RESTORING THE TRUST

FOR ALL GENERATIONS

Committee on the Budget
U.S. House of Representatives

Chairman Tom Price, M.D.

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RESTORING THE TRUST FOR YOUNGER AMERICANS

CHALLENGES OF TODAY'S GOVERNMENT POLICIES

THE FISCAL DILEMMA YOUNG AMERICANS FACE

SUMMARY

- The Federal Government's unrestrained spending and mounting debt burden today's younger generations with higher taxes, slower wage growth, and lower standards of living – a daunting future of obligations made by past and present policymakers.
- Young Americans are facing two main financial challenges. First is student loan debt, which drains years of future income and leads many into default. Second is the burden of unfunded health and retirement security programs, whose long-term obligations exceed their resources by an estimated $210 trillion – 12 times the size of today's economy.
- Sluggish economic growth impedes younger Americans, especially those seeking their first jobs. For 20- to 24-year-olds, unemployment remains higher than in any recovery since the 1980s.
- Millennials understand innovation to be a regular and necessary aspect of a growing and evolving society. This way of thinking has become part of this generation's everyday lives and should be extended to the public sector. Restoring the trust in the government's major benefits programs requires exploring beyond the conventional, rigid government strategies.

Young Americans today face a daunting and largely unprecedented outlook. The expansive opportunities available to previous generations – thanks largely to abundant economic growth – are receding. The distinctly American promise of leaving the next generation better off is now uncertain. Instead, today's young people foresee a future of higher taxes, slower wage growth, and lower standards of living. Many young Americans doubt they can achieve the American dream through the traditional formula of determination, hard work, and education. Furthermore, while working Millennials[1] currently contribute part of each paycheck to the government's major retirement security programs, Medicare and Social Security, they have lost confidence that these programs will be there for them when they themselves reach retirement age.

Saira Blair, the youngest legislator in America, summarizes these discouraging prospects this way: "Young Americans are facing a time of hopelessness where they feel as if it'll be impossible to get ahead and that they're paying into programs in which they've heard over and over again that will inevitably fail."[2]

The principal cause of this dilemma is a shift in Federal Government spending. Over the past half-century, Congress has allowed an ever-increasing share of the budget to become automatic and essentially unlimited; the vast majority now runs on effectively permanent authorizations, without regular congressional review. This form of

[1] Although there are no precise dates for this generation, they are generally considered to be those born from the early 1980s to the early 2000s.

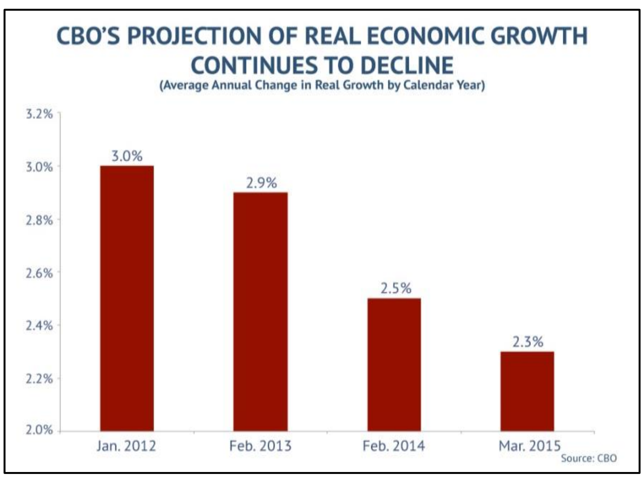
[2] Testimony of Saira Blair, Member of the West Virginia House of Delegates, to the Committee on the Budget, U.S. House of Representatives, 9 September 2015.

