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CONGRESSIONAL TESTIMONY

Facing America's Long-Term Entitlement Challenges Laid Out in the Financial Report of the United States Government

Testimony before
The Subcommittee on Government Management, Organization, and Procurement
House Committee on Oversight and Government Reform

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My name is Brian Riedl. I am the Grover M. Hermann Fellow in Federal Budgetary Affairs at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

The most striking part of the *2008 Financial Report of the United States Government* is not the balance sheets showing total assets of $2 trillion dwarfed by total liabilities of $12 trillion. Rather, it is the Statements of Social Insurance, which show $43 trillion in excess future expenditures over future revenues for Social Security and Medicare. Indeed, the Statement of the Comptroller General notes the need for the nation's leaders to "turn their attention to the long-term challenges of addressing the federal governments large and growing structural deficits" and warns that "the federal government is on an unsustainable long-term fiscal path.[1]"

As a member of the bipartisan Fiscal Wake-Up Tour that consists of representatives of the Concord Coalition, Heritage Foundation, and Brookings Institution, and former United States Comptroller General David Walker, I have spoken to thousands of Americans at public town hall meetings from coast to coast on the need to reform these entitlements. I will share with you what I have shared with these audiences.

First, in the short term, President Obama has offered a budget that would increase federal spending to a peacetime-record 24.5 percent of GDP by 2019 – not even counting the health care plan. Because tax revenues cannot keep up with this spending growth, the President's budget would add $9.1 trillion in new debt over the next decade. It would double the national debt to 82 percent of GDP by 2019.

[1] U.S. Department of the Treasury, *2008 Financial Report of the United States Government*, at *http://www.gao.gov/financial/fy2008/08frusg.pdf* pp. 29, 39-41.

By steeply increasing spending, and digging the nation deeper in debt, the President would leave the nation with less financial flexibility and fewer resources to deal with the $43 trillion shortfall that Social Security and Medicare face over the next 75 years.

The basic entitlement challenge is as follows: The first of 77 million baby boomers have already begun retiring. Combined with longer life spans, these retirements drive down the ratio of workers supporting each retiree. In 1960, five workers funded the benefits of each retiree. Today that ratio is 3:1, and by 2030 it will be just 2:1. To understand what a 2:1 worker-to-retiree ratio means, imagine a boy and a girl born today, in 2009. In 2030, they marry and start a family. This young couple will have to support themselves, their children – and the Social Security and Medicare benefits of their very own retiree. The costs will be enormous, especially given the steep rise in health care costs that plagues Medicare. The baby boomers' long-term care expenses will also drive Medicaid costs upward as well.

Overall, the combined cost of Social Security, Medicare, and Medicaid is projected to rise by 10 percent of GDP – from 8.4 percent to 18.4 percent of GDP – by 2050. In the absence of reform, these costs must be financed by raising taxes, slashing other government programs, or running ruinous budget deficits.

First, let's examine the tax increase option. Raising taxes to close that 10 percent of GDP gap would be economically devastating. In today's economy, a 10 percent of GDP tax increase would cost $12,000 per household annually. According to the Congressional Budget Office, the middle class would be pushed into a 63 percent income tax bracket, the wealthy into an 88 percent bracket[2] – and even that assumes health care cost growth slows down. And allowing the

[2] Peter R. Orszag, Director, Congressional Budget Office, letter to Representative Paul Ryan (R–WI), May 19, 2008, at *http://www.cbo.gov/ftpdocs/92xx/doc9216/05-19-LongtermBudget_Letter-to-Ryan.pdf*

2001 and 2003 tax cuts to expire – including those that currently benefit low-income families – would close just one-tenth of the long-term gap.

A second option would finance these entitlements by cutting other programs. Surely, there are candidates for spending cuts. But in order to make room for the "big 3" entitlements, every remaining program except defense would have to be eliminated by 2030. And by 2049, defense would have to be eliminated as well. At that point, 100 percent of the federal budget would have to go towards Social Security, Medicare, Medicaid, and net interest.

The third option, simply running budget deficits, is no better. Borrowing an additional 10 percent of GDP annually – the equivalent today of $1.4 trillion – would drive the national debt to levels unseen in history, and create a vicious circle of rising interest rates and debt, resulting in economic collapse.

The only real option is to reform Social Security, Medicare, and Medicaid. An entitlement reform commission, such as the SAFE Commission[3] proposed by Congressmen Jim Cooper (D–TN) and Frank Wolf (R–VA), could design sustainable entitlement reforms and allow Congress to vote up or down on the package.[4] The Breaux–Thomas Bipartisan Medicare Commission of 1997 is another example, but unfortunately, their strong reforms were not adopted.

Some have asked why Congress should worry now about long-term costs. These "big 3" entitlements already consume 42 percent of regular federal spending. More importantly, every year of delay raises the final reform cost by about $1 trillion, as higher Social Security benefit levels and Medicare costs become locked in. Furthermore, many believe that anyone over age 55

[3] H.R. 1557.
[4] Alison Acosta Fraser, "The SAFE Commission Act (H.R. 3654) and the Long-Term Fiscal Challenge" Heritage Foundation Testimony before Committee on the Budget, United States House of Representatives, June 25, 2008 at *http://www.heritage.org/Research/Budget/tst062508b.cfm*

should be exempt from entitlement reforms. Yet every year, 4 million more baby boomers cross that threshold. By 2019, all 77 million baby boomers will have turned 55. So if we don't want to pull the rug out from underneath baby boomers over age 55, lawmakers must begin reforming these programs as soon as possible. Tackling reforms immediately will reduce their ultimate costs, spread the burden across more people, and give baby boomers more time to adjust their retirement strategies.

Nor does the Social Security Trust Fund reduce these long-term obligations. Yes, the Social Security Trust Fund likely guarantees that full benefits will be paid through 2037. But without any actual economic assets in the trust fund, the painful tax increases or spending cuts will need to begin in 2016 when the Social Security program falls into deficit. The trust fund does not reduce the burden on future taxpayers at all.

The challenge of financing retirement benefits is perhaps the greatest economic challenge of our era. Unless lawmakers promptly reform Social Security, Medicare, and Medicaid, America faces a future of soaring taxes and government spending that will cause poor economic performance. Americans will pay onerous taxes, and future generations will have lower living standards than Americans enjoy today. The longer lawmakers wait to enact the necessary reforms, the more painful those reforms will be. Thank you.

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