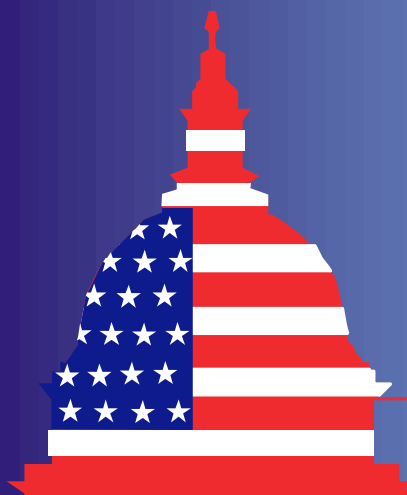


Social Security Reform



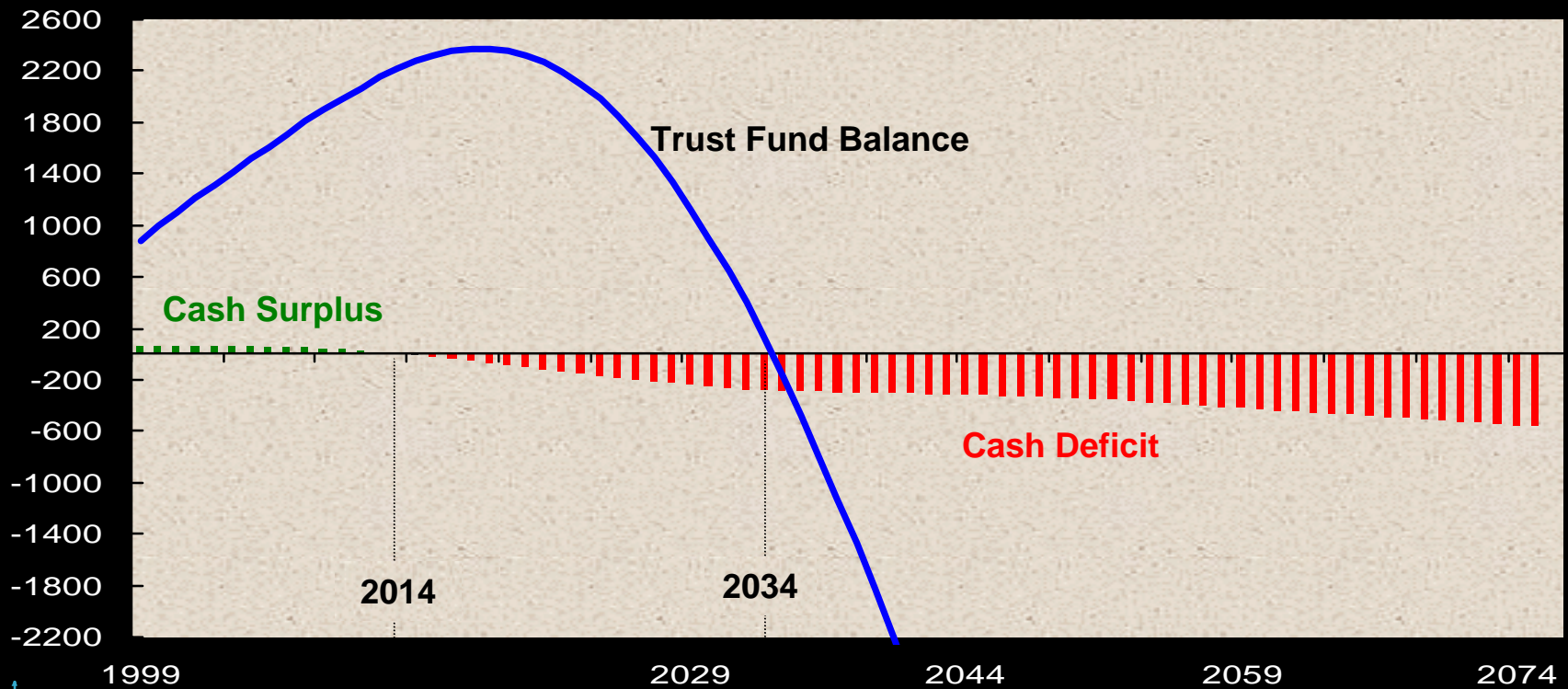
G A O

Accountability ★ Integrity ★ Reliability

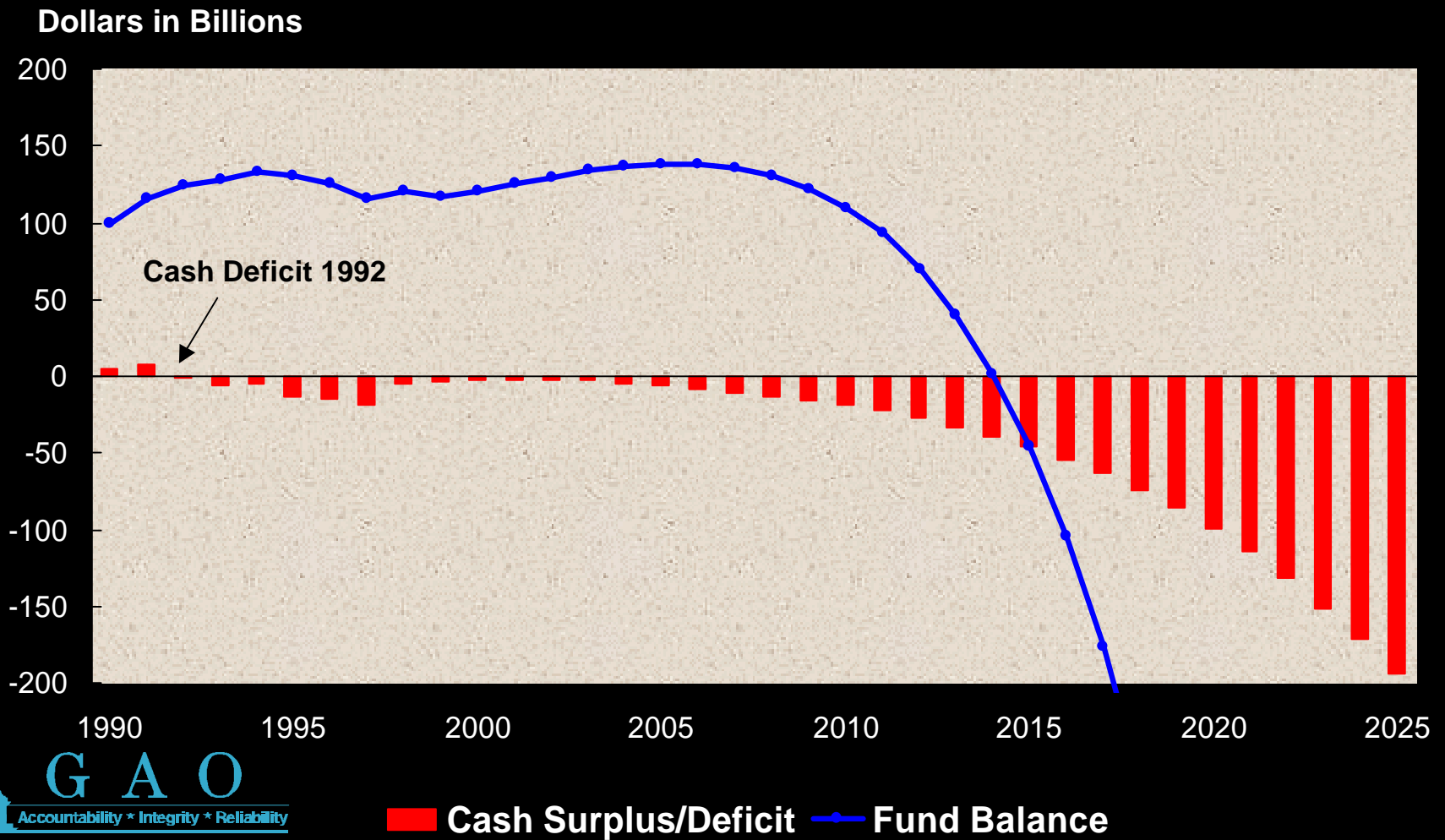
David M. Walker
Comptroller General
of the United States
November 16, 1999

