



U.S. Financial Condition and Fiscal Future Briefing

The Honorable David M. Walker
Comptroller General of the United States

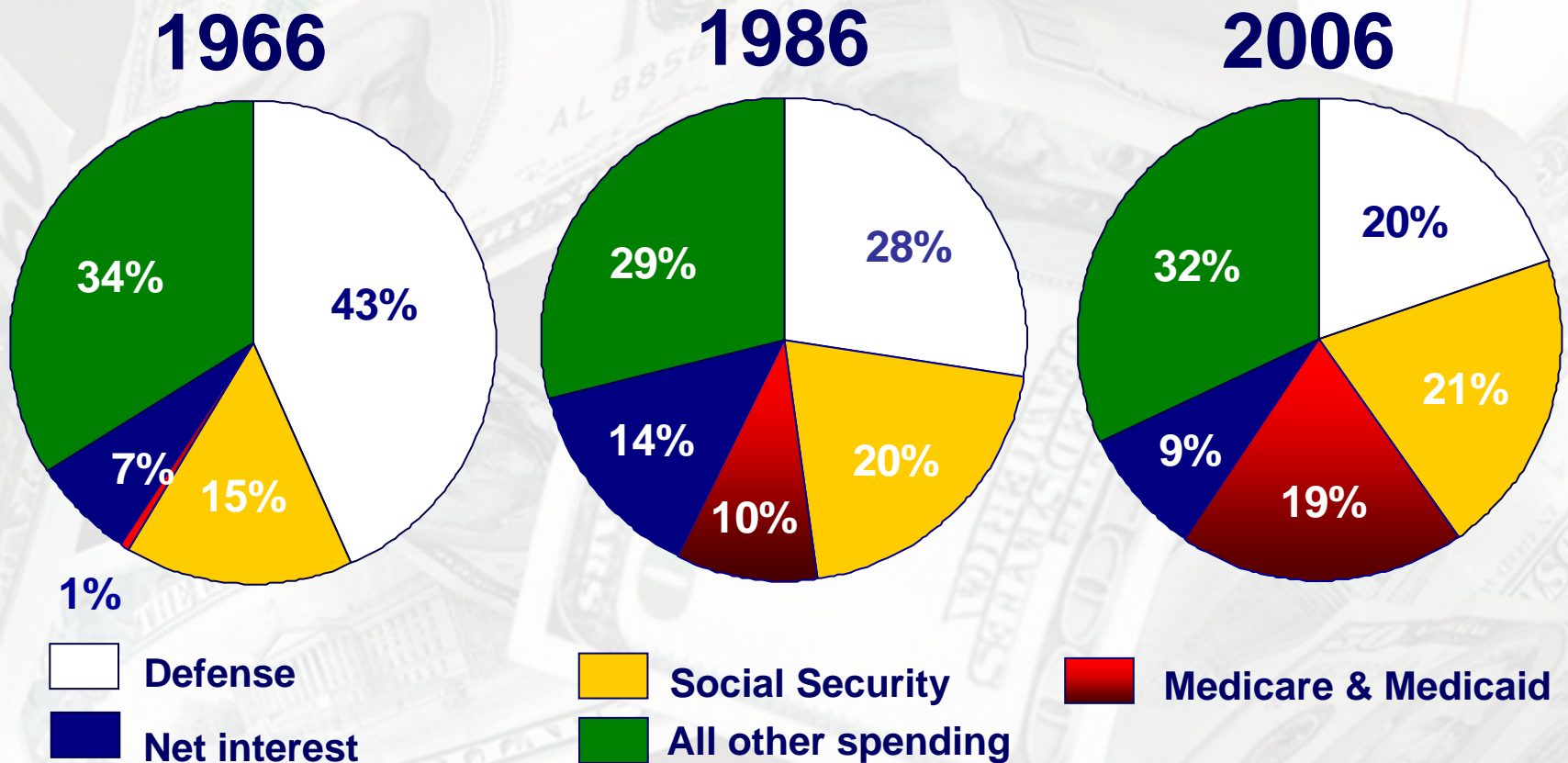
University of Akron
January 29, 2008

The Case for Change

The federal government is on a “burning platform,” and the status quo way of doing business is unacceptable for a variety of reasons, including:

- Past fiscal trends and significant long-range challenges
- Selected trends and challenges having no boundaries
- Additional resource demands due to Iraq, Afghanistan, incremental homeland security needs, and recent natural disasters in the United States
- Numerous government performance/accountability and high risk challenges
- Outdated federal organizational structures, policies, and practices
- Rising public expectations for demonstrable results and enhanced responsiveness

Composition of Federal Spending



Source: Office of Management and Budget.

