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## **LONG-TERM FISCAL OUTLOOK**

# **Long-Term Federal Fiscal Challenge Driven Primarily by Health Care**

Statement of Gene L. Dodaro  
Acting Comptroller General of the United States



Highlights of GAO-08-912T, a testimony to the Committee on Finance, U.S. Senate

## Why GAO Did This Study

GAO was asked to provide its views on the long-term fiscal outlook. This statement addresses four key points: (1) the federal government's long-term fiscal outlook is a matter of utmost concern; (2) this challenge is driven primarily by health care cost growth; (3) reform of health care is essential but other areas also need attention which requires a multipronged solution; and (4) the federal government faces increasing pressures yet a shrinking window of opportunity for phasing in needed adjustments.

GAO's simulations of the federal government's long-term fiscal outlook were updated with the Trustees 2008 intermediate projections and continue to indicate that the long-term outlook is unsustainable. This update combined with GAO's analysis of the fiscal outlook of state and local governments demonstrates that the fiscal challenges facing all levels of government are linked and should be considered in a strategic and integrated manner.

Since 1992, GAO has published long-term fiscal simulations of what might happen to federal deficits and debt levels under varying policy assumptions. GAO developed its long-term model in response to a bipartisan request from Members of Congress who were concerned about the long-term effects of fiscal policy. Information about GAO's model and assumptions can be found at <http://www.gao.gov/special.pubs/longterm/>.

To view the full product, including the scope and methodology, click on [GAO-08-912T](#). For more information, contact Susan J. Irving at (202) 512-9142 or [irvings@gao.gov](mailto:irvings@gao.gov) or Marjorie Kanof at (202) 512-7114 or [kanofm@gao.gov](mailto:kanofm@gao.gov).

June 17, 2008

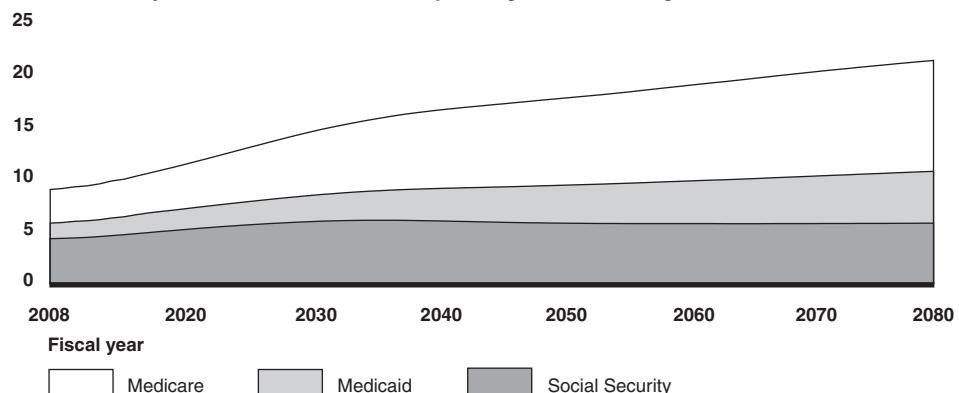
## LONG-TERM FISCAL OUTLOOK

### Long-Term Federal Fiscal Challenge Driven Primarily by Health Care

## What GAO Found

Long-term fiscal simulations by GAO, the Congressional Budget Office (CBO), and others all show that despite a decline in the federal government's unified budget deficit between fiscal years 2003 and 2007, it still faces large and growing structural deficits driven primarily by rising health care costs and known demographic trends. Simply put, the federal government is on an unsustainable long-term fiscal path. Although Social Security is important because of its size, over the long term health care spending is the principal driver—Medicare and Medicaid are both large and projected to continue growing rapidly in the future.

Social Security, Medicare, and Medicaid Spending as a Percentage of GDP



Source: GAO analysis.

Rapidly rising health care costs are not simply a federal budget problem. Growth in health-related spending is the primary driver of the fiscal challenges facing state and local governments as well. Unsustainable growth in health care spending also threatens to erode the ability of employers to provide coverage to their workers and undercuts their ability to compete in a global marketplace. Public and private health care spending continues to rise because of several key factors: (1) increased utilization of new and existing medical technology; (2) lack of reliable comparative information on medical outcomes, quality of care, and cost; and (3) increased prevalence of risk factors such as obesity that can lead to expensive chronic conditions.

Addressing health care costs and demographics—and their interaction—will be a major societal challenge. The longer action on reforming health care and Social Security is delayed, the more painful and difficult the choices will become. The federal government faces increasing pressures yet a shrinking window of opportunity for phasing in adjustments. In fact, the oldest members of the baby-boom generation are now eligible for Social Security retirement benefits and will be eligible for Medicare benefits in less than 3 years. Additionally, in addressing this fiscal challenge it will be important to review other programs and activities on both the spending and revenue sides of the budget.

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Chairman Baucus, Senator Grassley, and Members of the Committee:

I appreciate this invitation to talk with you about the federal government's long-term fiscal outlook. Under any plausible scenario, the federal budget is on an unsustainable path. Long-term fiscal simulations by GAO, the Congressional Budget Office (CBO), and others all show that despite a decline in the federal government's unified budget deficit between fiscal years 2003 and 2007, it still faces large and growing structural deficits. This long-term path is driven primarily by rising health care costs and known demographic trends. In fact, the oldest members of the baby-boom generation are now eligible for Social Security retirement benefits and will be eligible for Medicare benefits in less than 3 years. According to the Social Security Administration, nearly 80 million Americans will become eligible for Social Security retirement benefits over the next two decades—an average of more than 10,000 per day. Although Social Security is important because of its size, the principal driver of the long-term fiscal outlook is health care spending. Medicare and Medicaid are both large and projected to continue growing rapidly in the future.

