

A LOOK AT



**OUR
FUTURE:
WHEN BABY BOOMERS
RETIRE**

**Policy Committee
2005 White House
Conference on Aging**

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

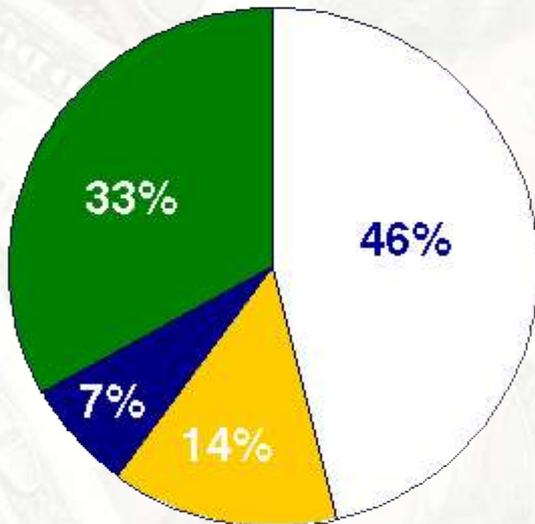
Accountability

Integrity

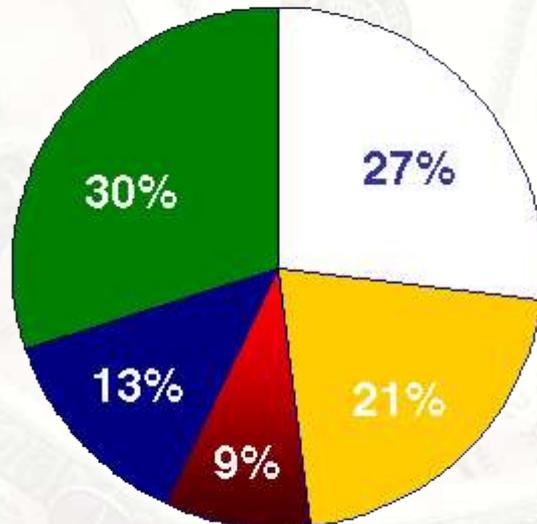
Reliability

Composition of Federal Spending

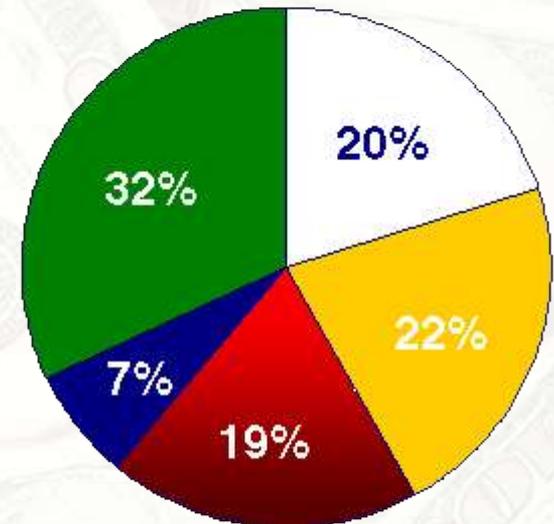
1964



1984

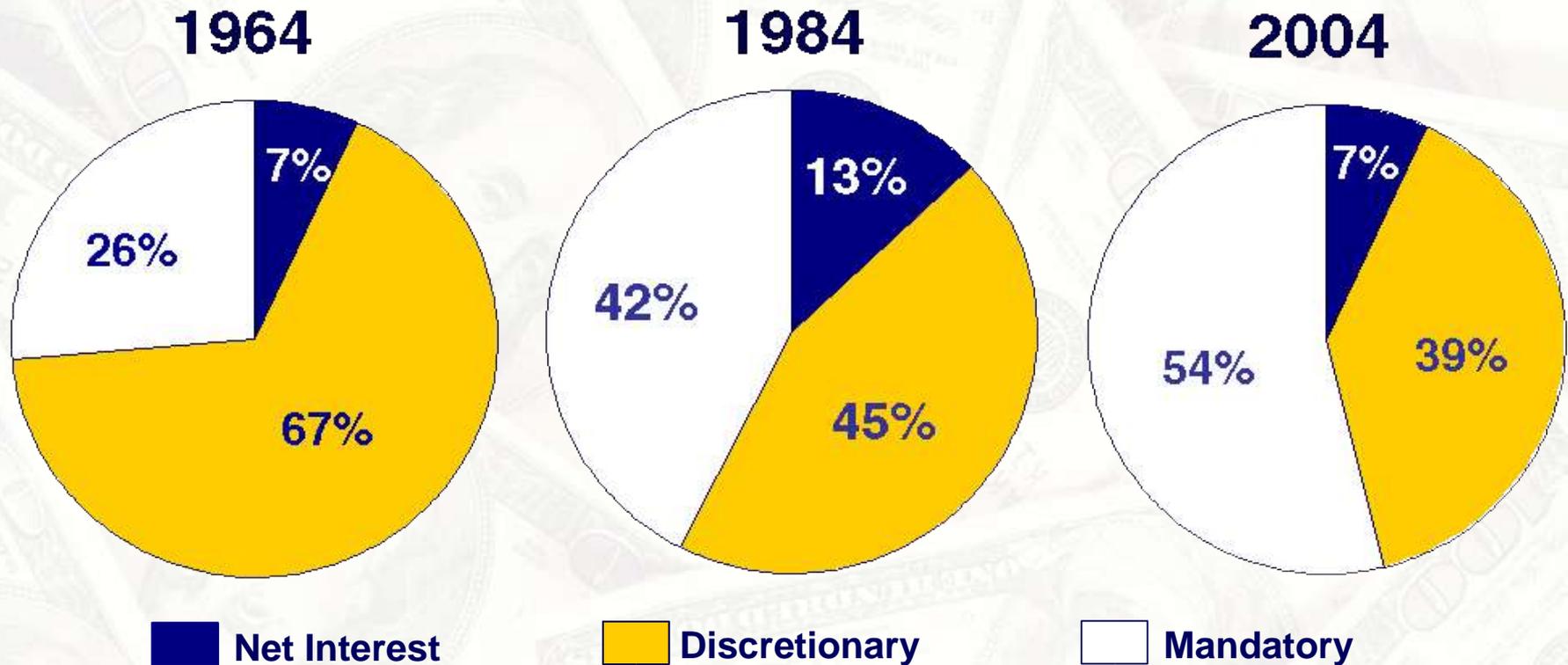


2004