Social Security Trust Fund Financial Outlook

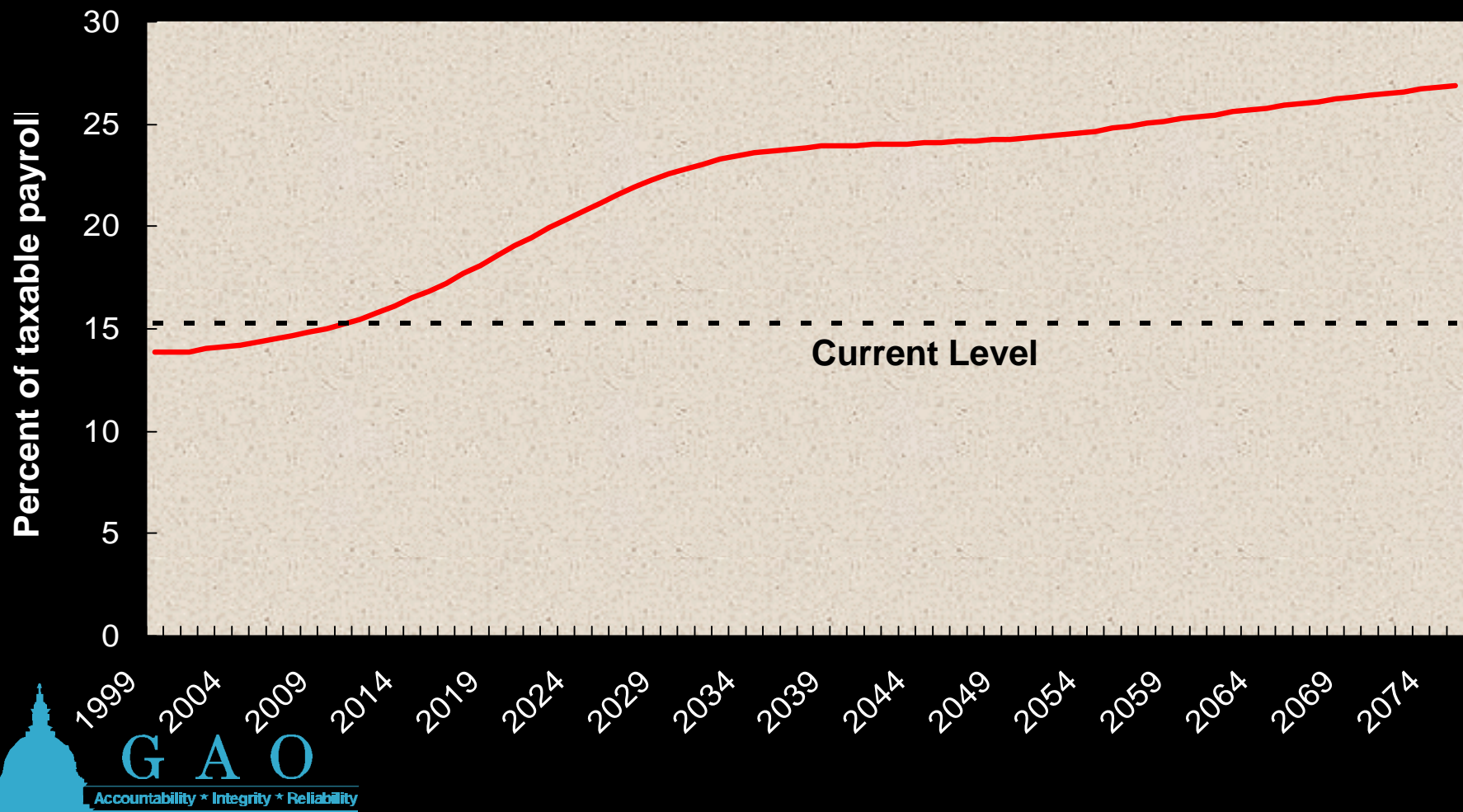
Dollars in Billions



Medicare's Hospital Insurance Trust Fund Financial Outlook



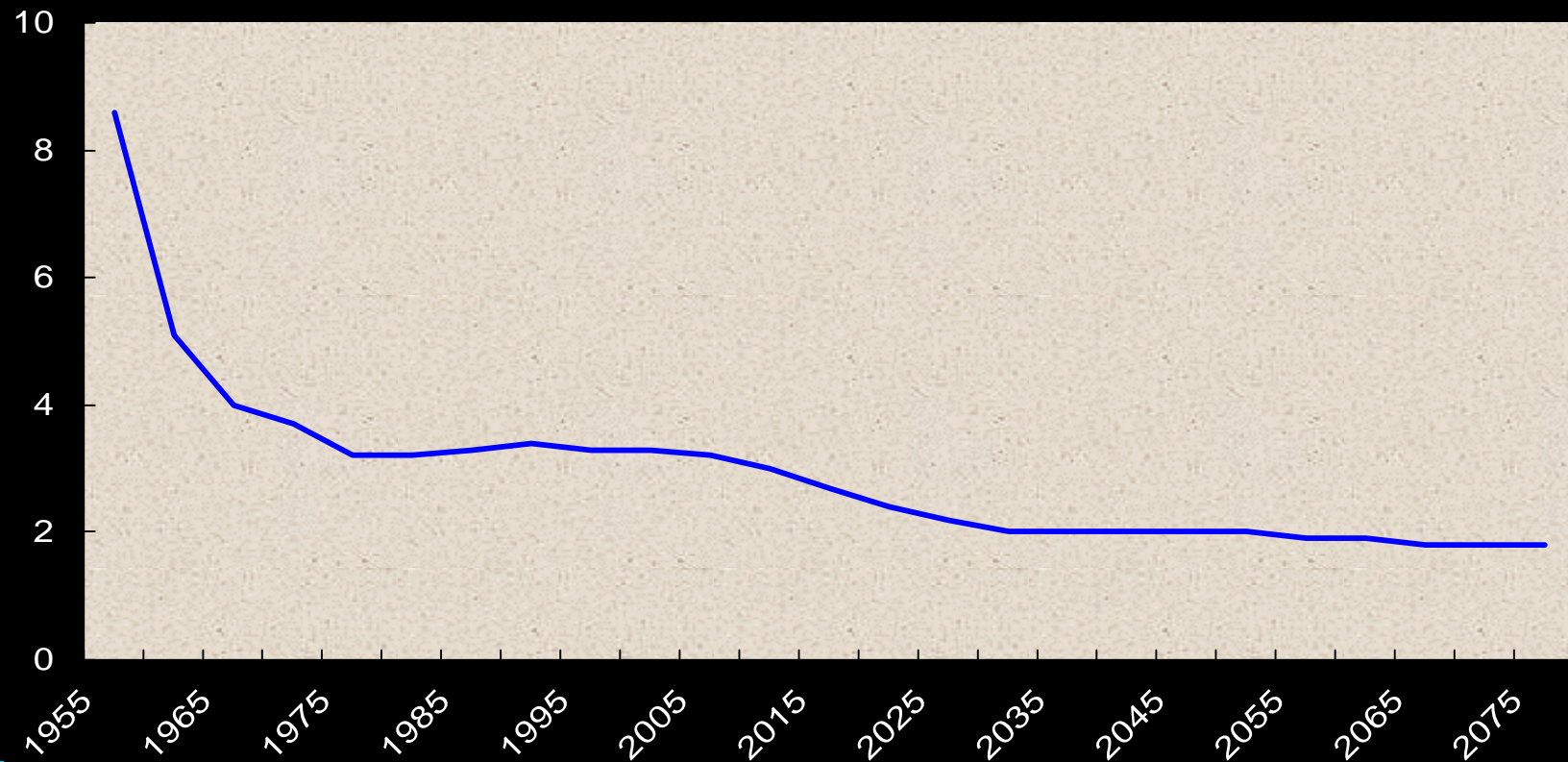
Social Security and Medicare Part A as a Percent of Taxable Payroll



Source: 1999 OASDI Trustees' Report.