Today, I will emphasize a few key points:

- the federal government's long-term fiscal outlook is a matter of utmost concern,
- this challenge is driven primarily by health care cost growth,
- reform of health care is essential but other areas also need attention—this is a multipronged problem that requires a multipronged solution, and
- the federal government faces increasing pressures yet a shrinking window of opportunity for phasing in adjustments needed by individuals in the public and private sectors.

My remarks are based on GAO's previous work on a variety of issues, including various reports and testimonies on our nation's long-term fiscal challenges, health care, and the need for budget process reform. These efforts were conducted in accordance with generally accepted government auditing standards.

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## The Long-Term Fiscal Outlook Remains Unsustainable

The unified budget deficit declined between fiscal years 2003 and 2007, but this did not change the long-term path: it remains unsustainable. Moreover, while the recent past shows some progress in the annual unified deficit figures, any assessment of the federal government's long-term fiscal outlook also needs to recognize the fact that the Social Security cash surplus has been used to offset spending in the rest of government

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for many years. In fiscal year 2007, for example, the “on-budget” deficit—the deficit excluding the Social Security surplus<sup>1</sup>—was \$344 billion, more than double the size of the unified deficit of \$163 billion. There is a limit to how long the Social Security surplus will offset other spending. The rest of the budget will feel the pressure when the Social Security cash surplus begins to decline starting in 2011—less than 3 years from now. In 2017 the Social Security cash flow turns negative—at that point the choices will be increased borrowing from the public, reduced spending, or increased revenue.

These dates call attention to the narrowing window. The real challenge then is not this year’s deficit or even next year’s; it is how to change the current fiscal path so that growing deficits and debt levels do not reach unsustainable levels. By definition something that is unsustainable will stop—the challenge is to take action before being forced to do so by some sort of crisis. Health care costs are growing much faster than the economy, and the nation’s population is aging. These drivers will soon place unprecedented, growing, and long-lasting stress on the federal budget. Absent action, debt held by the public will grow to unsustainable levels.

Figure 1 shows GAO’s simulation of the deficit path based on recent trends and policy preferences. In this simulation, we start with CBO’s baseline and then assume that (1) all expiring tax provisions are extended through 2018—and then revenues are brought to their historical level as a share of gross domestic product (GDP) plus expected revenue from deferred taxes—(2) discretionary spending grows with the economy, and (3) no changes are made to Social Security, Medicare, or Medicaid.<sup>2</sup>

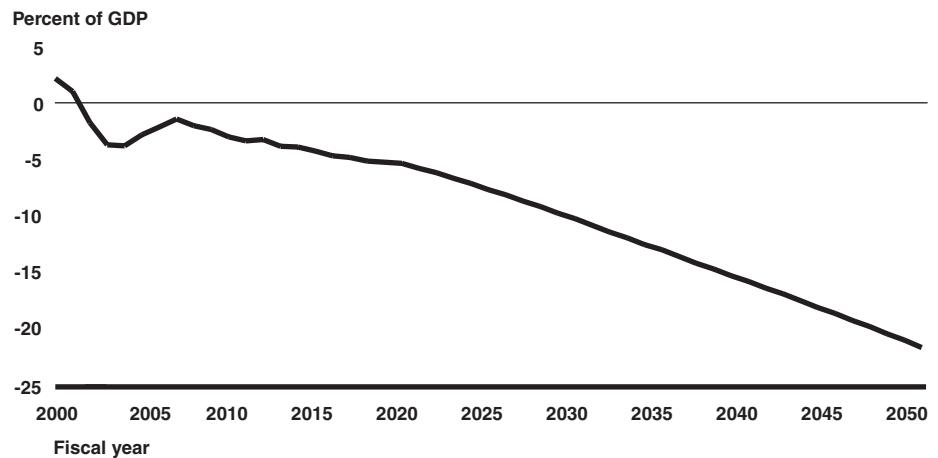
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<sup>1</sup>The Postal Service is also off-budget, but it had a deficit of \$5 billion in fiscal year 2007.

<sup>2</sup>Social Security and Medicare spending are based on the programs’ 2008 Trustees’ intermediate projections. Medicare spending is adjusted using the Centers for Medicare and Medicaid Services’ estimates assuming that physician payments are not reduced as required under current law. Medicaid spending is based on CBO’s December 2007 long-term projections adjusted to reflect excess cost growth consistent with the Trustees’ intermediate projections. Additional information about GAO’s simulation model, assumptions, data, and results can be found at <http://www.gao.gov/special.pubs/longterm/>.

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**Figure 1: Unified Federal Surpluses and Deficits under GAO's Alternative Simulation**



Source: GAO's April 2008 analysis.

