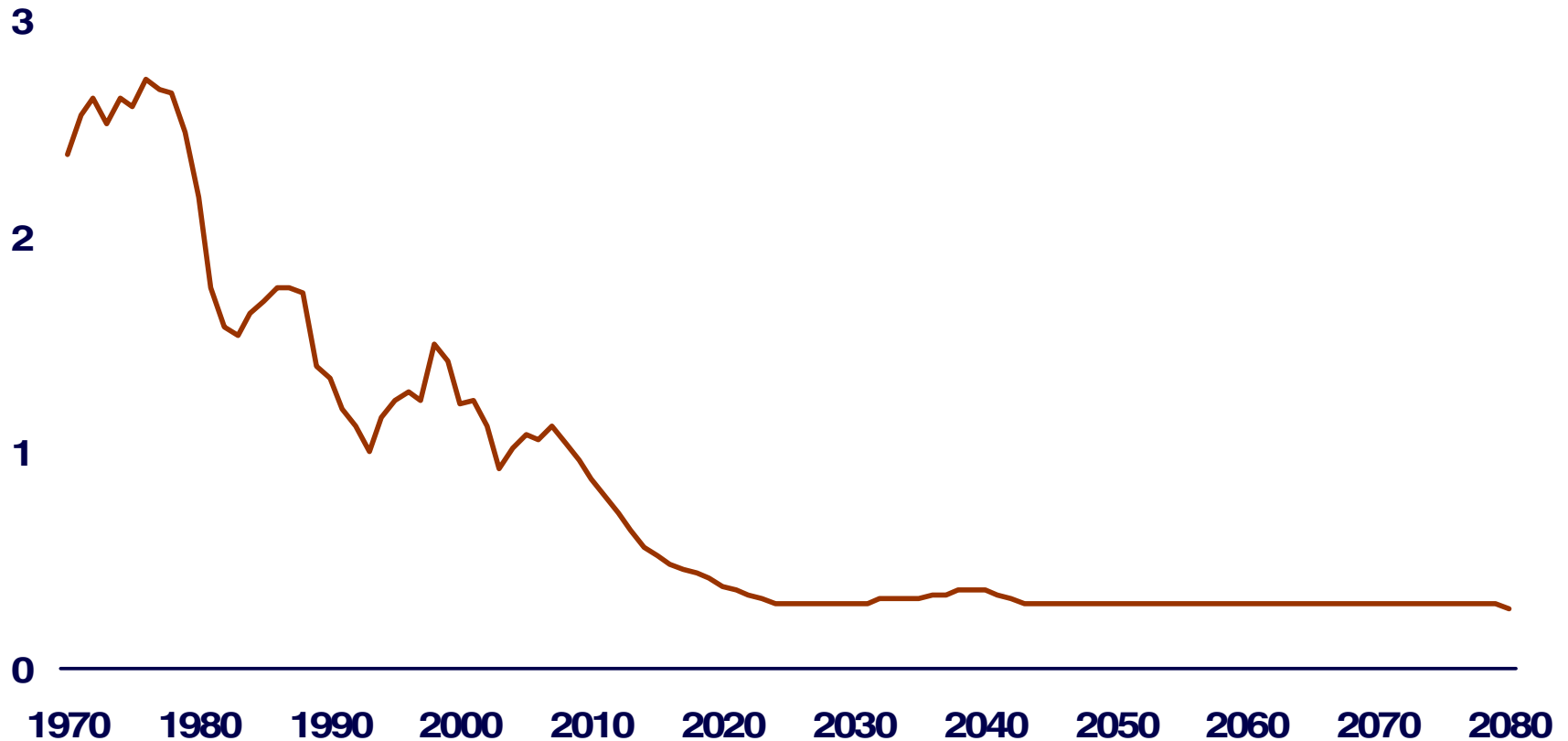


Source: Office of the Chief Actuary, Social Security Administration.