Restoring the Trust for All Generations is a project of the Committee on the Budget, U.S. House of Representatives, aimed at promoting innovative solutions for keeping the promises of the Federal Government's health, retirement, and income security programs. This discussion, prepared by the committee's majority staff, is one of a series of white papers examining specific aspects of the fiscal and policy challenge.

spending, which constituted roughly one-third of the Federal budget in 1965, has now doubled to two-thirds through both the development and expansion of benefits programs. It continues to grow largely due to factors outside Congress's control, such as demographics, inflation, and interest rates. It is the main cause of the government's mounting deficits and debt.[3]

For a time, lawmakers could largely ignore the predictable consequences of this profligacy, which appeared somewhere in the future. That is no longer possible; in fact, the consequences are already manifesting in the economy. Most forecasters have lowered their projections of economic growth in recent years. For instance, the Congressional Budget Office [CBO] has reduced its forecast of average growth in real gross domestic product [GDP] over the next 10 years from 3.0 percent back in 2012 to just 2.3 percent this year (see Figure 1). The growth rate is well below the historical average of about 3.3 percent, and will not produce sufficient prosperity to leave the current generation better off while also supporting the 80 million Americans expected to retire in the next two decades.[4]

Figure 1



In addition to slowed economic growth, young Americans "are facing two separate, unprecedented financial burdens," according to Jared Meyer, co-author of *Disinherited: How Washington is Betraying America's Young*: "The first, student loan debt, was a burden that young people chose to incur, though increasing debt levels have been driven by poor federal policies. The second type of financial burden, unfunded health and retirement programs, was never voted on or approved by the young, yet they are still liable for the countless unfunded promises made by past policymakers."[5] In other words, this generation contends with increasing education costs, the debt burden from student loans, a sluggish economy, stagnant wages, and the burden of government's unfunded promises to older generations.

Yet these same young Americans are not tied to the governing philosophies of the past, which created today's fiscal problems. Millennials are especially inclined to the kind of innovative thinking and entrepreneurial spirit needed to change the government's unsustainable fiscal course. To appreciate the need for a new approach, it is necessary to grasp the nature of the challenges facing younger Americans.

Economic Security

Traditionally, education has been the key to unlocking opportunity and an essential element in the pursuit of a better future and a better life. As Benjamin Franklin once said: "[A]n investment in knowledge pays the best interest." The Federal Government has supported student loans since the late 1950s, and expanded access with passage of the Higher Education Act of 1965.

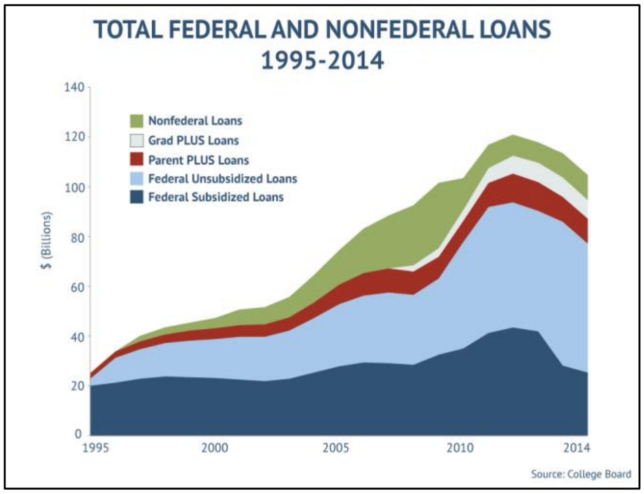
Yet while intended to help bring college within the financial reach of more Americans, the Federal Government's policies have actually made the cost of higher education more difficult to bear. Easier access to Federal financial aid lures individuals into acquiring more loans, encouraging colleges to consistently raise tuition and fees at rates well above inflation. The New York Federal Reserve recently reported that for every dollar in increased subsidized Federal loans, tuition increases by an estimated 65 cents.[6] Citing a phenomenon previously noted by William J. Bennett, former education secretary, Meyer says: "[A]utomatically providing student loans through the government (which is how the system has worked since 2010) or offering loans at low interest rates subsidized by

