

A LOOK AT

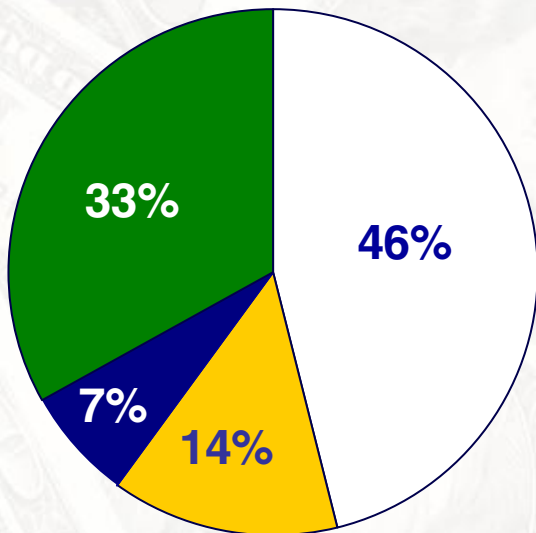


**OUR**  
**FUTURE:**  
Social Security and  
America's Long-Term  
Fiscal Challenge

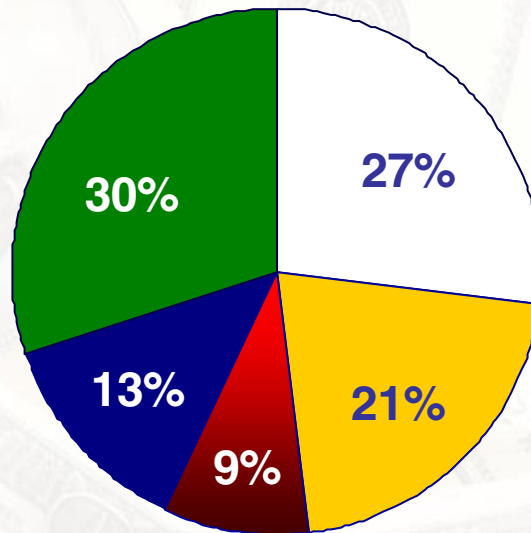
**The Honorable David M. Walker**  
Comptroller General of the United States  
US-UK Dialogue on Pensions  
July 21, 2005

# Composition of Federal Spending

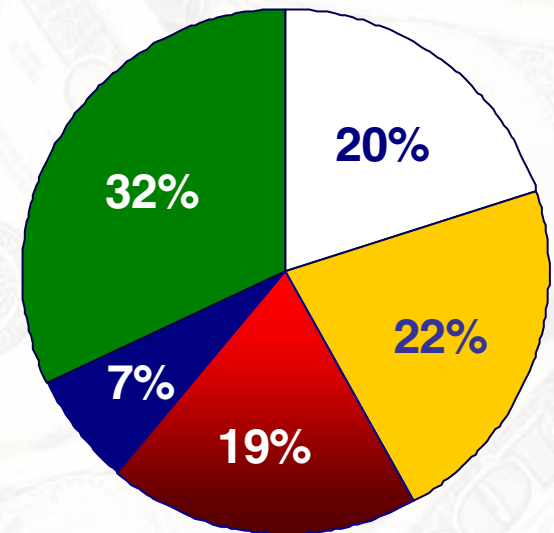
1964



1984



2004



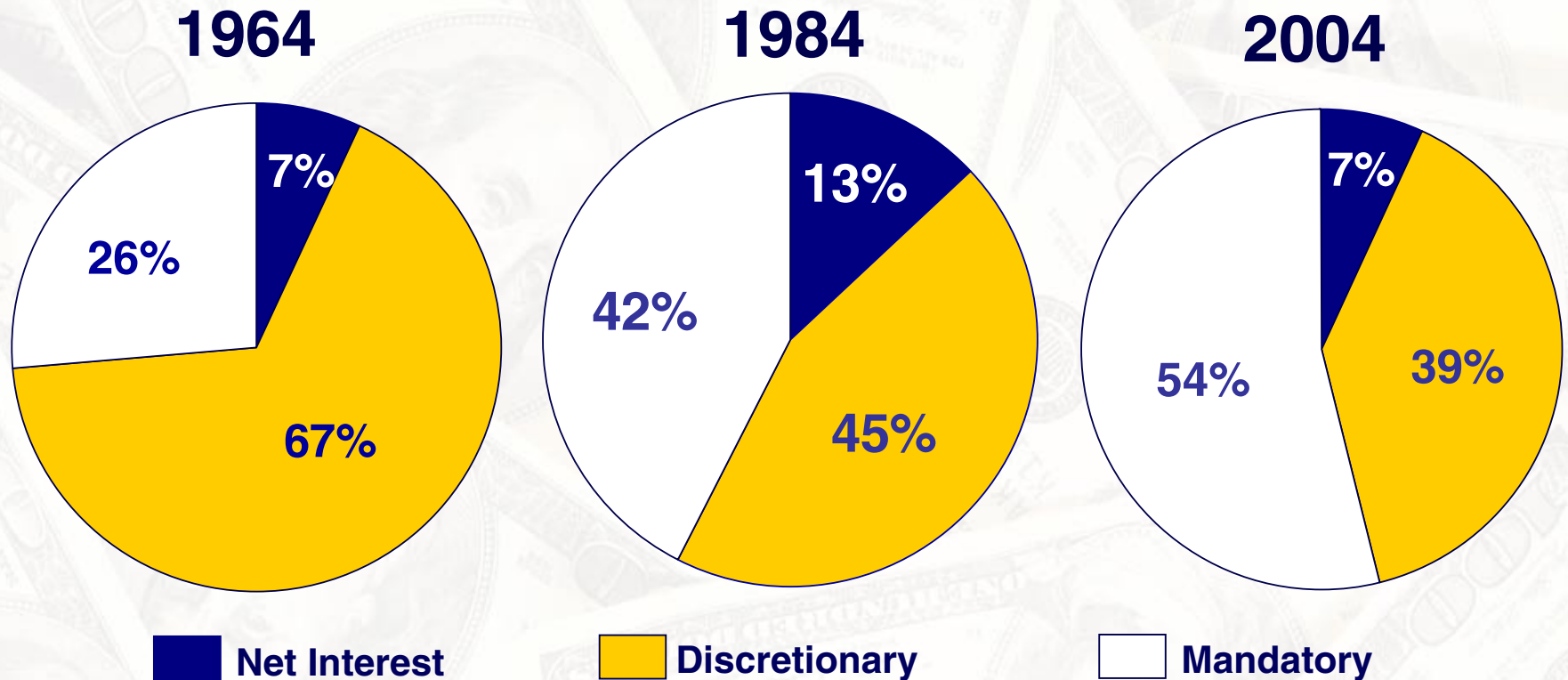
White: Defense  
Dark blue: Net interest