Source: Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

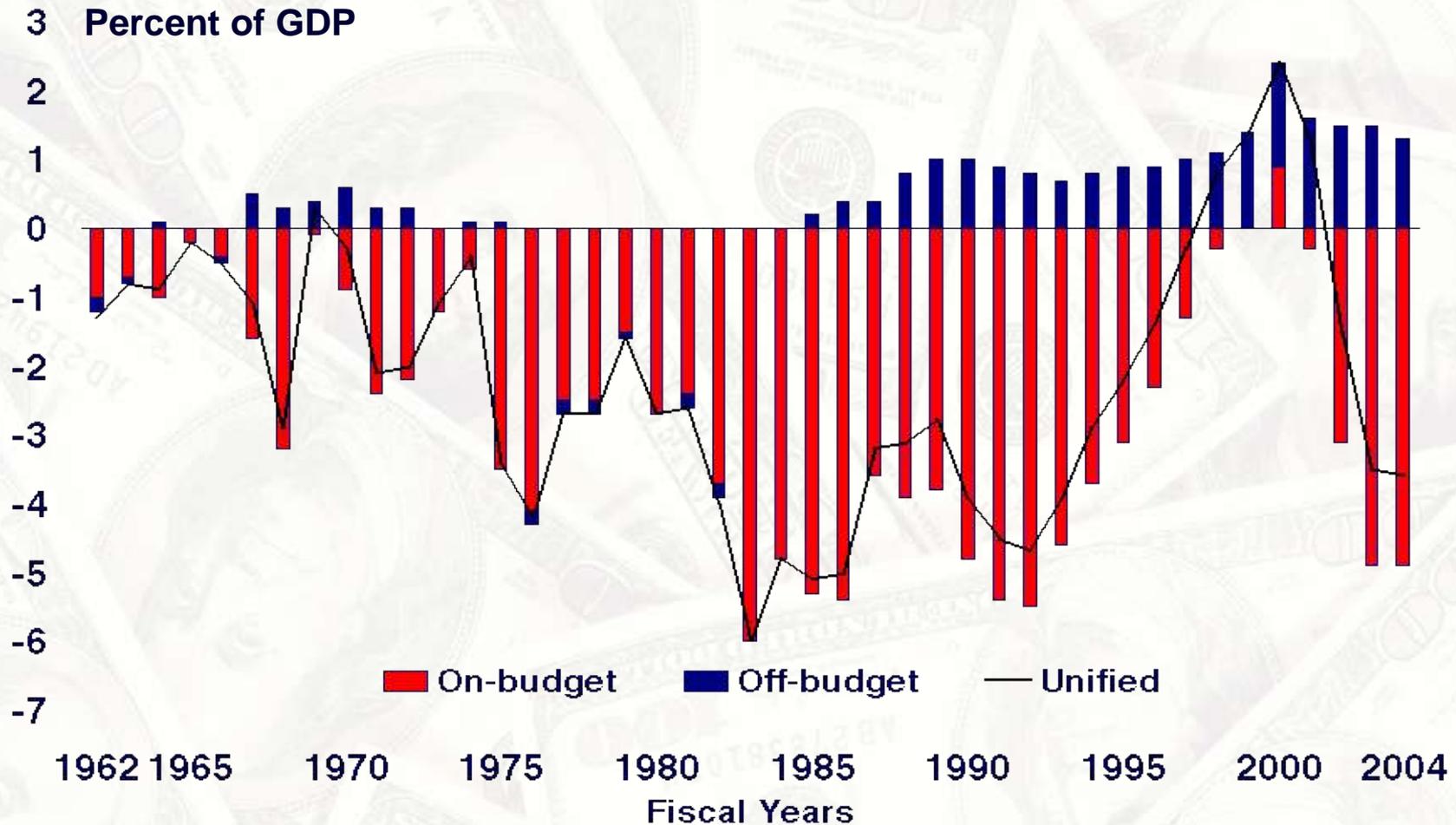
Fiscal Year 2004 Deficit Numbers

	\$ Billion	% of GDP
On-Budget Deficit	(567)	(4.9)
Off-Budget Surplus	155*	1.3
Unified Deficit	(412)	(3.6)

*Includes the \$151 billion Social Security surplus and a \$4 billion surplus for the Postal Service
March 2005

Surplus or Deficit as a Share of GDP

Fiscal Years 1962-2004



