Composition of Federal Spending

1966

- Defense: 15%
- Social Security: 34%
- Net interest: 7%
- All other spending: 43%
- Medicare & Medicaid: 1%

1986

- Defense: 10%
- Social Security: 29%
- Net interest: 14%
- All other spending: 28%
- Medicare & Medicaid: 20%

2006

- Defense: 19%
- Social Security: 32%
- Net interest: 9%
- All other spending: 21%
- Medicare & Medicaid: 20%

Source: 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: 44%
- Mandatory: 42%

2006
- Net Interest: 9%
- Discretionary: 38%
- Mandatory: 53%

Source: Office of Management and Budget.
## Major Fiscal Exposures ($ trillions)

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2006</th>
<th>% Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explicit liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$6.9</td>
<td>$10.4</td>
<td>52</td>
</tr>
<tr>
<td>Publicly held debt</td>
<td></td>
<td></td>
<td></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>Commitments &amp; contingencies</strong></td>
<td>0.5</td>
<td>1.3</td>
<td>140</td>
</tr>
<tr>
<td>E.g., PBGC, undelivered orders</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Implicit exposures</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Future Social Security benefits</td>
<td>3.8</td>
<td>6.4</td>
<td>197</td>
</tr>
<tr>
<td>Future Medicare Part A benefits</td>
<td>2.7</td>
<td>11.3</td>
<td></td>
</tr>
<tr>
<td>Future Medicare Part B benefits</td>
<td>6.5</td>
<td>13.1</td>
<td></td>
</tr>
<tr>
<td>Future Medicare Part D benefits</td>
<td>--</td>
<td>7.9</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$20.4</td>
<td>$50.5</td>
<td>147</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>Total – major fiscal exposures</td>
<td>$50.5 trillion</td>
</tr>
<tr>
<td>Total household net worth</td>
<td>$53.3 trillion</td>
</tr>
<tr>
<td>Burden/Net worth ratio</td>
<td>95 percent</td>
</tr>
<tr>
<td>Burden</td>
<td></td>
</tr>
<tr>
<td>Per person</td>
<td>$170,000</td>
</tr>
<tr>
<td>Per full-time worker</td>
<td>$400,000</td>
</tr>
<tr>
<td>Per household</td>
<td>$440,000</td>
</tr>
<tr>
<td>Income</td>
<td></td>
</tr>
<tr>
<td>Median household income</td>
<td>$46,326</td>
</tr>
<tr>
<td>Disposable personal income per capita</td>
<td>$31,519</td>
</tr>
</tbody>
</table>

Source: GAO analysis.

Notes: (1) Federal Reserve Board, Flow of Funds Accounts, Table B.100, 2006:Q2 (Sept. 19, 2006); (2) Burdens are calculated using estimated total U.S. population as of 9/30/06, from the U.S. Census Bureau; full-time workers reported by the Bureau of Economic Analysis, in NIPA table 6.5D (Aug. 2, 2006); and households reported by the U.S. Census Bureau, in Income, Poverty, and Health Insurance Coverage in the United States: 2005 (Aug. 2006); (3) U.S. Census Bureau, Income, Poverty, and Health Insurance Coverage in the United States: 2005 (Aug. 2006); and (4) Bureau of Economic Analysis, Personal Income and Outlays: October 2006, table 2, (Nov. 30, 2006).
Potential Fiscal Outcomes
Under Baseline Extended (January 2001)
Revenues and Composition of Spending as a Share of GDP

Percent of GDP

Revenue

Fiscal year

2005 2015a 2030a 2040a

Net interest Social Security Medicare & Medicaid All other spending

Source: GAO’s January 2001 analysis.
Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2017 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2017, revenue as a share of GDP is held constant—implicitly assuming action to offset the impact of bracket creep and to modify or offset the AMT.
aAll other spending is net of offsetting interest receipts.
Discretionary Spending Grows with GDP After 2007 and All Expiring Tax Provisions Extended through 2017
(Thereafter Revenue Returns to Historical Average of 18.3% of GDP plus Deferred Revenue)

Source: GAO's January 2007 analysis.
Health Care Is the Nation’s Top Tax Expenditure in Fiscal Year 2006

Source: Office of Management and Budget (OMB), Analytical Perspectives, Budget of the United States Government, Fiscal Year 2008.

