

PART II

DEMOGRAPHICS IS DESTINY

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CHART 20

The Baby Boomers and the U.S. Population in 1960, 1990, 2030

- Over the long-term, the fiscal picture is much gloomy. In a nutshell, the aging of America threatens to undo all the recent progress that has been achieved — unless actions are taken now to moderate the impact gradually, fairly, and equitably.
- The U.S. historically has been a nation of young people. Our population chart looked like a pyramid in 1960, with huge numbers of children and youth, and a very small number of people in their 70s and 80s.
- The 76 million baby boomers born between 1946 and 1964 changed the shape of our population. Their ranks swelled the size of the work force in the 80s and 90s and will continue to do so in the first decade of the 21st Century.
- But when the boomers move into their 60s, 70s, and 80s, their large numbers will change the shape of our population from a pyramid to something more akin to a column.

By 2030, there will be as many people age 80 and older as age 5 and younger.

To get an idea of how much the number of seniors will grow by the time the youngest Baby Boomers are in their 70s, think of the entire population of California today plus that of all the New England states combined.

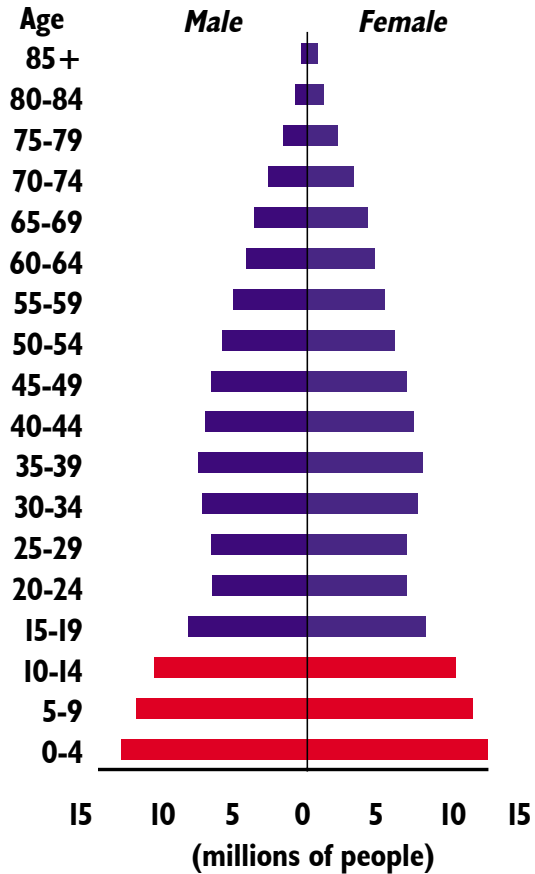
By 2040, the number of seniors will be at least double what it is today.

In 1900, only one in 25 Americans was over 65. The vast majority were completely self-supporting or supported by their families. By 2040, one out of every four or five Americans will be over 65, the vast majority supported to some degree by government.

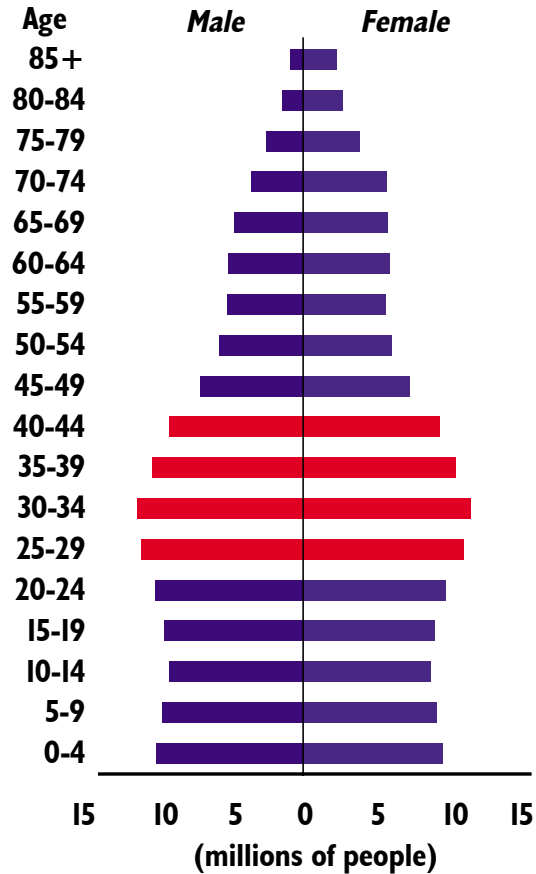
The number of “young old” aged 65 to 69 is projected to double over the next half century, but the number of “old old” aged 85 and older is projected to triple or quadruple.

The Baby Boomers and the U.S. Population in 1960, 1990, 2030

**United States Population in 1960:
Boomers (in red) Arrive
76 Million Strong**



**United States Population in 1990:
Boomers (in red)
Dominate the Workforce**



**United States Population in 2030:
Boomers (in red)
in Retirement**

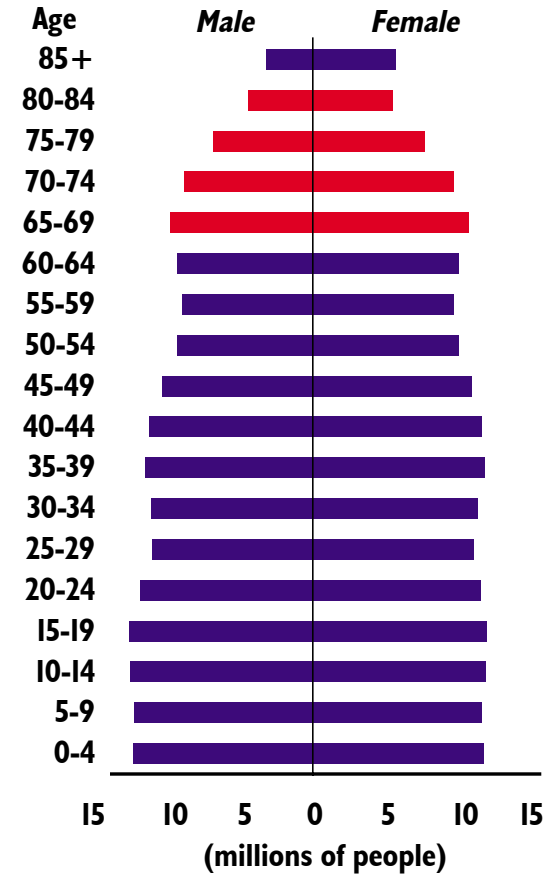


CHART 2I

America is Projected to Become a Nation of Floridas

- By the mid-2020s, the U.S. will be, on average, as old as Florida is today. Someone observed that there might be more people using walkers than in baby strollers.
- There are several reasons why America will be getting older.
- One reason we have already discussed: the baby boomers will be reaching retirement age.
- We are currently enjoying the lull before the storm. The percentage of people in the U.S. aged 65 and older has been about 12 percent in recent years, and it's expected to remain at 12 percent or so, for another decade.
- Then, when the huge wave of boomers begins reaching age 65 in 2011, the percentage of our population 65 and older will begin to increase dramatically.
- But that will not be a temporary phenomenon. If it were only temporary, it would be only a short term problem. We could just hunker down, pay the bills, borrow some money if necessary, get through it, and eventually return to "normalcy."
- But we expect that the Aging of America will be *permanent*. This change will begin when the baby boomer begin turning 65.

America is Projected to Become a Nation of Floridas

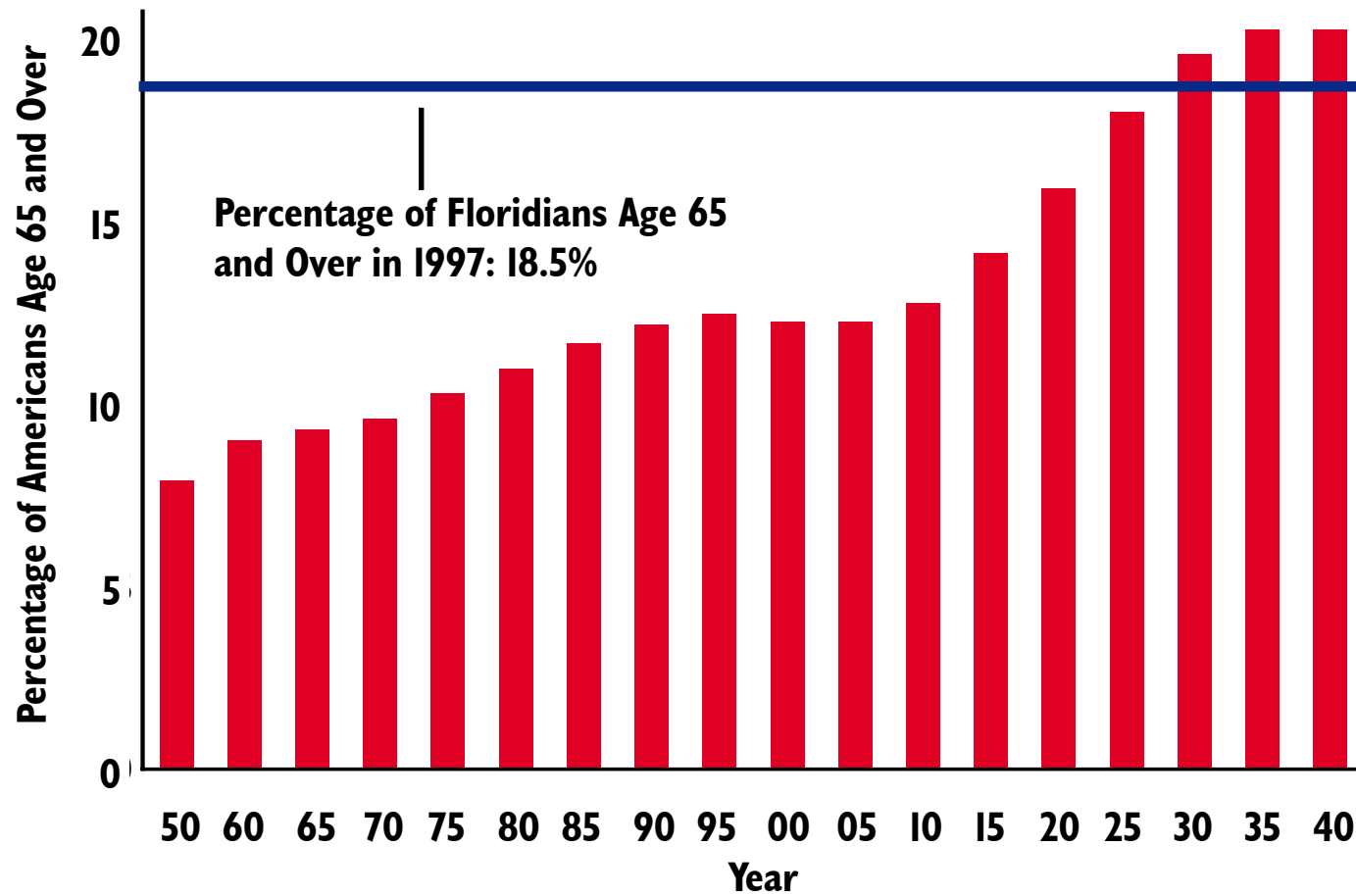


CHART 22

Fertility in Every Developed Country Has Fallen Beneath the “Replacement” Rate of 2.1

- We no longer have an ever-widening base of babies, children and youth at the bottom of the chart. Unless we go back to families with 3, 4 and 5 children on average, we never will again will have a population pyramid.
- Instead we see that fertility rates are steadying out at around 2 children born for each woman on average. This is slightly less than the 2.1 replacement rate required to keep population level.
- The official estimates of the Social Security trustees assume U.S. total fertility will decline to 1.9 births per woman and stay there indefinitely.
- However, many industrially developed nations have seen their fertility rates drop even lower. Canada, our closest neighbor, now has a fertility rate of 1.6 per woman.