Yellow: Social Security  
Green: All other spending

Red: Medicare & Medicaid

Source: Office of Management and Budget.

# Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

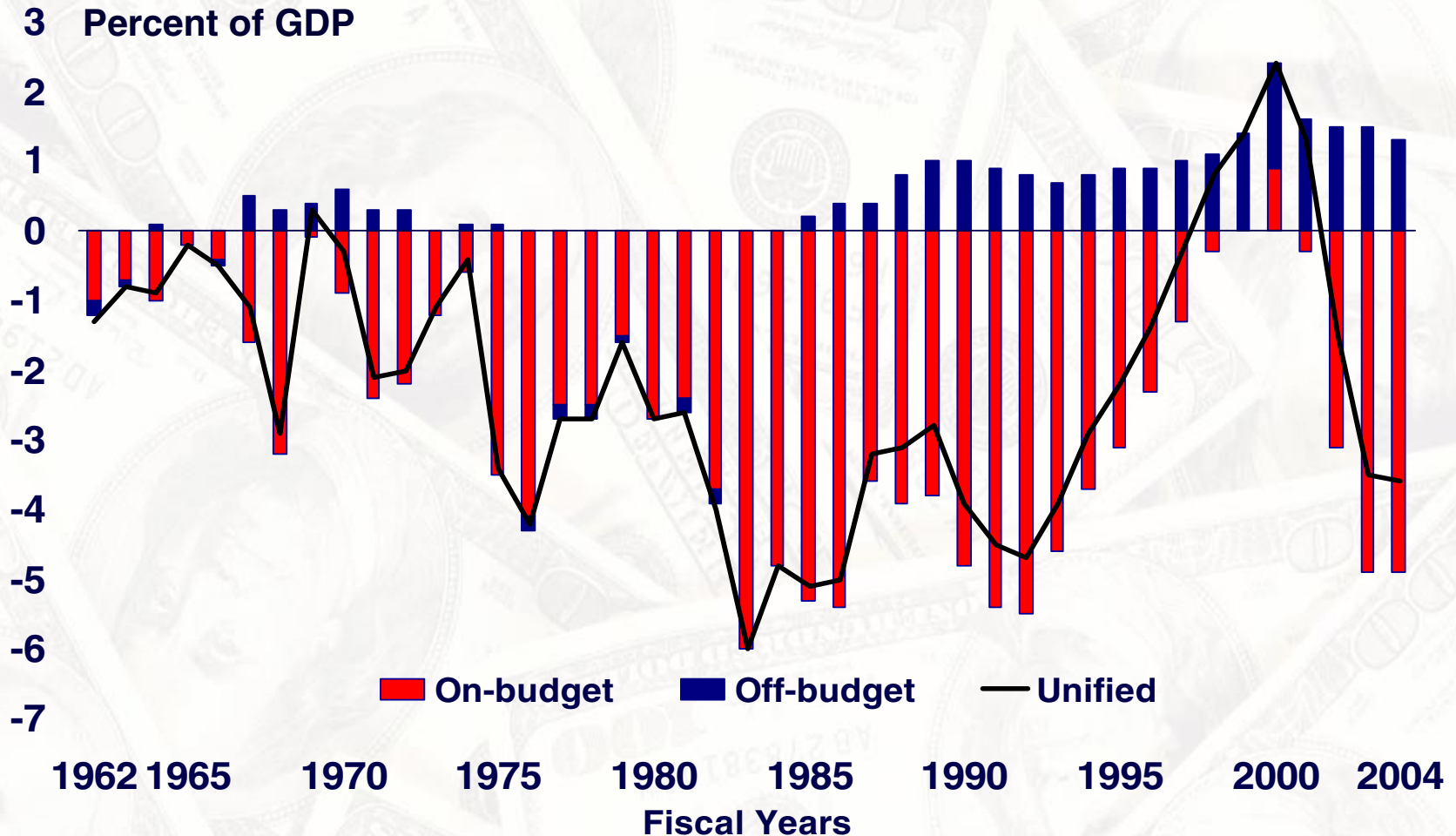
# Fiscal Year 2004 Deficit Numbers

	\$ 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)

<b>• Explicit liabilities</b>		<b>\$9.1</b>
• Publicly held debt	\$4.3	
• Military & civilian pensions & retiree health	3.1	
• Other	<u>1.7</u>	
<b>• Commitments &amp; Contingencies</b>		<b>0.9</b>
• E.g., PBGC, undelivered orders		
<b>• Implicit exposures</b>		
• Future Social Security benefits		5.7
• Obligations in excess of trust fund	\$4.0	
• Debt held by the trust fund	<u>1.7</u>	
• Future Medicare Part A benefits		8.8
• Obligations in excess of trust fund	\$8.6	
• Debt held by the trust fund	<u>0.3</u>	
• Medicare Part B benefits		12.4
• Medicare Part D benefits		8.7
<b>Total</b>		<b>\$45.6</b>

Source: 2004 Financial Report of the U.S. Government and 2005 Social Security and Medicare Trustees reports.