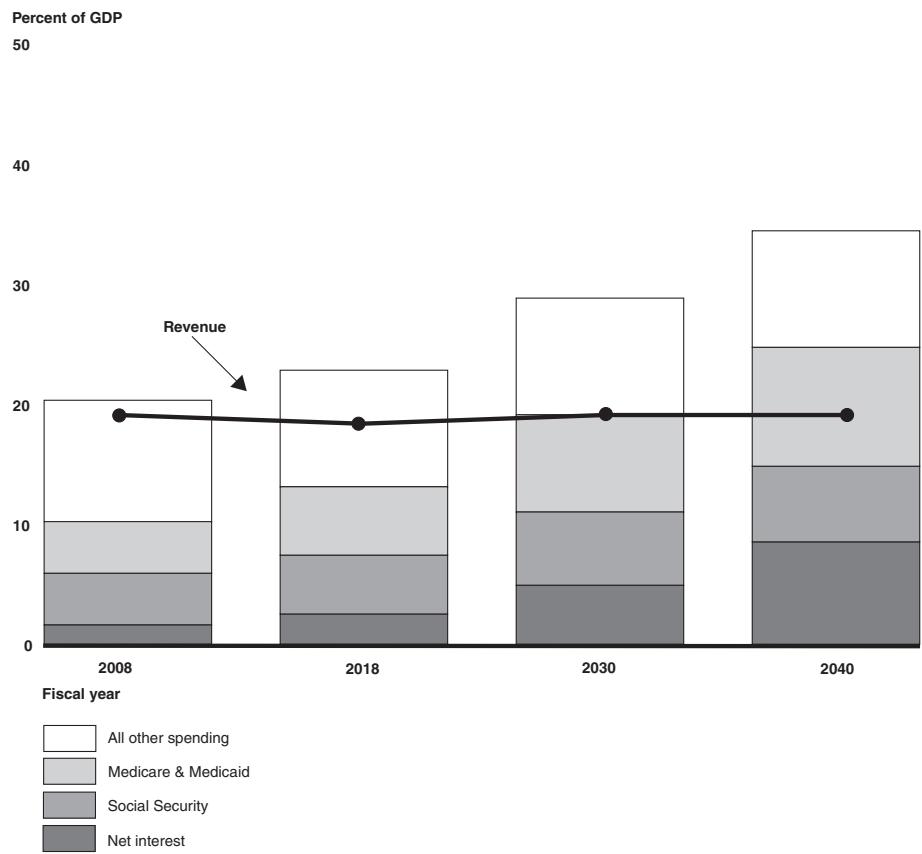
Note: Assumes currently scheduled Social Security and Medicare Part A benefits are paid in full throughout the simulation period.

Figure 2 looks behind the deficit path to the composition of federal spending. It shows that the estimated growth in Medicare, Medicaid, and to a lesser extent Social Security leads to an unsustainable fiscal future. In this figure the category “all other spending” includes much of what many think of as “government”—discretionary spending on such activities as national defense, homeland security, veterans health benefits, national parks, highways and mass transit, and foreign aid, plus mandatory spending on the smaller entitlement programs such as Supplemental Security Income, Temporary Assistance for Needy Families, and farm price supports.<sup>3</sup> The growth in Social Security, Medicare, Medicaid, and interest on debt held by the public dwarfs the growth in all other types of spending.

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<sup>3</sup>Discretionary spending refers to spending based on authority provided in annual appropriations acts. Mandatory spending refers to spending that Congress has authorized in legislation other than appropriations acts that entitles beneficiaries to receive payment or that otherwise obligates the government to make payment.

**Figure 2: Potential Fiscal Outcomes under GAO's Alternative Simulation: Revenues and Composition of Spending as Shares of GDP**



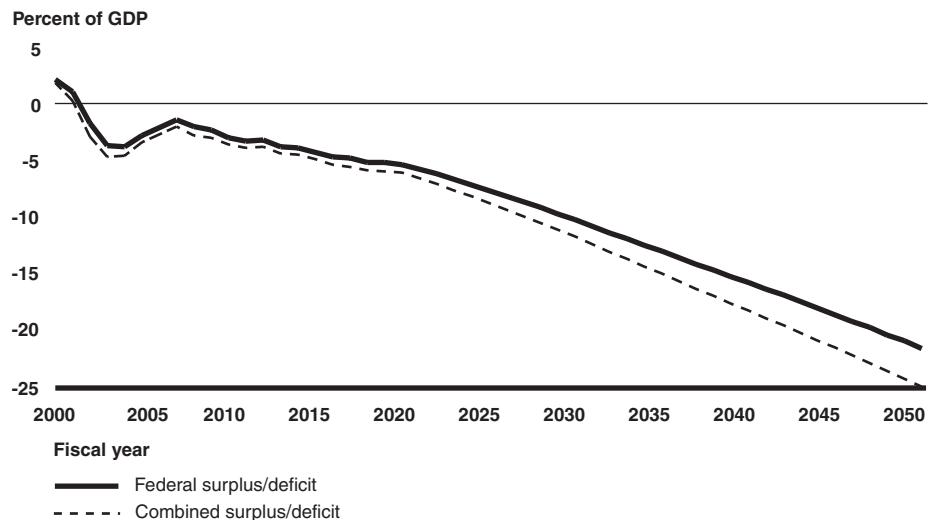
Source: GAO's April 2008 analysis.

Notes: Discretionary spending grows with GDP after 2008. The Alternative Minimum Tax (AMT) exemption amount is retained at the 2007 level through 2018 and expiring tax provisions are extended. After 2018, revenue as a share of GDP returns to its historical level of 18.3 percent plus expected revenues from deferred taxes (i.e., taxes on withdrawals from retirement accounts). Medicare spending is based on the Trustees' 2008 projections adjusted for the Centers for Medicare and Medicaid Services' alternative assumption that physician payments are not reduced as specified under current law.