Fertility in Every Developed Country Has Fallen Beneath the “Replacement” Rate of 2.1

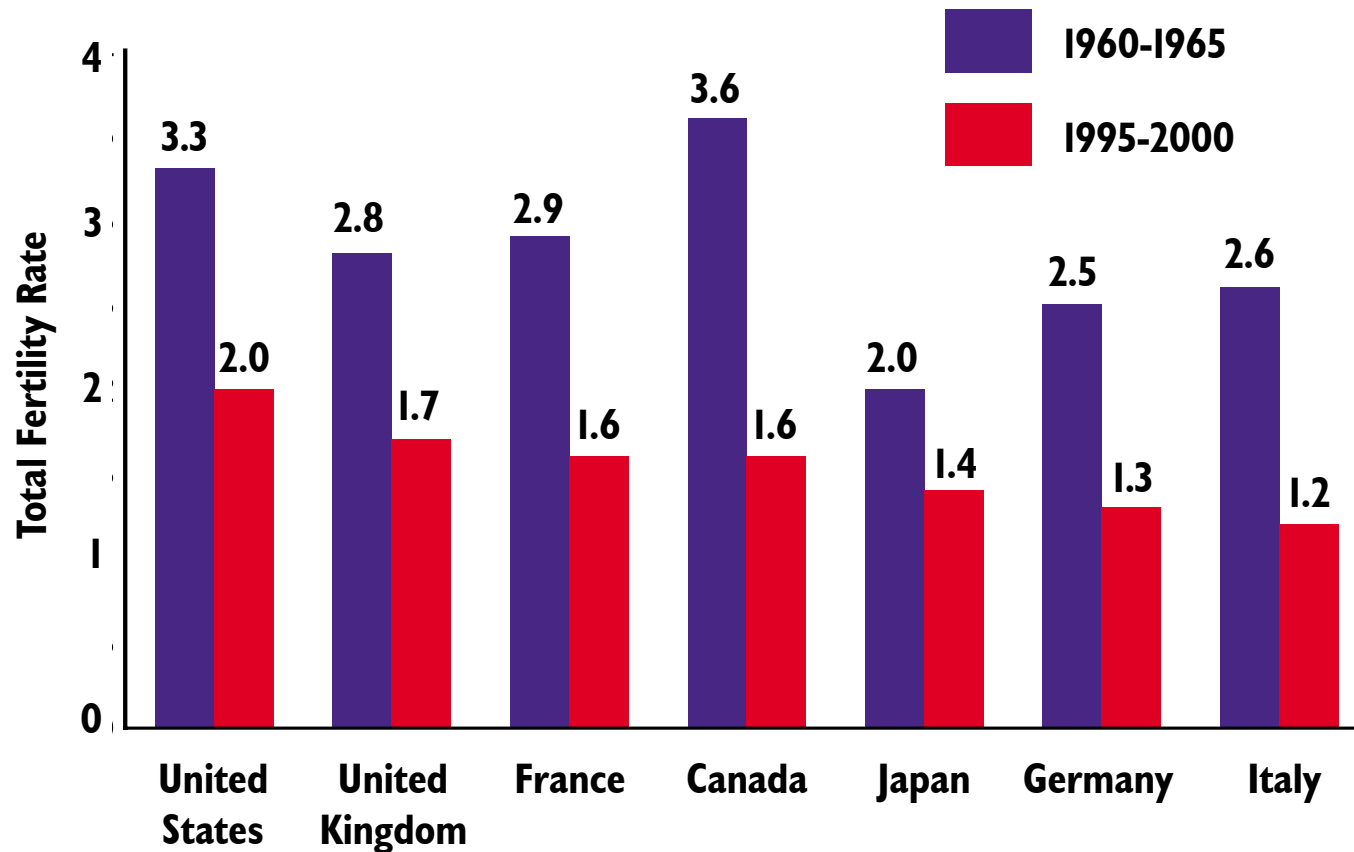


CHART 23

Life Expectancy at Birth Continues to Rise

- The other reason we will never return to a pyramid is that the 65-and-over people at the top of the pyramid no longer form the tiny little triangle they once did.
- Life expectancy has lengthened considerably thanks to improvements in public health, nutrition, antibiotics, and other factors that make it possible for more people to live longer.
- The actuaries at the Social Security Administration expect that longevity will continue to increase slowly. Their projected rates of increase might be overly pessimistic — for example, they figure it will take until 2050 for people in the U.S. to attain the life expectancy enjoyed by people in Japan today. A number of demographers have made credible cases that longevity may increase significantly faster than the official forecasts.

Life Expectancy at Birth Continues to Rise

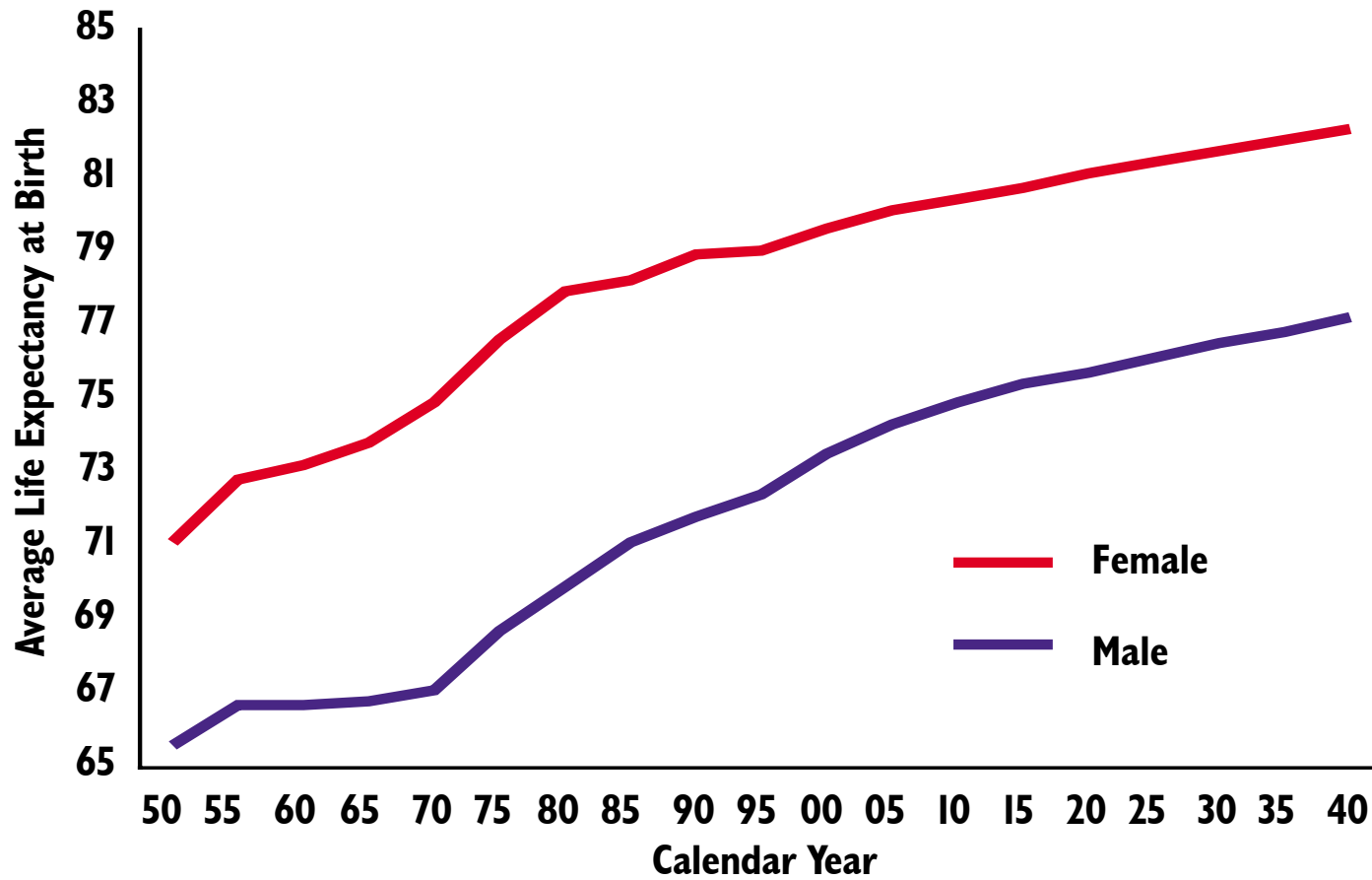


CHART 24

Life Expectancy at Age 65 Is Also Increasing

- Even more astonishing is what is happening to life expectancy for people who have reached age 65.
- The number of years a 65-year-old can expect to live has increased dramatically, thanks to the better general health of Americans overall, but also to medical developments that now enable people to live longer.
- In 1950, a person turning 65 could expect to live another 14 years. Today, a 65-year-old has a remaining life expectancy of almost 18 more years.
- This is good news, but not for the nation's ability to finance retirement income and health insurance programs.

Life Expectancy at Age 65 Is Also Increasing

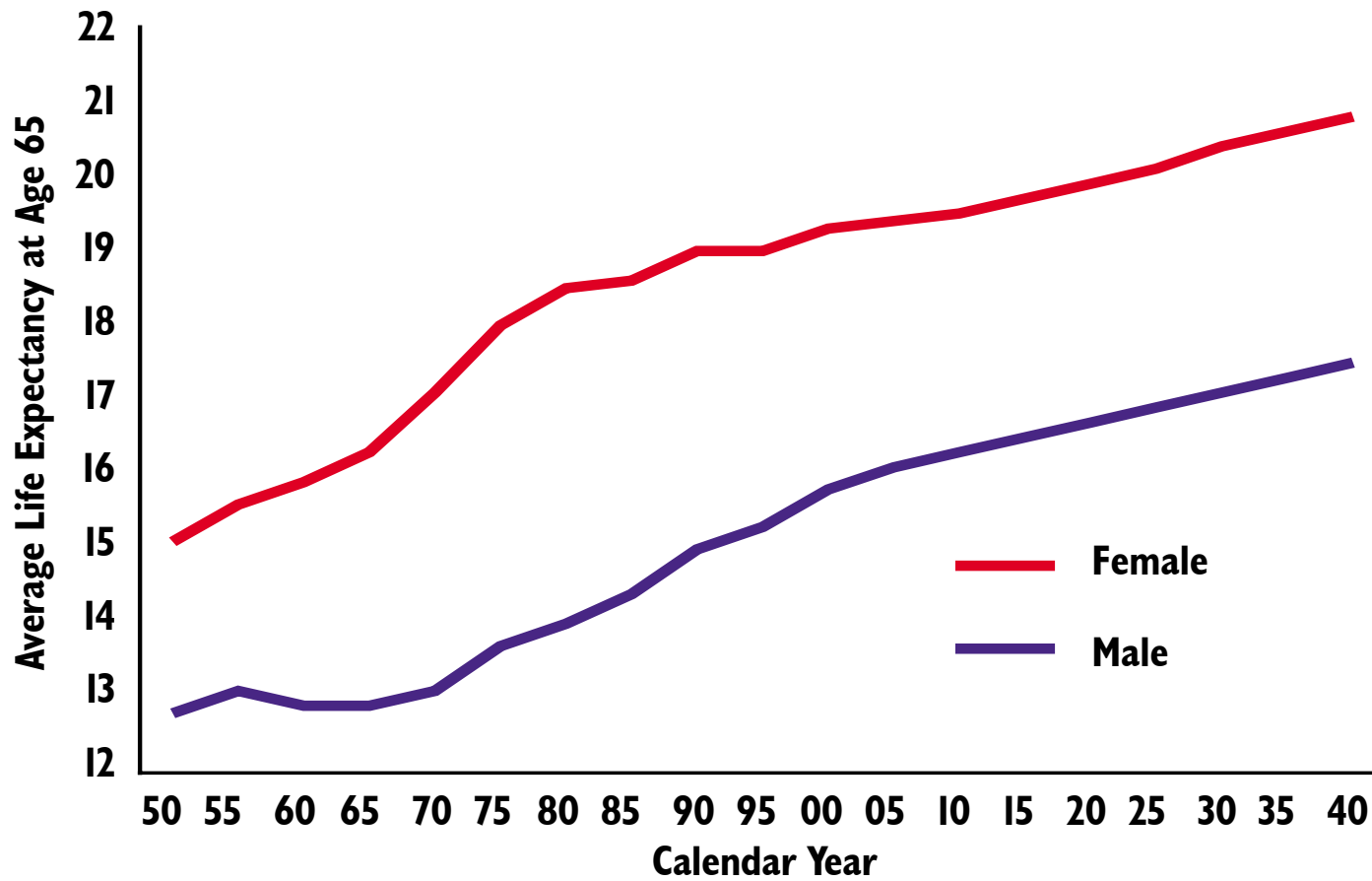


CHART 25

The Number of Workers Per Beneficiary Is Falling

- The combination of a birth rate at barely the replacement rate, coupled with increasing longevity, means that the number of working-age people is declining relative to the number of people receiving benefits.
- In 1960, there were more than 5.1 workers per beneficiary. Today the ratio is three to one. By 2030, when the boomers have all retired, there will be scarcely two workers for each beneficiary.
- If “your” two workers are Bill Gates and Warren Buffett, you’ll be fine. But most 2030 retirees will depend on two young workers in their children’s or grandchildren’s generation struggling to raise their own families while contributing enough payroll tax and income tax to finance their elders’ Social Security and Medicare benefits.