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)

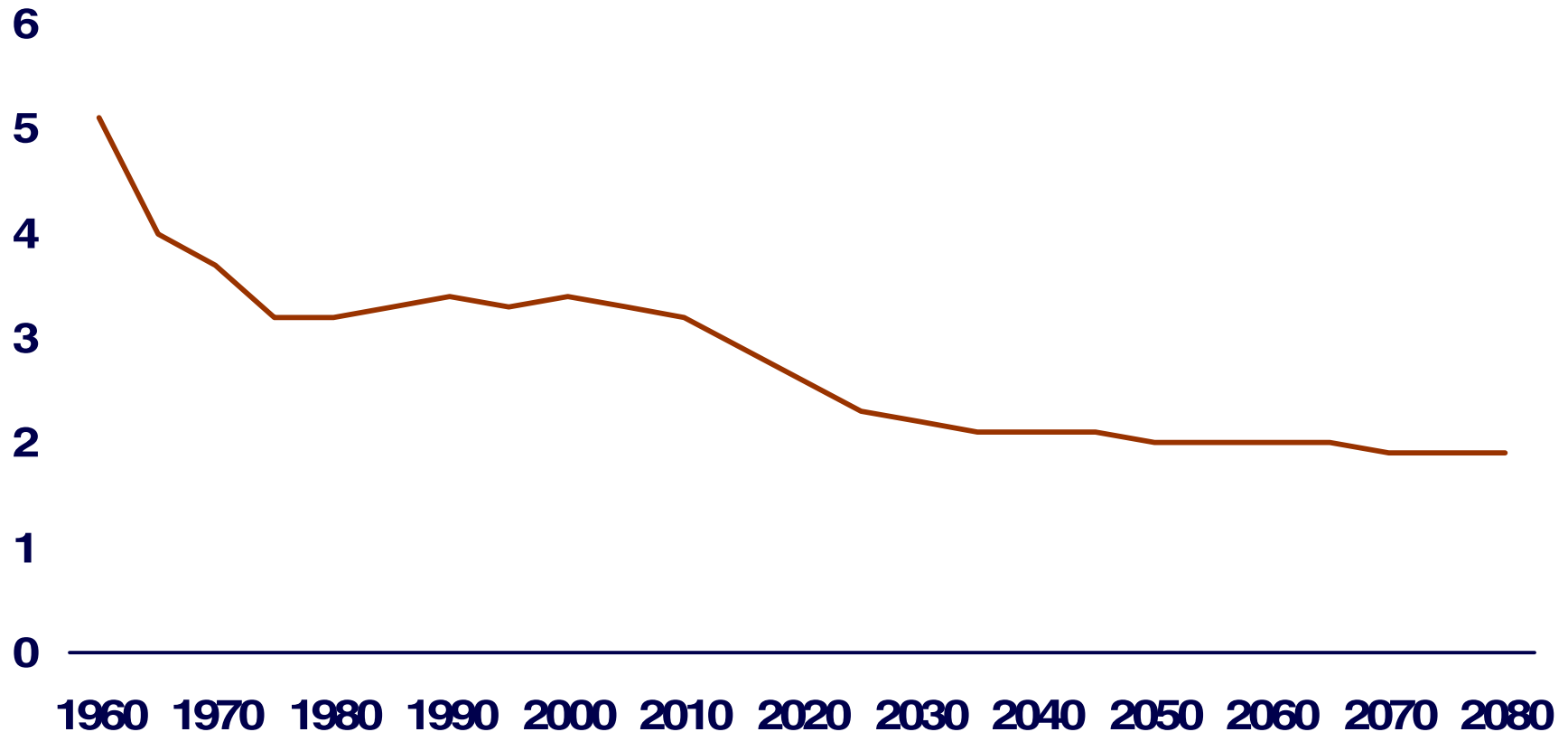


Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration.

