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BUDGET ISSUES

Long-Term Fiscal Challenges

Statement of David M. Walker
Comptroller General of the United States

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Chairman Conrad, Ranking Member Domenici, and Members of the Committee:

I am pleased to return this year to present GAO's perspective on the long-range fiscal policy challenges facing this Congress and our nation. We meet today in a situation that seems very different from that of last February. Today the challenges of combating terrorism and ensuring our homeland security have come to the fore as urgent claims on our attention and on the federal budget. While there are indications that an economic recovery is underway, the recession that began last spring has had real consequences for the budget. These are important changes in the last year. At the same time, the known fiscal pressures created by the retirement of the baby boom generation and rising health care costs remain the same. Absent substantive reform of the entitlement programs, a rapid escalation of federal spending for Social Security, Medicare, and Medicaid beginning less than 10 years from now is virtually certain to overwhelm the rest of the federal budget. Indeed, the slowing economy and tax and spending decisions, including the increased spending levels necessary to respond to new security challenges, have increased pressures on the budget. Correspondingly, the ultimate task of addressing these needs without unduly exacerbating the long-range fiscal challenge has become much more difficult.

In my testimony today I make the following points:

- The surpluses that many worked hard to achieve—with help from the economy—not only strengthened the economy for the longer term but also put us in a stronger position to respond to the events of September 11 and to the economic slowdown than would otherwise have been the case.

- Going forward, the nation's commitment to surpluses will be tested: a return to surplus will require sustained discipline and difficult choices.

- Because the longer-term outlook is driven in large part by known demographic trends, in some ways we can be surer about the outlook 20 years from now than the forecast for the next few years.

- The message of GAO's updated simulations remains the same as last year: absent structural changes in entitlement programs for the elderly, in the long term persistent deficits and escalating debt will overwhelm the budget.

- Both longer-term pressures and the new commitments undertaken after September 11 sharpen the need to look at competing claims and new priorities. A fundamental review of existing programs and activities is necessary both to increase fiscal flexibility and to make government fit the modern world. Stated differently, there is a need to consider what is the proper role of the federal government in the 21st century and how should the government do business in the future.

- The fiscal benchmarks and rules that moved us from deficit to surplus expire this fiscal year. Any successor system should facilitate both a debate about reprioritization today and a better understanding of the long-term implications of different policy choices. Simply stated, there are many things that we may be able to afford to do today but we may not be able to sustain in the future.

THE FISCAL BACKDROP FOR TODAY'S CHOICES

Today it is evident that recent surpluses were the result not only of hard choices made earlier in the 1990s, but also of fortuitous economic, demographic, and policy trends that are no longer working for us as we enter the 21st century. In retrospect, the nation emerged from deficits of nearly three decades only to find itself in what has been called "the eye of the storm." The passage to surpluses was aided by a tailwind consisting of (1) extraordinarily strong economic growth, (2) a slowing of health care cost growth, (3) a demographic holiday stemming from low birth rates during the Depression and World War II paired with a large workforce resulting from the post-war baby boom—which together gave rise to a stable worker-to-beneficiary ratio in Social Security, and (4) the fall of the Soviet Union permitting a decline in defense spending as a share of the economy.

The fiscal winds have now shifted—many of these fortunate trends have now reversed course and are making the choices harder. Although it appears the economy may have turned the corner, forecasters are not showing a return to the extremely rapid growth the nation enjoyed during the last half of the nineties. Health care costs have once again resumed growing at double-digit rates. Reductions in defense spending can no longer be used as a means to help fund other claims on the budget; indeed, spending on defense and homeland security will grow as we seek to defeat terrorism worldwide. Finally—and I know this is one of the reasons you invited me here today—the nation's demographic holiday is ending. In 2008—only 6 years from now—demographic storm clouds will begin to shadow the baseline as the first wave of baby boomers become eligible to claim Social Security.

However one allocates credit across the events and decisions that led to years of surpluses, we benefited from that achievement. These large surpluses not only helped in the short term by reducing debt and interest costs but also strengthened the budget and the economy for the longer term. The budgetary surpluses of recent years put us in a stronger position to respond both to the events of September 11 and to the economic slowdown than would otherwise have been the case.

However, going forward, the nation's commitment to surpluses will truly be tested. For the last few years surpluses were built in to the baseline so that given a lack of policy action, there would be a surplus. Last year, the Congressional Budget Office (CBO) baseline not only projected unified surpluses for at least the 10-year window but also substantial surpluses in the non-Social Security portion of the budget. Saving the Social Security surplus became an achievable and compelling fiscal policy goal for the nation in this context. This is no longer true. At least for the next several years the baseline does not turn to unified surplus. A surplus in the non-Social Security portion of the budget is not projected under the baseline to emerge until 2010. As a result, explicit policy actions on spending and/or revenue will be necessary to return to and maintain surpluses over the next 10 years.