The Number of Workers Per Beneficiary Is Falling

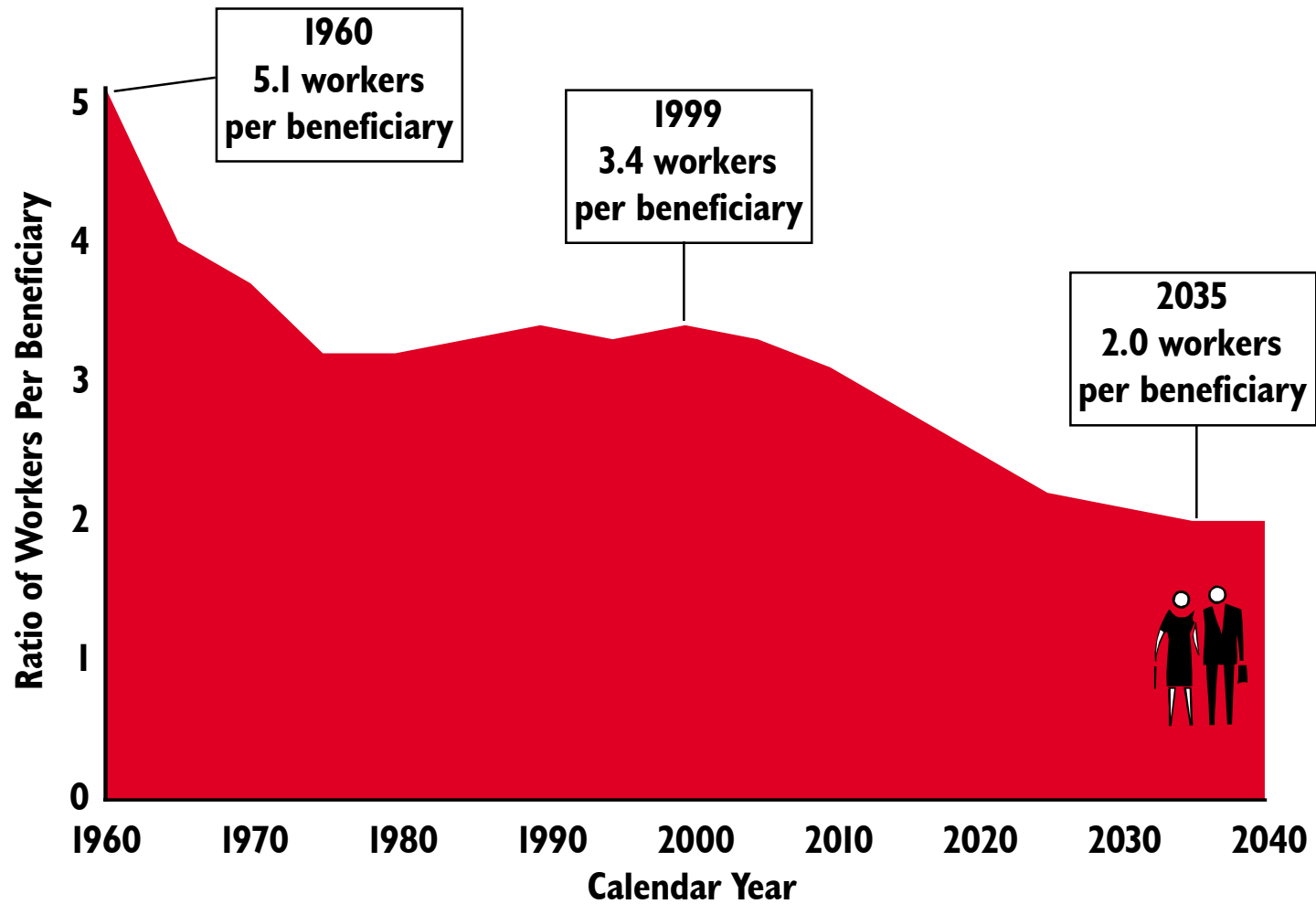


CHART 26

Social Security Is Unsustainable In Its Present Form

- For Social Security, the changing population dynamics spell serious problems ahead. Today, benefits cost less than the taxes flowing into the program (shown as the blue line.)
- When the boomers begin turning 65, that surplus turns into a quickly mounting deficit.
- By 2030, Social Security benefits will cost nearly *18 percent* of the taxable payroll of working age citizens, compared to slightly more than *11 percent* today.
- Costs are expected to continue rising even after the boomers have all retired. By 2060, benefits will cost *19 percent* of payroll, and by 2075, the end of the official forecasting window, benefits are expected to cost nearly *20 percent* of payroll. In other words, paying for all promised benefits would require a 50% increase in Social Security payroll contributions over today's level.
- Under the more pessimistic high-cost projections, benefit costs would soar to a staggering *29 percent* of payroll.

Social Security Is Unsustainable In Its Present Form

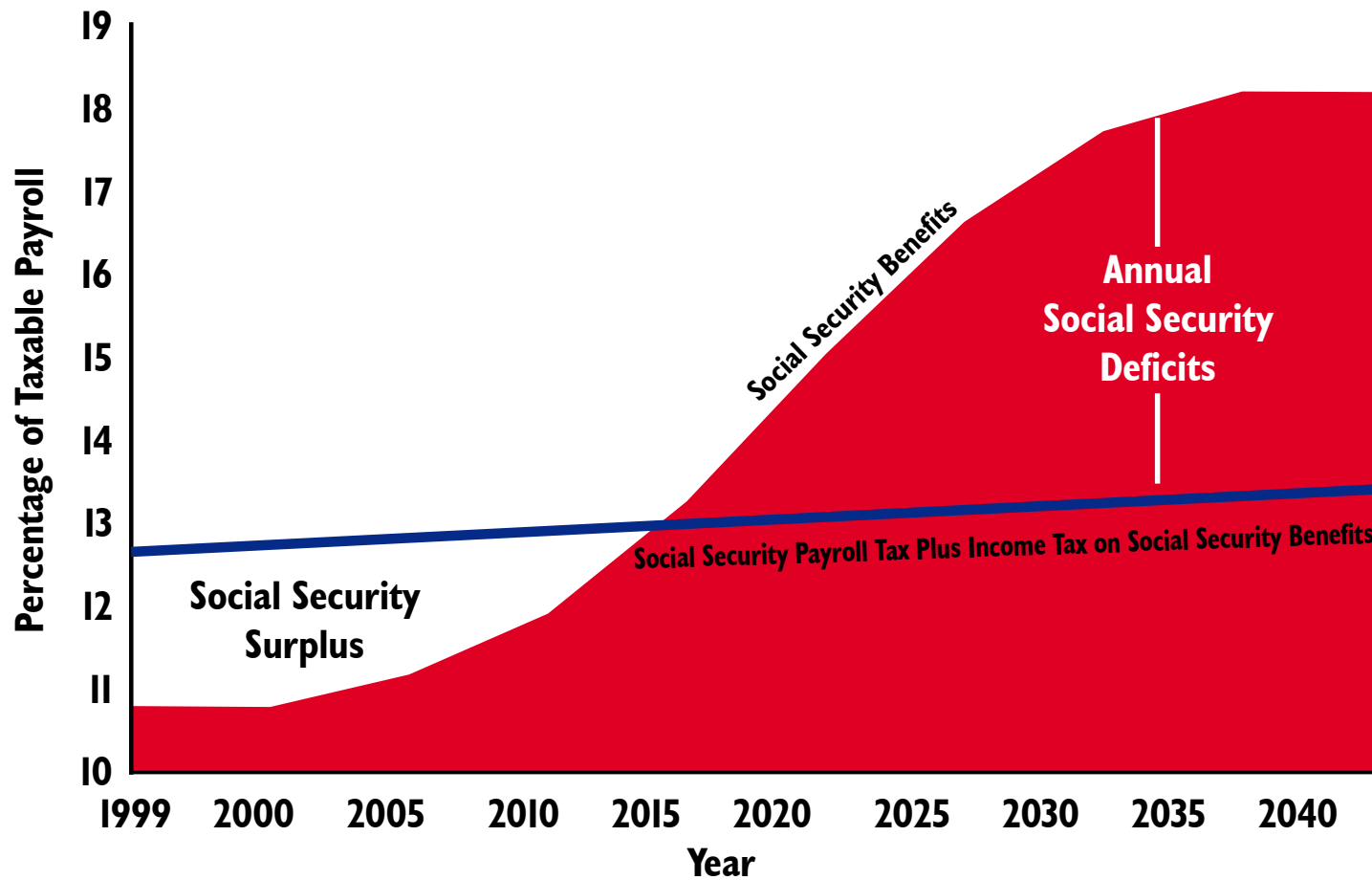


CHART 27

Social Security Will Begin Running Cash Deficits in 2014

- Shown in terms of today's dollars, the picture is equally dismal. What is now a \$70 billion cash surplus will become a gaping annual cash deficit. In 2020, the deficit for that year will be nearly \$105 billion. By 2030, the annual deficit will have grown to \$253 billion.
- Current cash surpluses are now invested in Federal Treasury Bonds. When boomers retire and the system begins to run short of money to pay benefits, the bonds can be cashed in to cover boomers' benefits.
- Such a plan makes sense for programs like unemployment compensation that fluctuate between surplus and deficit according to the economic cycle and unemployment rates. Money can be saved when unemployment is low to pay benefits when unemployment is high. But Social Security's dynamics are not governed by the economic cycle as much by demographics:

For Social Security, the pattern will be a few more years of demographic good times with a relatively small number of retirees and an unusually large number of working age Americans at the peak of their earning years.

Then, starting in 2008, the first boomers turn 62 and begin claiming early Social Security benefits.

By 2014, give or take a year or two, crossover will occur: taxes paid into Social Security will no longer be sufficient to finance benefits.

But unlike cyclical programs such as unemployment compensation, the picture never will improve. The number of retirees will continue to grow inexorably, putting the system further and further into the red. There will be no turn around point.

- It is true that the bonds held by the Trust Fund are solid assets. But they are at the same time a liability for future taxpayers. When the time comes to cash in the bonds, taxpayers that year will have to supply the cash to make good on those debt obligations.
- How will they do this? By raising taxes, cutting other spending, or trying to borrow the money. Or, the worst alternative of all, deliberately boosting inflation so the value of what is owed will not be so burdensome.

Social Security Will Begin Running Cash Deficits in 2014

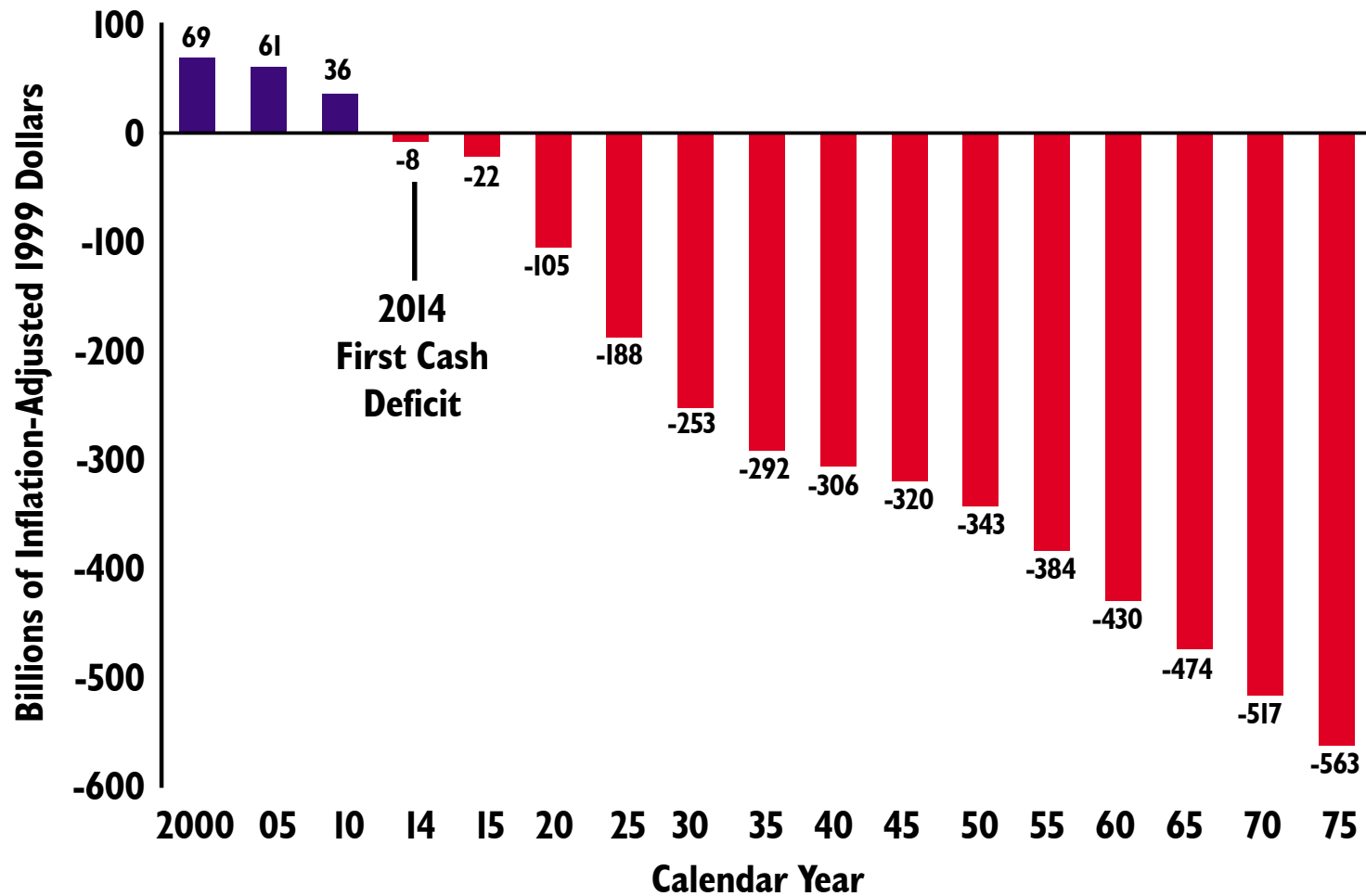


CHART 28

Medicare Explosion = Aging Population X Healthcare Inflation

- Of course, the aging of America involves Medicare as well as Social Security. For many retirees, having government-paid health insurance is perhaps even more important to their economic security and peace of mind than Social Security's cash benefits.
- The **blue** portion of each bar shows how much Medicare costs would increase in the future due to more beneficiaries in the system. In the future, increasing numbers of beneficiaries are expected to account for *only half* of Medicare's spending growth.
- The **red** portion indicates the additional growth in Medicare costs due to the ever-increasing intensity of medical services. On average, the per person cost of Medicare will rise in real terms simply because medical science's advances and new technologies make possible diagnoses and sophisticated treatment that were unimaginable even a decade ago.