Rapidly rising health care costs are not simply a federal budget problem; they are a problem for other levels of government and other sectors. As shown in figure 3, GAO's fiscal model demonstrates that state and local governments—absent policy changes—will also face large and growing

fiscal challenges beginning within the next few years.<sup>4</sup> As is true for the federal budget, growth in health-related spending—Medicaid and health insurance for state and local employees and retirees—is the primary driver of the long-term fiscal challenges facing the state and local governments. These simulations imply that state and local fiscal challenges will add to the nation's fiscal difficulties and suggest that the nation's fiscal challenges cannot be remedied simply by shifting the burden from one sector to another.

**Figure 3: Federal and Combined Federal, State, and Local Fiscal Imbalance**



Source: GAO's April 2008 analysis.

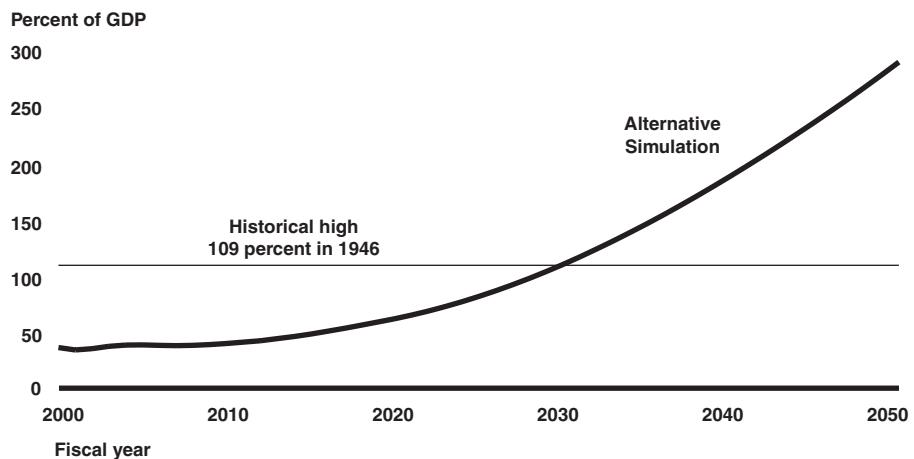
Note: Federal surpluses and deficits are from GAO's alternative simulation.

If unchanged, the federal government's increased spending and rising deficits will drive a rising debt burden. At the end of fiscal year 2007, federal debt held by the public exceeded \$5 trillion. Figure 4 shows that this growth in the federal government's debt cannot continue unabated without causing serious harm to the economy. In the last 200 years, only during and after World War II has debt held by the public exceeded 50 percent of GDP.

<sup>4</sup>See GAO, *State and Local Governments: Growing Fiscal Challenges Will Emerge during the Next 10 Years*, GAO-08-317 (Washington, D.C.: Jan. 22, 2008), and *State and Local Governments: Persistent Fiscal Challenges Will Likely Emerge within the Next Decade*, GAO-07-1080SP (Washington, D.C.: July 18, 2007).

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**Figure 4: Debt Held by the Public under GAO's Alternative Simulation**



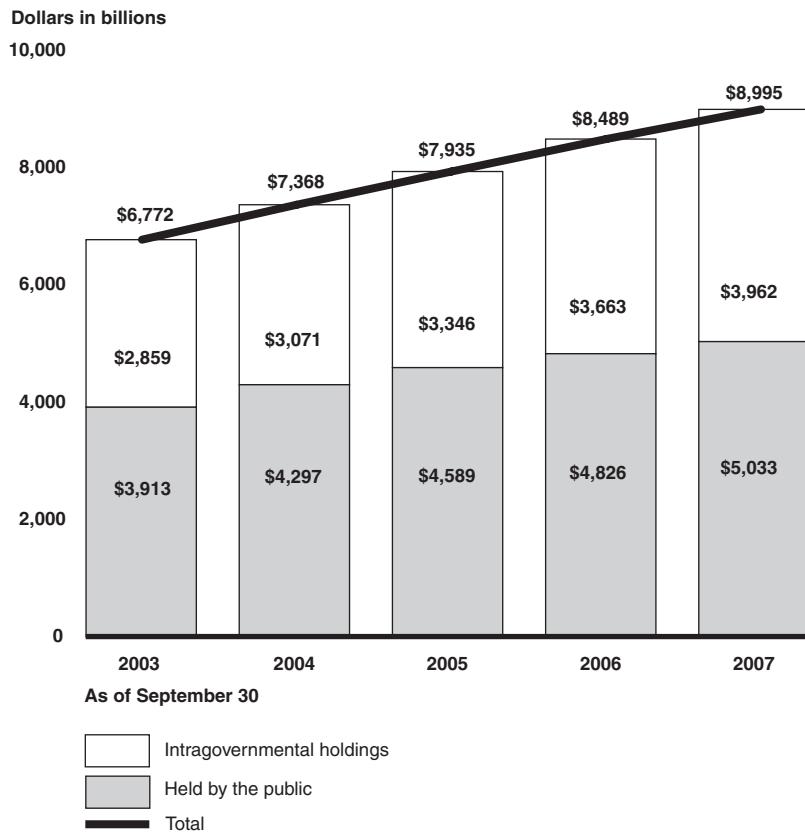
Source: GAO's April 2008 analysis.

Note: Assumes currently scheduled Social Security and Medicare Part A benefits are paid in full throughout the simulation period.