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

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	\$43.2

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.

Growing Fiscal Burden

Another way to think about these fiscal exposures is:

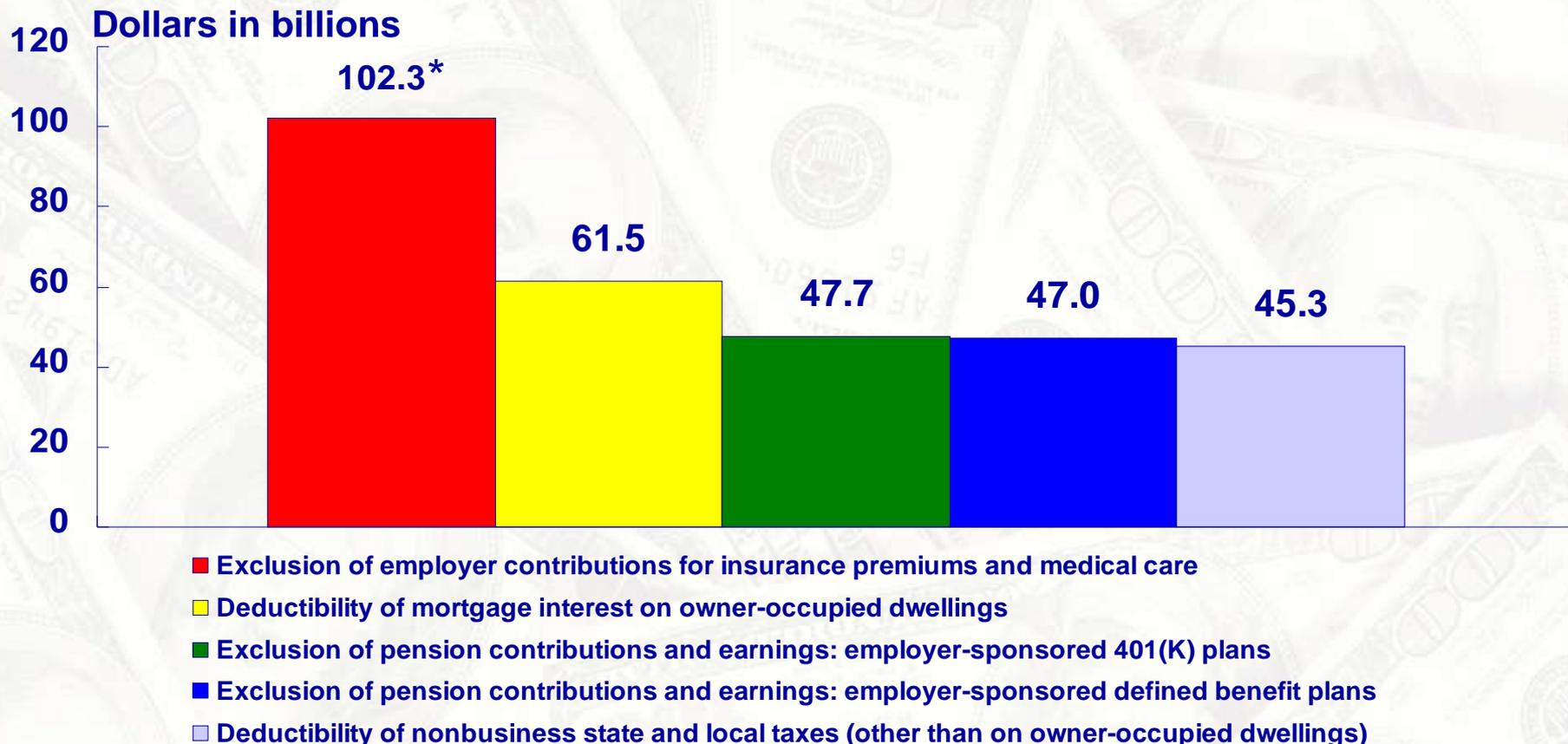
	2000	2002	2004
Fiscal exposures [from previous page]	\$20.4	\$26.4	\$43.2
Per person	\$72,000	\$92,000	\$147,000
Per full-time worker	\$165,000	\$214,000	\$350,000