Medicare Explosion = Aging Population X Healthcare Inflation

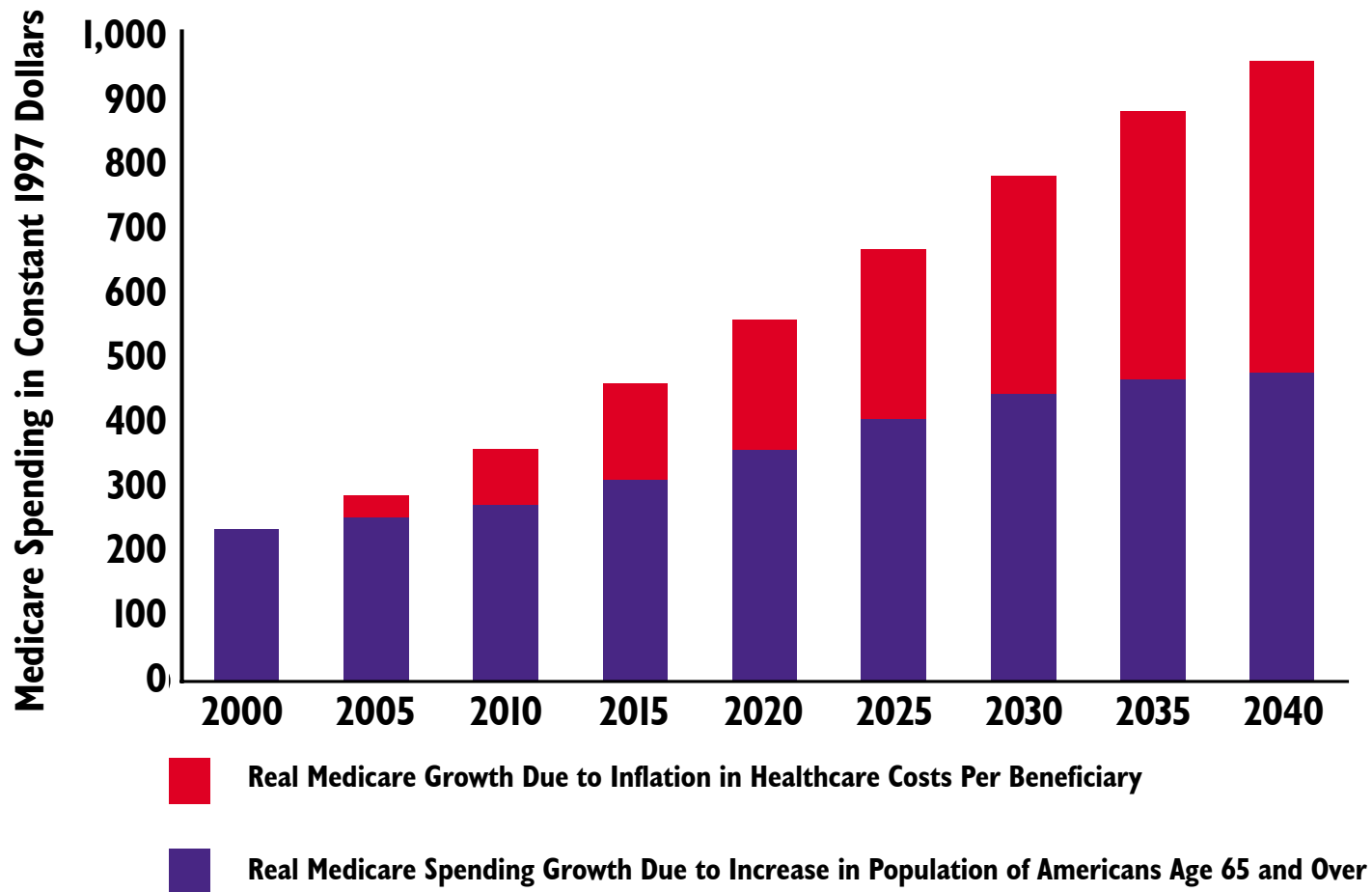


CHART 29-A

Medicare is Unsustainable in its Present Form

- The double whammy of more beneficiaries plus higher cost per beneficiary makes Medicare costs just as unsustainable as Social Security costs.
- *The **black** portion of each bar shows the current and future deficits in Part A of the Medicare program.* This is the part of Medicare that provides hospitalization insurance. It is financed through a 2.9 percent payroll tax.

Medicare Part A has been running annual cash deficits since 1992. The shortfall is made up each year by cashing in some of the Treasury bonds acquired by the program when it ran surpluses.

It is expected that the last bonds will be used up in 2008, often called the Medicare “bankruptcy” date. But the program is already running cash deficits.

Currently, Part A costs about 3.4 percent of payroll. The program’s income from payroll taxes and taxes paid on Social Security benefits equals 3.02 percent of payroll, leaving a gap of 0.38 percent.

By 2030, this cost will have grown to almost 6 percent of payroll, and by 2070, to nearly 8 percent of payroll.

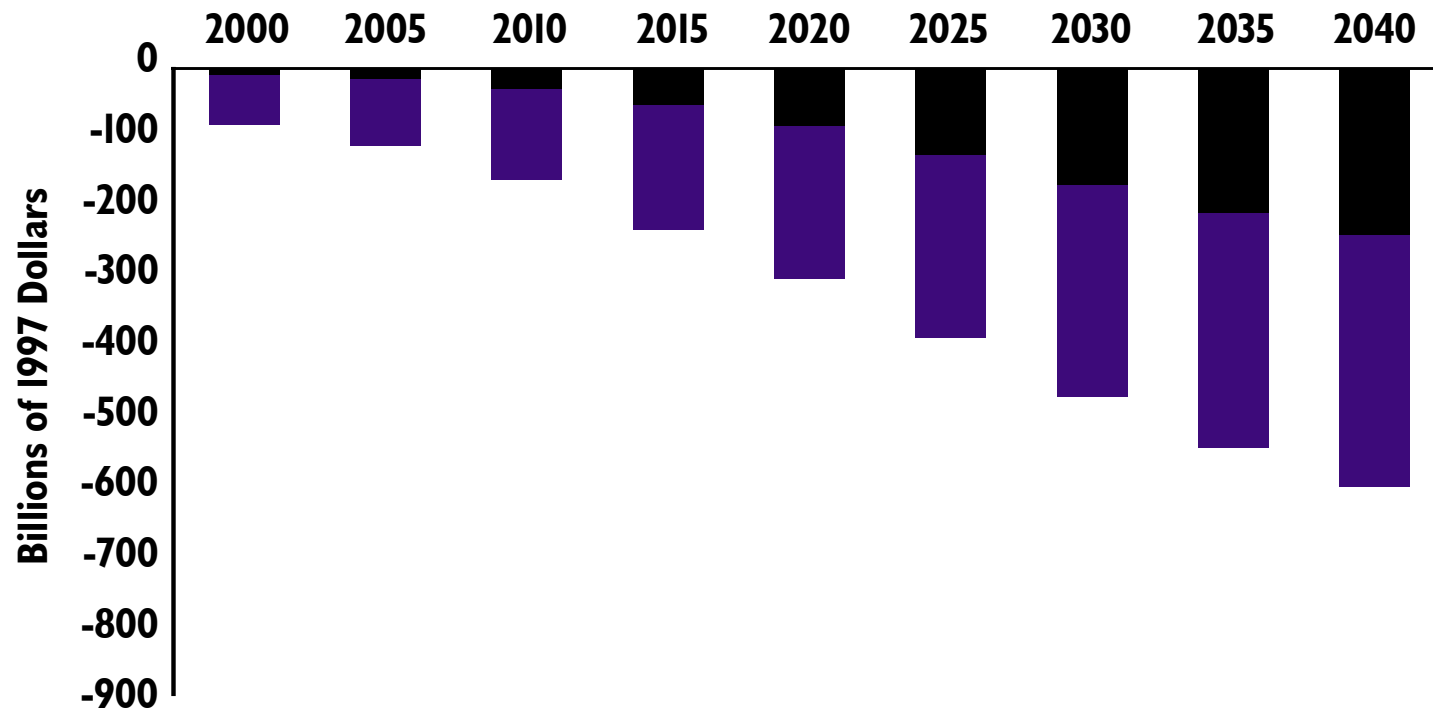
- *The **blue** portion of each bar represents the annual deficit in the Medicare Part B program.* This part of Medicare is called Supplemental Medical Insurance.

It covers physician’s services, diagnostic services, durable medical equipment (pacemakers, wheel chairs, hospital beds), hospital outpatient services, and home health services. It also covers end stage renal disease regardless of beneficiaries age.

Part B is financed by beneficiary premiums that are set at 25 percent of total costs. The premium currently runs about \$50 per month and most beneficiaries have it deducted automatically from their Social Security checks. The other 75 percent is financed through federal general revenues.

The **blue** portion of each bar shows the increasing shortfall in the Medicare Part B program.

Medicare is Unsustainable in its Present Form



- Medicare Hospital Insurance (Part A) Annual Deficit
- Medicare Supplemental Medical Insurance (Part B) Annual Deficit

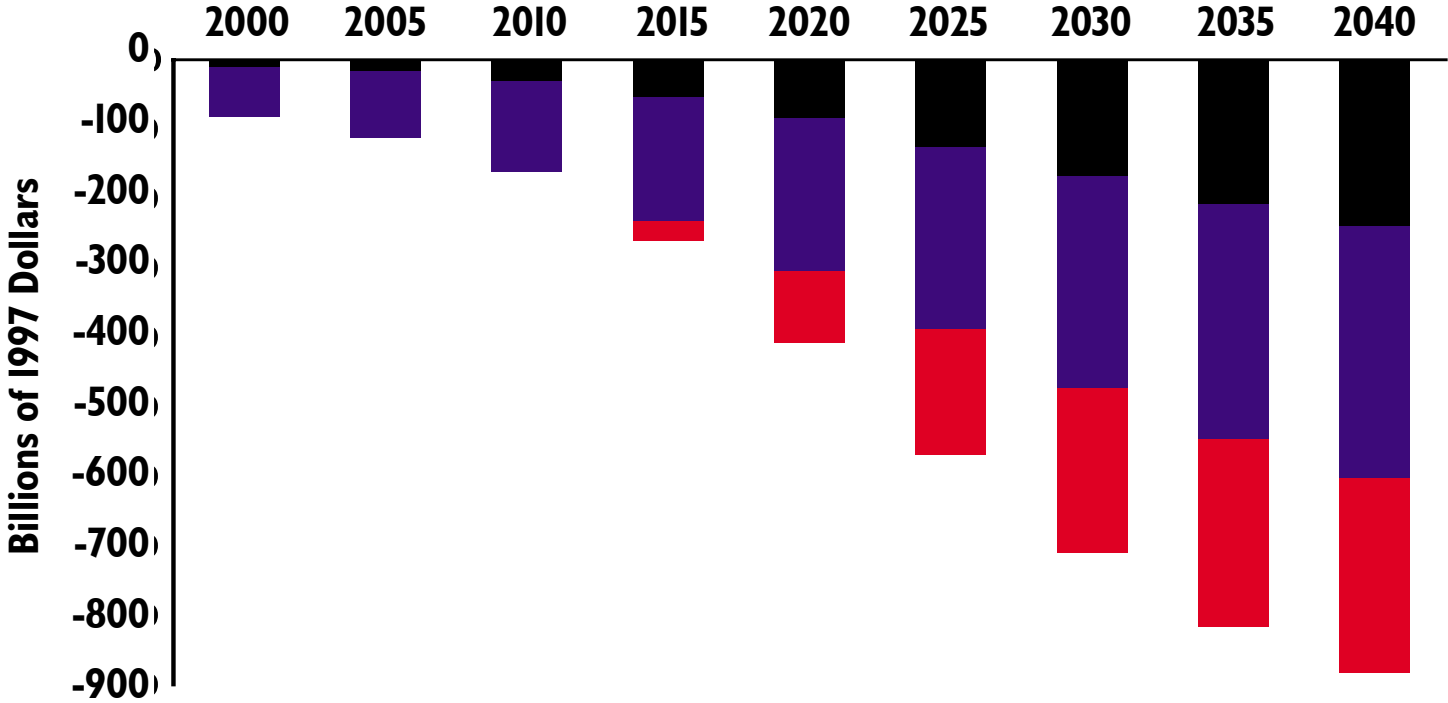


CHART 29-B

Medicare and Social Security Combined Are Unsustainable

- When Medicare's annual deficit and Social Security's annual deficit are added, it is clear that the combined programs are on an unsustainable path.
- The combined costs for all three elements are poised to grow exponentially as the population ages.
- These figures, of course, do not include the portion of Medicaid that specifically helps the elderly by financing nursing home care for elderly people who have used up (or given away) their financial resources, and by paying some or all of the Part B premium, deductibles and copayments for low income seniors.
- If this were added in, the liabilities would run more than 800 billion dollars a year (in current dollars) by 2040, or about half of all federal spending.