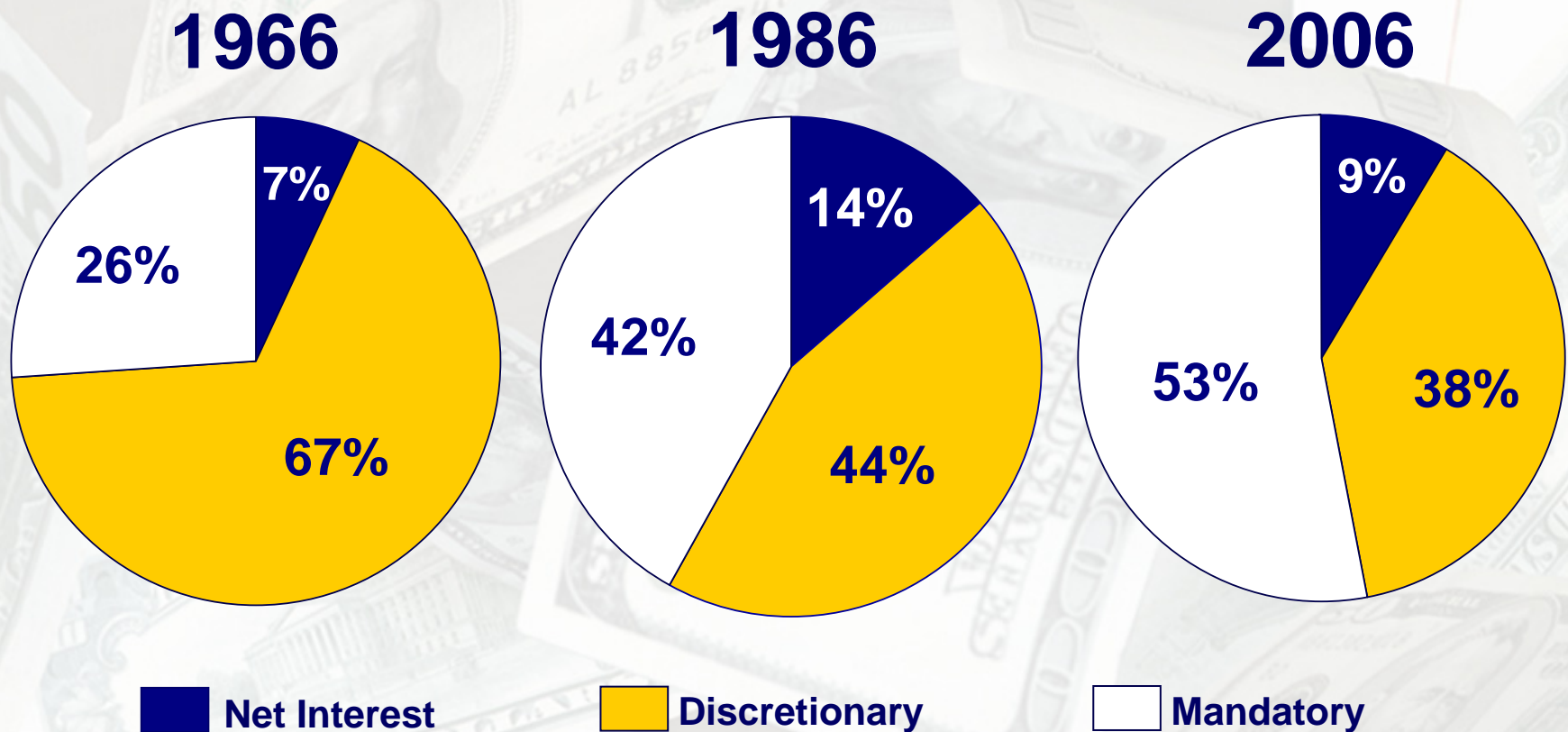
Note: Numbers may not add to 100 percent due to rounding.

What Does “All Other” Spending Include?

Some examples of “all other” spending are:

- The Departments of State, Homeland Security, Treasury, Justice, Transportation, and Education
- The Federal Bureau of Investigation
- The Internal Revenue Service
- The Park Service
- The Environmental Protection Agency
- Unemployment Compensation
- Veterans' Benefits
- Food and Nutrition Assistance

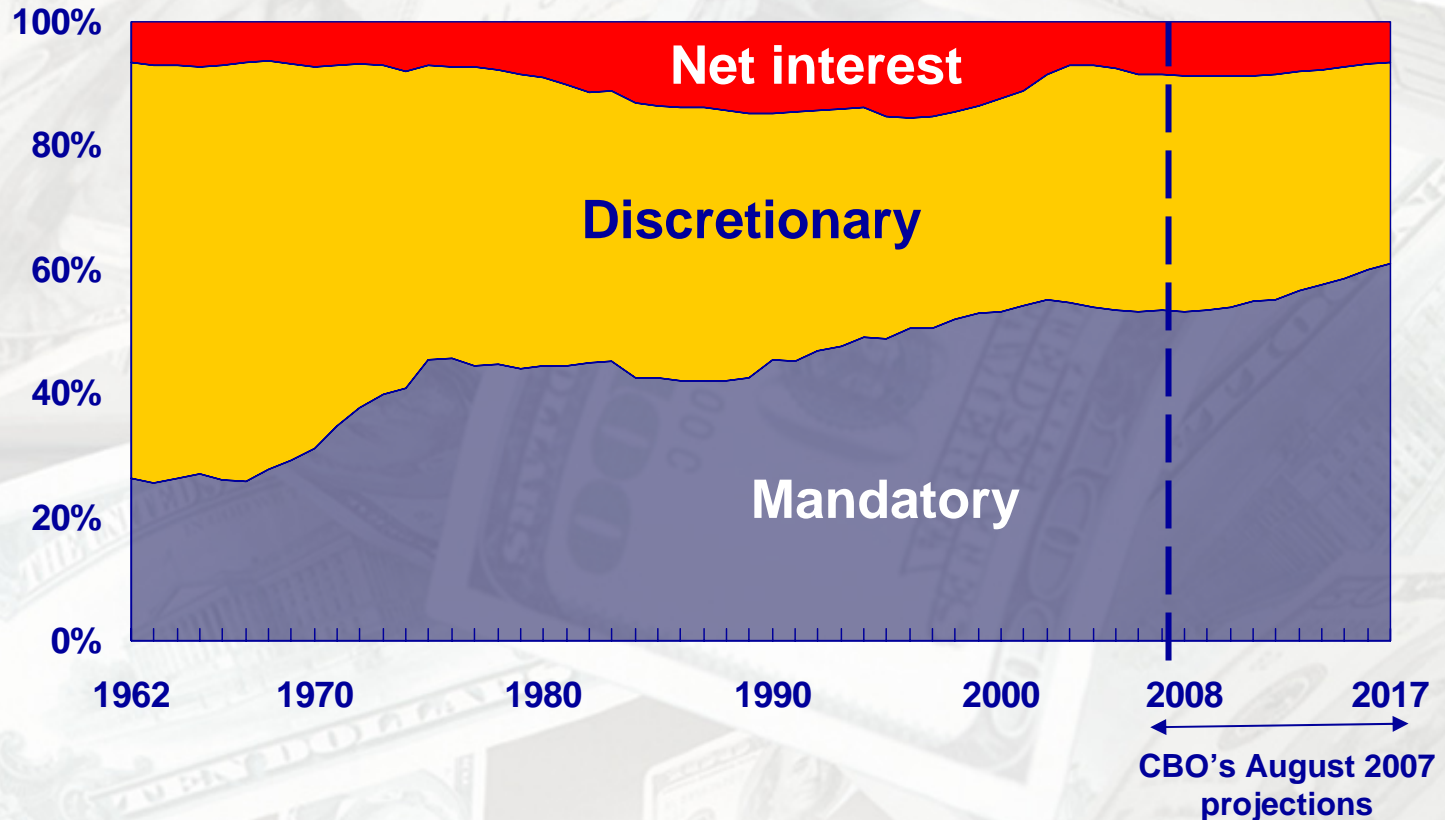
Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