Note: Estimates for Social Security and Medicare are the intermediate 75-year estimates of the Social Security and Medicare Trustees as of January 1, 2005. All other data are as of September 30, 2004. Totals may not add due to rounding.

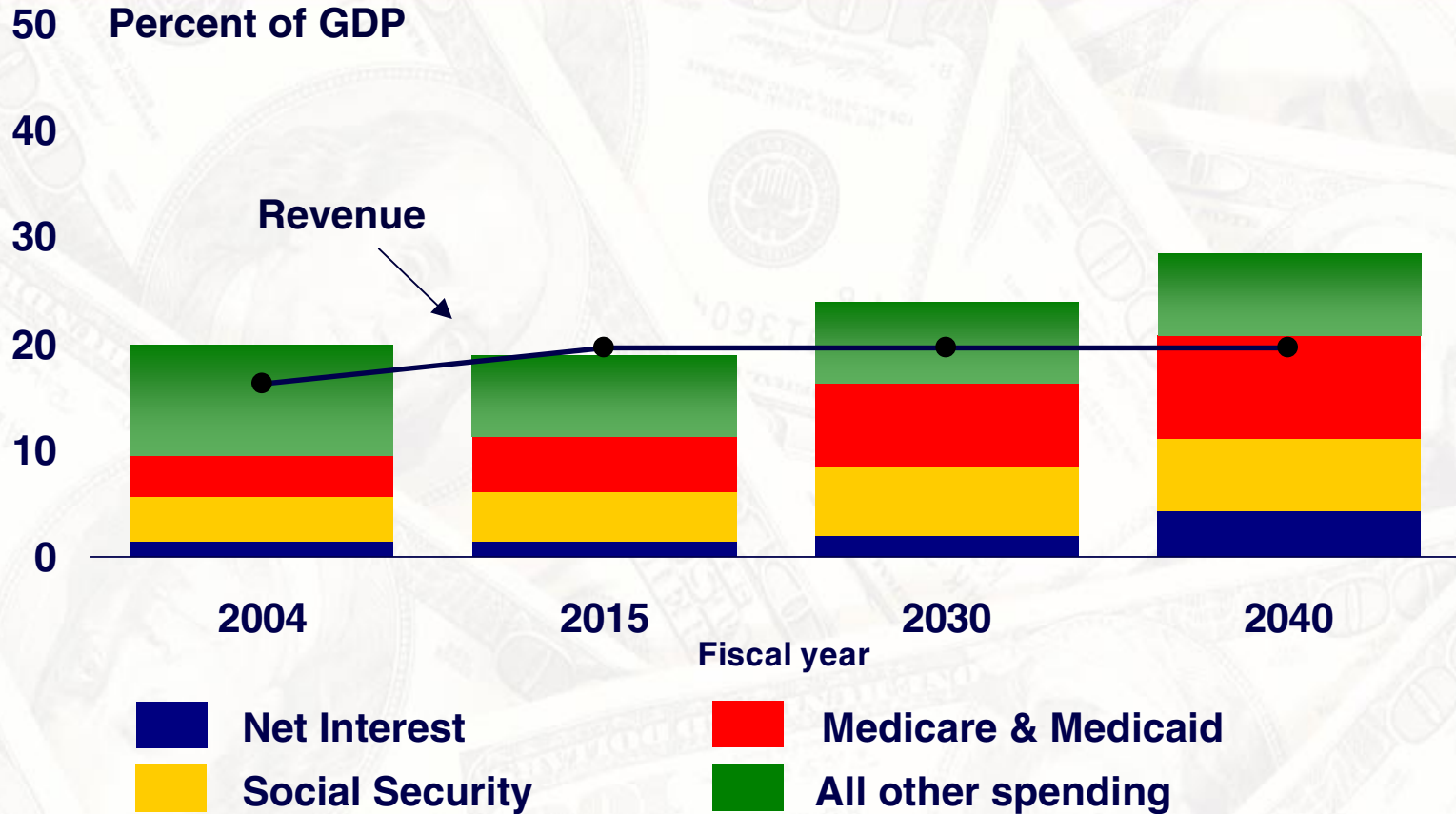
# Another Way to Think About These Numbers

- Debt held by the public \$4.3 trillion
- Trust fund debt<sup>1</sup> 3.1
- Gross debt \$7.4 trillion
- Gross debt per person—about \$25,000
- The \$46 trillion in fiscal exposures is:
  - a burden of more than \$150,000 per person or more than \$370,000 per full-time worker
  - nearly 19 times the current annual federal spending and 4 times the current annual GDP
  - almost equal to the estimated \$48.5 trillion in total net worth, including home equity, for all Americans

<sup>1</sup>Includes all debt held by government accounts.