Medicare and Social Security Combined Are Unsustainable



- Social Security Annual Deficit
- Medicare Supplemental Medical Insurance (Part B) Annual Deficit
- Medicare Hospital Insurance (Part A) Annual Deficit

CHART 30

The Growth of Entitlement Programs is Unsustainable

- Cascading costs of senior benefits add up to an unsustainable trend. Therefore, Chart 29 is not a picture of where we are headed. Instead it is a picture of what would happen if we did nothing. And it explains why doing nothing is the one option we do not have.

If revenues remain at about 20 percent of GDP, which is on the high side historically, the nation's finances will be fine for another decade or so.

The surplus depicted in 2010 assumes that discretionary spending, (shown in gray), will decline as a percent of GDP and subsequent bars assume that discretionary spending will never again rise. That is an optimistic assumption and does not allow for war or other unexpected events.

The surplus in 2010 also assumes that budget surpluses between now and then will be used to pay down some of the nation's \$5.5 trillion public debt and that interest costs will therefore shrink. If the debt is not reduced, of course, the red bar in 2010 and 2020 will be larger.

By 2030, 2040, and 2050, entitlements plus reduced discretionary spending will cost more than 20 percent of GDP.

This chart assumes that spending is not reduced and that to cover costs, the shortfall is made up by borrowing. Therefore by 2050, interest will become the government's largest spending category.
- Analysts at the Congressional Budget Office produce tables tracking these trends. Beyond 2050, 2060 and 2070, their tables show "n.c." rather than dollar amounts. This, they explain, stands for "not calculable." Or as one analyst observed, it really means "fiscal meltdown."
- Quite simply, the U.S. would not be able to service debt of the magnitude reflected on this chart. And just as obviously, no one would be willing to lend the money in the first place. The hemorrhage would be permanent; the problem would not be self-correcting. Other industrialized nations that now supply capital to the U.S. will have more rapidly aging societies than our own and will themselves be strapped for cash.

The Growth of Entitlement Programs is Unsustainable

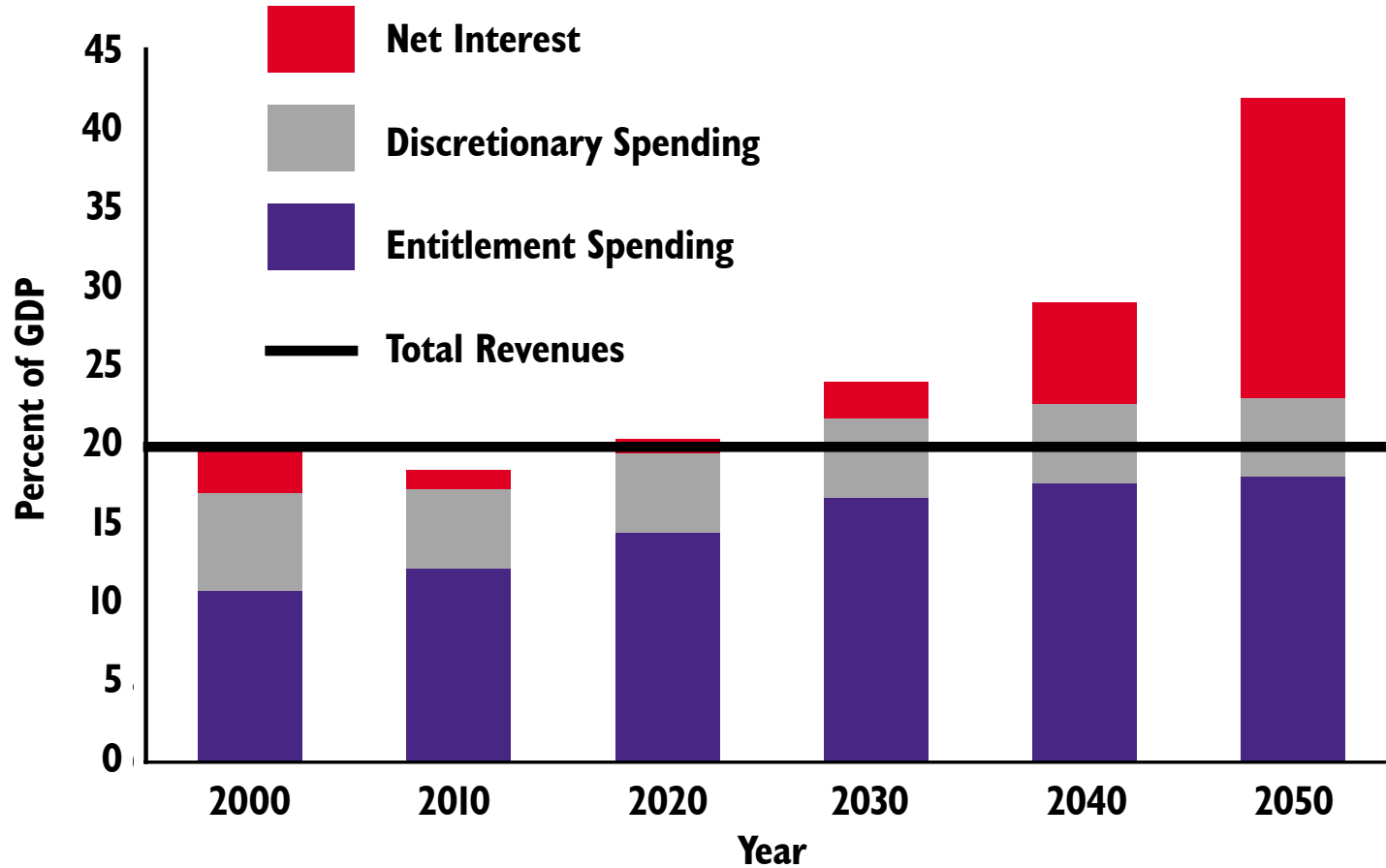


CHART 3I

The National Debt Continues to Grow: 1962-1998

- This chart shows the total national debt, including debt owed to Social Security and other trust funds.
- The national debt has grown incredibly over the past 20 years.
 - from about \$1 trillion in 1981 as President Reagan's first term began,
 - to \$1.6 trillion as Reagan's second term began,
 - to \$2.3 trillion as President Bush's term began,
 - to \$3.9 trillion as President Clinton's first term began,
 - to \$5.1 trillion as President Clinton's second term began.
- Despite all of the talk about "surpluses," the national debt continues to grow. By the time President Clinton leaves office, the debt will probably be \$5.7 trillion.

The National Debt Continues to Grow: 1962-1998

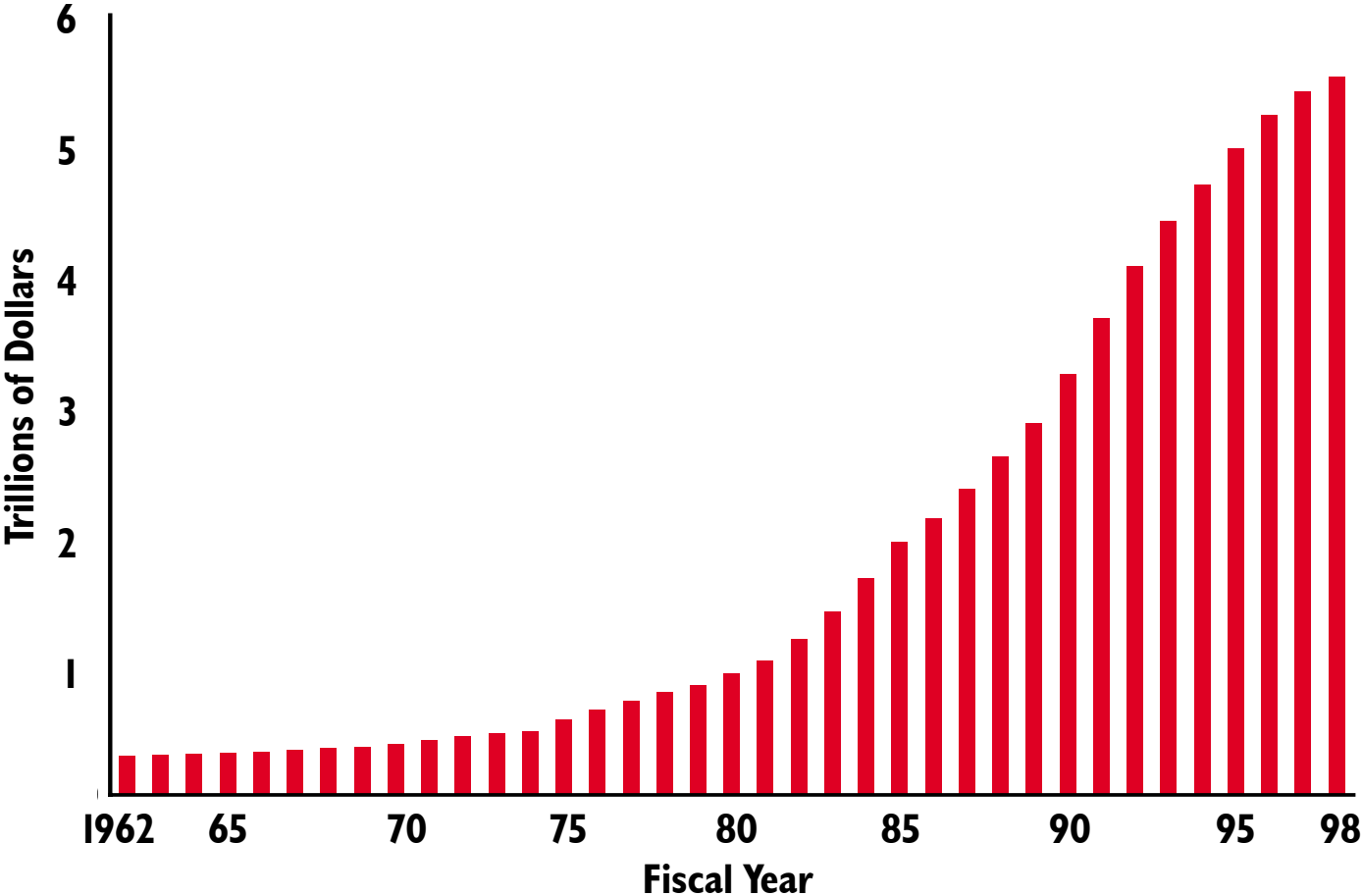


CHART 32

Interest Payments on the Total Public Debt, 1962-1999

- Interest costs have risen along with the debt.
- Fortunately, the economy has grown faster during the current expansion than our interest costs, so interest costs as a percent of GDP have moderated.
- Nevertheless, more than 4 percent of the nation's GDP still goes to pay interest charges on the total public debt.

This is a larger share of GDP than we spend on defense.

And it is a larger share of GDP than we spend on all domestic discretionary programs.