THE KNOWN DEMOGRAPHIC CHALLENGE

Although in important ways you begin the task of crafting a budget this year in a very different place than you did last year, in other ways the responsibilities remain the same. We still have a stewardship obligation to future generations. By stewardship obligation I mean that in making budget decisions today, it is important to be mindful of their impact on the future. This means that in responding to the legitimate needs of today, we should take into account the longer-term fiscal pressures we face. The message of GAO's long-term simulations, updated using CBO's new budget estimates, is consistent with previous simulations: absent change, spending for federal health and retirement programs eventually overwhelms all other federal spending.

As we look ahead we face an unprecedented demographic challenge. A nation that has prided itself on its youth will become older. Between now and 2035, the number of people who are 65 or over will double. As the share of the population over 65 climbs, federal spending on the elderly will absorb larger and ultimately unsustainable shares of the federal budget. Federal health and retirement spending are expected to surge as people live longer and spend more time in retirement. In addition, advances in medical technology are likely to keep pushing up the cost of providing health care. Moreover, the baby boomers will have left behind fewer workers to support them in retirement, prompting a slower rate of economic growth from which to finance these higher costs. Absent substantive change in related entitlement programs, large deficits return, requiring a combination of unprecedented spending cuts in other areas, and/or unprecedented tax increases, and/or substantially increased borrowing from the public (or correspondingly less debt reduction than would otherwise have been the case). These trends have widespread implications for our society, our culture, our economy, and—of most relevance here—our budget.

Ultimately, as this Committee and its counterpart in the House recommended on October 4,[1] the federal government should attempt to return to a position of surplus as the economy returns to a higher growth path. Returning to surpluses will take place against the backdrop of greater competition of claims within the budget. Although budget balance may have been the desired fiscal position in the past decade, surpluses would promote the level of savings and investment necessary to help future generations better afford the commitments of an aging society.

Early action is important. We all recognize that we have urgent matters to address as a nation and our history shows we have been willing to run deficits during wars and recessions. However, it remains important that to get on with the task of addressing the long-term pressures sooner rather than later. Some will suggest that early action may not be necessary—for example, that faster economic growth may enable a smaller pool of workers to more easily finance the baby boom retirement. While this might happen, the best estimates of the actuaries suggest it is unlikely. CBO has also said that the nation's long-term fiscal outlook will largely be determined by federal spending for retirees, especially for health.

Although long-term projections are inherently more uncertain than short-term forecasts, in some ways we can be surer about the outlook 20 years from now since it is driven by known

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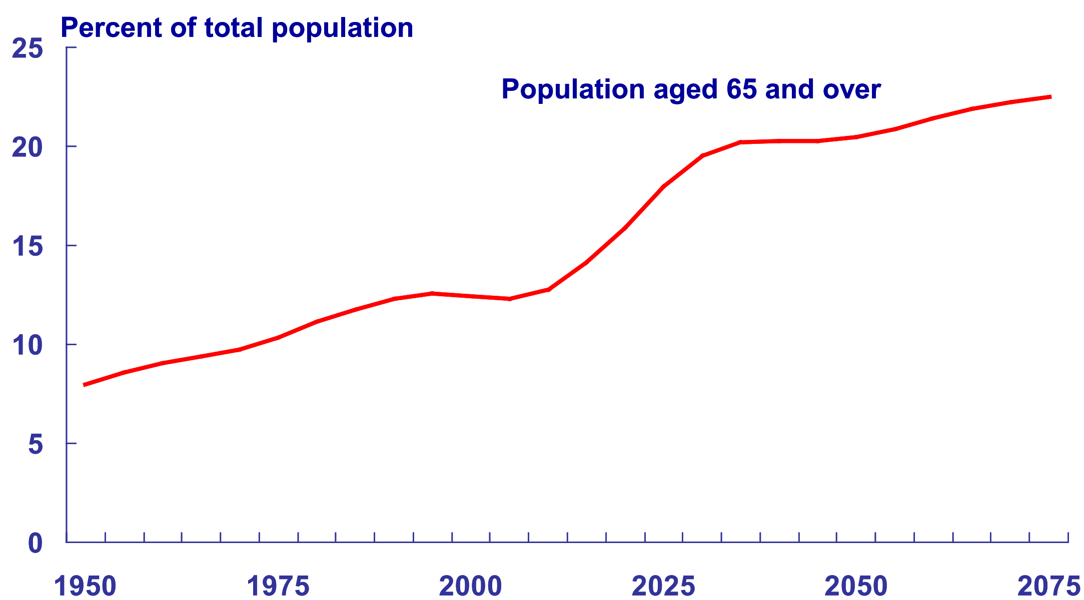
[1] House and Senate Budget Committees, *The Revised Budgetary Outlook and Principles for Economic Stimulus* (Oct. 4, 2001).

demographics. The swing in 1-, 5-, and 10-year projections over the last 12 months has served to emphasize the extent to which short-term projections are subject to uncertainty. And CBO notes that this year the near-term projections are subject to unusual uncertainties as the nation wages war on terrorism and recovers from a recession. CBO pointed out that it is considered more difficult to forecast the economy when it is entering or exiting a recession. This year there are additional uncertainties in the near-term budget outlook. CBO's reference case—the baseline—from which you begin your deliberations (and which in the first 10 years is the underpinning for our long-term model) is a representation of current laws and policies. Thus, by definition it does not account for the effects of future legislation, including likely increases in spending for defense and homeland security to which both parties have agreed in principle. Nor, as CBO noted, does it make assumptions about a number of issues, e.g., the extension of agriculture programs, Medicare prescription drug coverage, changes in the Alternative Minimum Tax, or the extension of various expiring tax provisions.