# Composition of Spending as a Share of GDP

## Under Baseline Extended



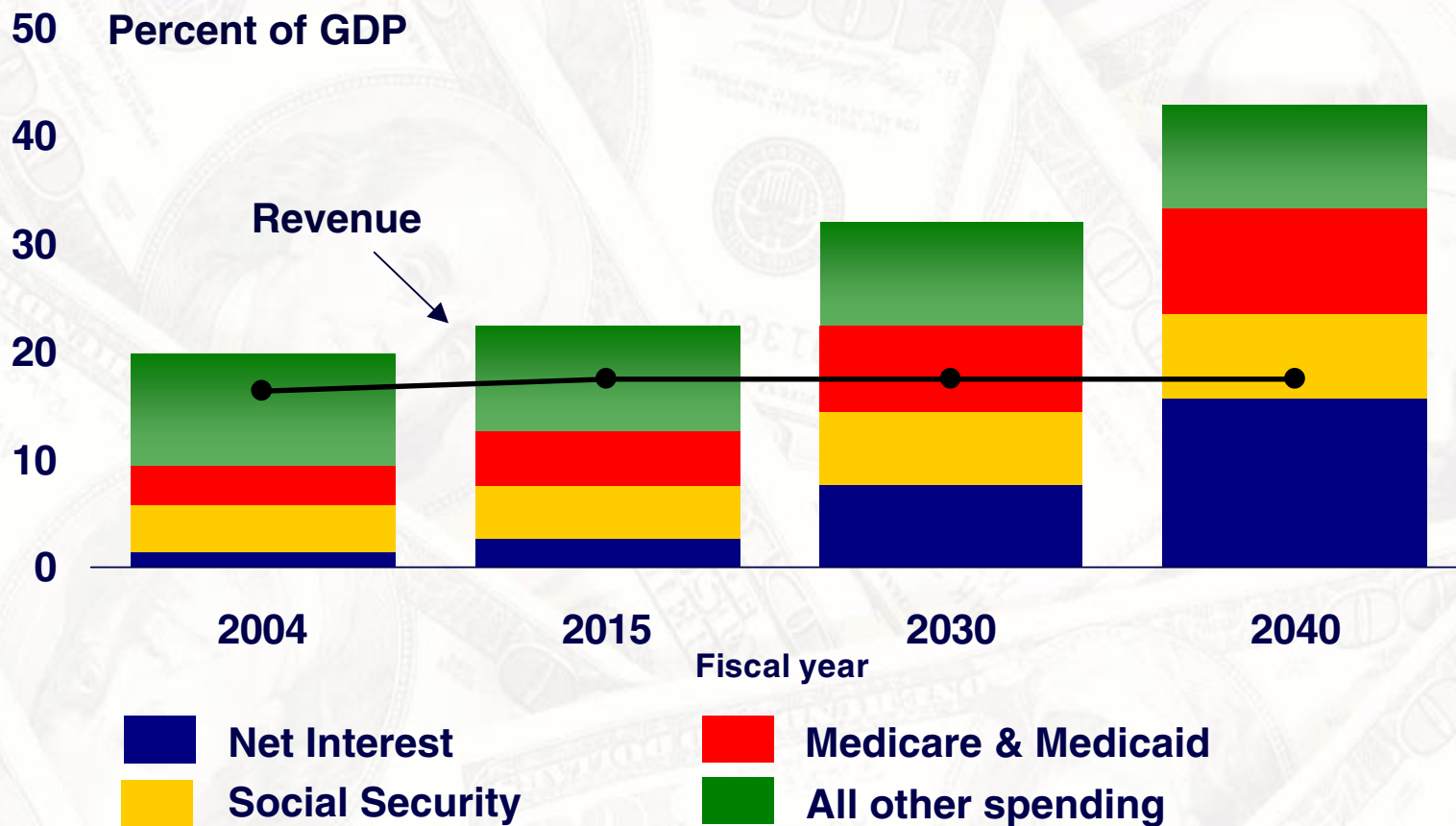
Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

Source: GAO's March 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 March 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 federal 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 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 Sooner We Get Started, the Better**

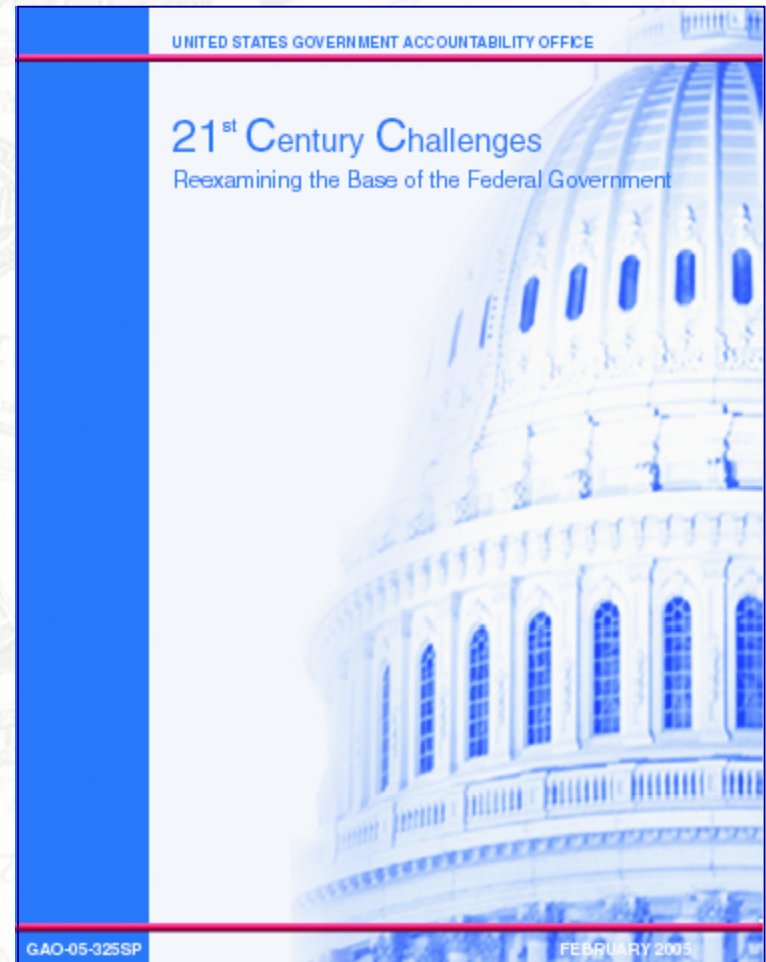
- Less change would be needed, and there would be more time to make adjustments.
- The miracle of compounding would work with us rather than against us.
- Our demographic changes will serve to make reform more difficult over time.