Interest Payments on the Total Public Debt, 1962-1999

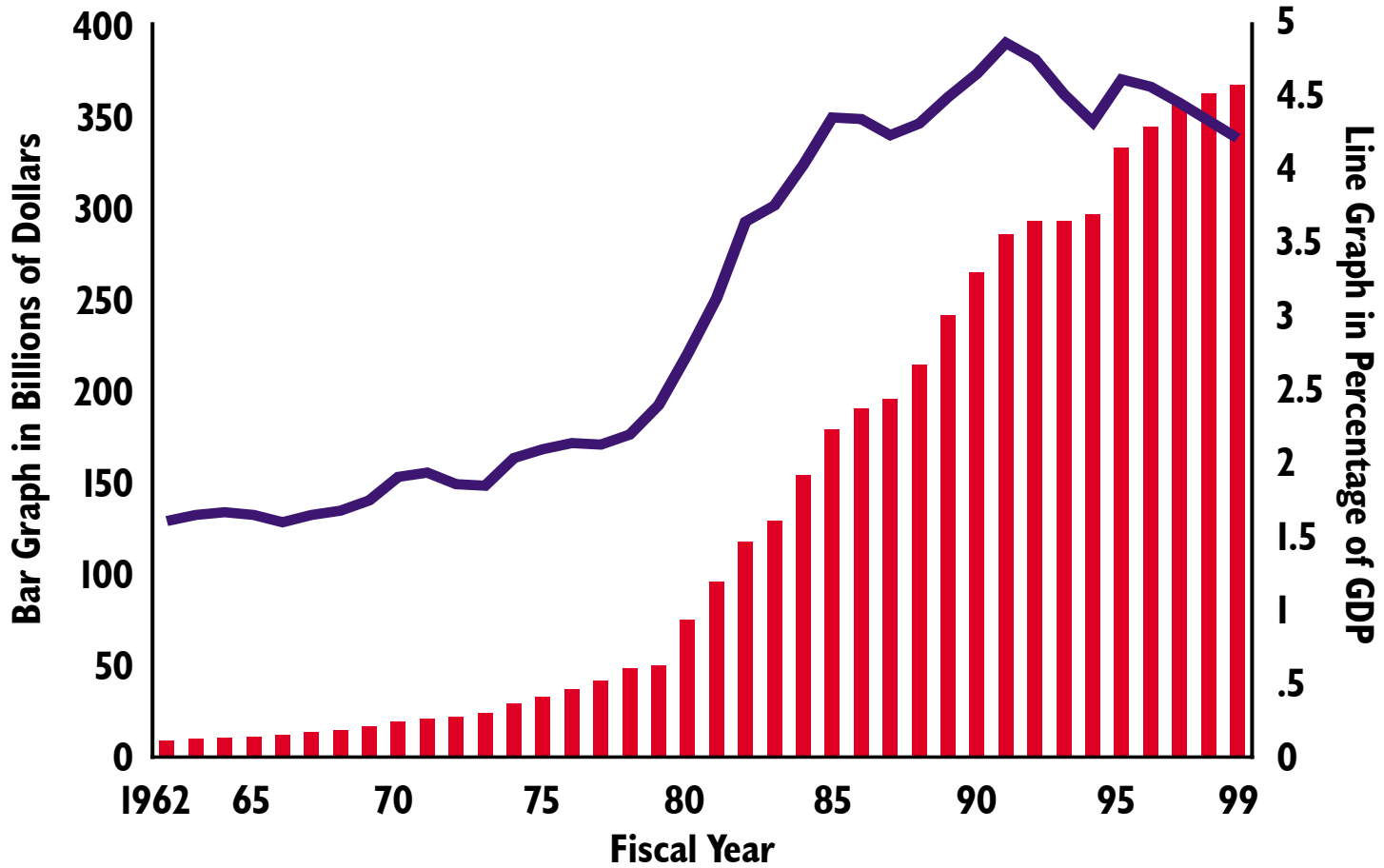


CHART 33

Course of Federal Debt Under Present Law, 1998-2009

- With surpluses around the corner for Social Security and also for the rest of government, the debt owed to the public will stop growing and will begin to shrink.
- Over the next ten years, if all projected surpluses are used to pay down the debt, the debt owed to the public will decline from \$3.7 trillion at the end of 1998 to \$1.2 trillion at the end of 2009. (Blue Line)
- However, the surpluses of Social Security and other government trust funds are invested in Treasury Bonds, so the debt held by government accounts will continue to grow. (White Line)
- Debt held by government accounts will increase from \$1.8 trillion at the end of 1998 to nearly \$4.4 trillion by the end of 2009.
- Because debt held by government accounts will grow faster than debt held by the public will decline, the gross federal debt will continue to rise, finally peaking at \$5.8 trillion in 2005. (Red area equals Blue line plus White lines)
- By 2009, gross federal debt under current law will be \$5.6 trillion, somewhat more than today (indicated by dotted line), but much less than expected just a few years ago.

Course of Federal Debt Under Present Law, 1998-2009

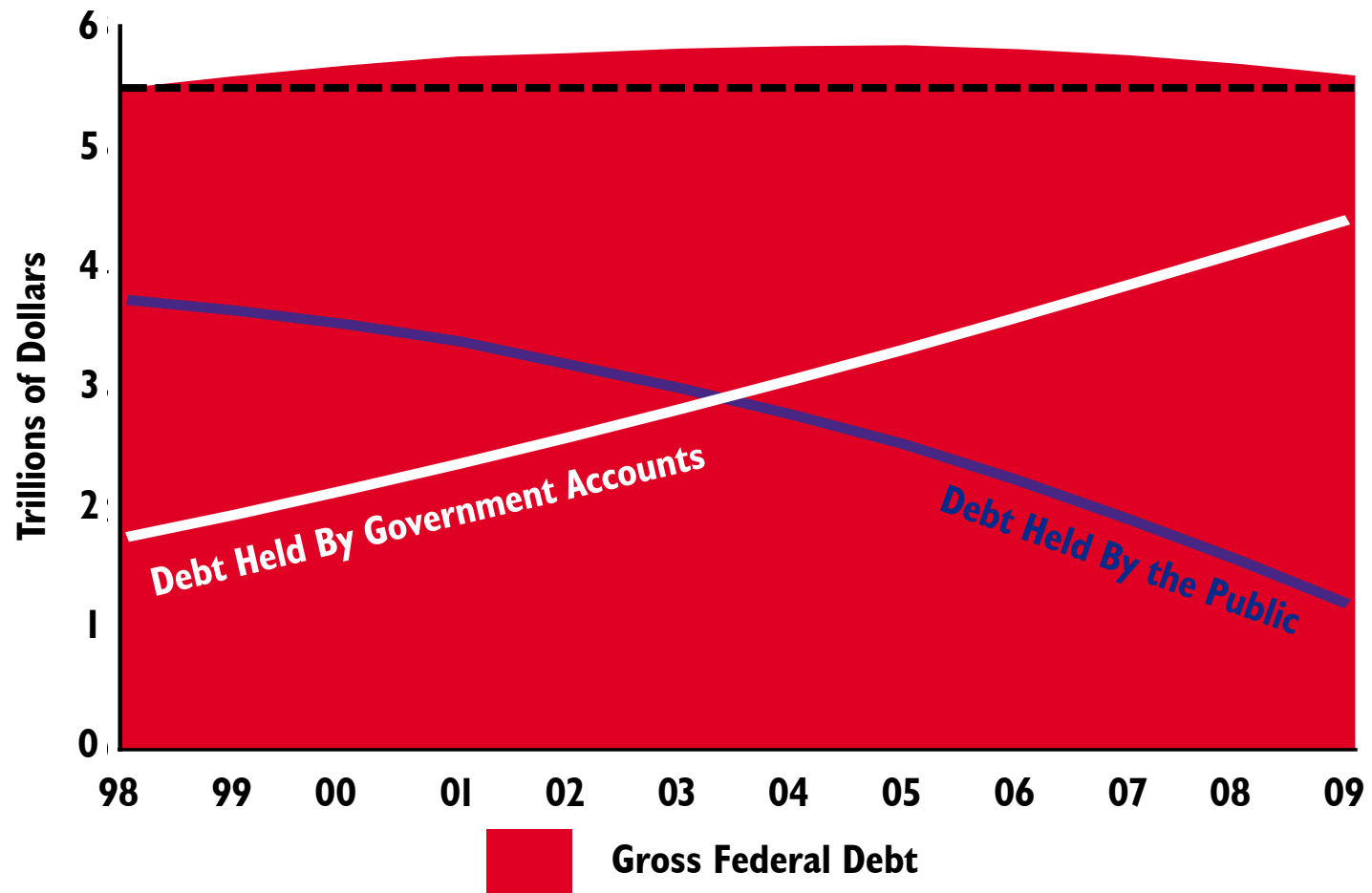


CHART 34

The Growth Of Our National Debt Is Unsustainable

- For most of its history, the nation has incurred large debt only in times of war or serious depression. Neither of these circumstances prevailed in the 1980s and 1990s.
 - Although cold war costs in the 1980s were small compared to previous wars, political leaders were unwilling to raise taxes or reduce domestic spending to offset defense outlays.
 - Instead, income tax cuts reduced revenues more than payroll taxes increased them. During the period of 5 and 6 percent of GDP deficits, revenues were 2 to 3 percent of GDP lower than today.
 - Chart 34 shows not only where we have been but where the path of current programs would take us if we borrowed to pay their future costs.
 - *Thus, this chart is not a prediction of what will happen but an illustration of where the current path would take us. Obviously, we cannot and will not go there.*
 - The reduction in debt held by the public is a welcome possibility. This will free up money from investment in government consumption programs. Instead, the money will be returned to investors who will put it to more productive uses in our economy.
- Defense spending consumed **37 percent** of GDP in 1943, 1944 and 1945.
 - The Korean war cost **13 to 14 percent** of GDP in 1952, 1953 and 1954.
 - Vietnam spending peaked at **9.4 percent** of GDP in 1968.
 - The Reagan era build-up took defense spending from just **below 6 percent** of GDP to slightly **more than 6 percent**, peaking in 1968.
 - By 1991, defense spending had fallen **below 5 percent** of GDP. By 1995, it was less than 4 percent. Today defense spending is **barely 3 percent** of GDP.

The Growth Of Our National Debt Is Unsustainable

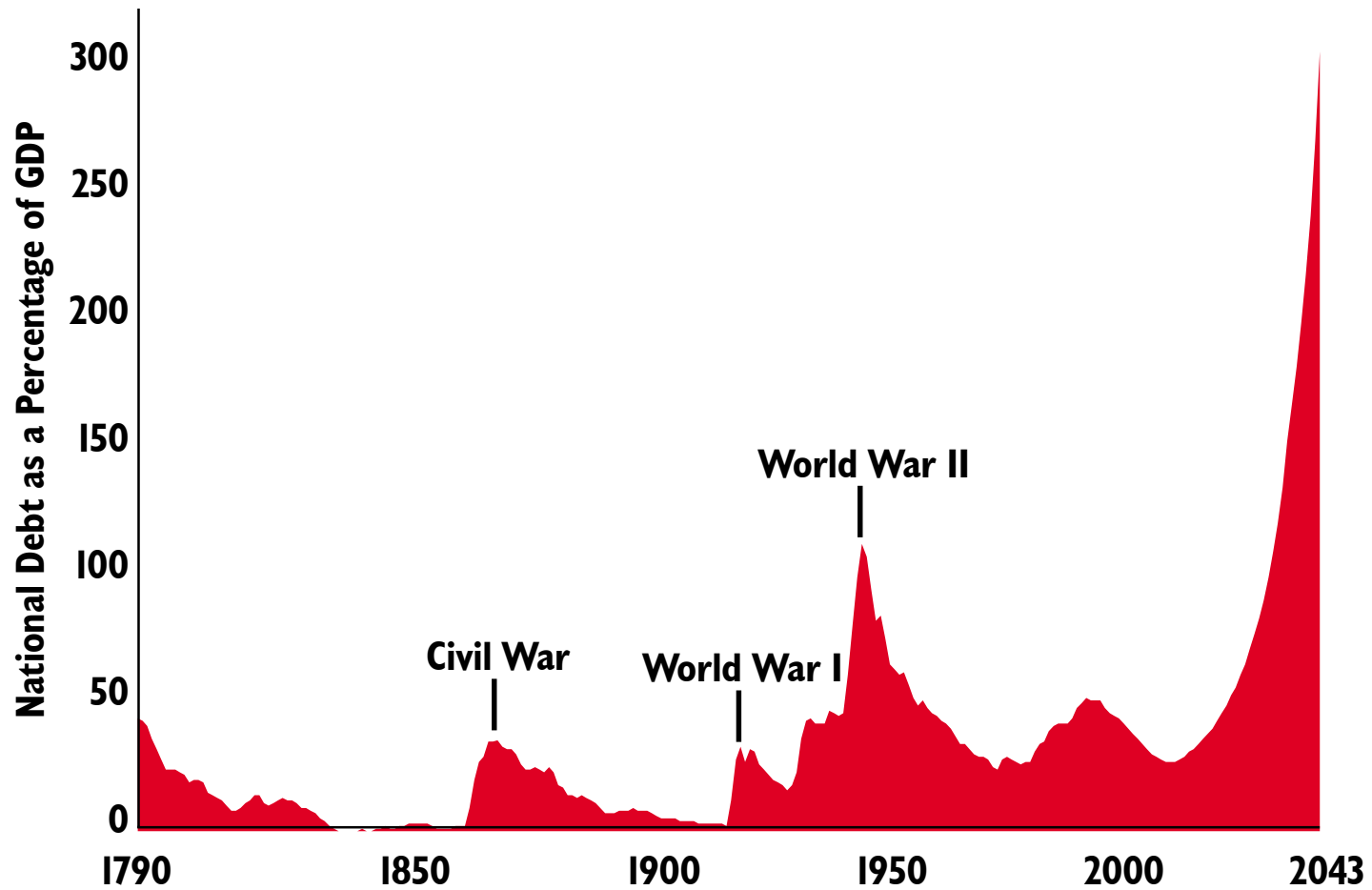


CHART 35

U.S. Annual Workforce Growth Will Slow Almost to a Halt

- Ultimately, economic growth depends on two factors:
 - 1) increasing the number of workers, and
 - 2) increasing the output per worker.
- However, the same population dynamics that will result in a larger proportion of elderly will also virtually stop the growth of the workforce.
- During the 1960s and 1970s, the U.S. workforce grew by about 2 percent annually. Currently it is growing about 1 percent per year.
- About the time the baby boomers begin retiring from the work force, the flow of additional workers will just about grind to a halt. *By 2020, the workforce will grow by barely two-tenths of one percent each year.*
- For every young person entering the workforce from high school or college, an older person will be leaving the workforce, heading toward retirement.
- Therefore, dramatically increasing the labor supply is not a realistic option for increasing economic growth. (But expect great efforts to keep people in the work place past age 62, the age at which most people leave today.)