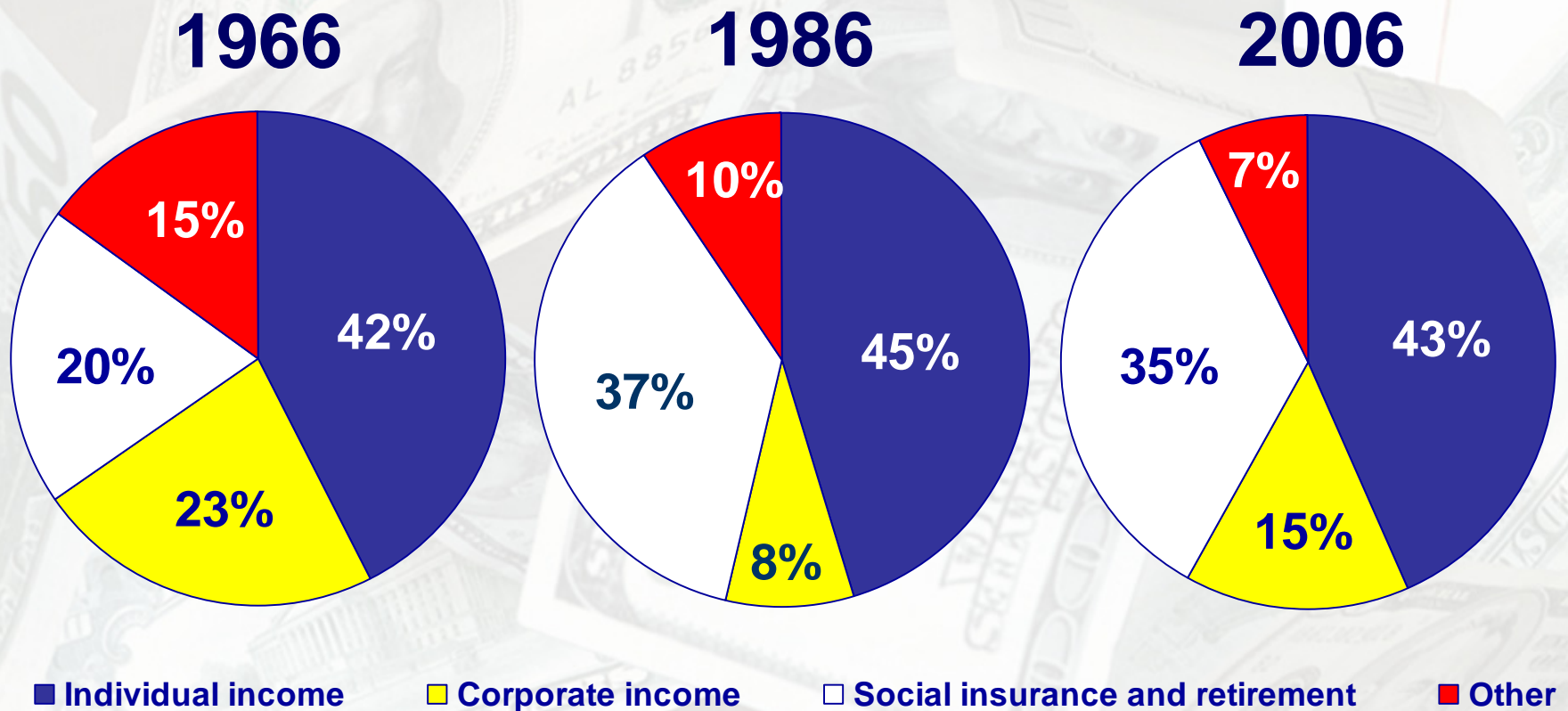
A Different View: Federal Spending for Mandatory and Discretionary Programs

Percent of total outlays



Sources: Office of Management and Budget and the Congressional Budget Office.

Composition of Federal Receipts by Source



Note: Numbers do not add to 100 percent due to rounding.

Source: GAO analysis of data from the Office of Management and Budget.