# 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

# 21<sup>st</sup> 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





# 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



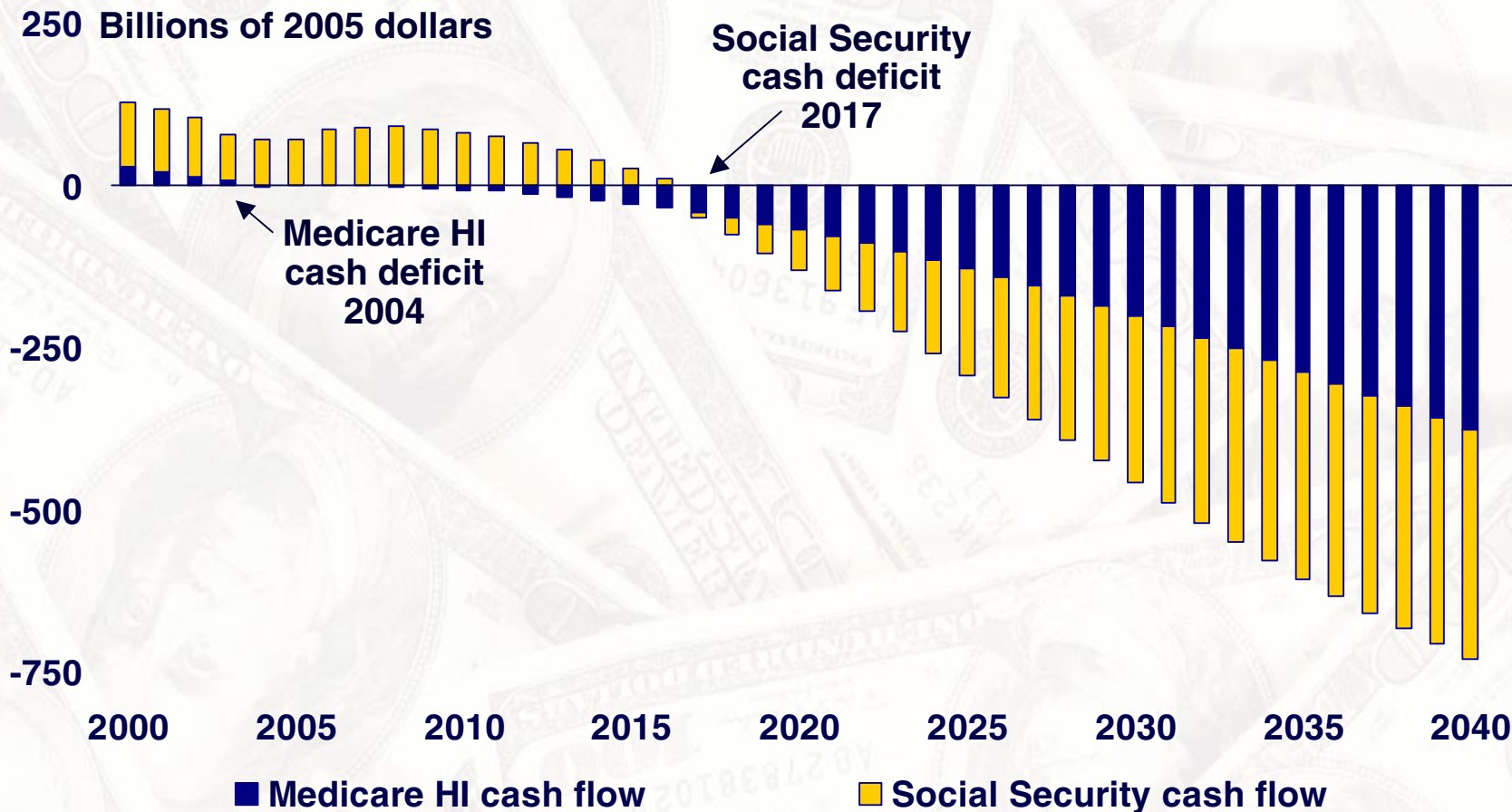
# GAO Criteria for Evaluating Social Security Reform Proposals

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 and Medicare's Hospital Insurance Trust Funds Face Cash Deficits