Fiscal Exposures: The Importance of Looking Beyond the 1st Year

- Terrorism Risk Insurance expansion to aircraft and aircraft engine manufacturers enacted in 2003
 - Estimate for FY 2004: \$3 million income
 - Estimate for 10 years (2004-2013): \$47 million cost
- Health Care Benefit extension to older uniformed services retirees enacted in 2000
 - Estimate for FY 2001: \$223 million cost
 - Estimate for 10 years (2001-2010): \$40.4 billion cost
 - Financial statement liability: \$293 billion
- Medicare Drug Benefit enacted 2003
 - Estimate for CY 2006: \$64.4 billion
 - Estimate for 2006-14: \$851 billion
 - Estimate from program inception through 2079: \$8.7 trillion in present value terms

Sources: Medicare estimates for net federal spending are drawn from the 2005 Medicare Trustees' intermediate estimates. All others are CBO cost estimates in year of enactment and 2001 Consolidated Financial Statement.

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



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

Percent of GDP

50

40

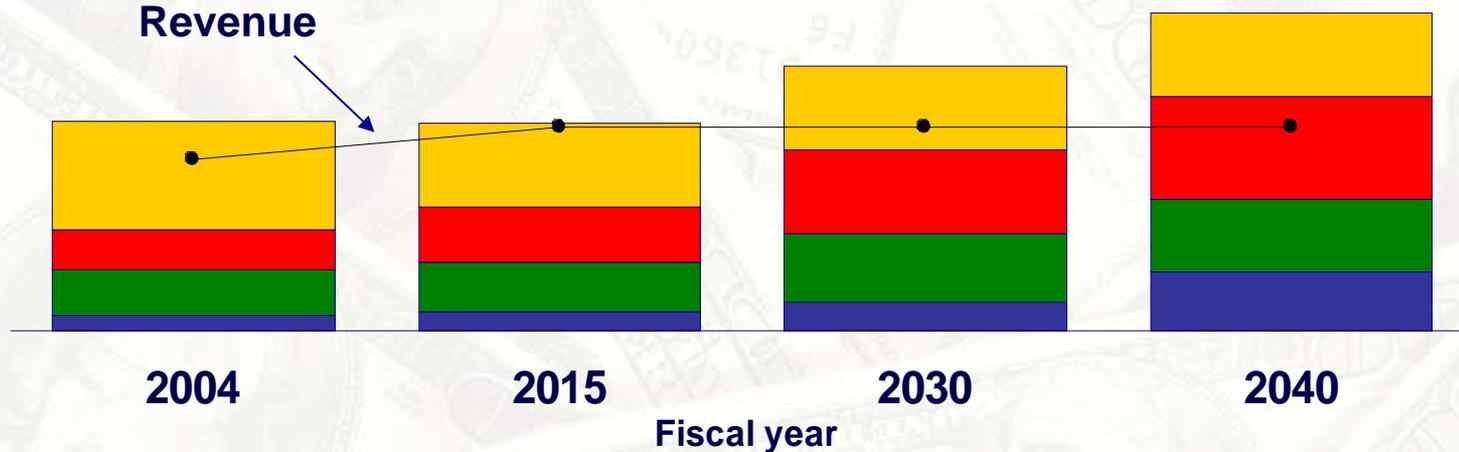
30

20

10

0

Revenue



■ Net interest

■ Social Security

■ Medicare & Medicaid

■ All other spending

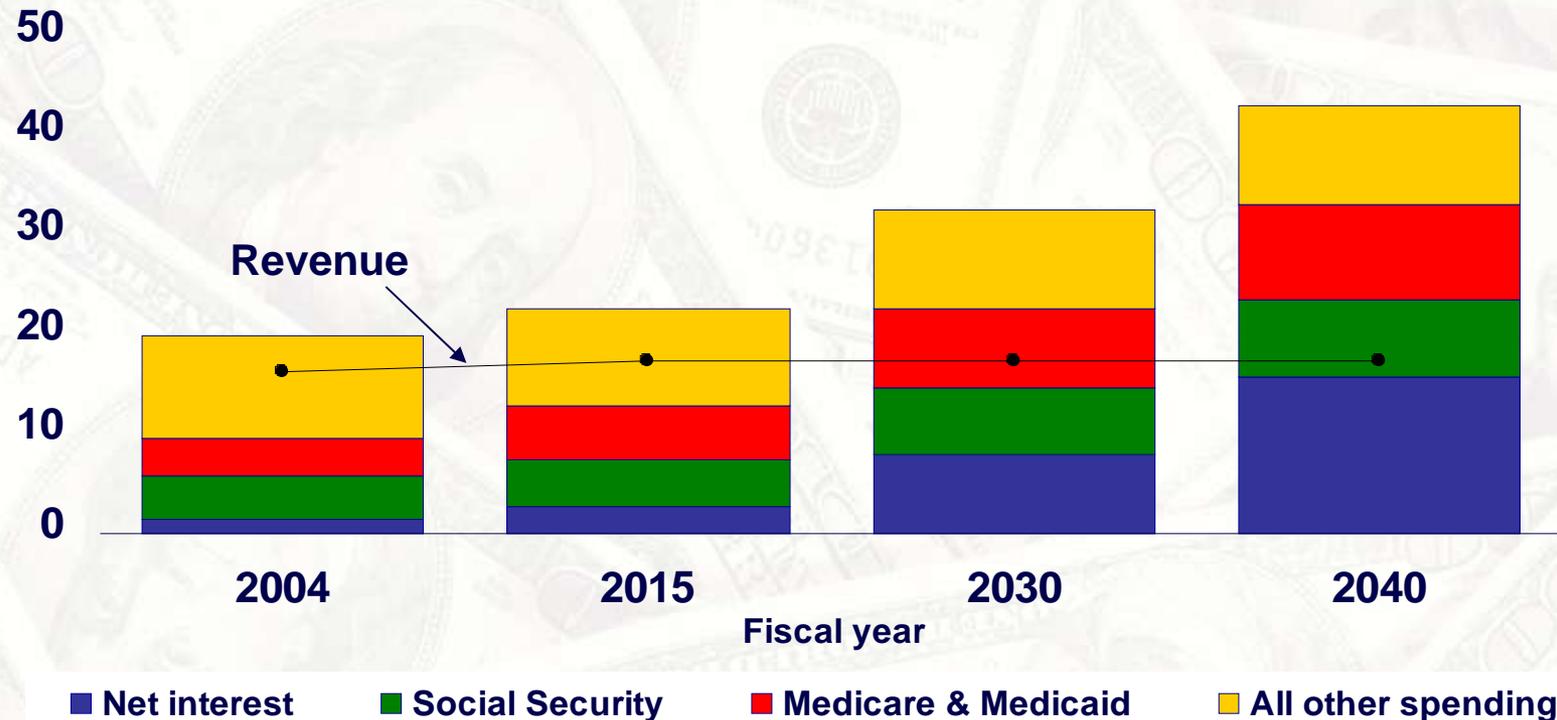
Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

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

Percent of GDP



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**

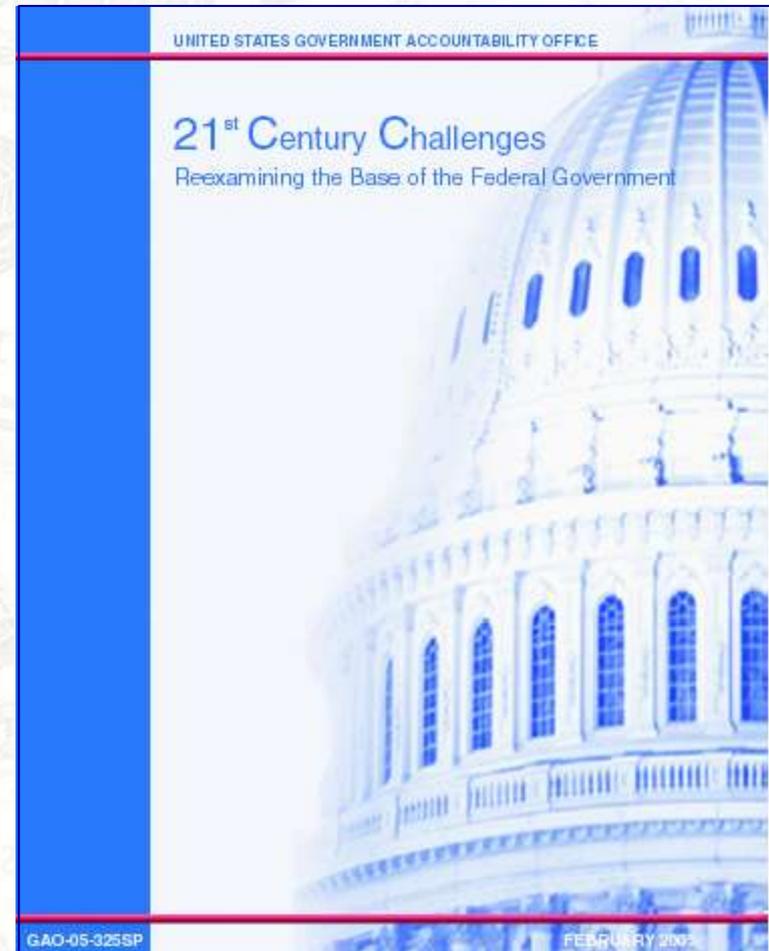
- Less change would be needed, and there would be more time to make adjustments.
- The miracle of compounding would work with us rather than against us.
- Our demographic changes will serve to make reform more difficult over time.