[3] For a further discussion, see the Committee on the Budget, U.S. House of Representatives, *Source of the Government's Fiscal Problem: Reckless Automatic Spending*, Policy Brief Volume 1 Number 2, October 2015.
[4] The economy's growth rate is highly important for both the Nation's prosperity and the government's fiscal health. According to CBO, if real GDP growth were just 0.1 percentage point higher per year over 10 years, revenues would be $288 billion higher over the period, spending would be $37 billion less, and resulting deficits $326 billion lower.
[5] Testimony to the Committee on the Budget, U.S. House of Representatives, 9 September 2015.
[6] David O. Lucca, Taylor Nadauld, and Karen Shen, "Credit Supply and the Rise in College Tuition: Evidence from the Expansion in Federal Student Aid Programs, federal Reserve Bank of New York, July 2015, http://www.newyorkfed.org/research/staff_reports/sr733.pdf

the government increases the demand for college education. These low rates allow schools to raise tuition costs exponentially – and they have been doing just that."[7]

The result? "Rather than fulfilling their original mission of opening the doors of institutions of higher learning to low-income students, government financial-aid programs have raised the costs of higher education."[8]

Figure 2



Easier access to aid has enabled students and parents to borrow substantially. Borrowing stood at $106.0 billion for the 2013-2014 academic year (see Figure 2 above). As of the end of June 2015, outstanding student loan balances totaled roughly $1.2 trillion. The Federal Government's direct student loan portfolio has grown from about $106 billion outstanding in fiscal year 2007 to more than $800 billion today.[9]

As of 2012, 71 percent of undergraduate students in the 2012-13 academic year graduated with debt (see Figure 3). These students borrowed an average of $29,400, more than a three-fold increase from 1993 (see Figure 4). The delinquency rate on student loans (90 or more days past due) also continues to rise; it is estimated at 11.5 percent, although it is likely twice as high given the number of loans in grace periods, deferment, or forbearance.[10] Students who extend their education may find even their graduate degrees do not yield the return on investment needed to pay down their loan debt. A lackluster labor market with fewer opportunities compounds the problem. Such trends have led scholars such as Meyer, a fellow at the Manhattan Institute for Policy Research, to declare that "outstanding student loan debt is indeed a crisis."[11]

Figure 3

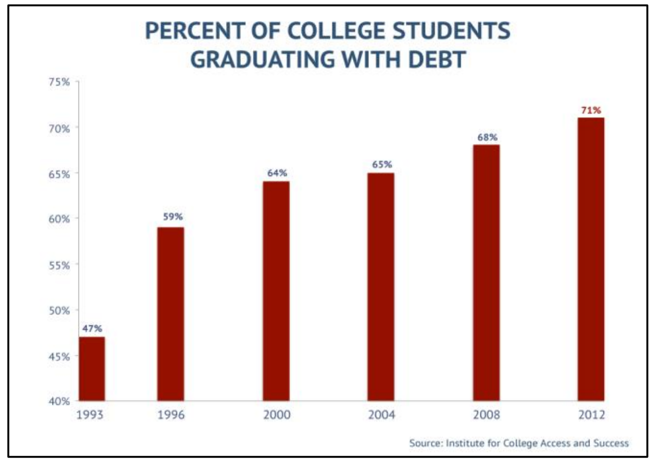
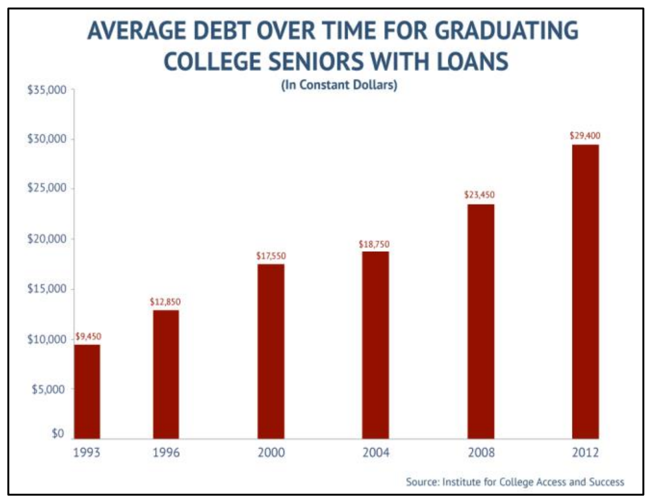