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

Key Dates Highlight Long Term Challenges of the Social Security System

Date			Event
OASI	DI	OASDI	
2009	--	2009	Cash surplus begins to decline
2018	2005	2017	Annual benefit costs exceed cash revenue from taxes
2028	2013	2027	Trust fund ceases to grow because even taxes plus interest fall short of benefits
2042	2026	2041	Trust fund exhausted

Source: Social Security Administration, *The 2007 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (Washington, DC: April 2007).

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

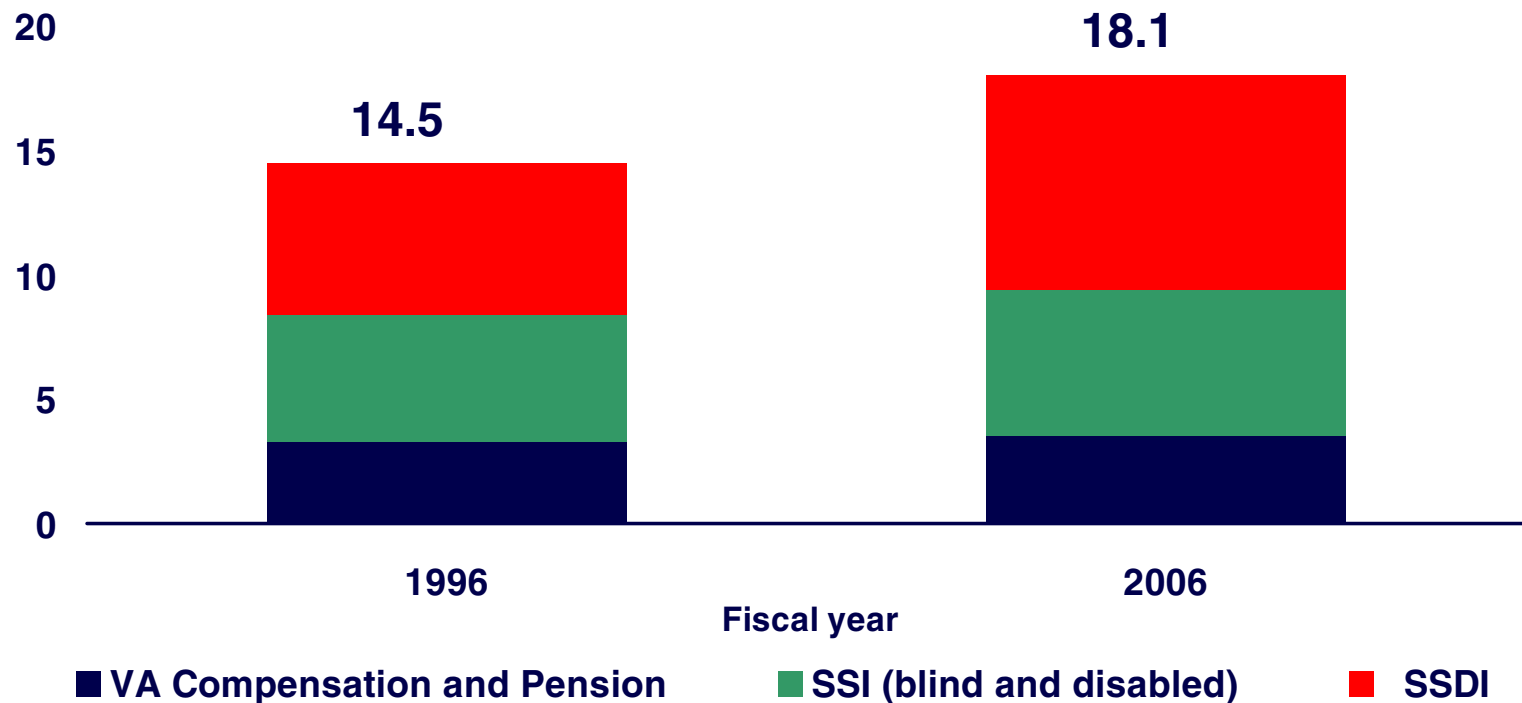
Agencies Have Difficulty Managing Disability Programs