But this is only part of the story. The federal government for years has been borrowing the surpluses in the Social Security trust funds and other similar funds and using them to finance federal government costs. When such borrowings occur, the Department of the Treasury issues federal securities to these government funds that are backed by the full faith and credit of the U.S. government. Although borrowing by one part of the federal government from another does not have the same economic and financial implications as borrowing from the public, it represents a claim on future resources and hence a burden on future taxpayers and the future economy. If federal securities held by those funds are included, the federal government's total debt is much higher—about \$9 trillion as of the end of fiscal year 2007. As shown in figure 5, total federal debt increased over each of the last 4 fiscal years.

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**Figure 5: Total Federal Debt Outstanding**



Source: The Department of the Treasury.

On September 29, 2007, the statutory debt limit had to be raised for the third time in 4 years in order to avoid being breached; between the end of fiscal year 2003 and the end of fiscal year 2007, the debt limit had to be increased by about one-third. It is anticipated that actions will need to be taken in fiscal year 2009 to avoid breaching the current statutory debt limit of \$9,815 billion.

While today's debt numbers are large, they do not represent a measure of all future claims. They exclude a number of significant items, such as the gap between currently scheduled Social Security and Medicare benefits and the revenues earmarked for these programs as well as the likely cost of veterans' health care and a range of other commitments and contingencies that the federal government has pledged to support. For example, the Statement of Social Insurance in the 2007 *Financial Report*

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*of the United States Government* disclosed that as of September 30, 2007, for Social Security and Medicare alone, projected expenditures for scheduled benefits exceed earmarked revenues (i.e., dedicated payroll taxes and premiums) by approximately \$41 trillion over the next 75 years in present value terms. Of that amount, \$34 trillion is related to Medicare and \$7 trillion to Social Security. While Social Security, Medicare, and Medicaid dominate the long-term outlook, policymakers need to look at other policies that limit flexibility—not necessarily to eliminate them but to at least be aware of them and make a conscious decision about them. Several years ago, we developed the term “fiscal exposures” to provide a framework for considering the wide range of responsibilities, programs, and activities that may explicitly or implicitly expose the federal government to future spending.<sup>5</sup>

Fiscal exposures vary widely as to source, extent of the government’s legal obligation, likelihood of occurrence, and magnitude. They include not only liabilities, contingencies, and financial commitments that are identified on the balance sheet or accompanying notes, but also responsibilities and expectations for government spending that do not meet the recognition or disclosure requirements for that statement. By extending beyond conventional accounting, the concept of fiscal exposure is meant to provide a broad perspective on long-term costs and uncertainties. Fiscal exposures include items such as retirement benefits, environmental cleanup costs, the funding gap in Social Security and Medicare, and the life cycle-cost for fixed assets. Given this variety, it is useful to think of fiscal exposures as lying on a spectrum extending from explicit liabilities to the implicit promises embedded in current policy or public expectations.

Many ways exist to assess the long-term fiscal challenge. One quantitative measure is called “the fiscal gap.” This measures the amount of spending cuts or tax increases that would be needed to keep debt as a share of GDP at or below today’s ratio. The fiscal gap is an estimate of the action needed to achieve fiscal balance over a certain time period such as 75 years. Another way to say this is that the fiscal gap is the amount of change needed to prevent the kind of debt explosion shown in figure 4. The fiscal gap can be expressed as a share of the economy or in present value dollars.

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<sup>5</sup>GAO, *Fiscal Exposures: Improving the Budgetary Focus on Long-Term Costs and Uncertainties*, GAO-03-213 (Washington, D.C.: Jan. 24, 2003).

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For example, under our alternative simulation closing the fiscal gap would require spending cuts or tax increases equal to 6.7 percent of the entire economy over the next 75 years, or about \$54 trillion in present value terms. To put this in perspective, closing the gap would require an increase in today's federal tax revenues of more than one-third or an equivalent reduction in today's federal program spending (i.e., in all spending except for interest on the debt held by the public, which cannot be directly controlled) and maintained over the entire period. Table 1 shows the changes necessary to close the fiscal gap over the next 75 years.

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**Table 1: Federal Fiscal Gap 2008–2088**

Fiscal gap	Change required to close gap compared to today's levels				
	Trillions of 2008 dollars	Share of GDP	Percentage increase in revenue	Percentage increase in individual income taxes	Percentage decrease in noninterest spending
Alternative	\$54.0	6.7%	35.8%	78.3%	35.5%

Source: GAO's April 2008 analysis.

Policymakers could phase in the policy changes so that the tax increases or spending cuts would grow over time and allow people to adjust. The size of these annual tax increases and spending cuts would be more than five times the fiscal year 2007 deficit of 1.2 percent of GDP. Delaying action would make future adjustments even larger. Under our alternative simulation, waiting even 10 years would require a revenue increase of about 45 percent or noninterest spending cuts of about 40 percent. This gap is too large to grow out of the problem. To be sure, additional economic growth would certainly help the federal government's financial condition, but it will not eliminate the need for action.

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## The Federal Government's Long-Term Fiscal Outlook Is Driven Primarily by Health Care

The large fiscal gap is primarily the result of spending on Medicare and Medicaid, which continue to consume ever-larger shares of both the federal budget and the economy. Federal expenditures on Medicare and Medicaid represent a much larger, faster-growing, and more immediate problem than Social Security. Medicare and Medicaid are not unique in experiencing rapid spending growth, but instead this growth largely mirrors spending trends in other public health care programs and the overall health care system. A number of factors contribute to the rise in spending, including the use of new medical technology and market

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dynamics that do not encourage the efficient provision of health care services. Addressing these challenges will not be easy.