Figure 4

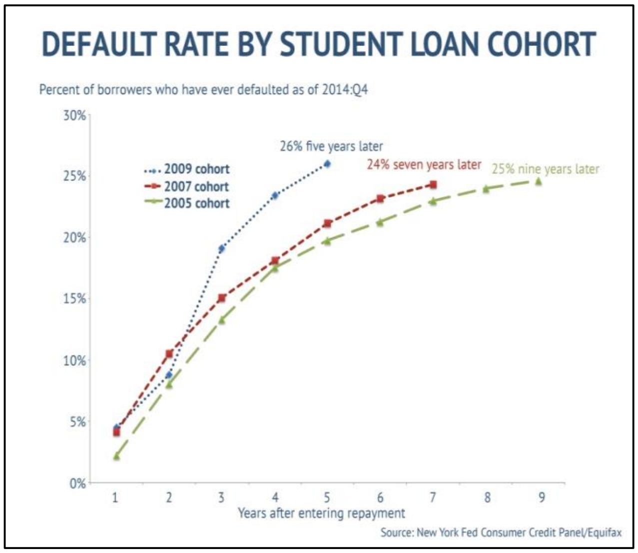


Ultimately, many students find themselves unable to pay back their student loans, and therefore default. Roughly 25 percent of borrowers from the 2005, 2007, and 2009 cohorts have defaulted on their student loans (meaning a

[7] Meyer, op. cit.
[8] Ibid.
[9] U.S. Department of Education Office of Federal Student Aid, "Federal Student Aid Portfolio Summary," https://studentaid.ed.gov/sa/sites/default/files/fsawg/datacenter/library/PortfolioSummary.xls, accessed 2 September 2015.
[10] Federal Reserve Bank of New York: Research and Statistics Group, *Quarterly Report on Household Debt and Credit*, August 2015: http://www.newyorkfed.org/householdcredit/2015-q2/data/pdf/HHDC_2015Q2.pdf, accessed 17 August 2015; http://libertystreeteconomics.newyorkfed.org/2015/02/looking_at_student_loan_defaults_through_a_larger_window.html#.VdIsTvlVhBc, accessed 17 August 2015.
[11] Meyer, op. cit.

payment is 270 or more days past due).[12] The rate of default for the 2009 cohort is worse than the previous two groups (see Figure 5).

Figure 5



The Federal Government does eventually collect the vast majority of those student loan dollars, but defaulting still carries a cost. As the CBO reports: "The government is exposed to market risk when the economy is weak because borrowers default on their debt obligations more frequently and recoveries from borrowers are lower."[13] Yet the Federal Government's accounting methods ignore this risk. Consequently, student loans appear less expensive than they actually are – both to borrowers and to taxpayers.[14] "Talk of 'free' or 'debt-free' college panders to emotion but does nothing to address the underlying reason why student loan debt is increasing – the perverse incentives created by Federal student aid programs."[15]

As a result, roughly half of Millennials (47 percent) start their working years with more than half of their monthly income already committed to paying off debt (medical, student loans, car, mortgage, personal debt).[16] Many young adults are forced to delay reaching other important milestones, such as buying a home, getting married and starting a family. According to a PEW Research Center report, just 26 percent of individuals 18 to 32 years old are married. The marriage rate for the same age group in previous generations was 36 percent for Generation X, 48 percent for Baby Boomers, and 65 percent for the Silent Generation. In addition, 69 percent of single Millennials say they would like to marry but feel they lack the necessary solid economic foundation.[17] Regarding home purchases specifically: "Among the 22 percent of Millennials who took longer to save for a down payment, 54 percent cited student loan debt as the biggest obstacle – down slightly from 56 percent a year ago."[18]