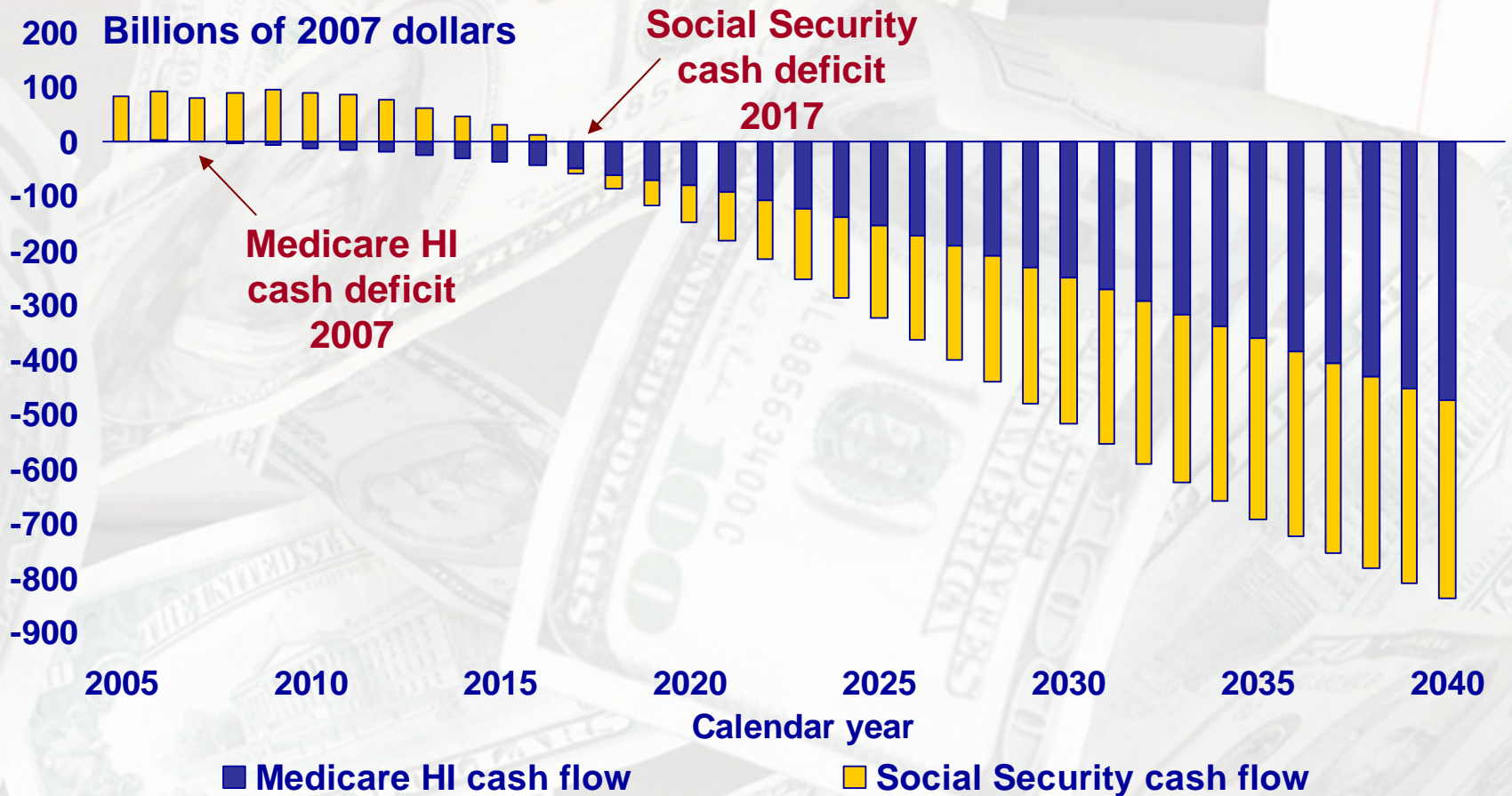
Main Measures of the Budget Deficit

- **“On-Budget Deficit”**
 - The deficit minus the Social Security Trust Fund and Postal Service surpluses
- **Unified Budget Deficit:**
 - The most commonly reported measure
 - A comprehensive measure of cash flow, assessing how much we have to borrow today to meet current obligations
 - The difference between revenues & outlays when the money actually leaves the Treasury

If the Unified Budget is Commonly Reported, Why is the On-Budget Deficit So Important?

- Today, Social Security taxes exceed Social Security benefits—the Social Security surplus is invested in Treasuries and it offsets the deficit in the rest of government
- BUT that surplus shrinks in 2009 and disappears in 2017, so we need to know the deficit in the rest of the budget

Social Security and Medicare's Hospital Insurance Trust Funds Face Cash Deficits



Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration and Office of the Actuary, Centers for Medicare and Medicaid Services.

Note: Projections based on the intermediate assumptions of the 2007 Trustees' Reports. The CPI is used to adjust from current to constant dollars.

Still a Third Deficit Measure: Net Operating Cost

Net operating cost (or the “accrual deficit”):

- Like the unified budget deficit, net operating cost accounts for all federal activities (i.e., both on- and off-budget). However, unlike the unified budget deficit, expenses in this measure are recorded on an **accrual basis**—when goods are used or services are performed rather than when the resulting cash payments are made
- In some cases, expenses are estimates of amounts that will be outlaid in the future and thus depend on assumptions regarding interest rates, inflation, and wage growth, among other things
- See GAO-07-117SP and GAO-07-341SP to understand cash & accrual deficits