Demographic Trends Drive Financing of Social Security and Medicare

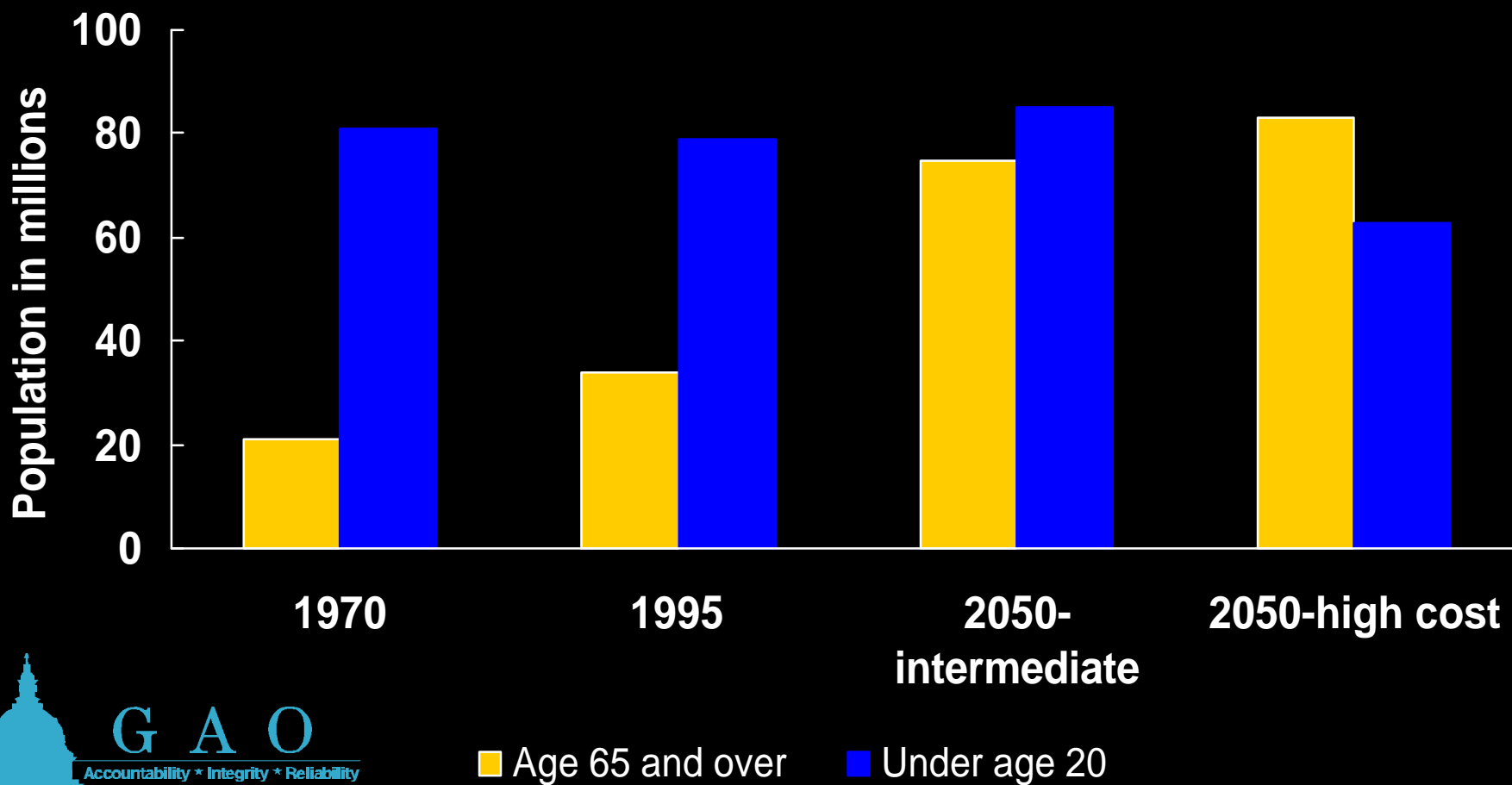
Workers per Beneficiary



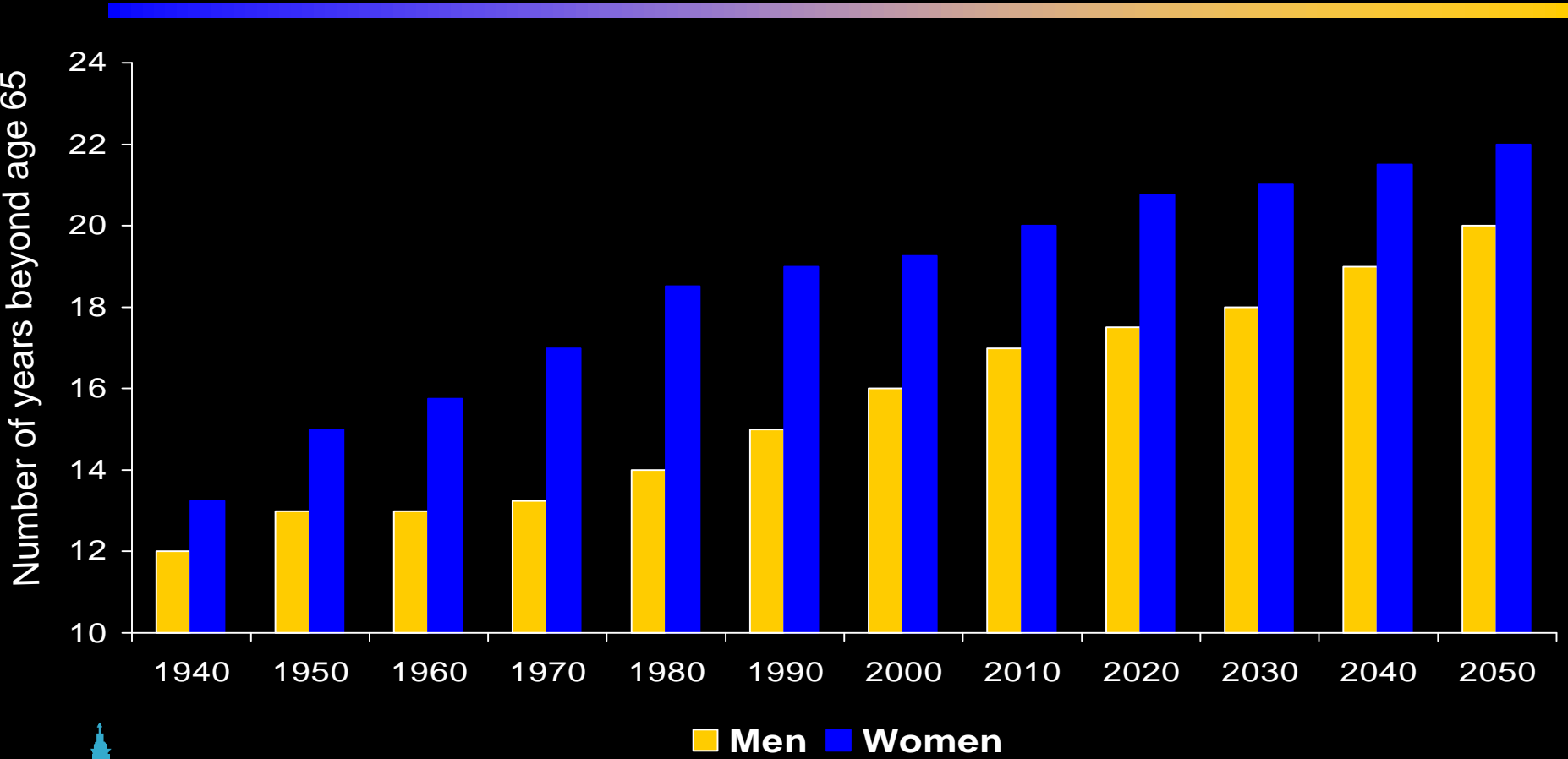
Source: 1999 OASDI Trustees Report

Changes: Demographics

The Aging of the U.S. Population



Life Expectancy Beyond 65



Budget Outlook Provides Context

- Shift from nearly 30 years of budget deficits to projections for unified budget surpluses out into the future
- Welcome news--but we need to act prudently
 - Uncertainty inherent in projections
 - Large debt overhang from years of deficits
 - Looming cost pressures over next decades

Long-Term Simulations

- Since 1992 GAO has been simulating interaction of budget & economy over long term. Assumptions of this model are based on CBO and the Social Security and Medicare Trustees' best estimates.
- We use these simulations to provide qualitative illustrations of fiscal & economic outcomes associated with alternative policy paths.
- Long-term outlook is especially important now.
 - Achievement of unified budget surplus could lull us into thinking job is done.
 - BUT surpluses could also present opportunity to address the future.
 - We know that a demographic tidal wave will overwhelm future surpluses.



How Should We Use the Surplus?

- Meet pent-up demand for spending in some domestic discretionary areas?
- Increase defense spending?
- Cut taxes?
- Secure existing unfunded entitlement promises?
- Reduce publicly held debt?
- A combination of all?