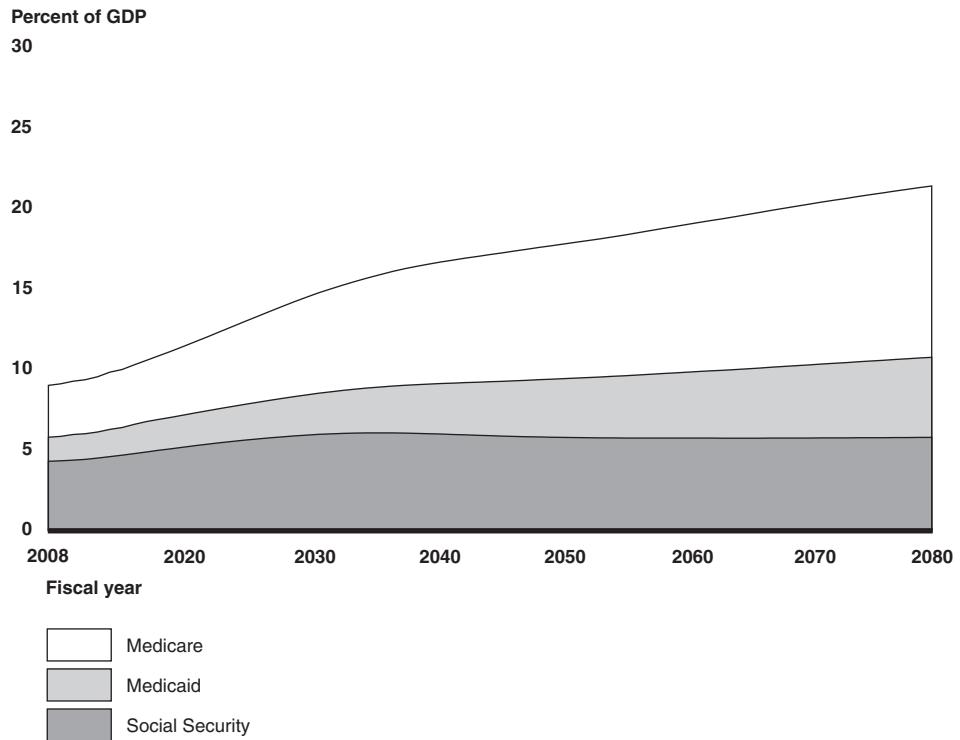
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## Health Care Costs Have Outpaced Economic Growth

Federal health care spending comprises a myriad of programs, but federal obligations are driven by the two largest programs, Medicare and Medicaid. Spending for these two programs threatens to consume an untenable share of the budget and economy in the coming decades. Figure 6 shows the total future draw on the economy represented by Social Security, Medicare, and Medicaid. While Social Security will grow from 4.3 percent of GDP today to 5.8 percent in 2080, Medicare and Medicaid's burden on the economy will more than triple—from 4.7 percent to 15.7 percent of the economy. Although some of the increased burden is due to the aging of the population, the majority is due to increased costs per beneficiary, some of which is the result of interaction between demographics and health care spending. Consequently, unlike Social Security, which will level off after growing as a share of the economy, Medicare and Medicaid will continue to grow. The projections for Medicaid spending assume a long-term cost growth rate consistent with the long-term growth rate assumption of the Medicare Trustees—GDP per capita plus about 1 percent on average. This growth rate, which would represent a slowing of the current trend, is well below recent historical experience of about 2.5 percent above GDP per capita.

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**Figure 6: Social Security, Medicare, and Medicaid Spending as a Percentage of GDP**



Source: GAO analysis.

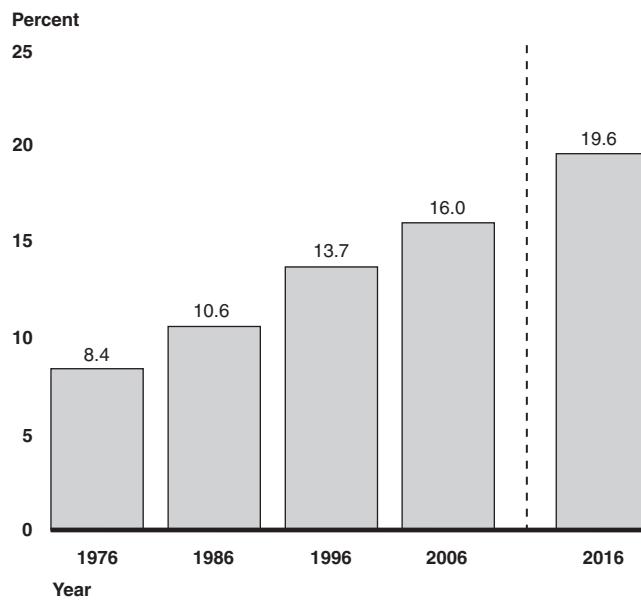
Note: Social Security and Medicare projections are from the Office of the Chief Actuary, Social Security Administration, and Office of the Actuary, Centers for Medicare and Medicaid Services under the intermediate assumptions of the 2008 Trustees. Medicaid projections based on CBO's January 2008 short-term Medicaid estimates and CBO's December 2007 long-term Medicaid projections adjusted to reflect excess cost growth consistent with the 2008 Trustees intermediate assumptions.

The federal government and other public payers are not the only ones facing rapidly rising health care expenses. Private payers face the same challenges. As shown in figure 7, total health care spending from both public and private payers is absorbing an increasing share of our nation's GDP. From 1976 through 2006, spending on health care grew from about 8 percent of GDP to 16 percent, and it is projected to grow to about 20 percent of GDP by 2016. While growth in public spending strains government budgets, growth in private sector health care costs erodes employers' ability to provide coverage to their workers and undercuts their ability to compete internationally.