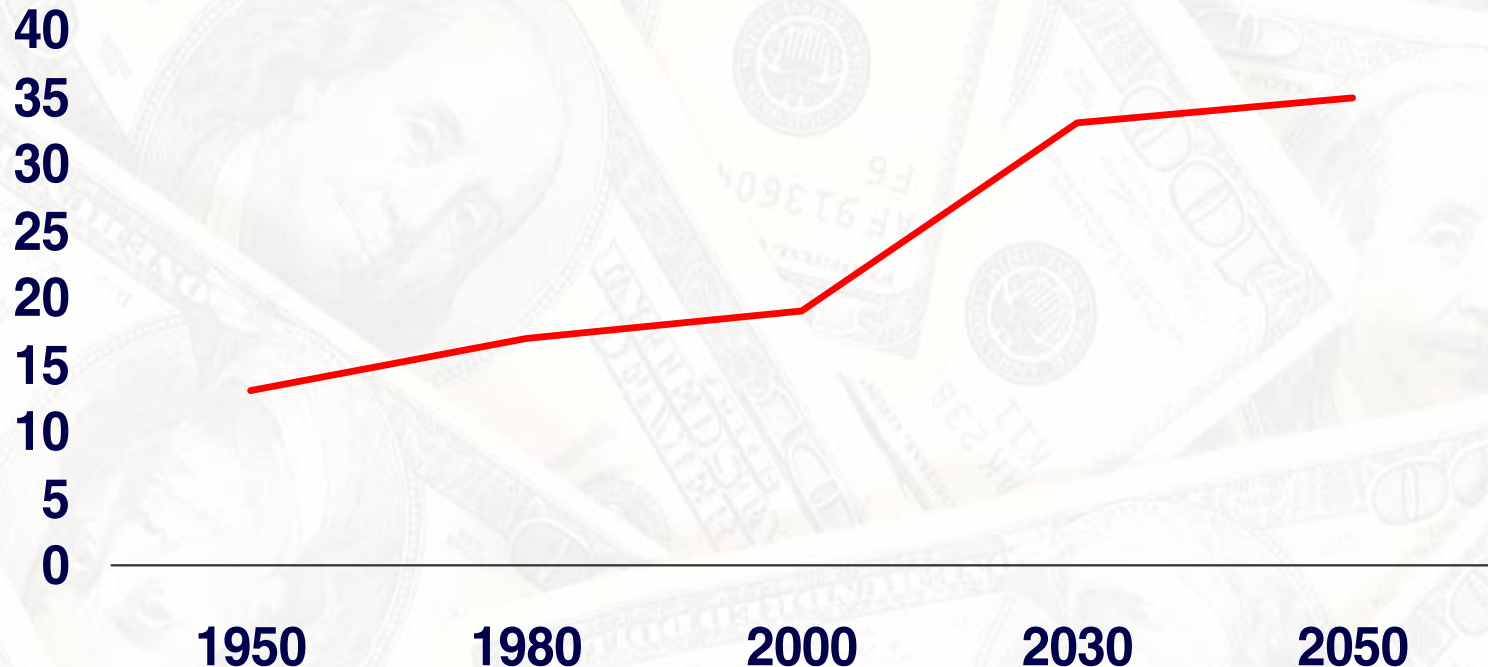


Note: Projections based on the intermediate assumptions of the 2005 Trustees' Reports.

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.

# 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

<b>Date</b>	<b>Event</b>
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).



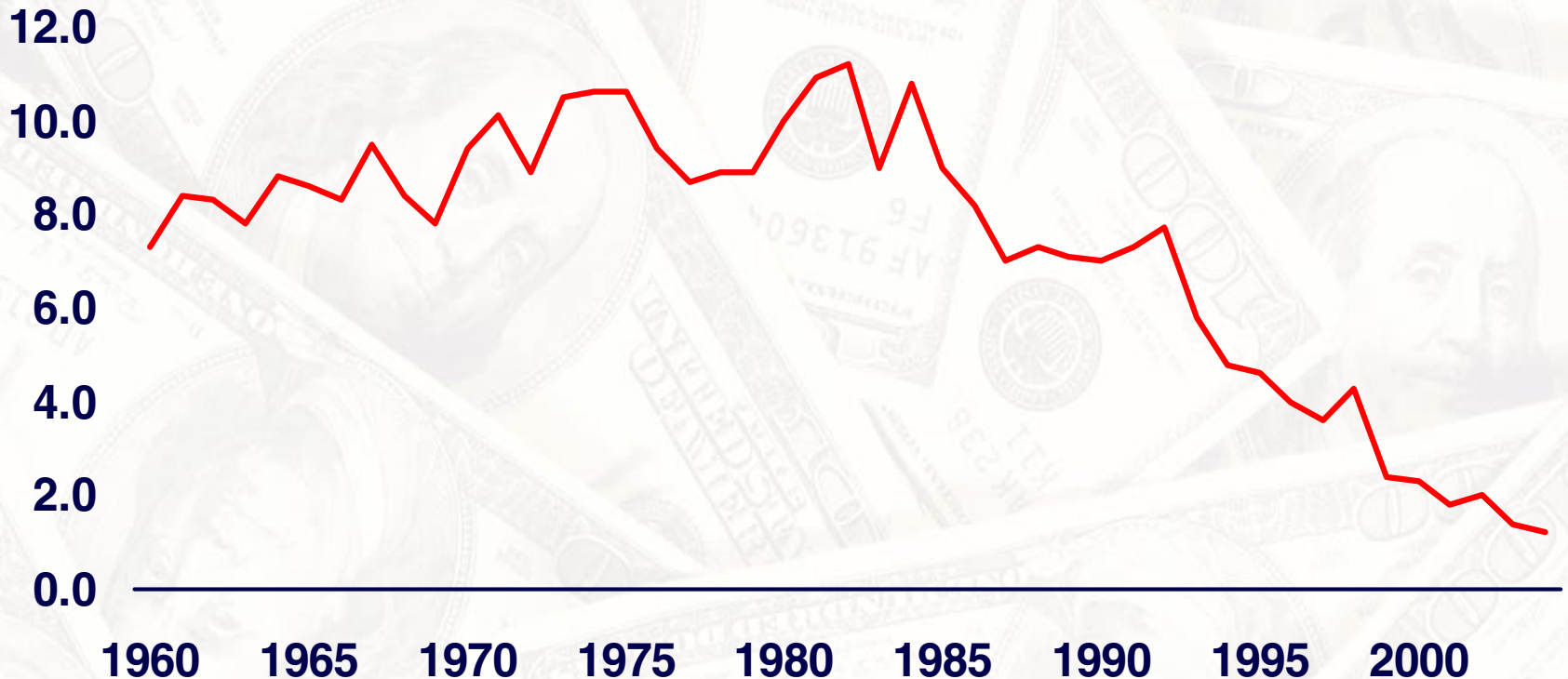
# Different Measures, Same Challenge

- 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).