Given this extreme uncertainty around the next 1 to 5 years, why look out 20 or 30 years? Absent some draconian or unexpected dramatic event, the long-term budget outlook is driven by factors already in motion—most notably the aging of the population. In previous testimonies before you, I have talked about a demographic tidal wave. Beginning about 2010, the share of the population that is age 65 or older will begin to climb, surpassing 20 percent by 2035. (See fig. 1.)

Figure 1: Aged Population as a Share of Total U.S. Population Continues to Grow



Note: Projections based on intermediate assumptions of the 2001 Trustees' reports.
Source: *The 2001 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*.

GAO'S MODEL SIMULATIONS ILLUSTRATE LONG-TERM BUDGET CHALLENGES

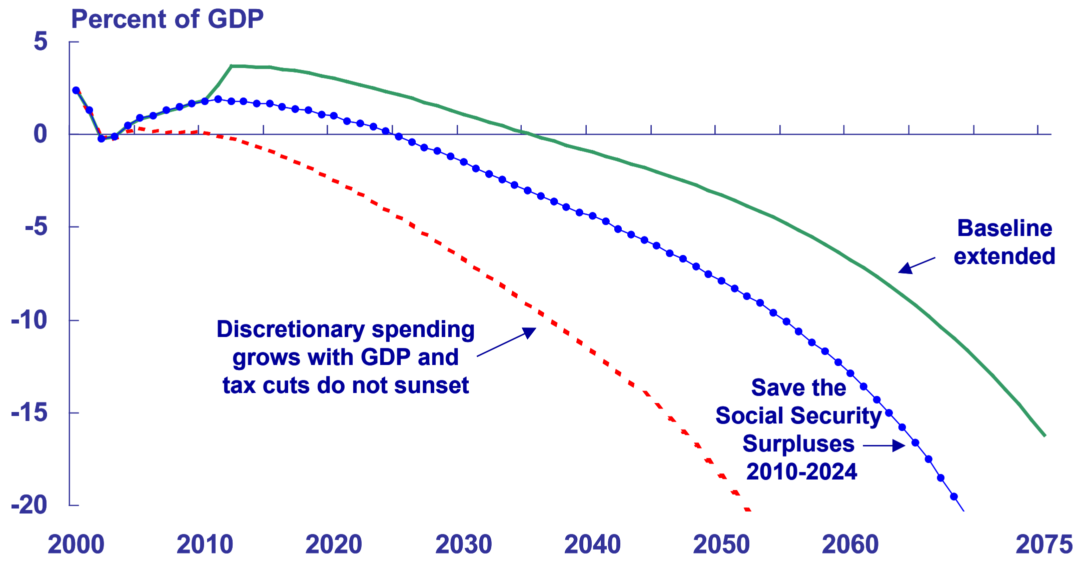
Because of the coming demographic shift, the message from our simulations remains the same as last year, indeed as since we first published results from our long-term model in 1992: Absent policy change, in the long term, persistent deficits and escalating debt driven by entitlement spending will overwhelm the budget. This year we ran three different policy paths to illustrate the implications of a range of budgetary choices. I'd like to emphasize again that these simulations are not intended to endorse a particular policy but rather to illustrate the long-term implications of different scenarios.

All three scenarios begin with CBO's baseline estimates. The first starts with the baseline where for the first 10 years tax and entitlement laws are unchanged—including sunset provisions—and discretionary spending grows with inflation. After the first 10 years, we hold discretionary spending and revenues constant as a share of gross domestic product (GDP) and allow Social Security and Medicare to grow based on the actuaries' intermediate estimates.[2] In this path, the unified surpluses that emerge in 2004 are saved. Nevertheless, deficits return in 2036. At the other end is an alternative policy path in which discretionary spending grows with the economy in the first 10 years and in which last year's tax cuts are extended. This yields a smaller period of surpluses with deficits returning in 2011. In both of these paths taxes remain constant as a share of GDP after 2012; this is, of course, a policy decision. To illustrate something in between these two paths, we simulated a third that tracks the CBO baseline until 2010. After 2010 we assume that the full Social Security surplus is saved through 2024[3]—this requires some combination of tax and spending policy actions. In this simulation deficits reemerge in 2025. (See fig. 2.)