When compared with other nations, the United States is an outlier in its high level of health care spending. For example, in 2005, health care

accounted for about 15 percent of GDP in the United States, the largest share among developed nations who are members of the Organization for Economic Co-operation and Development (OECD). The United States also ranks far ahead of other OECD countries in terms of per capita health spending. In that same year, the United States spent \$6,401 per person, a level nearly twice that found in France, Canada, and Germany, and about two and a half times higher than the levels found in Italy, Japan, and the United Kingdom. Despite this higher level of health care spending, the United States still fares poorly on many health measures. Compared to other nations, the United States has above-average infant mortality, below-average life expectancy, and the largest percentage of uninsured individuals. For example, according to the most recent published data from OECD, the United States ranked 27 out of 30 in infant mortality and 24 out of 30 in life expectancy.<sup>6</sup>

**Figure 7: Health Care Spending as a Percentage of GDP**



Source: Centers for Medicare and Medicaid Services, Office of the Actuary.

Notes: The figure for 2016 is projected. The most current data available on health care spending are for 2006.

<sup>6</sup>Data for most OECD countries are for 2005. Data on life expectancy and infant mortality in the United States are for 2004 and 2002 respectively. Recent preliminary data show a slight improvement in life expectancy in the United States for 2006.

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## Systemwide Growth in Health Care Spending Is Driven by Certain Key Factors

Public and private health care spending continues to rise because of several key factors, including the following:

- **Medical technology.** While new and existing medical technology can lead to medical benefits, in some cases technology can lead to the excessive use of resources. On the one hand, experts agree that technology's contributions over the past 20 years—new pharmaceuticals, diagnostic imaging, and genetic engineering, among others—have been, on the whole, of significant value to the nation's health. Such advances in medical science have allowed providers to treat patients in ways that were not previously possible or to treat conditions more effectively. On the other hand, experts note that the nation's general tendency is to treat patients with available technology even when there is little chance of benefit to the patient and without consideration of costs.<sup>7</sup>
- **Market dynamics.** Another cost-containment challenge for all payers relates to the market dynamics of health care compared with other economic sectors. In an ideal market, informed consumers prod competitors to offer the best value. However, without reliable comparative information on medical outcomes, quality of care, and cost, consumers are less able to determine the best value. Insurance masks the actual costs of goods and services, providing little incentive for consumers to be cost-conscious. Many insured individuals pay relatively little out of pocket for care at the point of delivery because of comprehensive health care coverage. Current federal tax policies encourage such comprehensive coverage, for example, by excluding employers' contribution for premiums from employees' taxable income. These tax exclusions represent a significant source of forgone federal revenue and work at cross-purposes to the goal of moderating health care spending. Furthermore, clinicians must often make decisions in the absence of universal medical standards of practice. Under these circumstances, medical practices vary across the nation, as evidenced by wide geographic variation in per capita spending and outcomes, even after controlling for patient differences in health status.
- **Population health.** Obesity, smoking, and other population risk factors can lead to expensive chronic conditions, such as diabetes and heart disease. The increased prevalence of such conditions drives spending as the utilization of health care resources rises. For example, one study indicated that the rising prevalence of obesity and higher relative per capita health care spending among obese individuals resulted in 27

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<sup>7</sup>GAO, *Health Care: Unsustainable Trends Necessitate Comprehensive and Fundamental Reforms to Control Spending and Improve Value*, GAO-04-793SP (Washington, D.C.: May 2004).

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percent of the growth in inflation-adjusted per capita health care spending from 1987 through 2001.<sup>8</sup>

Addressing these drivers will be a major societal challenge. Solving the problem of the federal government's escalating health care costs is especially difficult, since changing programs such as Medicare and Medicaid will involve changes, not just within these federal programs, but to our country's health care system as a whole. However, many experts have recommended that the federal government could help drive improvement in the health care system. For example, experts note the need for strong financial incentives to overcome a lack of systems—including information systems—to reduce error and reinforce best practices. Medicare—the single, largest purchaser of health care services in the United States—could play a more active role in promoting a market that rewards better performance through payment incentives that promote the pursuit of improved quality and efficiency.

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## The Window of Opportunity Is Narrowing

Here in the first half of 2008, the long-term fiscal challenge is not in the distant future. The first baby boomers have already retired. (See table 2.) The budget and economic implications of the baby-boom generation's retirement have already become a factor in CBO's 10-year baseline projections and that effect will only intensify as the baby boomers age. As the share of the population over 65 climbs, demographics will interact with rising health care costs. The longer action on reforming health care and Social Security is delayed, the more painful and difficult the choices will become. Simply put, the federal budget is on an unsustainable long-term fiscal path that is getting worse with the passage of time.

The window for timely action is shrinking. Albert Einstein said the most powerful force in the universe is compound interest, and today the miracle of compounding is working against the federal government. After 2011 the Social Security cash surplus—which has cushioned and masked the effect of the federal government's fiscal policy—will begin to shrink, putting pressure on the rest of the budget. The Medicare Hospital Insurance trust fund is already in a negative cash-flow situation. Demographics narrow the window for other reasons as well. People need time to prepare for and

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<sup>8</sup>Kenneth E. Thorpe et al., "The Impact of Obesity on Rising Medical Spending," *Health Affairs Web Exclusive*, (Oct. 20, 2004) <http://content.healthaffairs.org/cgi/content/abstract/hlthaff.w4.480>.