# Personal Saving Rate Has Declined

Percent of disposable personal income

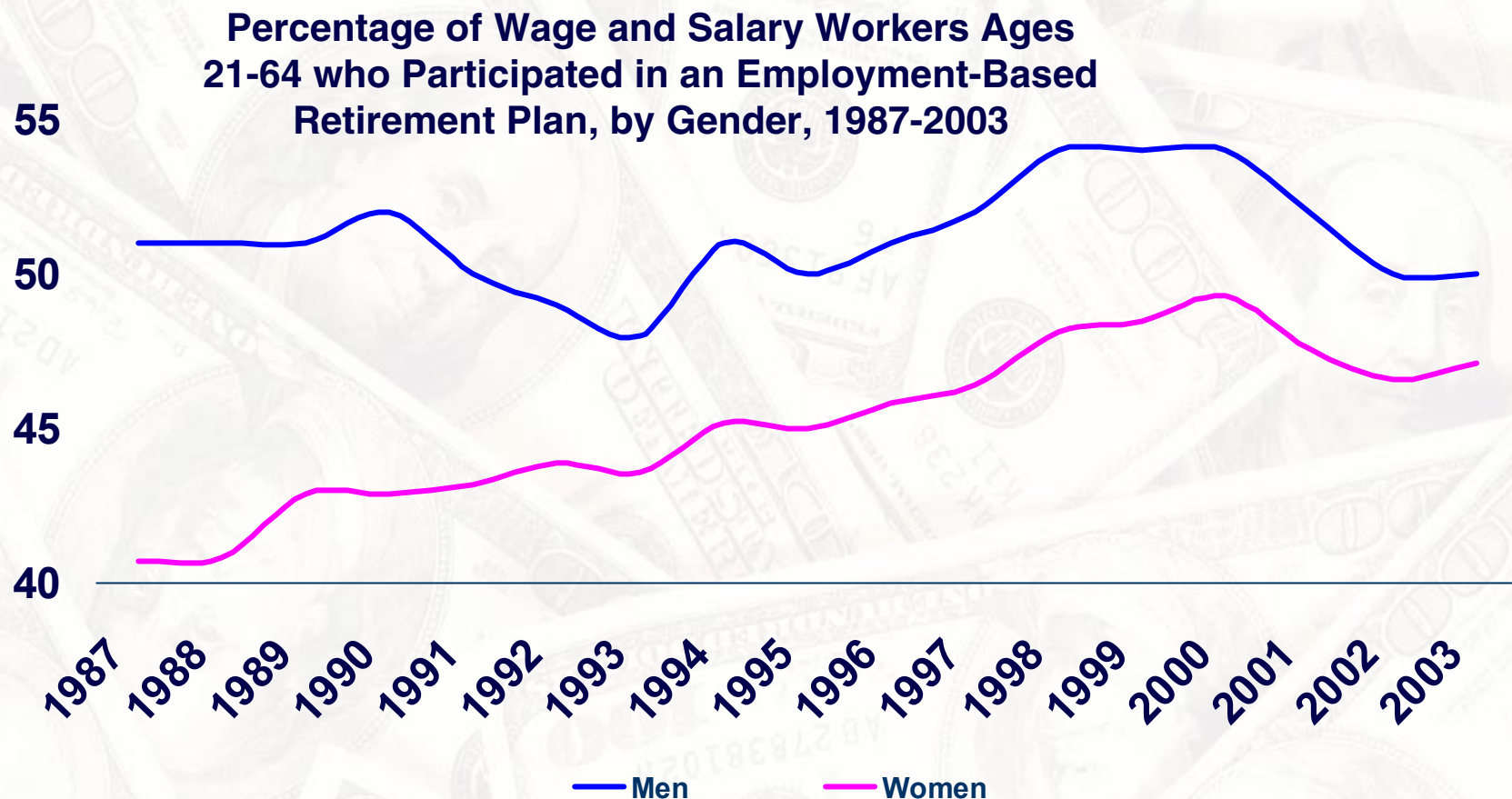


Source: Bureau of Economic Analysis, Department of Commerce.

# Pension System Faces Variety of Challenges

- Significant coverage gaps and pre-retirement leakage
- Long term decline in the number of DB plans and active participants and change in the nature of DB plans
- Recent and prospective large plan terminations by bankrupt sponsors have placed Pension Benefit Guaranty Corporation (PBGC), the federal agency insuring benefits, in financial jeopardy
  - Stock market, interest rate declines this decade have worsened overall plan funding
  - Demographics, global competition (Steel, auto) industry deregulation restructuring (airlines) have contributed to both plan and corporate weakness
- Plan funding rules have proven to be inadequate
- Certain PBGC premium insurance issues need to be reviewed
- Selected other issues also require attention (e.g., lump sums, bankruptcy laws)

# Participation Rates in Employment-Based Retirement Plans Are Converging for Men and Women, but Only about Half Have Coverage