[2] We also assume that all current-law benefits in entitlement programs are paid in full (i.e., we assume that all promised Social Security and Medicare benefits are paid including after the projected exhaustion of the respective trust funds).

[3] The last year of projected Social Security surpluses (including interest income) under the 2001 trustees' intermediate estimates. As discussed later in this testimony, program expenses exceed non-interest income beginning in 2016.

Figure 2: Unified Surpluses and Deficits as a Share of GDP Under Alternative Fiscal Policy Simulations



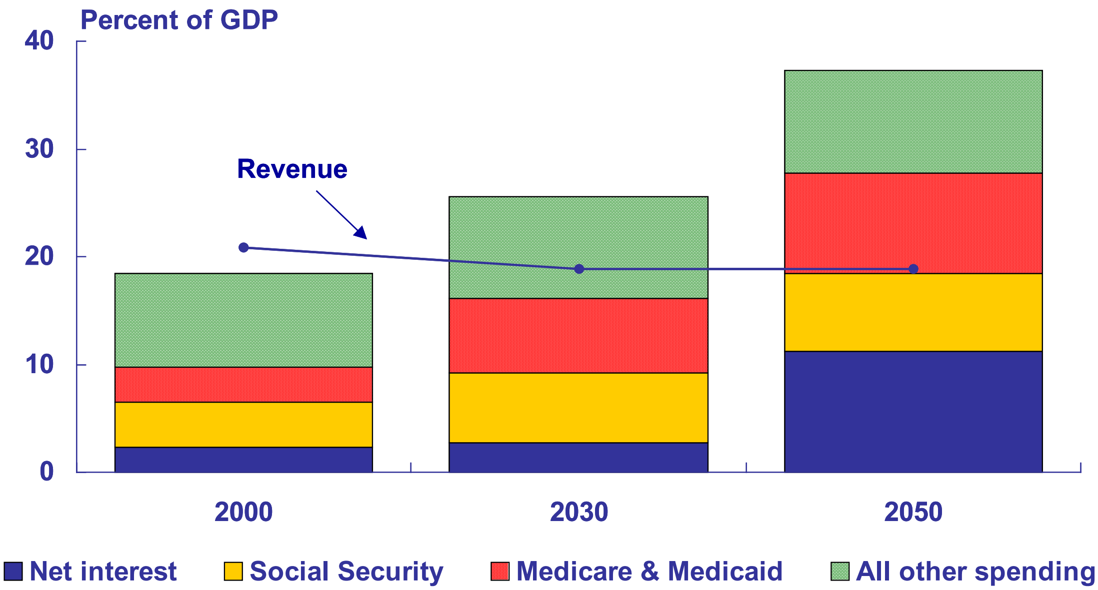
Source: GAO's January 2002 analysis.

In all three paths, surpluses eventually give way to large and persistent deficits. These simulations show that there is a benefit to fiscal discipline—it delays the return to deficits—but that even the most demanding path we simulated—a path that does not provide for funding Presidential or many Congressional initiatives—is structurally imbalanced over the long term. Although savings from higher surpluses are important, they must be coupled with action to slow the long-term drivers of projected deficits, i.e. Social Security and health programs. Surpluses can help—they could, for example, facilitate the needed reforms by providing resources to ease transition costs—but, by themselves, surpluses will not be sufficient.

In the long term, under all three paths federal budgetary flexibility becomes increasingly constrained and eventually disappears. To move into the future with no changes in federal health and retirement programs is to envision a very different role for the federal government. Assuming, for example, that last year's tax reductions are made permanent and discretionary spending keeps pace with the economy, spending for net interest, Social Security, Medicare, and Medicaid consumes nearly three-quarters of federal revenue by 2030, leaving little room for other federal priorities including defense and education. By 2050, total federal revenue is insufficient to fund entitlement spending and interest payments—and deficits are escalating out of control.[4] (See fig. 3.)

[4] Due to recent changes in methodology as well as updates to underlying assumptions, simulations presented in this testimony are not comparable to previously published simulations.

Figure 3: Composition of Spending as a Share of GDP Assuming Discretionary Spending Grows with GDP and the Tax Cuts Do Not Sunset



Source: GAO's January 2002 analysis.

Reducing the relative future burdens of Social Security and federal health programs is critical to promoting a sustainable budget policy for the longer term. Absent reform, the impact of federal health and retirement programs on budget choices will be felt as the baby boom generation begins to retire. While much of the public debate concerning the Social Security and Medicare programs focuses on trust fund balances—that is on the programs' solvency—the larger issue concerns sustainability.