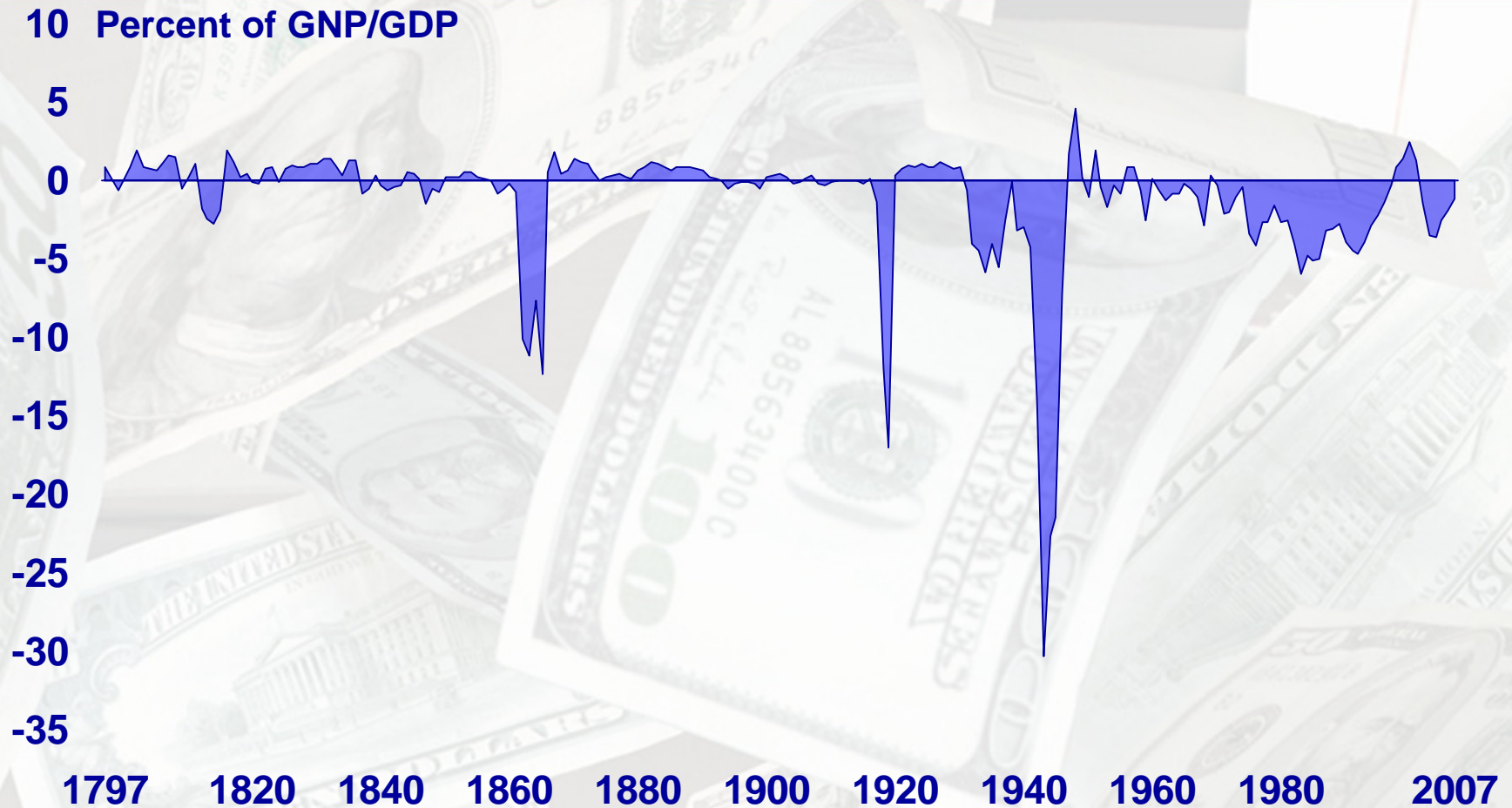
Fiscal Year 2006 and 2007 Deficits and Net Operating Costs

	Fiscal Year 2006	Fiscal Year 2007
	(\$ Billion)	
On-Budget Deficit	(434)	(344)
Unified Deficit^a	(248)	(163)
Net Operating Cost	(450)	(276)

Sources: Office of Management and Budget and Department of the Treasury.

^aIncludes \$185 billion in Social Security surpluses for fiscal year 2006 and \$186 billion for fiscal year 2007; \$1 billion in Postal Service surpluses for fiscal year 2006 and a \$5 billion deficit for fiscal year 2007.

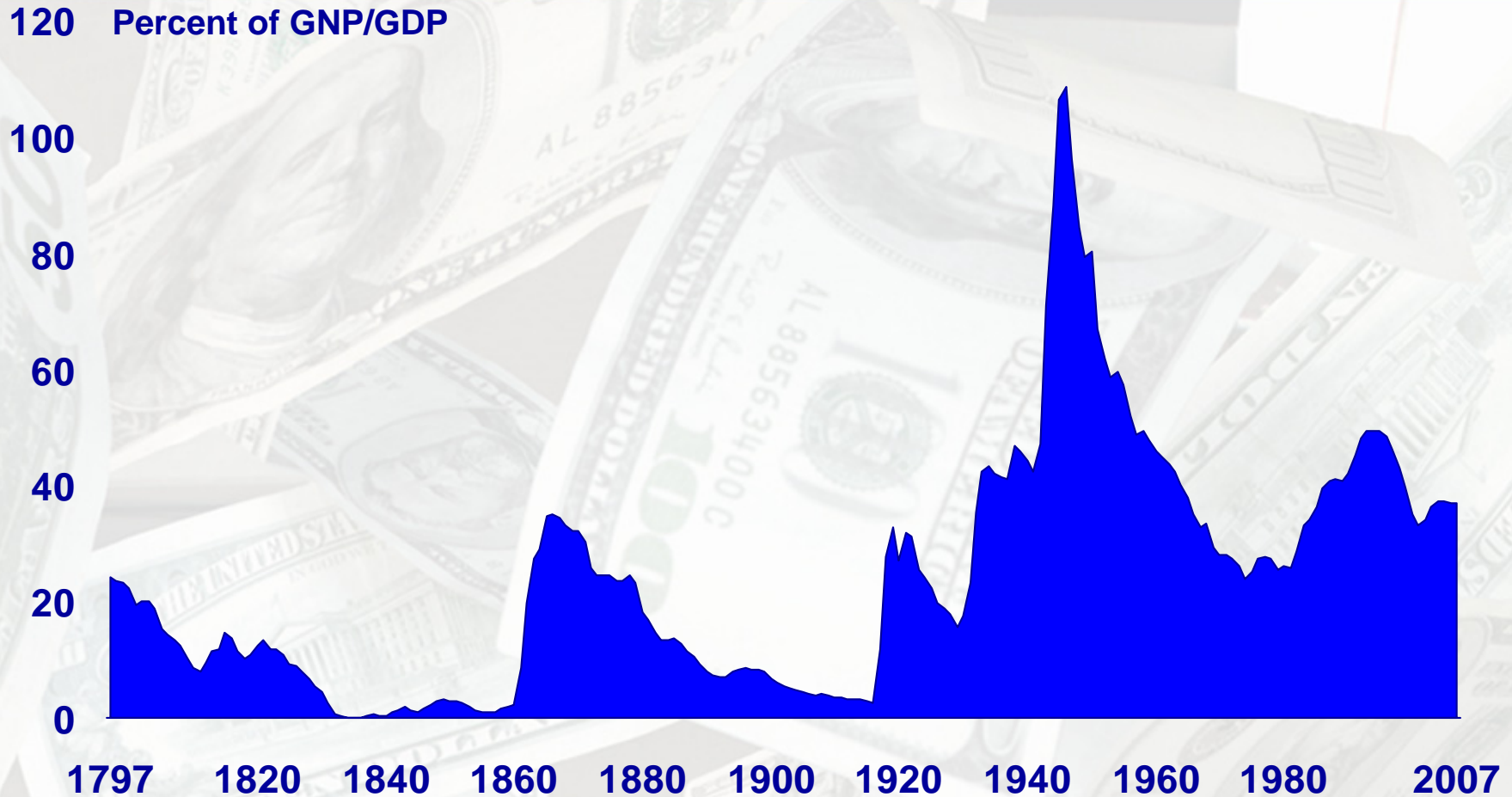
Surplus or Deficit as a Share of GDP (1797-2007)