The 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

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



Generic Reexamination Criteria and Sample Questions

Relevance of purpose and the federal role

Why did the federal government initiate this program and what was the government trying to accomplish?

Have there been significant changes in the country or the world that relate to the reason for initiating it?

Measuring success

Are there outcome-based measures? If not, why?

If there are outcome-based measures, how successful is it based on these measures?

Targeting benefits

Is it well targeted to those with the greatest needs and the least capacity to meet those needs?

Affordability and cost effectiveness

Is it using the most cost-effective or net beneficial approaches when compared to other tools and program designs?

Best practices

Is the responsible entity employing prevailing best practices to discharge its responsibilities and achieve its mission?

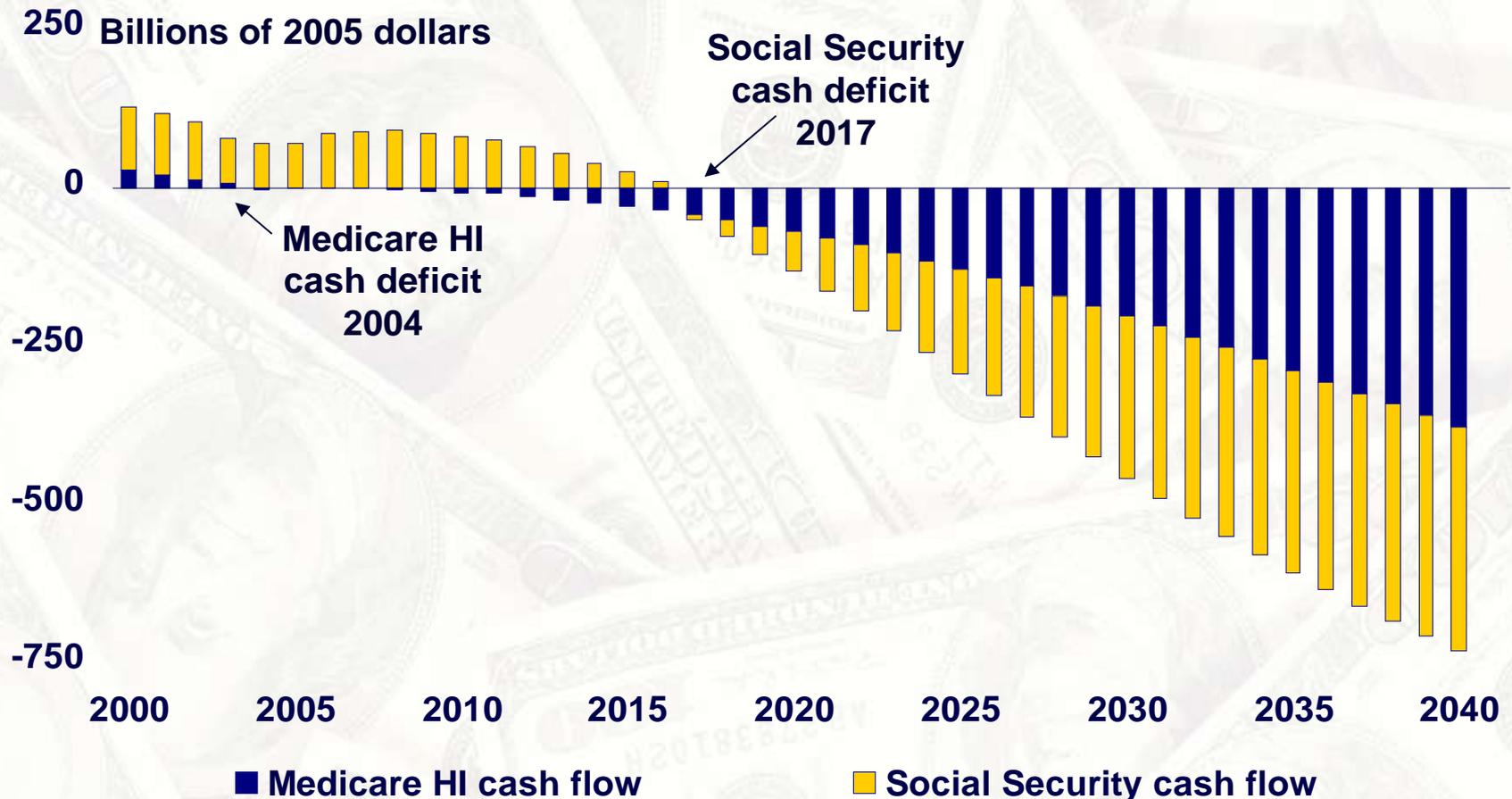
Illustrative 21st Century Questions

- How should the historical allocation of resources across services and programs be changed to reflect the results of a forward-looking comprehensive threat/risk assessment as part of DOD's capabilities-based approach to determining defense needs?