U.S. Annual Workforce Growth Will Slow Almost to a Halt

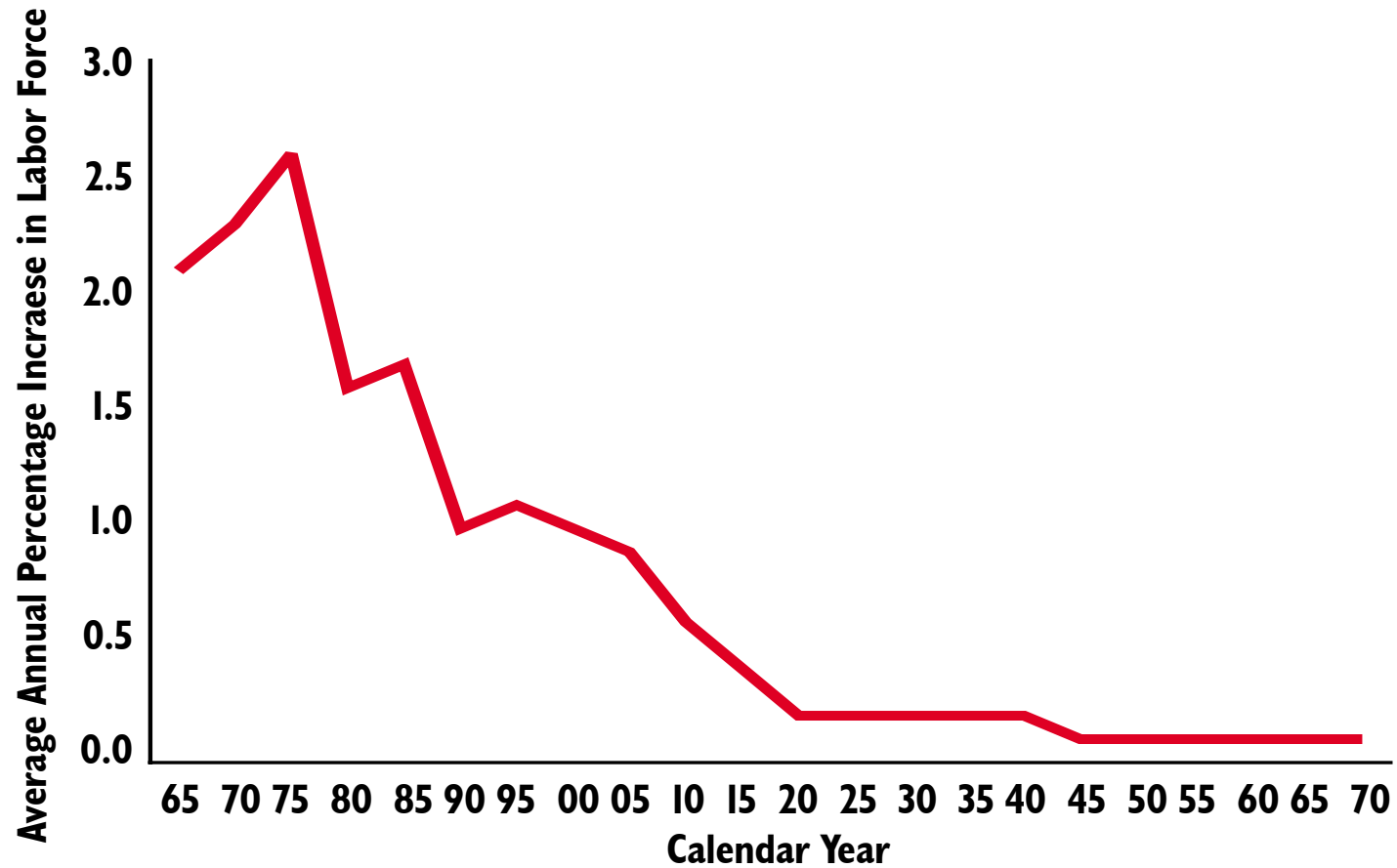


CHART 36

Productivity Growth (Avg. Increases in Productivity), 1948-97

- The other option is to increase productivity. If each worker could produce more goods or services, the economy still could grow despite the stagnation of the size of the work force.
- However, productivity increases are hard to achieve.
- In our mature economy, productivity growth has been declining since World War II. There have been some hopeful spurts in the last year, but overall the trend continues down.
- Productivity increases come about principally as a result of investment. Investment in the skills, education, and health of the workforce itself. Investment in infrastructure — communications and transportation. Investment in research and development. And investment in new products, production processes, and ways of delivering services.

Productivity Growth (Avg. Increases in Productivity), 1948-97

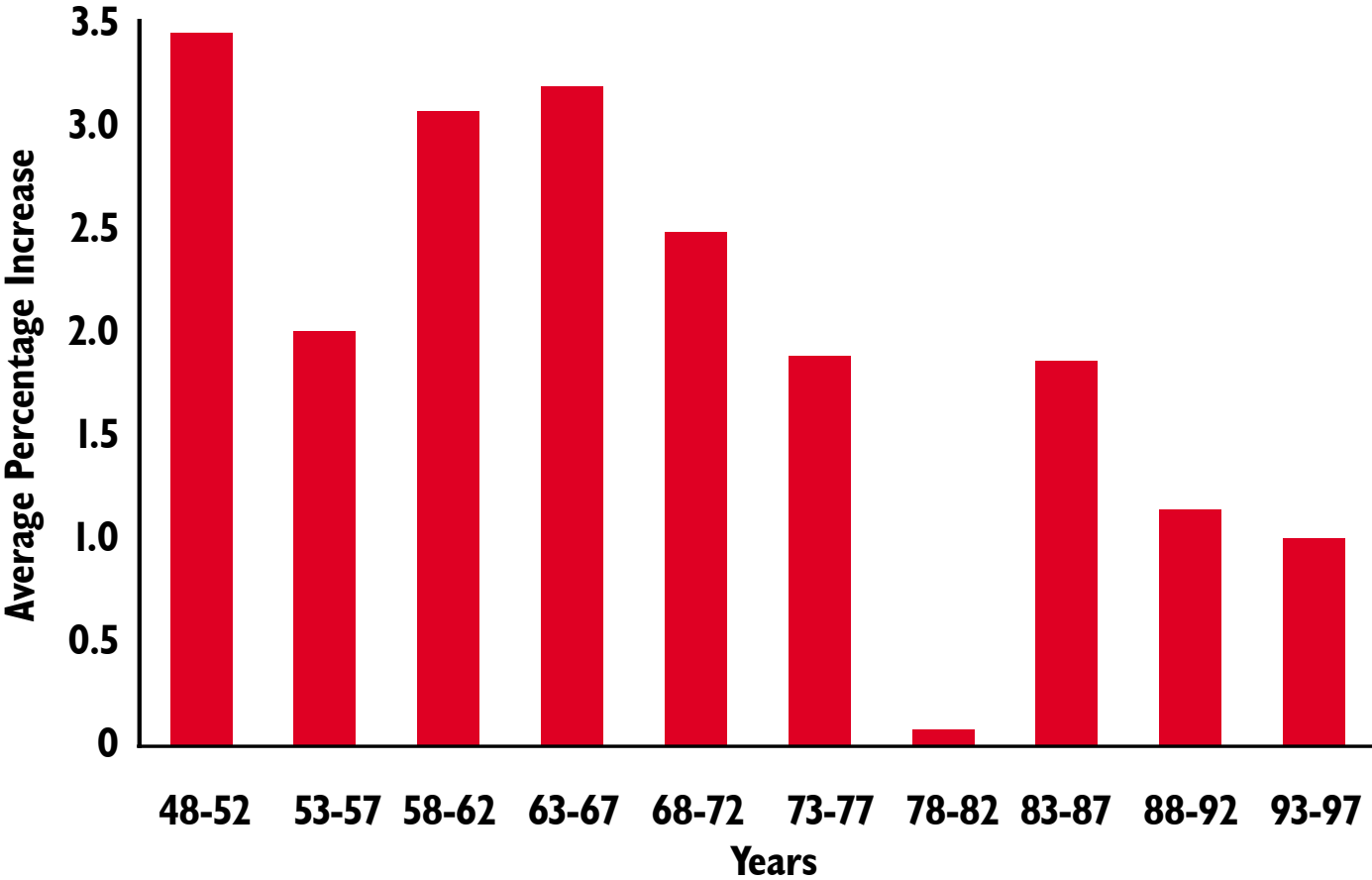


CHART 37

Americans Are Saving and Investing Less Than They Should

- The investments needed to raise productivity require money — money that is not consumed, but rather saved and invested.
- Unfortunately, savings in the U.S. have been declining.
- The **red** portion of the bars indicate that Federal, State and Local governments once ran surpluses, but have more recently run deficits. Since these deficits must be financed by private savings, the government was dis-saving.
- Notice too that the **blue** portions of the bars, which represent private savings, have also been shrinking. Net national savings has declined dramatically.
- The U.S. fortunately has been able to attract in capital from the rest of the world. Foreign investors have been happy to set up auto plants, put up huge office buildings and so forth. This has enabled the U.S. to invest more than it saved.
- But dependence on foreign capital has risks. While American workers get jobs in foreign-owned enterprises that pay competitive wages, it is the foreign owners of those enterprises who decide what to do with the profits — whether to reinvest them in Indianapolis or Indonesia.
- Also, many nations that now invest in the U.S. have aging problems more severe than ours; in the future, they may not have excess funds to invest in the U.S.
- Foreigners may not invest in all the kinds of research, physical infrastructure, and work force development needed to enhance productivity; investment will go where profits are most promising.
- Dependence on foreign capital is not, therefore, a solution for raising U.S. productivity in the long-term.