Note: Data until 1929 are shown as a percent of gross national product (GNP); data from 1930 to present are shown as a percent of GDP.

Source: Department of Commerce, Office of Management and Budget, and Congressional Budget Office.

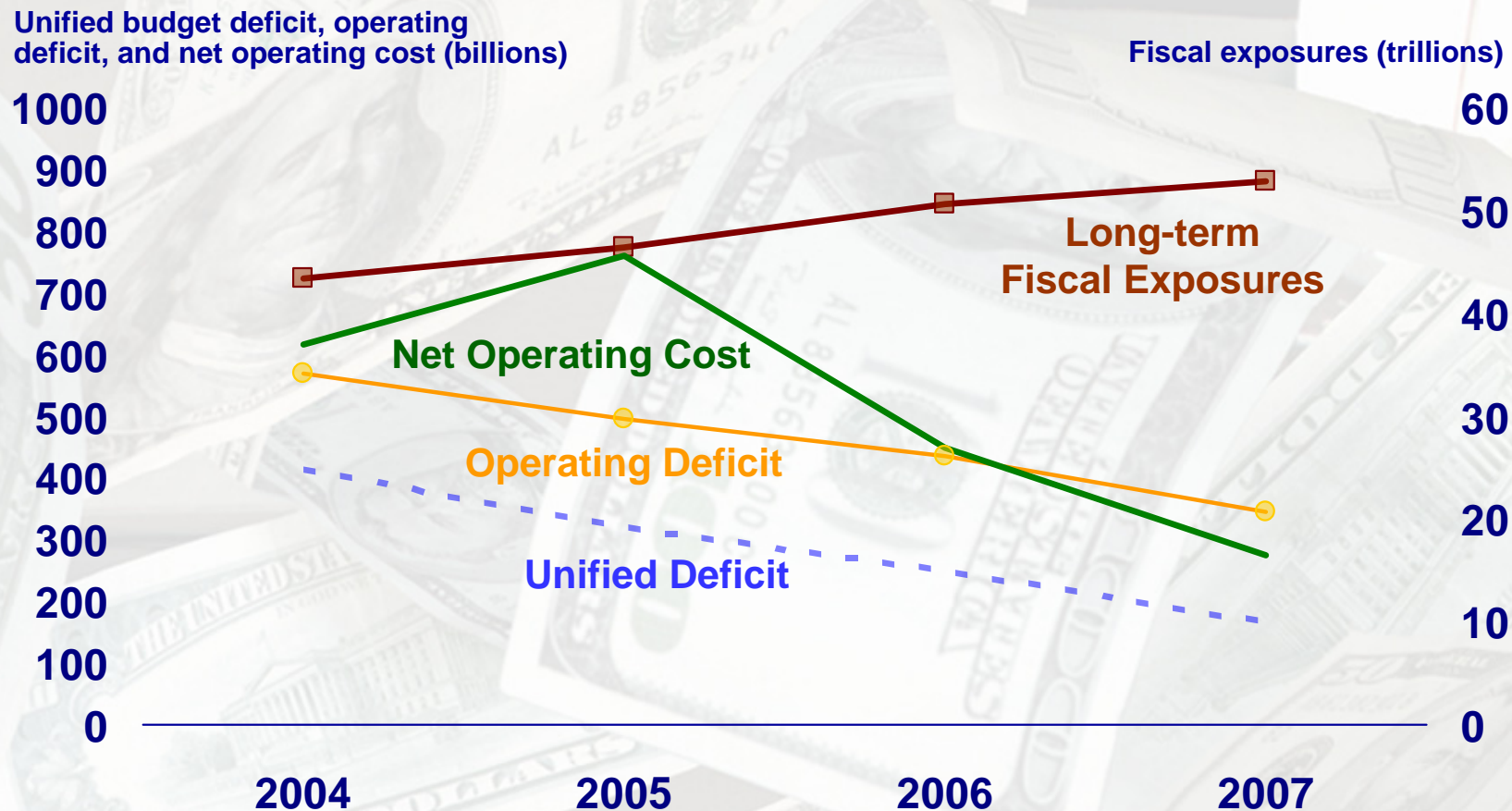
Debt Held by the Public as a Share of GDP (1797-2007)



Note: Data until 1929 are shown as a percent of gross national product (GNP); data from 1930 to present are shown as a percent of GDP.