Note: “Tax expenditures” refers to the special tax provisions that are contained in the federal income taxes on individuals and corporations. Treasury does not include forgone revenue from other federal taxes such as Social Security and Medicare payroll taxes.

aIf 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 $187.5 billion.

bThis tax expenditure does not include $40.8 billion in revenue losses due to defined contribution plans.
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 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
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

Source: GAO.
Aged Population as a Share of Total U.S. Population

Percent of total population

Population aged 65 and over

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

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.
Personal Saving Rate Has Declined

Percent of disposable personal income

Source: Bureau of Economic Analysis, Department of Commerce.
Social Security Workers per Beneficiary

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.
Annual Saving Required for a 35-Year Old, with Social Security

Required Contribution: Percentage of Gross Income

<table>
<thead>
<tr>
<th>Retirement Age</th>
<th>Male</th>
<th>Female</th>
</tr>
</thead>
<tbody>
<tr>
<td>62</td>
<td>14%</td>
<td></td>
</tr>
<tr>
<td>63</td>
<td>12%</td>
<td></td>
</tr>
<tr>
<td>64</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>65</td>
<td>8%</td>
<td></td>
</tr>
<tr>
<td>66</td>
<td>6%</td>
<td></td>
</tr>
<tr>
<td>67</td>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>68</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>69</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>70</td>
<td>0%</td>
<td></td>
</tr>
</tbody>
</table>

Source: GAO analysis, based on Social Security Administration data.

Note: The chart shows the percentage of gross salary 35-year old male and female earning an average wage in 2005 would need to withhold so that the individual would accumulate funds sufficient, along with scheduled social security benefits, to provide retirement income equal to 75% of his or her pre-retirement income. The projections are based on economic assumptions from the 2005 Social Security Trustees Report for inflation (2.8%), real wage growth (1.1%), real interest rate (3%), and nominal interest rate (5.8%).
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
Social Security and Medicare’s Hospital Insurance Trust Funds Face Cash Deficits

Calendar year

Medicare HI cash deficit 2007

Social Security cash deficit 2017


Note: Projections based on the intermediate assumptions of the 2007 Trustees’ Reports. The CPI is used to adjust from current to constant dollars.
### Key Dates Highlight Long Term Challenges of the Social Security System

<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>
</tbody>
</table>

Possible Way Forward on Social Security Reform

Hold harmless 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 retirement age and index it to life expectancy
- Modify income replacement and/or indexing formulas for middle and upper income earners
- Strengthen the minimum benefit
- 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)
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 DB freezes and retiree health plan limitations are likely to accelerate due to prospective changes in current accounting for pension and post-employment benefits
- 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 earlier this decade worsened overall plan funding
  - Demographics, global competition (steel, auto), industry deregulation restructuring (airlines) have contributed to both plan and corporate weakness
- Plan funding rules and PBGC premiums have proven to be inadequate
PBGC's Net Accumulated Deficit for Single-Employer Plans Was Over $18 Billion in 2006

Dollars in Billions

Year

Accumulated surplus/deficit
Annual net gain/loss

Source: Pension Benefit Guaranty Corporation.
PBGC Claims and Exposures by Principle Industry Category

PBGC Claims by Industry, FY 1975-2006
Total = $32.6 billion

Reasonably Possible Exposure, FY 2006
Total = $73.3 billion

Source: Pension Benefit Guaranty Corporation.
Note: Claims data based on preliminary estimates. The transportation category may also include communications and/or utilities.
Broad Goals for Reform of the DB System

- Provide incentives and safeguards for plan sponsors to improve plan funding without causing terminations that would otherwise not occur

- Hold plan sponsors accountable for adequately funding their plans

- Improve transparency and timeliness of plan financial information
Pension Protection Act of 2006: An Important Reform with Unfinished Business

PPA provisions affecting DB plan funding and design:

- **Revised Plan Funding Rules** - Sponsors have 7 years to fund initial shortfall and each additional shortfall
- **“Smoothing” Period Reduced** - for liabilities, from 4 to 2 years; for assets, also from 4 to 2 years
- **Yield Curve** - Modified corporate bond yield curve replaces 30-year Treasuries as key discount rate
- **Credit Balances** - Use of balances restricted in some cases
- **“At Risk” Plans** - Tougher funding rules, other restrictions for weakly funded “at risk” plans
- **Cash Balance Plans** - not deemed to be age discriminatory prospectively, “wearaway” and whipsaw prohibited, shorter vesting (reduced from 5 years to 3 years)
- **Multiemployer Plans** - Benefit restrictions placed on certain underfunded plans
- **Phase-in** – Funding target phased-in from 2008 to 2011 for certain plans
Pension Protection Act of 2006: An Important Reform with Unfinished Business

- **PBGC Premiums:**
  - Loopholes in Variable-Rate Premium closed (e.g. previous exemption for plans at “full-funding” removed)
  - Extension of distress termination premium of $1250 per participant (as originally enacted in Deficit Reduction Act of 2005, or DRA)
  - DRA raised flat-rate premiums from $19 to $30 per participant and indexes growth in these premiums to wage growth

- **Shutdown Benefits** – Restricts shutdown benefits and their PBGC guarantee

- **Industry Relief** - Longer funding period for airlines and select other industries
Pension Protection Act of 2006: An Important Reform with Unfinished Business

PPA provisions related to defined contribution plans:

• **Automatic Enrollment** - Option of automatic enrollment as default

• **Financial Advice** – Allows for investment companies to offer financial advice to plan participants under certain conditions

• **Employer Stock** - Plans required to allow diversification of employer stock after 3 years
Pension Protection Act of 2006: An Important Reform with Unfinished Business

- PPA shrinks, but does not close, many loopholes regarding DB plan funding
- PBGC deficit expected to continue to grow
- Ultimately does not address fundamental mismatch between DB plan assets and liabilities
- Will likely not reverse long-term decline in DB system
- Long phase-in period and uncertain effects suggest that careful ongoing monitoring of DB plans and PBGC deficit is needed
- Financing of adequate retirement for all Americans continues to pose a major national challenge
  - Issues of coverage remain largely unanswered
  - Appropriate balance of responsibility for retirement among employers, government and workers remains unclear
GAO’s Ongoing Work: State and Local Retiree Benefits

- **Request from Senators Baucus and Grassley**, Senate Finance Committee, covering both pensions and other post-employment benefits (OPEB)

- **Currently planning 2 reports for late 2007**
  - **Nationwide Overview** describing governance, benefits provided, and fiscal implications
  - **Status Report on Funding and Contributions**, with discussion of actuarial methods and implications of under-funding
  - Both will explore differences and interactions between pensions and OPEB

- **Have met with** NASRA, NCTR, NCSL, NCPERS, NASACT, GASB, NASBO, NEA, AFSCME, and others
SMI Premium as Share of Average Social Security (OASI) Benefit

Source: CMS, Office of the Actuary.

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.
Number of Non-elderly Uninsured Americans, 1999-2005

Source: GAO and Urban Institute and Kaiser Commission on Medicaid and the Uninsured analyses.

Notes: Figures for 1999-2000 are from Urban Institute and Kaiser Commission on Medicaid and the Uninsured. The figures for 2001-2005 are from GAO analyses of the Bureau of the Labor Statistics and the Bureau of the Census Current Population Survey, Annual Social and Economic Supplement. Data for 2004 and 2005 were revised in March 2007 to reflect the results of a change to the survey process that assigns insurance coverage to dependents. In August 2007, the Census Bureau will release a revised time series for 1995 to 2003 reflecting these changes. To ensure the comparability of all the years, we are reporting the unrevised data for 2004 and 2005.
Growth in Health Care Spending: Health Care Spending as a Percentage of GDP

Source: The Centers for Medicare & Medicaid Services, Office of the Actuary.
Note: The figure for 2015 is projected.
Growth in Health Care Spending: Cumulative Growth in Real Health Care Spending Per Capita and Real GDP Per Capita, 1960-2005

Average annual growth rate of 4.9%

Average annual growth rate of 2.3%

Source: GAO analysis of data from the Centers for Medicare & Medicaid Services, Office of the Actuary, and the Bureau of Economic Analysis.