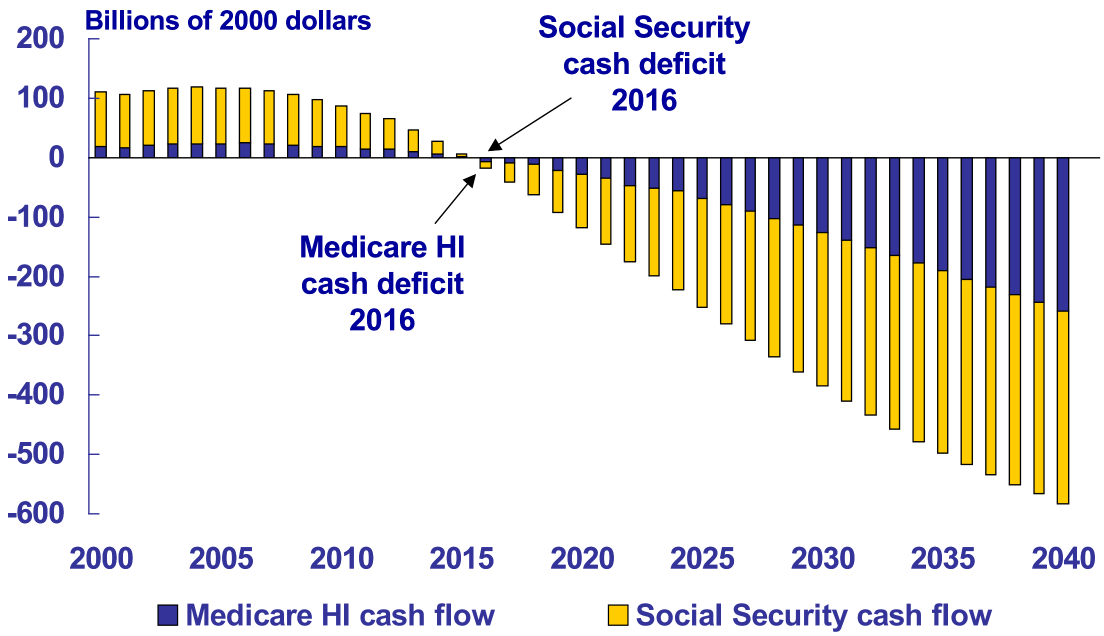
The 2001 Trustees Reports estimate that the Old-Age Survivors Insurance and Disability Insurance (OASDI) Trust Funds will remain solvent through 2038 and the Hospital Insurance (HI) Trust Fund through 2029.[5] Furthermore, because of the nature of federal trust funds, HI and OASDI Trust Fund balances do not provide meaningful information about program sustainability—that is, the government's fiscal capacity to pay benefits when the program's cash income falls below benefit expenses. From this perspective, the net cash impact of the trust funds on the government as a whole—not trust fund solvency—is the important measure. Under the trustees' intermediate assumptions, the OASDI Trust Funds are projected to have a cash deficit beginning in 2016 and the HI Trust Fund a deficit also beginning in 2016. (See fig. 4.) At that point, the programs become net claimants on the Treasury. In addition, as we have noted in other testimony,[6] a focus on HI solvency presents an incomplete picture of the Medicare program's expected future fiscal claims. The Supplementary Medical Insurance (SMI) portion of Medicare, which is not reflected in the HI solvency measure, is projected to grow even faster than HI in the near future. According to the best estimates of the Medicare trustees, Medicare HI

[5] In the FY 2000 *Financial Report of the United States Government*, issued in March 2001, the net present value of the estimated expenditures in excess of income as of January 1, 2000, was $3.8 trillion for Social Security and $2.7 trillion for Medicare Part A. The 2001 figures will be available at the end of next month.

[6] *Medicare: New Spending Estimates Underscore Need for Reform* (GAO-01-1010T, July 25, 2001).

and SMI together will double as a share of GDP between 2000 and 2030 (from 2.2 percent to 4.5 percent) and reach 8.5 percent of GDP in 2075. Under the trustees' best estimates, Social Security spending will grow as a share of GDP from 4.2 to 6.5 percent between 2000 and 2030, reaching 6.7 percent in 2075.

Figure 4: Social Security and Medicare's Hospital Insurance Trust Funds Face Cash Deficits as Baby Boomers Retire



Note: Projections based on intermediate assumptions of the 2001 OASDI and HI reports.

Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration and the Office of the Actuary, Health Care Financing Administration.

To finance these cash deficits, Social Security and the Hospital Insurance portion of Medicare will need to draw on their special issue Treasury securities acquired during the years when these programs generated cash surpluses. This negative cash flow will placed increased pressure on the federal budget to raise the resources necessary to meet the program's ongoing costs. In essence, for OASDI or HI to "redeem" their securities, the government will need to obtain cash through increased taxes, and/or spending cuts, and/or increased borrowing from the public (or correspondingly less debt reduction than would have been the case had cash flow remained positive).