- How can the United States better develop a world-class technical and scientific domestic workforce that is not as dependent on large inflows of international students and researchers? For example, are different educational tools or targeted funding strategies needed to enhance U.S. student achievement in math and science?
- To what extent are federal energy policies and incentive structures adequately preparing the nation to satisfy its energy needs over the long term?
- How can industry standards for acceptable care be established and payment reforms be designed to bring about reductions in unwarranted medical practice variation?
- Which tax incentives need to be reconsidered because they fail to achieve the objectives intended by the Congress, their costs outweigh their benefits, they duplicate other programs, or other more cost-effective means exist for achieving their objectives?

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

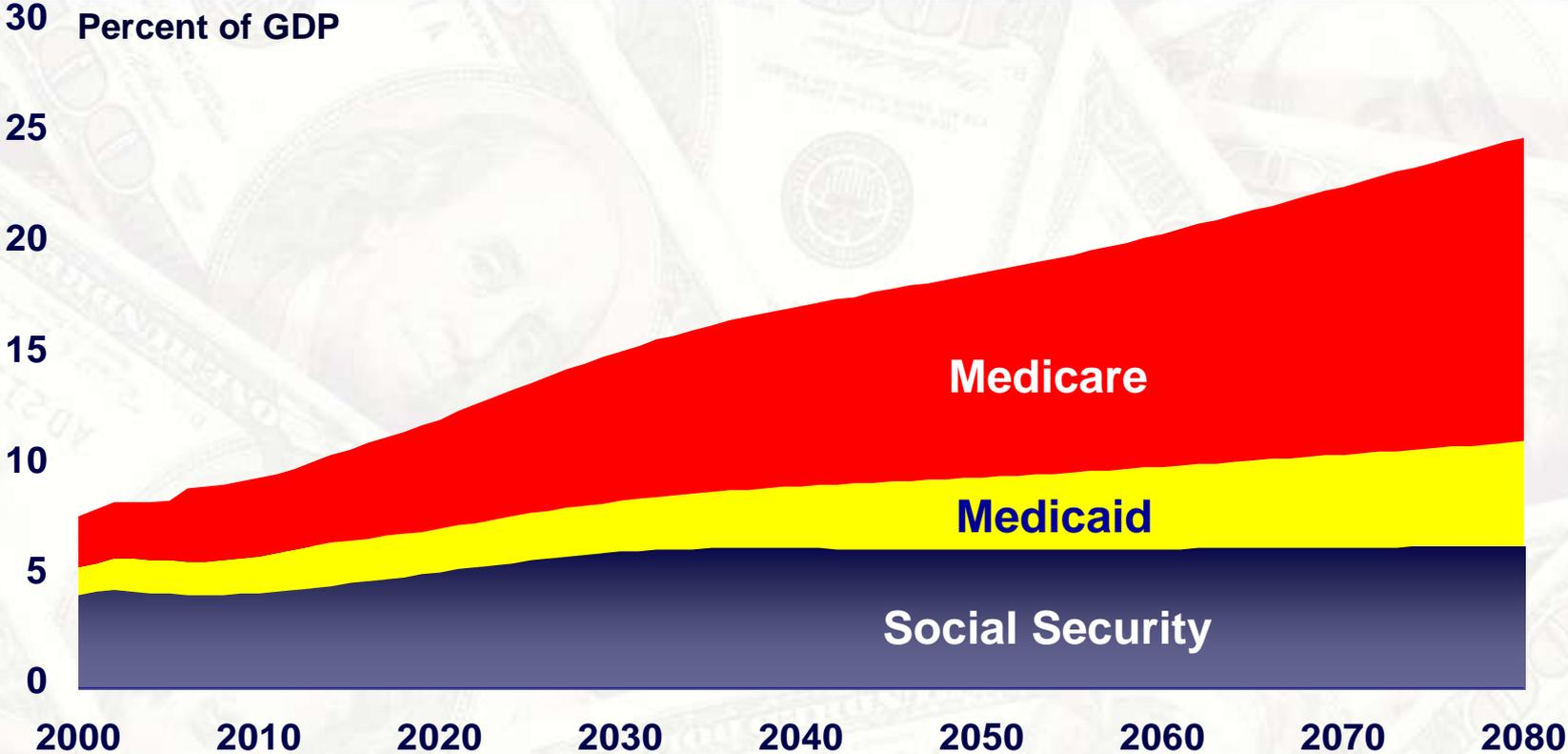
Social Security and Medicare's Hospital Insurance Trust Funds Face Cash Deficits



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



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: 2000 Revision and World Urbanization Prospects: 2001 Revision.