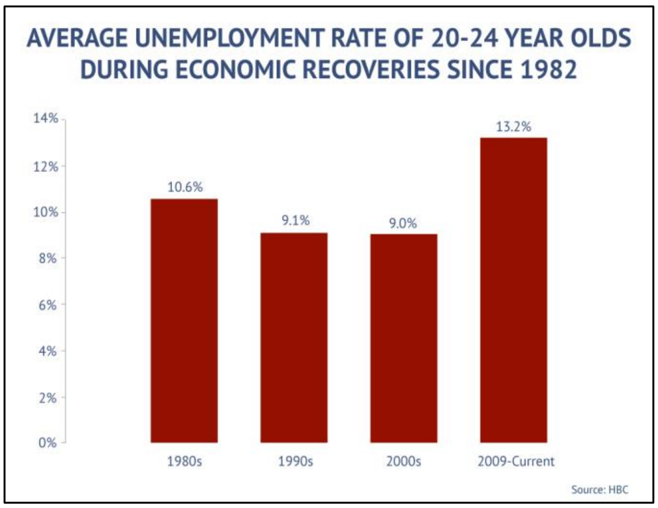
Current economic conditions add to the strain. While unemployment has slowly declined since the Great Recession, falling to 5.1 percent in September 2015 from its peak of 10.0 percent in October 2009, sharp variations by age persist.[19] The sluggish economic recovery hinders young Americans who are looking for their first jobs and who face greater competition from older, more experienced candidates; the result is higher rates of unemployment and underemployment among young Americans 25 years old and under. Before the Great Recession, unemployment rates for college graduates under 25 years old were 6 percent; today, after 6 years of economic recovery, they are up to 8 percent. Further, according to the New York Federal Reserve, approximately 44 percent of college graduates today are underemployed compared to 34 percent in 2001. For 20- to 24-year-olds, post-recession unemployment remains higher than any recovery since

[12] An "origination completion cohort" is a group of borrowers for each academic year in which the students stopped taking new loans.
[13] "Fair-Value Estimates of the Cost of Selected Federal Credit Programs for 2015 to 2024," Congressional Budget Office, May 22, 2014, at https://www.cbo.gov/sites/default/files/113th-congress-2013-2014/reports/45383-FairValue.pdf
[14] The situation argues for fair value accounting practices, which would include the effects of market risk.
[15] Meyer, op. cit.
[16] Wells Fargo, *2014 Wells Fargo Millennial Study*: https://www08.wellsfargomedia.com/downloads/pdf/com/retirement-employee-benefits/insights/2014-millennial-study-report.pdf, accessed 17 August 2015.
[17] PEW Research Center, *Millennials in Adulthood: Detached from Institutions, Networked with Friends*, 7 March 2014: http://www.pewsocialtrends.org/2014/03/07/millennials-in-adulthood/, accessed 17 August 2015. The generational break is as follows: the Silent Generation, those born from the mid-1920s to the early 1940s; Baby Boomers, those born between 1946 and 1964; Generation X, those born after the Baby Boomers through the early 1980s.
[18] National Association of Realtors, *NAR Generational Survey: Millennials Lead All Buyers, Most Likely to Use Real Estate Agent*, 11 March 2015: http://www.realtor.org/news-releases/2015/03/nar-generational-survey-millennials-lead-all-buyers-most-likely-to-use-real-estate-agent, accessed 17 August 2015.
[19] Bureau of Labor Statistics, Employment Situation Summary for September 2015, 2 October 2015: http://www.bls.gov/news.release/empsit.nr0.htm. The report also noted the labor participation rate fell to 62.4 percent, its lowest level since 1977.

the 1980s (see Figure 6).[20] It is no wonder that nearly 14 percent of loan recipients default.