Our long-term simulations illustrate the magnitude of the fiscal challenges associated with an aging society and the significance of the related challenges the government will be called upon to address. As we have stated elsewhere,[7] early action to change these programs would yield the highest fiscal dividends for the federal budget and would provide a longer period for prospective

[7] *Major Management Challenges and Program Risks: A Governmentwide Perspective* (GAO-01-241, January 2001), p. 45.

beneficiaries to make adjustments in their own planning. Waiting to build economic resources and reform future claims entails risks. First, we lose an important window where today's relatively large workforce can increase saving and enhance productivity, two elements critical to growing the future economy. We lose the opportunity to reduce the burden of interest in the federal budget, thereby creating a legacy of higher debt as well as elderly entitlement spending for the relatively smaller workforce of the future. Most critically, we risk losing the opportunity to phase in changes gradually so that all can make the adjustments needed in private and public plans to accommodate this historic shift. Unfortunately, the long-range challenge has become more difficult, and the window of opportunity to address the entitlement challenge is narrowing. It remains more important than ever to return to these issues over the next several years. Ultimately, the critical question is not how much a trust fund has in assets, but whether the government as a whole can afford the promised benefits now and in the future and at what cost to other claims on scarce resources.

THE NEED TO REEXAMINE GOVERNMENT ACTIVITIES AND PROGRAMS

One of the reasons to address these longer-term pressures is their potential to crowd out the capacity to support other important priorities throughout the rest of the budget. The tragedy of September 11 made us all realize the benefits fiscal flexibility provides to our nation's capacity to respond to urgent and newly emergent needs. Obviously we will allocate whatever resources are necessary to protect the nation. However, these new commitments will compete with and increase the pressure on other priorities within the budget. Financing these compelling new claims within an overall fiscal framework that eventually returns the budget to surplus is a tall order indeed.

The budget process is the one place where we as a nation can conduct a healthy debate about competing claims and new priorities. However, such a debate will be needlessly constrained if only new proposals and activities are on the table. A fundamental review of existing programs and operations can create much-needed fiscal flexibility to address emerging needs by weeding out programs that have proven to be outdated, poorly targeted, or inefficient in their design and management. It is always easier to subject proposals for new activities or programs to greater scrutiny than that given to existing ones. It is easy to treat existing activities as "given" and force new proposals to compete only with each other. Such an approach would move us further, rather than nearer, to budgetary surpluses.

Moreover, it is healthy for the nation periodically to review and update its programs, activities and priorities. As we have discussed previously,[8] many programs were designed years ago to respond to earlier challenges. In the early years of a new century, we have been reminded how much things have changed. For perspective, students who started college this past fall were 9 years old when the Soviet Union broke apart and have no memory of the Cold War; their lifetimes have always known microcomputers and AIDS. In previous testimony,[9] both before

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[8] *Budget Issues: Effective Oversight and Budget Discipline are Essential—Even in a Time of Surplus* (GAO/T-AIMD-00-73, Feb. 1, 2000).
[9] *Homeland Security: Challenges and Strategies in Addressing Short- and Long-Term National Needs* (GAO-02-160T, Nov. 7, 2001) and *Budget Issues: Effective Oversight and Budget Discipline are Essential—Even in a Time of Surplus* (GAO/T-AIMD-00-73, Feb. 1, 2000).

this Committee and elsewhere, I noted that it should be the norm to reconsider the relevance or "fit" of any federal program or activity in today's world and for the future. Such a review might weed out programs that have proven to be outdated or persistently ineffective, or alternatively could prompt us to update and modernize activities through such actions as improving program targeting and efficiency, consolidation, or reengineering of processes and operations. Ultimately, we should strive to hand to the next generations the legacy of a government that is effective and relevant to a changing society—a government that is as free as possible of outmoded commitments and operations that can inappropriately encumber the future. We need to think about what government should do in the 21st century and how it should do business.

The events of last fall have provided an impetus for some agencies to rethink approaches to long-standing problems and concerns. In particular, agencies will need to reassess their strategic goals and priorities to enable them to better target available resources to address urgent national preparedness needs. For instance, the threat to air travel has already prompted attention to chronic problems with airport security that we and others have been pointing to for years. Moreover, the crisis might prompt a healthy reassessment of the broader transportation policy framework with an eye to improving the integration of air, rail, and highway systems to better move people and goods.

Other long-standing problems also take on increased relevance in today's world. Take, for example, food safety. Problems such as overlapping and duplicative inspections across many federal agencies, poor coordination, and inefficient allocations of resources are not new and have hampered productivity and safety for years. However, they take on new meaning and urgency given the potential threat from bioterrorism. We have argued for a consolidated food safety initiative merging the separate programs of the multiple federal agencies involved. Such a consolidated approach can facilitate a concerted and effective response to the new threats.

The federal role in law enforcement is another area that is ripe for reexamination following the events of September 11. In the past 20 years, the federal government has taken on a larger role in financing criminal justice activities that have traditionally been viewed as the province of the state and local sector. This is reflected in the growth of the federal share of financing—from 12 percent in 1982 to nearly 20 percent in 1999.