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adjust to changes in benefits. There has been general agreement that there should be no change in Social Security benefits for those currently in or near retirement. If changes are delayed until the entire baby-boom generation has retired, that becomes much harder and much more expensive.

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**Table 2: The Long-Term Fiscal Challenge Has Begun**

<b>2008</b> —Oldest members of the baby-boom generation eligible for Social Security
<b>2008</b> —Medicare Hospital Insurance (HI) outlays exceed cash income
<b>2009</b> —Debt ceiling will need to be raised
<b>2011</b> —Oldest members of the baby-boom generation eligible for Medicare
<b>2011</b> —Social Security cash surplus begins to decline
<b>2017</b> —Annual Social Security benefits exceed cash income
<b>2019</b> —Medicare HI trust fund exhausted, income sufficient to pay about 79 percent of promised benefits
<b>2026</b> —Youngest members of the baby-boom generation eligible for Social Security
<b>2030</b> —Debt held by the public under GAO’s Alternative simulation exceeds the historical high reached in the aftermath of World War II
<b>2041</b> —Social Security trust fund exhausted income sufficient to pay about 75 percent of promised benefits

Source: GAO.

Meeting this long-term fiscal imbalance is the nation’s largest sustainability challenge. Aligning the federal government to meet the challenges and capitalize on the opportunities of the 21<sup>st</sup> century will require a fundamental review of what the federal government does, how it does it, and how it is financed. Attention should be focused not only on the spending side of the budget but also on the revenue side. Tax expenditures,<sup>9</sup> for example, should be reexamined with the same scrutiny as spending programs. Moving forward, the federal government needs to start making tough choices in setting priorities and linking resources and activities to results.

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<sup>9</sup>Tax expenditures are revenue losses attributable to provisions of the federal tax laws that allow a special exclusion, exemption, or deduction from gross income or that provide a special credit, a preferential rate of tax, or a deferral of liability. These exceptions may be viewed as alternatives to other policy instruments, such as spending or regulatory programs.

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Meeting the nation's long-term fiscal challenge will require a multipronged approach bringing people together to tackle health care, Social Security, and the tax system as well as

- strengthening oversight of programs and activities, including creating approaches to better facilitate the discussion of integrated solutions to cross-cutting issues; and
- reengineering and reprioritizing the federal government's existing programs, policies, and activities to address 21<sup>st</sup> century challenges and capitalize on related opportunities.

There are also some process changes that might help the discussion by increasing the transparency and relevancy of key financial, performance, and budget reporting and estimates that highlight the fiscal challenge. Stronger budget controls for both spending and tax policies to deal with both near-term and longer-term deficits may also be helpful.

As we recently reported,<sup>10</sup> several countries have begun preparing fiscal sustainability reports to help assess the implications of their public pension and health care programs and other challenges in the context of overall sustainability of government finances. European Union members also annually report on longer-term fiscal sustainability. The goal of these reports is to increase public awareness and understanding of the long-term fiscal outlook in light of escalating health care cost growth and population aging, to stimulate public and policy debates, and to help policymakers make more-informed decisions. These countries used a variety of measures, including projections of future revenue and spending and summary measures of fiscal imbalance and fiscal gaps, to assess fiscal sustainability. Last year, we recommended that the United States should periodically prepare and publish a long-range fiscal sustainability report.<sup>11</sup> I am pleased to note that the Federal Accounting Standards Advisory Board (FASAB) is considering possible changes to social insurance reporting and has initiated a project on fiscal sustainability reporting.

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<sup>10</sup>GAO, *Budget Issues: Accrual Budgeting Useful in Certain Areas but Does Not Provide Sufficient Information for Reporting on Our Nation's Longer-Term Fiscal Challenge*, GAO-08-206 (Washington, D.C.: Dec. 20, 2007).

<sup>11</sup>GAO, *Long-Term Fiscal Challenge: Additional Transparency and Controls Are Needed*, GAO-07-1144T (Washington, D.C.: July 25, 2007) and *Long-Term Budget Outlook: Deficits Matter—Saving Our Future Requires Tough Choices Today*, GAO-07-389T (Washington, D.C.: Jan. 23, 2007).

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Mr. Chairman, Senator Grassley, members of the committee—health care may be the principal driver of the long-term fiscal outlook, but that does not mean government should ignore other drivers. Demographics are a smaller component than rapid health care cost growth, but the two interact, and aging is not a trivial contributor to the federal government's long-term fiscal condition. We have suggested that to right the fiscal path will require discussing health care and Social Security and looking at both the spending and tax sides of the budget. Although these entitlements and revenue drive the overall fiscal trends, it is also important that the federal government look at other programs and activities. Reexamining what government does and how it does business can help government meet the challenges of this century in providing some specific and practical steps that Congress can take to help address these long-term challenges. In this effort Congress may find a report we published in December 2007 useful. The report is entitled, *A Call for Stewardship: Enhancing the Federal Government's Ability to Address Key Fiscal and Other 21<sup>st</sup> Century Challenges.*<sup>12</sup>

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Thank you Mr. Chairman, Senator Grassley, and members of the committee for having me today. We at GAO, of course, stand ready to assist you and your colleagues as you tackle these important challenges.

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## Contacts and Acknowledgments

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<sup>12</sup>[GAO-08-93SP](#) (Washington, D.C.: Dec. 17, 2007).

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