Additionally, the Federal Government is more than $18 trillion in debt. Young Americans recognize they will be responsible for this burden. "The current debt per citizen in this country is just below $58,000. What is even more concerning though is that the debt per taxpayers is just short of $155,000. It's hard for younger Americans to be both optimistic and eager to enter the workforce when they're faced with an overwhelming and disheartening obstacle from day one."[21]

Figure 6



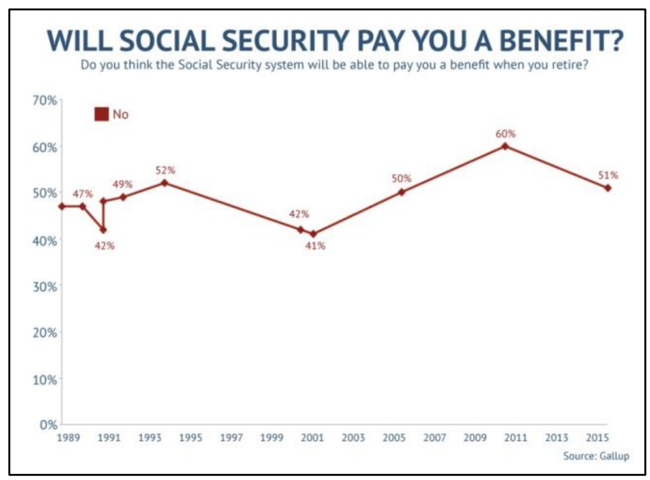
Health and Retirement Security

The Federal Government's two principal health and retirement security programs, Medicare and Social Security, were established to protect Americans against poverty in old age. Although these programs have successfully helped reduce poverty among America's seniors and extend life expectancy, their future for today's young Americans is uncertain; they are relentlessly approaching financial exhaustion despite historically high tax revenue.

The Social Security Act was passed in 1935 as a social insurance program for retired workers after poverty rates among seniors surpassed 50 percent during the Great Depression. "In 1937, the program included a mere 53,236 beneficiaries who received a total of just $22 million in today's dollars."[22] Though sold to Americans as a retirement *savings* system, Social Security includes no true savings component and fails to create greater wealth through compound interest. Instead, the program now acts as a pay-as-you-go system.

When Medicare was created in 1965, it covered 19 million individuals and had an annual budget of $10 billion. Today, Medicare covers 55 million older Americans and is projected to spend $639 billion in 2015.[23] As the Baby Boom generation ages into Medicare, the program's expenditures over the long term are projected to consume an increasing share of GDP, rising from 3 percent today to 5.5 percent by 2040. "When future spending obligations on health and retirement programs, such as Social Security and Medicare, are compared with future tax obligations, the so-called fiscal gap is $210 trillion. This is 12 times GDP and 16 times official debt held by the public."[24] Without changes to the programs, young Americans can either "pay substantially higher taxes than their parents do, while not receiving any more benefits, or they can pay the same rate as their elders and receive far fewer benefits. Both outcomes are unfair for millennials."[25]

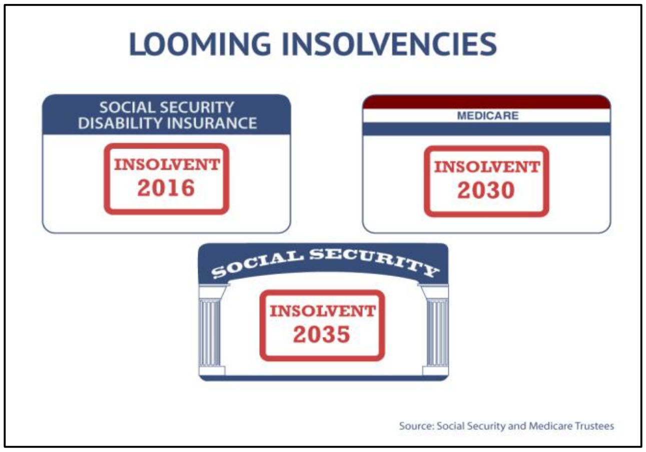
Figure 7



A recent Gallup poll showed that 51 percent of non-retired Americans do not believe they will receive a Social Security benefit. Included in that aggregate total, 64 percent of those 18 to 29 years old do not believe they will