Given the new daunting new law enforcement responsibilities in the wake of September 11 and limited budgetary resources at all levels, the question is whether these additional responsibilities should prompt us to rethink the priorities and roles of federal, state, and local levels of government in the criminal justice area and ultimately whether some activities are affordable in this new setting. The Federal Bureau of Investigation has already begun thinking about reprioritization and how its investigative resources will shift, given the new challenges posed by the terrorism threat.

With the Coast Guard's focus on homeland security, it has de-emphasized some of its other critical missions in the short term, most notably fisheries enforcement and drug and migrant interdiction. The Coast Guard is currently developing a longer-term mission strategy, although it has no plans at present to revise the schedule or asset mix for its Deepwater Project (which will be awarded mid-2002).

In rethinking federal missions and strategies, it is important to examine not only spending programs but the wide range of other more indirect tools of governance the federal government uses to address national objectives. These tools include loans and loan guarantees, tax expenditures, and regulations. For instance, in fiscal year 2000, the federal health care and Medicare budget functions include $37 billion in discretionary budget authority, $319 billion in entitlement outlays, $5 million in loan guarantees, and $91 billion in tax expenditures.

The outcomes achieved by these various tools are in a very real sense highly interdependent and are predicated on the response by a wide range of third parties, such as states and localities and private employers, whose involvement has become more critical to the implementation of these federal initiatives. The choice and design of these tools is critical in determining whether and how federal objectives will be addressed by these third parties. Any review of the base of existing policy should address this broader picture of federal involvement.

GAO has also identified a number of areas warranting reconsideration based on program performance, targeting, and costs. Every year, we issue a report identifying specific options, many scored by CBO, for congressional consideration stemming from our audit and evaluation work.[10] This report provides opportunities for (1) reassessing objectives of specific federal programs, (2) improved targeting of benefits, and (3) improving the efficiency and management of federal initiatives.

Just as long-standing areas of federal involvement need re-examination, so proposed new initiatives designed to address the new terrorism threat need appropriate review. With the focus on counterterrorism, you will undoubtedly face many proposals redefined as counterterrorism activities. The Congress will need to watch for the redefinition of many claims into counterterrorism activities. It will be especially important to seek to distinguish among these claims.

In sorting through these proposals, we might apply investment criteria in making choices. Well-chosen enhancements to the nation’s infrastructure are an important part of our national preparedness strategy. Investments in human capital for certain areas such as public health or airport security will also be necessary as well to foster and maintain the skill sets needed to respond to the threats facing us. A variety of governmental tools will be proposed to address these challenges—grants, loans, tax expenditures, and/or direct federal administration. The involvement of a wide range of third parties—state and local governments, nonprofits, private corporations, and even other nations—will be a vital part of the national response as well.

In the short term, we will do whatever is necessary to get this nation back on its feet and compassionately deal with the human tragedies left in its wake. However, as we think about our longer-term preparedness and develop a comprehensive homeland security strategy, we can and should select those programs and tools that promise to provide the most cost-effective approaches to achieve our goals.

[10] *Supporting Congressional Oversight: Framework for Considering Budgetary Implications of Selected GAO Work* (GAO-01-447, March 9, 2001).

BUDGET PROCESS SHOULD FACILITATE DISCIPLINE AND AWARENESS OF LONG-TERM IMPLICATIONS OF DECISIONS

Today the Congress faces the challenge of sorting out these many claims on the federal budget without the fiscal benchmarks and rules that served as guides through the years of deficit reduction. Going forward, new rules and goals will be important both to ensure fiscal discipline as we sort through these new and compelling claims and to prompt policymakers to focus on the longer-term implications of current policies and programs. For more than a decade, budget process adaptations have been designed to reach a zero deficit. With the advent of surpluses, a new framework was needed—one that would permit accommodating pent-up demands but not eliminate all controls. A broad consensus seemed to develop to use saving the Social Security surplus or maintaining on-budget balance as a kind of benchmark. However, the combination of the economic slowdown and the need to respond to the events of September 11 has overtaken that measure.

Once again, Congress faces the challenge of designing a budget control mechanism. Last October, Mr. Chairman, you and your colleague Senator Domenici and your House counterparts called for a return to budget surplus as a fiscal goal. This remains an important fiscal goal, but achieving it will not be easy. In the near term, limits on discretionary spending may be necessary to prompt the kind of reexamination of the base I discussed above. There are no easy choices. There will be disagreements about the merits of a given activity—reasonable people can disagree about federal priorities. There may also be disagreements about the appropriate response to program failure: Should the program be modified or terminated? Would the program work better with more money or should funding be cut? Spending limits can be used to force choices; they are more likely to do so, however, if they are set at levels viewed as reasonable by those who must comply with them.

Spending limits alone cannot force a reexamination of existing programs and activities. However, the recognition that for most agencies the new responsibilities acquired since September 11 cannot merely be added to existing duties requires that decisions be made about priorities. In the last decade Congress and the Administration put in place a set of laws designed to improve information about cost and performance. This information can help inform the debate about what the federal government should do. In addition, the budget debate can benefit from the kind of framework I discussed above. In previous testimony before this committee, I suggested that Congress might equip itself to engage in this debate by developing a congressional performance resolution to target its oversight on certain governmentwide performance issues cutting across agencies and programs.[11] Along with caps, this and other measures might help ensure that Congress becomes part of the debate over reprioritization and government performance.