Relative Risk

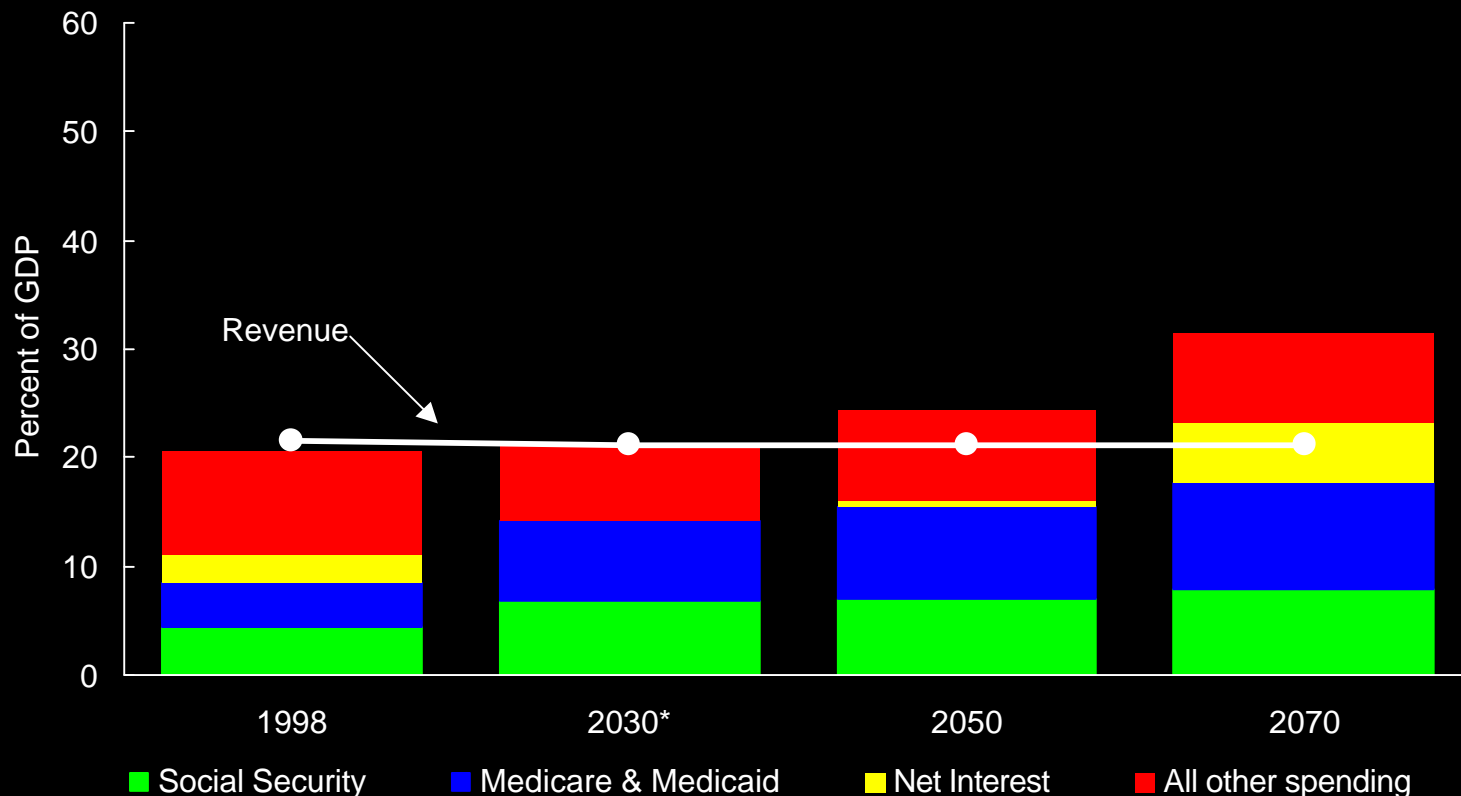
- Multiple benefits to devoting a good portion of the surplus to debt reduction, especially if comprehensive reform is postponed
 - interest savings
 - demographic tidal wave will overwhelm surplus AND reduce budgetary flexibility
- Policy choices vary in degree of risk
 - permanent changes in tax or spending paths present greatest risk
 - paying down publicly held debt presents least risk
- Paying down debt is very helpful, but not enough (See “No Action” simulation)

Alternative Fiscal Policy Simulations

- This presentation shows two alternative fiscal policy paths: “No Action” (“Save Unified Surpluses”) and “Eliminate Unified Surpluses.”
- **No action (“Save Unified Surpluses”)** assumes no changes in current policies and thus results in saving the unified surpluses. This assumption implies no emergency spending and that actual spending falls within the existing discretionary caps. Thus unified budget surpluses through 2029 are used to reduce debt held by the public. Thereafter, deficits are permitted to emerge. Discretionary spending follows CBO’s 10-year projections which assume compliance with the spending caps through 2002 and growth with inflation through 2008. Thereafter we assume discretionary spending grows with the economy.
- **Eliminate unified surpluses** assumes that surpluses are not retained. Policy actions that permanently increase spending and/or reduce revenue eliminate the surpluses but keep the unified budget in balance until unified deficits emerge in 2008.