[20] Bureau Labor of Statistics, *Table A-10, Unemployment Rates by Age, Sex, and Marital Status, Seasonally Adjusted*: http://www.bls.gov/web/empsit/cpseea10.htm accessed 17 August 2015.
[21] Blair, op. cit.
[22] Meyer, op. cit.
[23] Congressional Budget Office, *An Update to the Budget and Economic Outlook: 2015 to 2025*, p. 76 https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50724-Update-onecolumn_1.pdf.
[24] Meyer, op. cit.
[25] Ibid.

Figure 8



receive Social Security, and 63 percent of those 30 to 49 hold the same view (see Figure 7, previous page). Moreover, in addition to paying the costs for their own health and retirement security, roughly 20 percent of Millennials in a recent study are currently providing financial support for a family member. On average, they spent about $18,000 in financial support over 12 months. About half of these individuals delayed buying a house, some 38 percent delayed having children, and 29 percent delayed getting married.[26]

On their present course, Medicare and Social Security will be insolvent by 2030 and 2035, respectively (see Figure 8) – and these projections may be optimistic.[27] Absent improvements to make these programs sustainable, the combined employer/employee payroll tax to cover Medicare and Social Security payments would have to grow from 15 percent of a worker's income today to 32 percent by 2050.[28]

This outlook threatens the generational compact Americans have long maintained.

INNOVATIVE SOLUTIONS TO POLICY CHALLENGES

As it happens, many of the programs funded by Washington's unsustainable automatic spending are fundamentally flawed anyway, and constitute a disservice to the very people they are intended to help. The first step in correcting these flaws is to reconsider the premises under which these programs were developed – especially their highly regulated, Washington-centered strategies. This requires the kind of innovative thinking to which Millennials and other young Americans are accustomed.

While Millennials face a number of challenges, they also seek positive solutions. Some 55 percent of Millennials want to start a business, according to a Reason-Rupe Millennial Survey cited by Evan Baehr, a Millennial entrepreneur and cofounder of Able Lending, a collaborative small-business lender. This enthusiasm, Baehr notes, is "not merely for financial gain, but also to improve the world around them."[29]

Millennials believe they are part of the solution, but do not necessarily look first to government to help them. In fact, when Millennials were asked what was necessary to start a business, 61 percent said "hard work," 39 percent cited "ambition," and 36 percent pointed to "self-discipline." "At the bottom of that list – literally the lowest ranked option – was government," says Baehr. In an ever-changing world, the true success stories today are about the individuals and companies who are agile, innovative, and adaptable. "These millennial entrepreneurs seek to transform the world they live in through a for profit company that delights its customers, honors its employees and suppliers and returns a profit to its investors."[30]

Prior to testifying before Congress, Baehr solicited comments from his network of young Americans, asking them to complete the following sentence: "As a champion of entrepreneurship and small business, I want Congress to know . . . ." The widely varying responses reveal the kind of unconventional, and generally hopeful, thinking common among Millennials.

Among the responses were the following:

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[26] TD Ameritrade, Financial Support Study: Understanding Financial Obligations Across Generations, accessed on 2 September 2015: http://www.amtd.com/files/doc_downloads/research/TDA-Financial-Support-Study-2015.pdf.
[27] The projections for Medicare assume the government will maintain a number of deep spending cuts imposed by the Affordable Care Act. If Congress repeals those reductions, Medicare's insolvency will occur sooner.
[28] Diane Furchtgott-Roth and Jared Meyer, *Disinherited: How Washington is Betraying America's Youth* (New York: Encounter Books, 2015).
[29] Testimony of Evan Baehr, Cofounder of Able Lending, to the Committee on the Budget, U.S. House of Representatives, 9 September 2015. The Reason-Rupe 2014 Millennial Survey was conducted by the Reason Foundation with the support of the Arthur N. Rupe Foundation.
[30] Ibid.