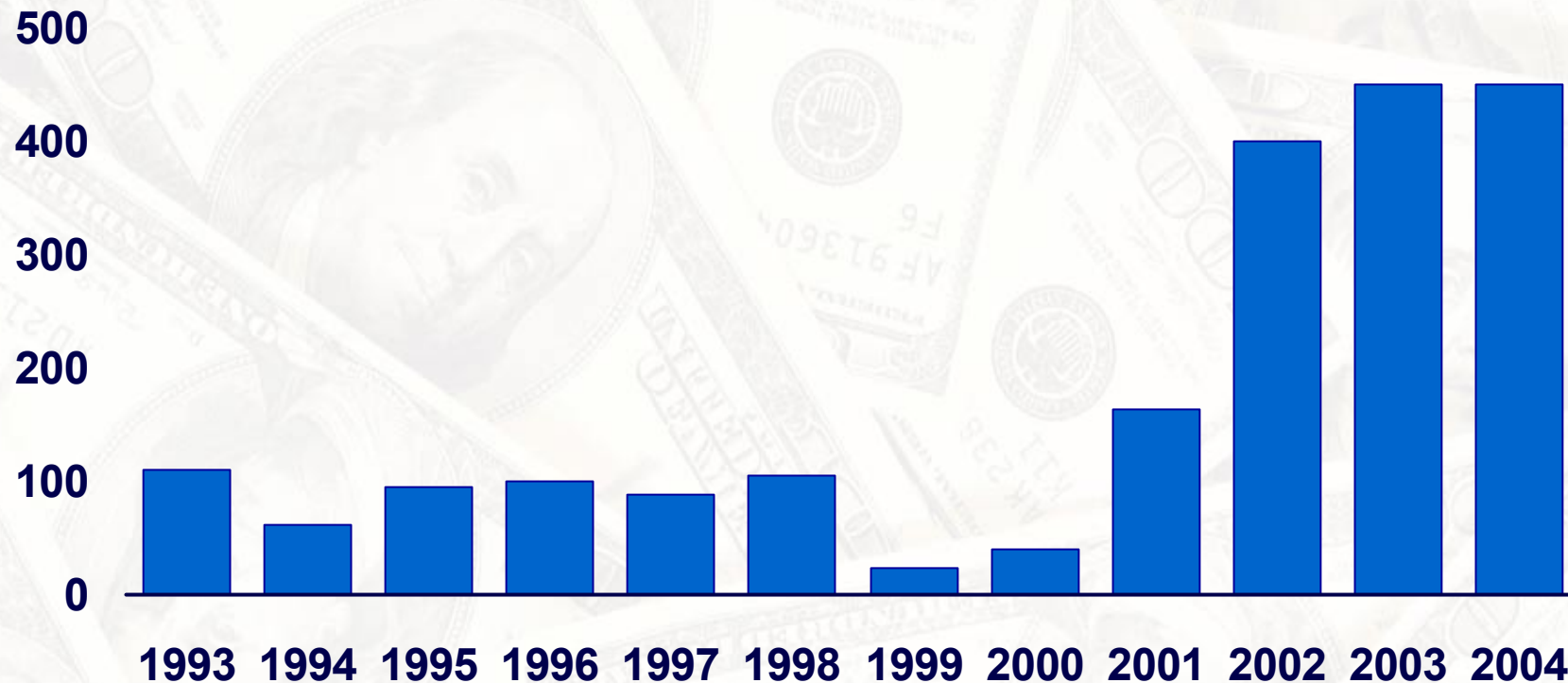


Source: Employee Benefit Research Institute estimates from the 1988-2004 March Current Population Surveys



# Total Underfunding among All PBGC-Insured Single-Employer DB Plans

Dollars in Billions

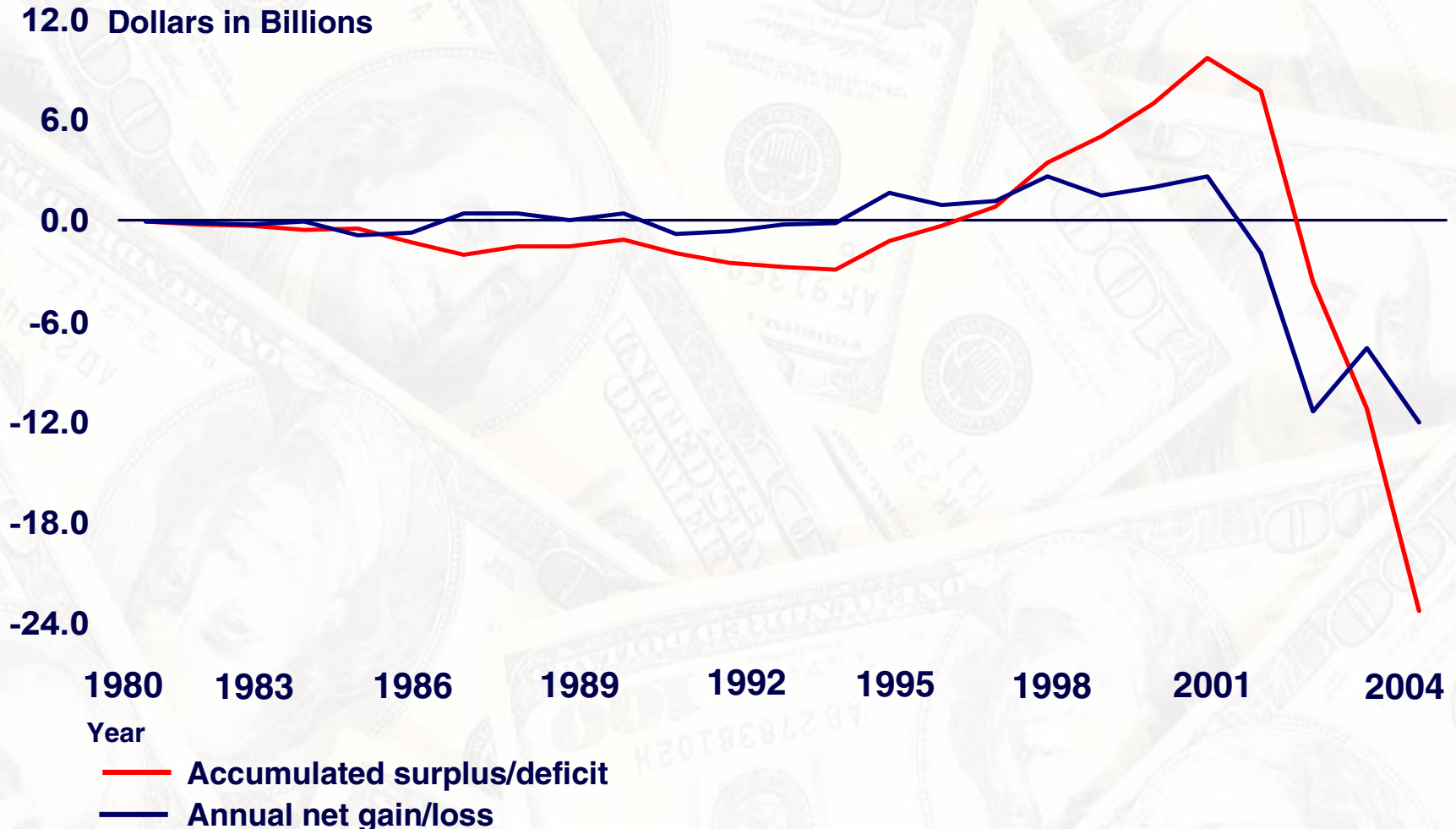


■ Total underfunding among al PBGC-insured signle-employer DB plan

Source: PBGC



# PBGC's Net Accumulated Deficit Topped \$23 Billion in 2004



Source: The Pension Benefit Guaranty Corporation.

# DB System Weaknesses Have Serious Implications for National Retirement Policy

- **Current Issue:**

- Protect the benefits of workers affected by terminated plans
- Address PBGC financial exposure
- Improve funding of DB plans generally

- **Broader Issue:**

## **What is Role of DB Plans in Ensuring Retirement Security?**

- Revitalized DB system vs smoother transition to all DC world
- Impact of Social Security reform on the private DB and DC system and personal savings arrangements

# 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)

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