Composition of Spending as a Share of GDP Under No Action Simulation

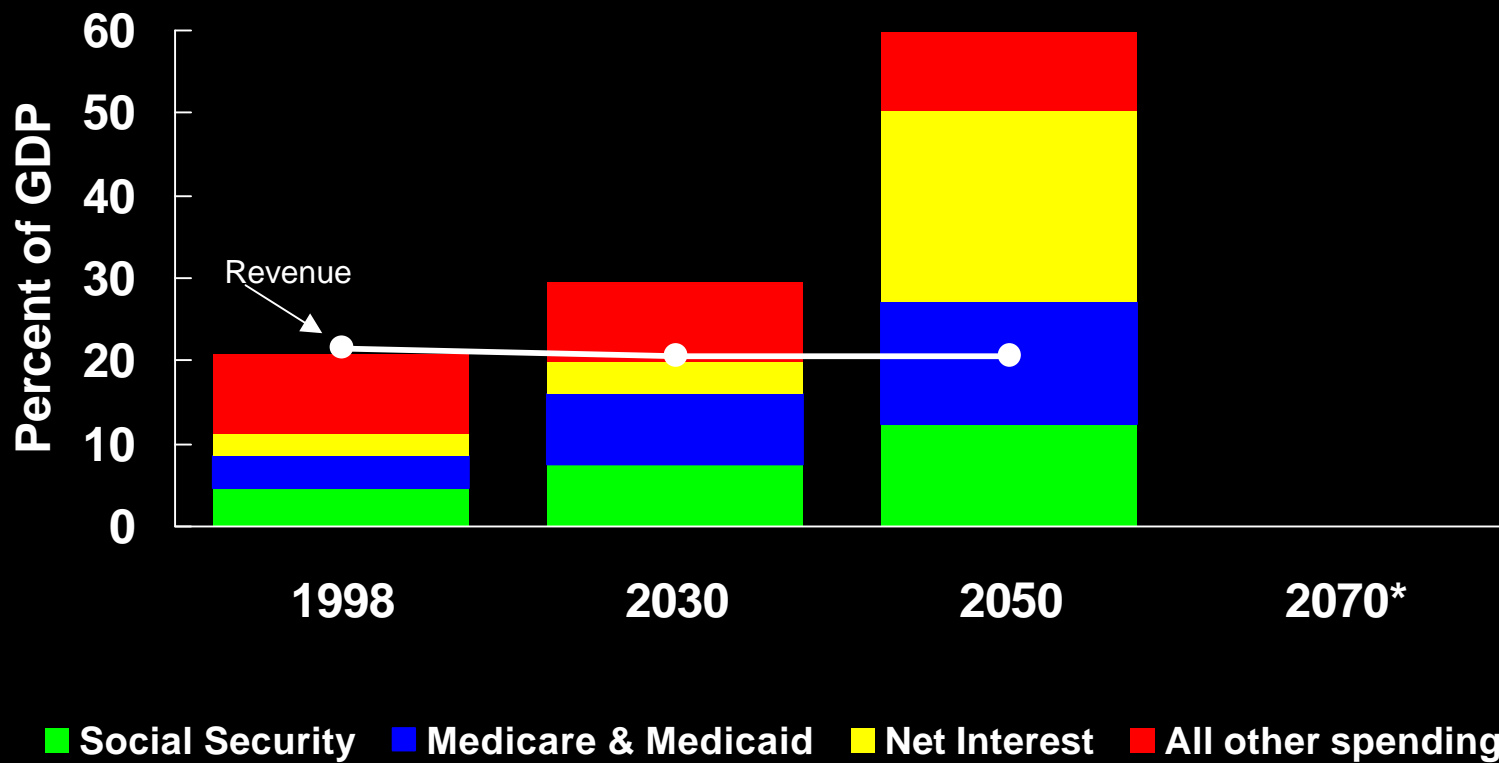


Note: Revenue as a share of GDP falls from its actual 1998 level of 21.6 percent to CBO's 2008 implied level and is held constant at this level for the remainder of the simulation period.

*In 2030, all other spending includes offsetting interest receipts.