Source: GAO analysis of data from the Department of Commerce, Office of Management and Budget, and Congressional Budget Office.

Short-term Fiscal Position versus Long-term Fiscal Exposures



Source: GAO analysis.

Note: Data are from the Congressional Budget Office and the Department of Treasury. Estimates of the federal government's long-term fiscal exposures are based on the Financial Report of the U.S. Government. These estimates include the present value of future social insurance obligations over a 75-year time horizon as of January 1st of the preceding year. These estimates have not been adjusted for inflation.

Major Fiscal Exposures (\$ trillions)

	2000	2007	% Increase
<ul style="list-style-type: none"> • Explicit liabilities <ul style="list-style-type: none"> • Publicly held debt • Military & civilian pensions & retiree health • Other 	\$6.9	\$10.8	57
<ul style="list-style-type: none"> • Commitments & contingencies <ul style="list-style-type: none"> • E.g., PBGC, undelivered orders 	0.5	1.1	97
<ul style="list-style-type: none"> • Implicit exposures <ul style="list-style-type: none"> • Future Social Security benefits • Future Medicare Part A benefits • Future Medicare Part B benefits • Future Medicare Part D benefits 	13.0	40.8	213
Total	\$20.4	\$52.7	158

Source: 2000 and 2007 Financial Report of the United States Government.

Note: Totals and percent increases may not add due to rounding. Estimates for Social Security and Medicare are at present value as of January 1 of each year and all other data are as of September 30.

How Big is Our Growing Fiscal Burden?

This fiscal burden can be translated and compared as follows:

Total –major fiscal exposures	\$52.7 trillion
Total household net worth¹	\$58.6 trillion
Burden/Net worth ratio	90 percent
Burden²	
Per person	\$175,000
Per full-time worker	\$410,000
Per household	\$455,000
Income	
Median household income³	\$48,201
Disposable personal income per capita⁴	\$33,253

Source: GAO analysis.

Notes: (1) Federal Reserve Board, Flow of Funds Accounts, Table B.100, 2007:Q3 (December 6, 2007); (2) Burdens are calculated using estimated total U.S. population as of 10/1/2007, from the U.S. Census Bureau; full-time workers reported by the Bureau of Economic Analysis, in NIPA table 6.5D (Aug. 1, 2007); and households reported by the U.S. Census Bureau, in Income, Poverty, and Health Insurance Coverage in the United States: 2006 (Aug. 2007); (3) U.S. Census Bureau, Income, Poverty, and Health Insurance Coverage in the United States: 2006 (Aug. 2007); and (4) Bureau of Economic Analysis, Personal Income and Outlays, table 2, (Nov. 29, 2007).

Potential Fiscal Outcomes

Under Baseline Extended (January 2001)

Revenues and Composition of Spending as a Share of GDP

Percent of GDP

50

40

30

20

10

0

Revenue

2005

2015^a

2030^a

2040^a

Fiscal year

■ Net interest

■ Social Security

■ Medicare & Medicaid

■ All other spending

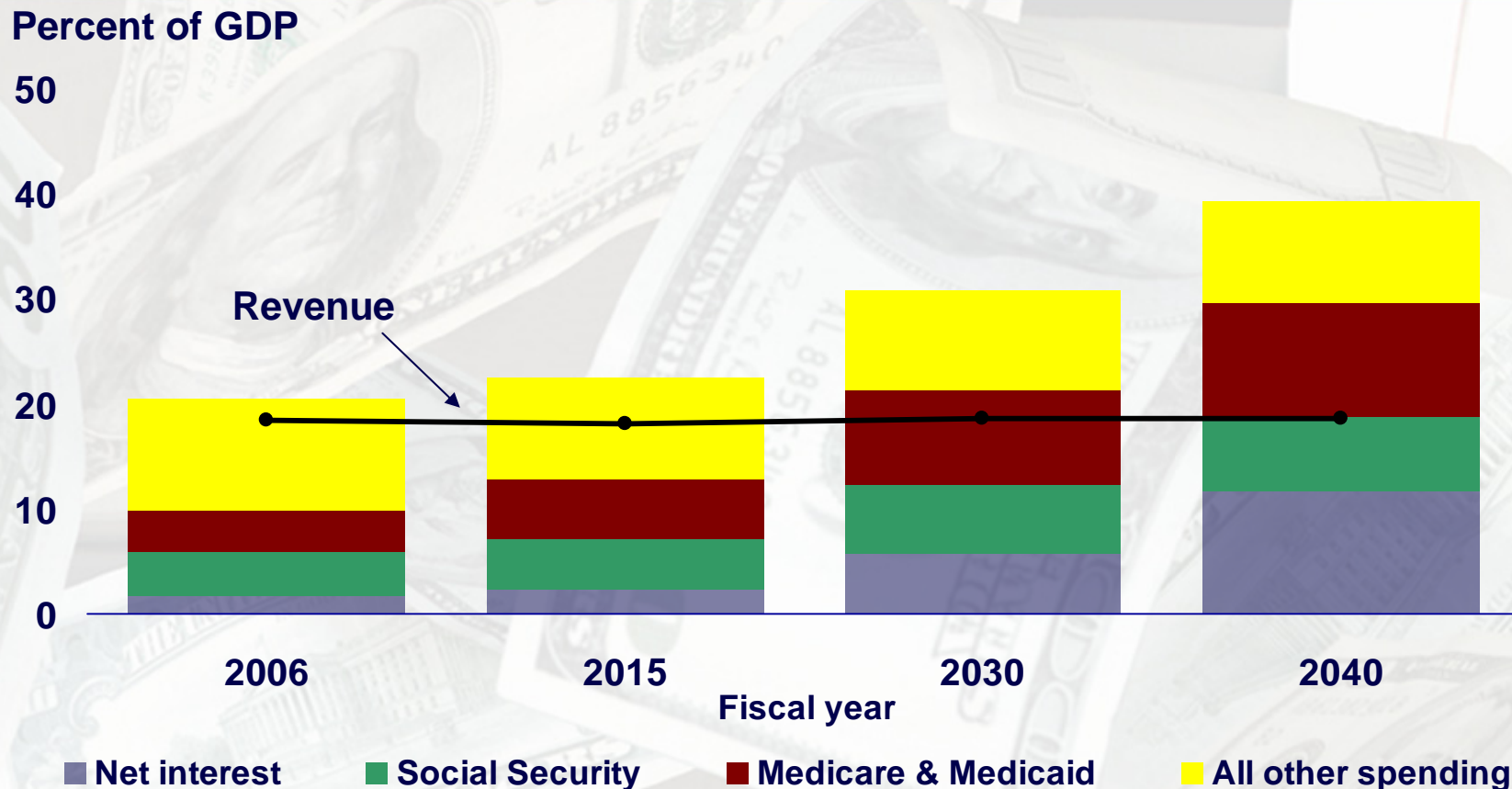
Source: GAO's January 2001 analysis.