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.

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).

Different Measures, Same Challenge

- 75-year projection of funding shortfall:
 - \$4.0 trillion in present value
 - 0.6% of GDP
 - 1.8% of taxable payroll
- Infinite horizon projection of funding shortfall:
 - \$11.1 trillion in present value
 - 1.2% of GDP
 - 3.5% of taxable payroll

Source: 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 D.C.: March 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

Social Security: The Bottom Line

Illustrative Questions and Answers Based on the Latest Trustees' Reports

- Does Social Security have a serious and growing financing problem? [Yes]
- Will the Social Security program ever go bust? [No]
- Will the Social Security trust fund balance ever be exhausted? [Yes]
- Should the trust fund solvency date be the primary action-forcing event for Social Security reform? [No]
- What other factors should be considered?
 - Cash flow
 - Total unfunded commitments
 - Percent of the budget and GDP
 - Percent of taxable payroll

Questions and Answers (cont'd)

- Should we act sooner rather than later to reform Social Security? [Yes]
 - Time is working against us
 - The sooner we act, the smaller the changes we'll need to make and the longer people will have to adjust
 - We have an opportunity to exceed the expectations of every generation of Americans
 - We have bigger problems that we ultimately will have to address
 - A successful reform effort would help to improve the credibility of government and enhance confidence in government

Questions and Answers (cont'd)

- Will individual accounts solve the problem by themselves? [No]
- Should they be considered as part of a more comprehensive reform proposal? [Yes]
- What other types of reforms need to be considered?
 - Strengthening progressivity (e.g., replacement rates)
 - Indexing formulas
 - Retirement ages
 - Tax base and rates

Questions and Answers (cont'd)

- What is an example of a government retirement system that includes private accounts? [The Federal Thrift Savings Plan]
- Would individual accounts, on a “carve-out” basis, involve significant transition costs? [Yes]
- What other possible implications would individual accounts have?
 - Personal savings rate
 - Rates of return on Social Security payroll taxes
 - Pre- and post-retirement survivors' benefits
 - Savings and investment education
 - Supplemental retirement savings vehicle

Questions and Answers (cont'd)

- Should we consider both promised and funded benefits in analyzing Social Security Reform proposals? [Yes]
- Should we consider both cash and present value related costs and implications of Social Security reform proposals? [Yes]
- Can Social Security reform exceed the expectations of all generations of Americans? [Yes]
- Does the Social Security reform process matter? [Yes]
- Does the case for timely reform need to be made before discussions about individual reform options? [Yes]
- Should Social Security reform consider trends and challenges relating to private pension and personal savings arrangements? [Yes]
- Should Social Security be about the public good versus political gain? [Yes]

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.

Quality and Availability of Affordable Health Care Has Broad Implications for Retirees

- Cost, access, and quality challenges—together with obstacles to achieving efficiency—argue for fundamental system reform.
- A comprehensive review and reassessment of the overall health care system raises the following questions:
 - **What** are societal needs versus individual wants in our health care system?
 - **Who** among individuals, employers, and governments—should be responsible for paying for health care?
 - **Where** would we get the largest return for our efforts to control spending?
 - **How** much of health care costs can government, employers, and individuals afford and sustain over time?
 - **When** are we going to get started, as the challenge gets bigger everyday and any delay compounds the problems

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

- Employ case management approaches to health care spending on people with chronic conditions and selected other circumstances to control costs, reduce patient risks, and avoid inappropriate “heroic measures.”
- Leverage the government’s purchasing power in connection with selected health care products and services
- Leverage technology to increase consistency, transparency and accountability in health care
- Revise certain federal tax preferences for health care (e.g., employee exclusion)
- Develop a set of national practice standards to help control cost, improve outcomes and reduce litigation

Selected Potential Health Care Reform Approaches

- Limit cost growth in government-sponsored health care programs (e.g., percentage of the budget and/or the economy)
- Pursue multilateral approaches to investing in health care R&D
- Rationalize excess capacity and integrate capabilities both within and outside of government
- Develop a core set of basic and essential services with supplemental coverage being available as an option but at a cost
- Create insurance pools for alternative levels of coverage, as necessary

Three Key Ingredients Needed for These Challenging and Changing Times

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

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