Source: GAO's Summer 1999 analysis.

Composition of Spending as a Share of GDP Under Eliminate Unified Surpluses Simulation

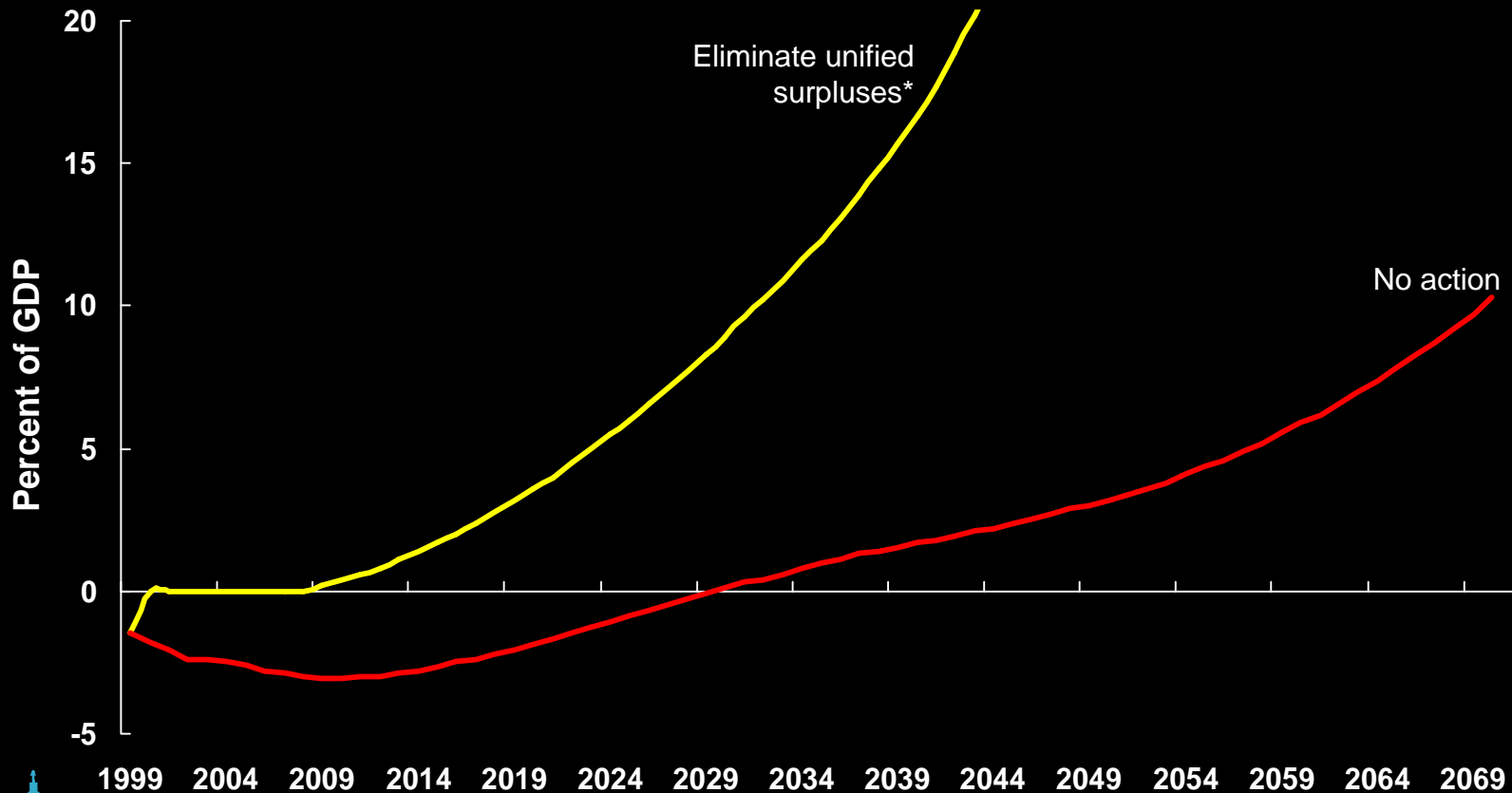


Note: Revenue as a share of GDP during the simulation period is lower than the 1998 level due to unspecified permanent policy actions that reduce revenue and increase spending to eliminate the unified surpluses.