The dramatic shift in budget projections since last year has prompted discussion of shortening the budget window. This may well be a sensible approach to reducing uncertainty. However, such a change should be coupled with steps to provide a broader and longer-term fiscal horizon: goals and metrics to address the longer-term implications of today's choices. This does not mean

[11] *Budget Issues: Effective Oversight and Budget Discipline Are Essential—Even in a Time of Surplus* (GAO/T-AIMD-00-73, Feb. 1, 2000).

that we should budget for a 20- or 30-year period. It does mean considering establishing indicators and targets that bring a long-term perspective to budget deliberations and a process that prompts attention to the long-term implications of today's decisions. Periodic simulations along the lines we and CBO have developed can and should become a regular feature of budget debate. We would be the first to say that the simulations are not predictions of the future or point estimates, rather they serve as indicators—or warning lights—about the magnitude and direction of different policy profiles. These scenarios are particularly helpful in comparing long-term consequences of different fiscal paths or major reforms of entitlements using the same assumptions. As I said earlier, the demographic tidal wave that drives the long-term budget challenge is a known element with predictable consequences.

Some kind of fiscal targets may be helpful. As a way to frame the debate, targets can remind us that today's decisions are not only about current needs but also about how fiscal policy affects the choices over the longer term. Other nations have found it useful to embrace broader targets such as debt-to-GDP ratios, or surpluses equal to a percent of GDP over the business cycle. To work over time targets should not be rigid—it is in the nature of things that they will sometimes be missed. It should be possible to make some sort of compelling argument for the target—and it should be relatively simple to explain. Reaching a target is not a straight line but an iterative process. The other nations we have studied have found that targets prompted them to take advantage of windows of opportunity to save for the future and that decisionmakers must have flexibility each year to weigh pressing short-term needs and adjust the fiscal path without abandoning the longer-term framework.

In re-examining what I have called the "drivers" of the long-term budget, we need to think about new metrics. We have been locked into the artifacts of the trust funds, which do not serve as appropriate signals for timely action to address the growth in these programs. As I mentioned earlier, trust fund solvency does not answer the question of whether a program is sustainable.

Although aggregate simulations are driven by these programs, the need for a longer-term focus is about more than Social Security and Medicare. In recent years there has been an increased recognition of the long-term costs of Social Security and Medicare. While these are the largest and most important long-term commitments—and the ones that drive the long-term outlook—they are not the only ones in the budget that affect future fiscal flexibility. For Congress, the President, and the public to make informed decisions about these other programs, it is important to understand their long-term cost implications. A longer time horizon is useful not only at the macro level but also at the micro-policy level. I am not suggesting that detailed budget estimates could be made for all programs with long-term cost implications. However, better information on the long-term costs of commitments like employee pension and health benefits and environmental cleanup could be made available. Here again, new concepts and metrics may be useful. We have been developing the concept of "fiscal exposures" to represent a range of federal commitments—from explicit liabilities to implicit commitments. Exactly how such information would be incorporated into the budget debate would need to be worked out—but it is worth serious examination.

CONCLUSION

In one sense much has changed in the budget world since last February. There are even more compelling needs and demands on the federal budget than a year ago—and policymakers must deal with them absent the surpluses that were projected then. However, the demographic trends that drive the long-term outlook have not changed. The baby boom generation is still getting older and closer to retirement. Because of the coming demographic shift, the message from our simulations remains the same as last year, indeed as since we first published results from our long-term model in 1992: Absent changes in Social Security and health programs, in the long term, persistent deficits and escalating debt driven by entitlement spending will overwhelm the budget.

The events of September 11 highlighted the benefits of fiscal flexibility. Addressing the long-term drivers in the budget is essential to preserving any flexibility in the long term. In the nearer term a fundamental review of existing programs and operations can create much-needed fiscal flexibility to address emerging needs by weeding out programs that have proven to be outdated, poorly targeted, or inefficient in their design and management.

Congress and the President stand at a point where current needs and wants must be balanced against known long-term pressures. And you face the challenge of sorting out these many claims on the federal budget without the fiscal benchmarks and rules that guided us through the years of deficit reduction into surplus. Going forward, new rules and goals will be important both to ensure fiscal discipline and to prompt a focus on the longer-term implications of decisions. It is still the case that the federal government needs a decision-making framework that permits it to evaluate choices against both today's needs and the longer-term fiscal future that will be handed to future generations. As stewards of our nation's future, we must begin to prepare for tomorrow. In this regard, we must determine how best to address these structural challenges in a reasonably timely manner in order to identify specific actions that need to be taken.

None of this is easy. We at GAO stand ready to assist you.

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