VOICES OF YOUNG AMERICANS

Jerry Bowerman, Founder and Chief Executive Officer, sonarDesign
As a champion of entrepreneurship and small business, I want Congress to know access to high quality, affordable higher education is critical for equipping our national talent for success in our information economy. Funding higher education with huge loans is going to handicap our workforce for decades.

Daniel Mark, Assistant Professor of Political Science, Villanova University
As a college professor, I regularly hear young people's concerns about the job market. They want — and deserve — a thriving and dynamic economy that is friendly to entrepreneurship and small businesses. They have ideas and energy, and mostly they just want to be free to be at their innovative best. They certainly don't want to all be funneled into the same few professions, but they need to believe there are wider opportunities out there for them. Without market-friendly policies, they are all going to end up in law school.

Reihan Salam, Executive Editor, *National Review*
Entitlement reform is about much more than debt and deficits. It is fundamentally about the kind of economy we will have in the decades to come. Will we have a dynamic, high-growth economy that generates high-wage job opportunities for every American willing to work? Or will we suffer from the economic sclerosis that has ravaged so much of southern Europe? To create a more sustainable safety net, we can't just double down on the programs we've inherited from previous generation. We need to look to the goals our safety net programs were designed to achieve and develop smarter, better, more cost-effective ways of meeting them.

Josh Belinfante, Attorney, Robbins Ross Alloy Belinfante Littlefield, LLC
Entitlements are my generation's albatross. They prevent comprehensive tax reform and rate reductions, undercut national defense, stymie medical advances, and tether Americans to a dated retirement system that neither I nor my children will likely benefit from. My generation did not ask for them, and we seek leaders with the courage to make them work.

Tiffany Shorter, Senior Change Manager, Harvard University
These debates on the longevity of Social Security, Medicare and Medicaid must end with actionable solutions. Unsustainable fiscal policies hinder our ability to provide for our families, contribute to our communities and pursue the American dream.

Michael Mannina, Chief Operating Office, zipboss
We must have leadership from Washington to tackle the tough issues of entitlement reform. Every year we postpone makes it a more costly venture. Soon, the debt entitlements yield will completely stifle America's small business engine.

Matt Stolhanske, Venture Architect, BCG Digital Ventures
Anyone can be an entrepreneur. You can create all the programs and initiatives with as targeted access as you want, and nothing could ever be as effective as the basic fundamentals of entrepreneurship. Innovation and entrepreneurship are found in every type of human being on this planet; they know no racial, gender, socioeconomic or other boundaries. Harness them to drive economic growth in every sector and at every level of our economy. Stifle them at our peril.

Cherie Harder, President, The Trinity Forum
I want Congress to know that saddling a new generation with an unbearable debt burden erodes the public trust, economic opportunity, and their chances for mobility. Americans want a strong safety net for those who need it, but now are stuck paying for an entitlement system that will bankrupt our future.

CONCLUSION

All demographic and age groups in America are affected by government policy and fiscal practices. For younger Americans, the reckless spending that has developed over the past several decades, a mounting student loan crisis, and the obligations of America's principal health and retirement programs is creating a debt burden that threatens their future with higher taxes, slower wage growth, and lower standards of living. At the same time, their limited attachment to the governing philosophies of the past, which largely caused these problems, leaves them open to innovative, alternative strategies to addressing the Nation's challenges. This is not, however, a competition among generations. The point is to break down the barriers and burdens that have come to encumber the pursuit of the American Dream. This is the idea young Americans represent, and sharing it can foster the improvements needed to restore the trust among all generations of Americans.