*The "Eliminate unified surpluses" simulation can only be run through 2050 due to the elimination of the capital stock.

Source: GAO's Summer 1999 analysis.

Unified Deficits as a Share of GDP Under Alternative Fiscal Policy Simulations



*Data end when deficits reach 20 percent of GDP.
Source: GAO's Summer 1999 analysis.

Simulation Results and Observations

- Despite short-term improvements in the fiscal outlook, “No action” remains economically unsustainable over the long term due to the aging population and rising health care costs.
- “No action” incorporates several optimistic assumptions which may not be realized. These include continued tight fiscal restraint on discretionary spending, no emergency spending, a three-decade long period of negative federal debt, and moderation in Medicare cost growth.
- Substantive Social Security and Medicare reforms would have significant positive impact on the long-term economic and budget outlook.
- Entitlement reform is critical to restoring fiscal flexibility and improving intergenerational equity.



Evaluating Social Security Reform Proposals

- Comprehensive proposals can be evaluated against three basic criteria.
- Reform proposals should be evaluated as packages that strike a balance among individual reform elements and important interactive effects.
- Some proposals will fare better or worse than other proposals under each criterion.
- Every proposal has a number of pros and cons. Meaningful program reform requires tough choices.
- Overall evaluation of each proposal depends on the weight individual policymakers place on each criterion.



Criteria for Assessing Social Security Reform Proposals

- Financing Sustainable Solvency
- Balancing Adequacy and Equity in the Benefits Structure
- Implementing and Administering Reforms

Financing Sustainable Solvency

To what extent does the proposal:

- Reduce future budgetary pressures?
- Reduce debt held by the public?
- Reduce the cost of the Social Security system as a percentage of GDP?
- Reduce the percentage of federal revenues consumed by the Social Security system?
- Increase national saving?



Financing Sustainable Solvency

To what extent does the proposal:

- Restore 75-year actuarial balance and create a stable system thereafter?
- Raise payroll taxes, draw on general revenues, and/or use Social Security trust fund surpluses to finance changes?
- Create contingent liabilities?
- Include “safety valves” to control future program growth?



Balancing Adequacy and Equity in the Benefits Structure

To what extent does the proposal:

- Change current-law benefits for current and future retirees?
- Maintain benefits for low-income workers who are most reliant on Social Security?
- Maintain benefits for the disabled, dependents, and survivors?
- Ensure that those who contribute receive benefits?

Balancing Adequacy and Equity in the Benefits Structure

To what extent does the proposal:

- Provide higher replacement rates for lower-income earners?
- Expand individual choice and control over program contributions?
- Increase returns on investment?
- Improve intergenerational equity?

Implementing and Administering Reforms

To what extent does the proposal:

- Provide reasonable timing and funds for implementation and result in reasonable administrative costs?
- Allow the general public to readily understand its financing structure and increase public confidence?
- Allow the general public to readily understand the benefit structure and avoid expectations gaps?
- Limit the potential for politically motivated investing?



Evaluating Social Security Reform Proposals: Conclusion

- A proposal's ability to achieve and sustain solvency is sensitive to economic and budgetary assumptions.
- All proposals present trade-offs between unified budget results and benefit levels.
- None of the proposals fully address implementation and administrative issues.
- Proposals that guarantee benefits place the risk of financing those benefits on the government. Proposals that provide more choice and control to individuals may place individual benefits at greater financial risk while giving them an opportunity for higher returns.
- In any reform proposal, attention must be paid to the impact on poverty among the elderly.

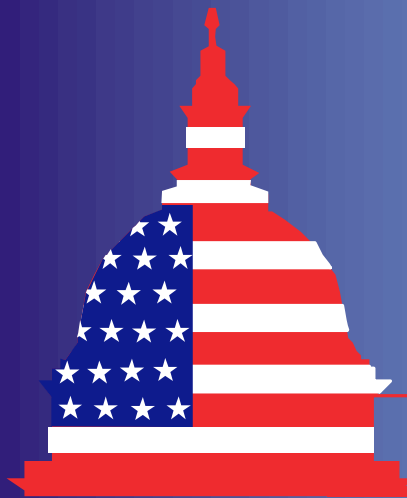


Opportunity and Obligation

- Unified budget surpluses present both an opportunity and an obligation.
- Today's fiscal and economic good fortune give us an opportunity to address the challenges of Social Security and Medicare reform--before the tidal wave of the baby boom's retirement.
- Our stewardship responsibility gives us an obligation to enact changes that improve prospects for future generations.
- Social Security reform that recognizes these factors can exceed the expectations of all Americans.
- Social Security reform is "easy lifting" compared to Medicare reform.



Social Security Reform



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