Americans Are Saving and Investing Less Than They Should

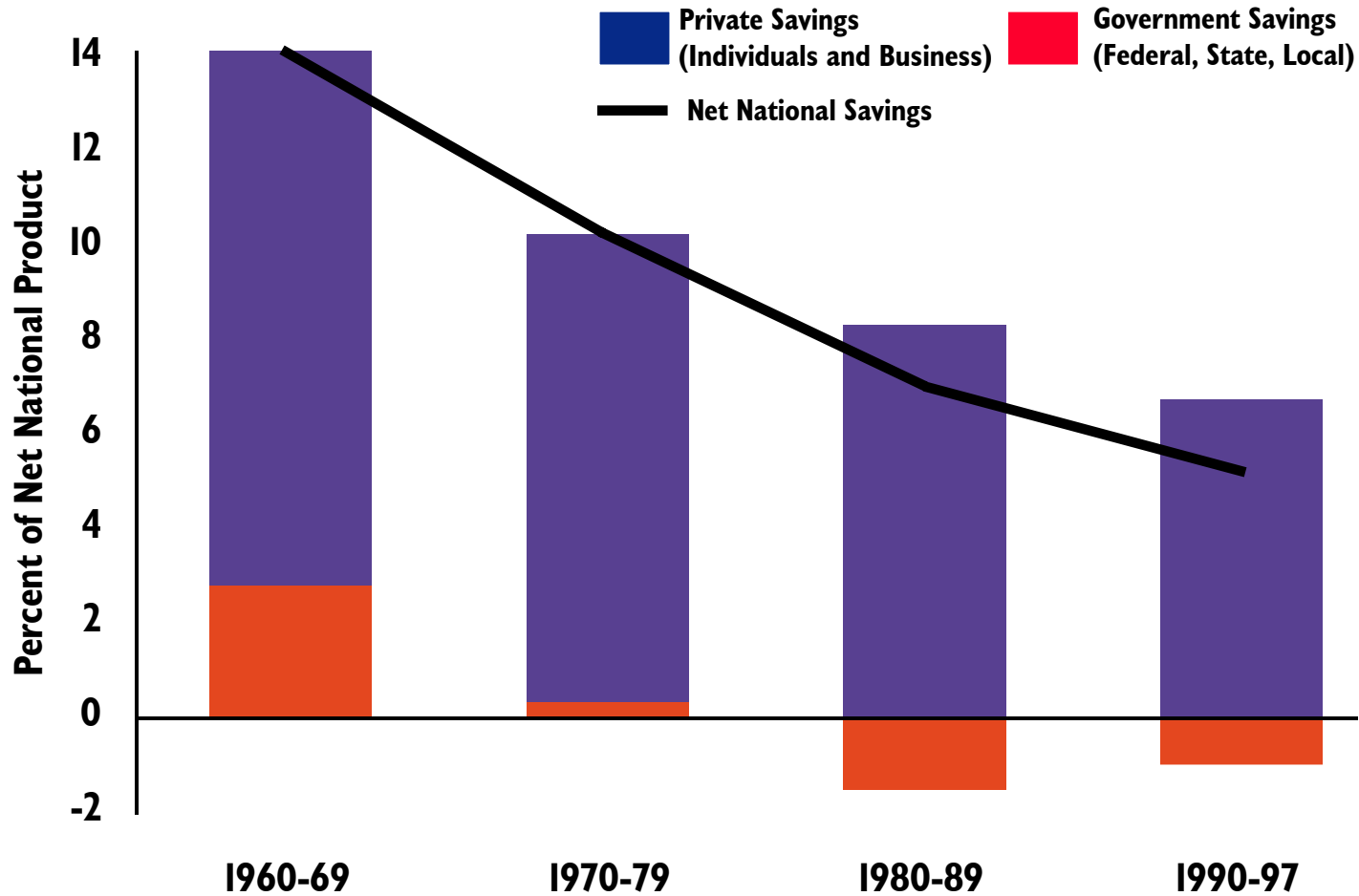


CHART 38

Excluding Housing, the Average U.S. Household Has Accumulated Few Financial Assets

- The Concord Coalition and others have demanded that the federal government stop the practice of running large budget deficits during times of peacetime prosperity. We are, at last, on the brink of seeing that happen and of that becoming the prevailing political ethic.
- However, it is also important to increase private savings. Not only are saving needed to invest in making the economy more productive, they would also help individuals prepare for their own lengthy years of retirement with something more than government benefit programs or pensions from employment.
- However, the picture for personal savings is not very good.
- As this chart shows, even people aged 55 to 64 who are approaching retirement years have saved only small amounts on average, far too little to supplement their retirement incomes
- Sadly, “shop till you drop” consumerism prevails, and the ethic of thrift has largely disappeared

Excluding Housing, the Average U.S. Household Has Accumulated Few Financial Assets

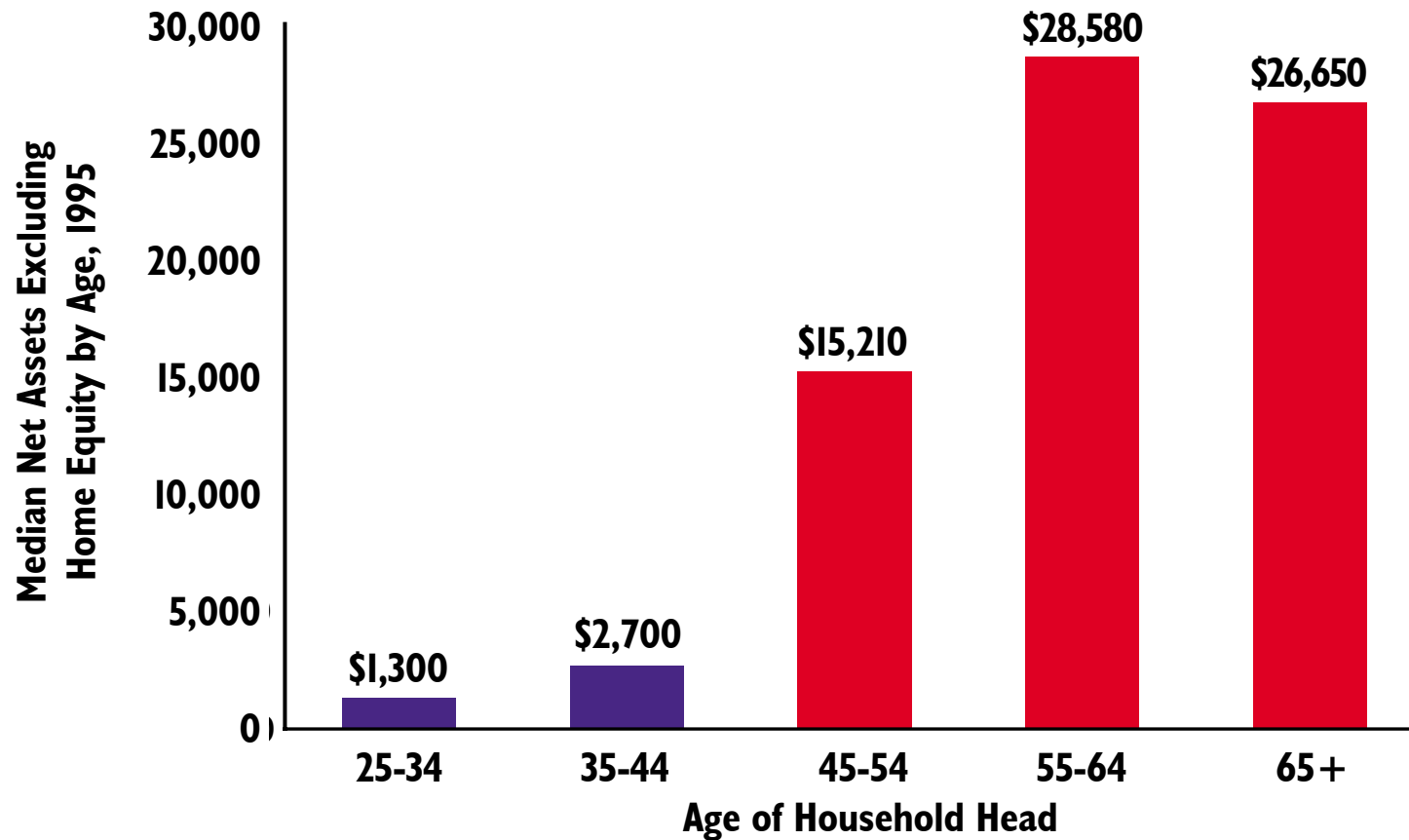


CHART 39-A

Solving the Entitlement Explosion Problem Will Have Enormous Long-Term Economic Benefits

- So while the economy looks rosy now, the tough choices for the future have not changed. The aging of America and the built-in increased real costs of senior benefits promise to undo the progress that has been made in balancing the federal budget.
- Changes must be made in the entitlement programs.

Either Americans must agree to pay the full costs of the promised benefits, or the benefits must be reduced to a level that Americans are willing to finance, or both. That is it. There are no other responsible courses.

- If we refuse to make those choices, and continue to deficit-finance runaway entitlement costs, the impact will be to gradually slow down the rate of economic growth in our nation.
- Our resources will be drained away from productive investments and will be used instead to provide income and health insurance for seniors.
- At first, the economy will continue to grow, giving most people a false sense of well being. But gradually growth will slow, until decades from now, the economy will be in decline. Then, repairing the damage, if it can be done at all, will be far more difficult than acting today to prevent it.
- Analogy: A huge ocean tanker continues to push up a bow wave for miles and miles down the sea lane after its engines have cut out. Similarly, the economy could continue to grow, but eventually it will be overwhelmed by debt required to finance burgeoning entitlement costs.

Solving the Entitlement Explosion Problem Will Have Enormous Long-Term Economic Benefits

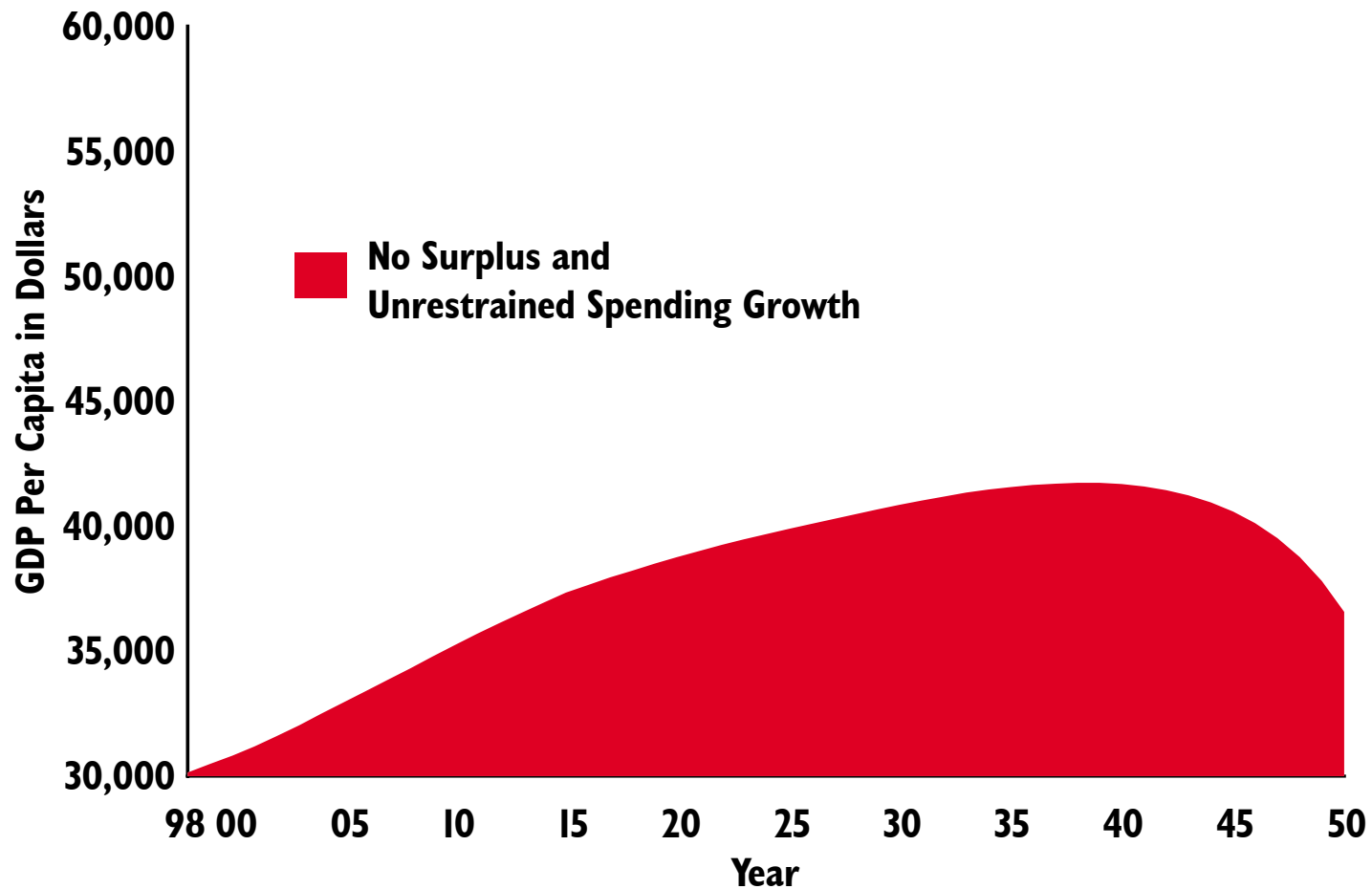


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Solving the Entitlement Explosion Problem Will Have Enormous Long-Term Economic Benefits

- There is another course. If we make the changes necessary to prevent the cost of benefits for seniors from becoming unsustainable and weighing down our economy with growing public debt, we could enjoy a future in which GDP per person continues to increase in the future much as it has in the past.
- If we have a larger economic pie, it will be easier to afford benefits for all those who need them, including the elderly. But if economic growth has stopped, each group will try desperately to hold on to what it has.
- Getting firm control of federal spending, not just now, but for coming decades, will enable our nation to enjoy the benefits of a *virtuous cycle* — lower debt will lead to lower interest costs, which will free up more private funds for investment, which will grow the economy, generate more revenue, and permit the debt to decline even further.
- If we fail to take these steps, we risk continuation of the *vicious cycle* — mounting program costs lead to more borrowing and debt, and higher interest costs, which drains resources from the productive parts of the economy, slows the flow of government revenue, and leads to more borrowing and more debt.

The choices are ours. They are not pleasant choices, but the responsibility rests with us — citizens, office holders, and opinion leaders.

***We can do nothing, and leave future generations to cope as best they can with the results of our inaction.
Or we can make the difficult choices now, while there is time to implement changes gradually, fairly, and equitably.***

- The choices will not be easy. But if they are not made, today's mature generations could be the first in our nation's history to leave the country worse off than they found it.

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