Note: The most current data available on health care spending per capita are for 2005.
## Where the United States Ranks on Selected Health Outcome Indicators

<table>
<thead>
<tr>
<th>Outcome</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life expectancy at birth</td>
<td>23 out of 30 in 2003</td>
</tr>
<tr>
<td><em>U.S. = 77.5 years in 2003</em></td>
<td></td>
</tr>
<tr>
<td>Infant Mortality</td>
<td>25 out of 30 in 2003</td>
</tr>
<tr>
<td><em>U.S. = 6.9 deaths in 2003</em></td>
<td></td>
</tr>
<tr>
<td>Potential Years of Life Lost</td>
<td>23 out of 26 in 2002</td>
</tr>
<tr>
<td><em>U.S. = 5,066 in 2002</em></td>
<td></td>
</tr>
</tbody>
</table>

Source: *OECD Health Data 2006.*

Notes: Data are the most recent available for all countries. Life expectancy at birth for the total population is estimated by the OECD Secretariat for all countries, as the unweighted average of the life expectancy of men and women. Infant mortality is measured as the number of deaths per 1,000 live births. Potential years of life lost (PYLL) is the sum of the years of life lost prior to age 70, given current age-specific death rates (e.g., a death at 5 years of age is counted as 65 years of PYLL).
### Key Dates Highlight Long Term Challenges of the Medicare Program

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>Medicare Part A outlays exceed cash income</td>
</tr>
<tr>
<td>2007</td>
<td>Estimated trigger date for “Medicare funding warning”</td>
</tr>
<tr>
<td>2013</td>
<td>Projected date that annual “general revenue funding” for Part B will exceed 45 percent of total Medicare outlays</td>
</tr>
<tr>
<td>2019</td>
<td>Part A trust fund exhausted, annual income sufficient to pay about 80% of promised Part A benefits</td>
</tr>
</tbody>
</table>

Issues to Consider in Examining 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 decisions about the use of medical services,
  • **Foster Transparency** with respect to the value and costs of care, and
  • **Ensure Accountability** from insurers and providers to meet standards for appropriate use and quality.

• Ultimately, we need to address four key dimensions: access, cost, quality, and personal responsibility.
## Selected Potential Health Care Reform Approaches

<table>
<thead>
<tr>
<th>Reform Approach</th>
<th>Short-term action</th>
<th>Long-term action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revise the government’s payment systems and leverage its purchasing authority to foster value-based purchasing for health care products and services</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Consider additional flexibility for states to serve as models for possible health care reforms</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Consider limiting direct advertising and allowing limited importation of prescription drugs</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Foster more transparency in connection with health care costs and outcomes</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Create incentives that encourage physicians to utilize prescription drugs and other health care products and services economically and efficiently</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Foster the use of information technology to increase consistency, transparency, and accountability in health care</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Encourage case management approaches for people with chronic and expensive conditions to improve the quality and efficiency of care delivered and avoid inappropriate care</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Reexamine the design and operational structure of the nation’s health care entitlement programs—Medicare and Medicaid, including exploring more income-related approaches</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Reform Approach</td>
<td>Short-term action</td>
<td>Long-term action</td>
</tr>
<tr>
<td>--------------------------------------------------------------------------------</td>
<td>-------------------</td>
<td>------------------</td>
</tr>
<tr>
<td>Revise certain federal tax preferences for health care to encourage more efficient use of health care products and services.</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Foster more preventative care and wellness services and capabilities, including fighting obesity and encouraging better nutrition</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Promote more personal responsibility in connection with health care</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Limit spending growth for government-sponsored health care programs (e.g., percentage of the budget and/or economy)</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Develop a core set of basic and essential services. Create insurance pools for alternative levels of coverage, as necessary</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Develop a set of evidence-based national practice standards to help avoid unnecessary care, improve outcomes, and reduce litigation</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Pursue multinational approaches to investing in health care R&amp;D</td>
<td></td>
<td>✓</td>
</tr>
</tbody>
</table>
Key Leadership Attributes Needed for These Challenging and Changing Times

- Courage
- Integrity
- Creativity
- Stewardship
- Partnership
Saving Our Future Requires Tough Choices Today:
Fiscal, Retirement, and Health Care Insecurity

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

Association for Advanced Life Underwriting (AALU)

May 2, 2007