- 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

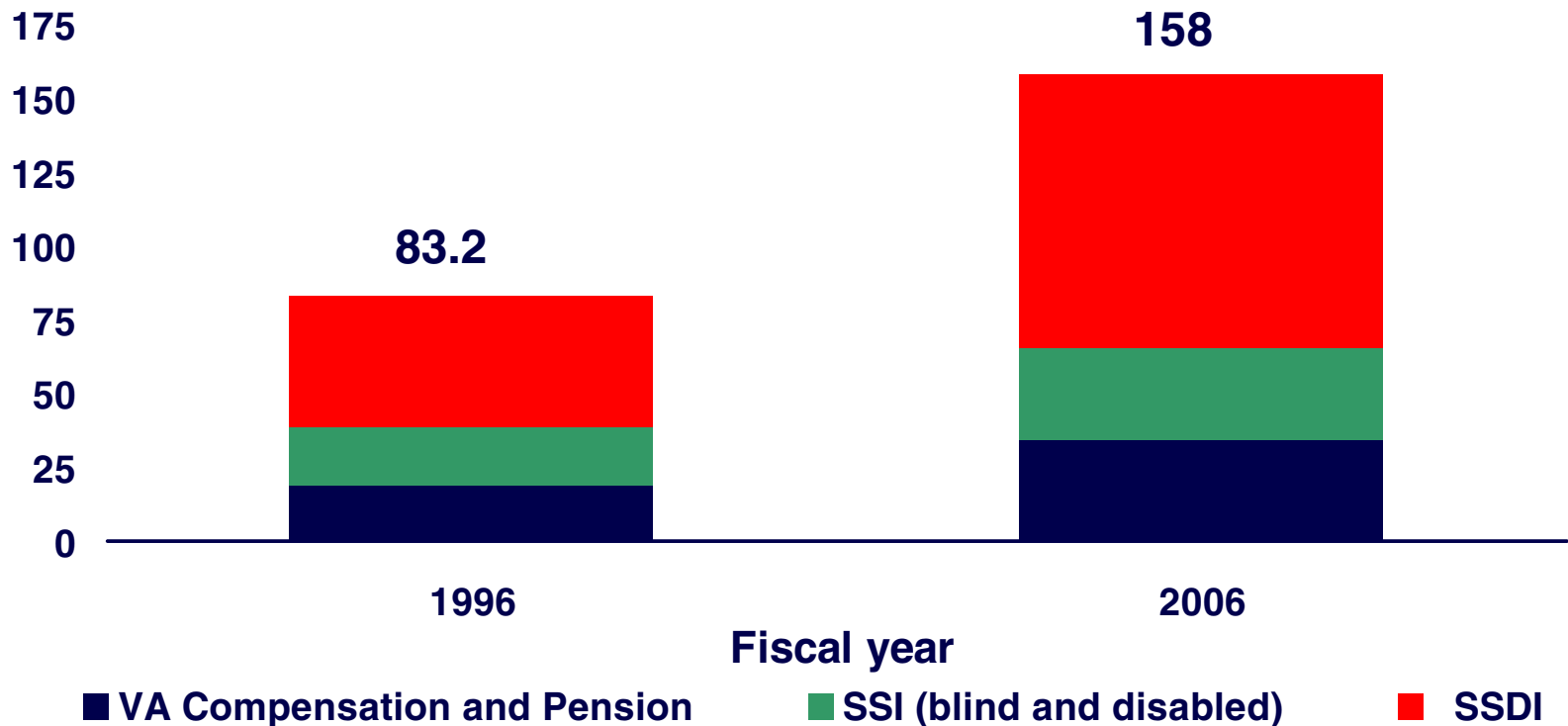
Millions of Beneficiaries



Growth in Costs of Larger Disability Programs Elevates Need to Modernize

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

Cash benefit (billions)



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

Moving the Debate Forward

- **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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