^aAll other spending is net of offsetting interest receipts.

Potential Fiscal Outcomes

Under Alternative Simulation

Revenues and Composition of Spending as a Share of GDP

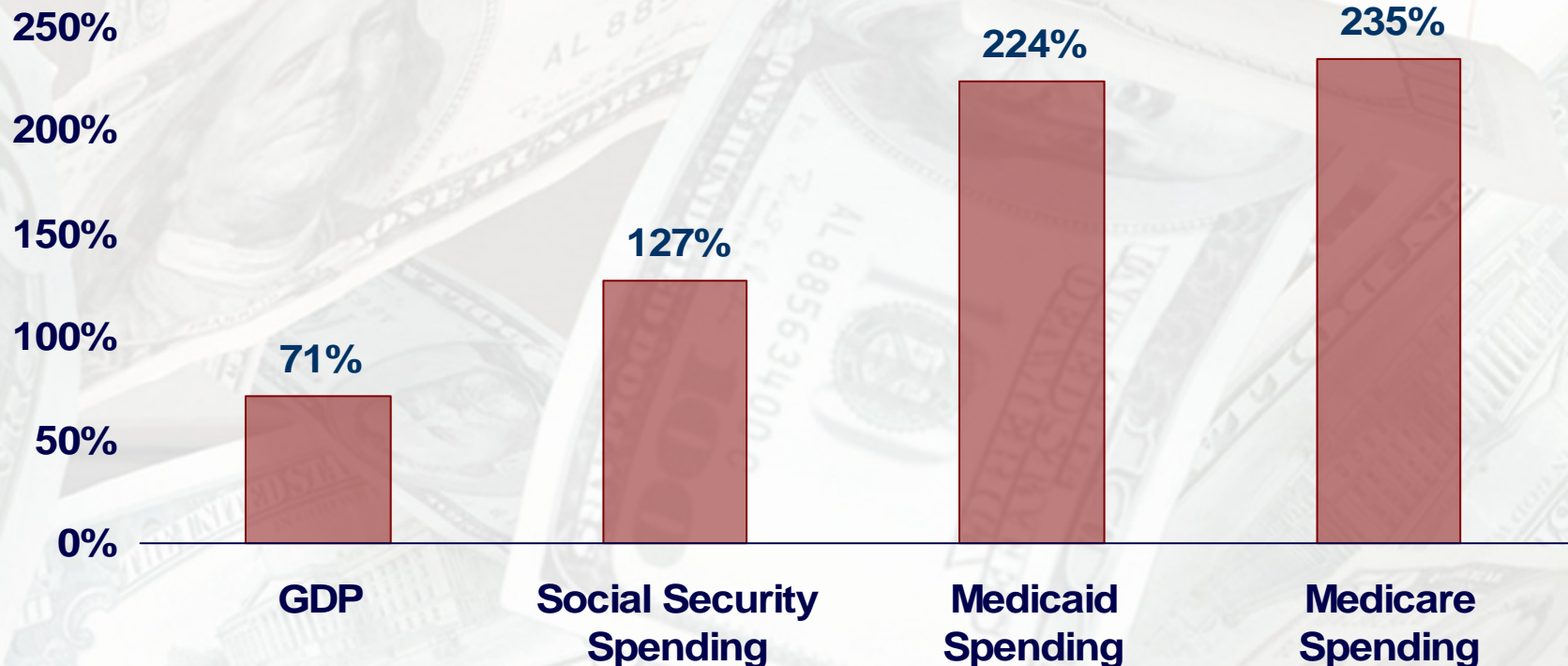


Source: GAO's August 2007 analysis.

Notes: AMT exemption amount is retained at the 2006 level through 2017 and expiring tax provisions are extended. After 2017, revenue as a share of GDP returns to its historical level of 18.3 percent of GDP plus expected revenues from deferred taxes, i.e. taxes on withdrawals from retirement accounts. Medicare spending is based on the Trustees April 2007 projections adjusted for the Centers for Medicare and Medicaid Services alternative assumption that physician payments are not reduced as specified under current law.

Growth in Spending for Social Security, Medicare, and Medicaid Expected to Outpace Economic Growth

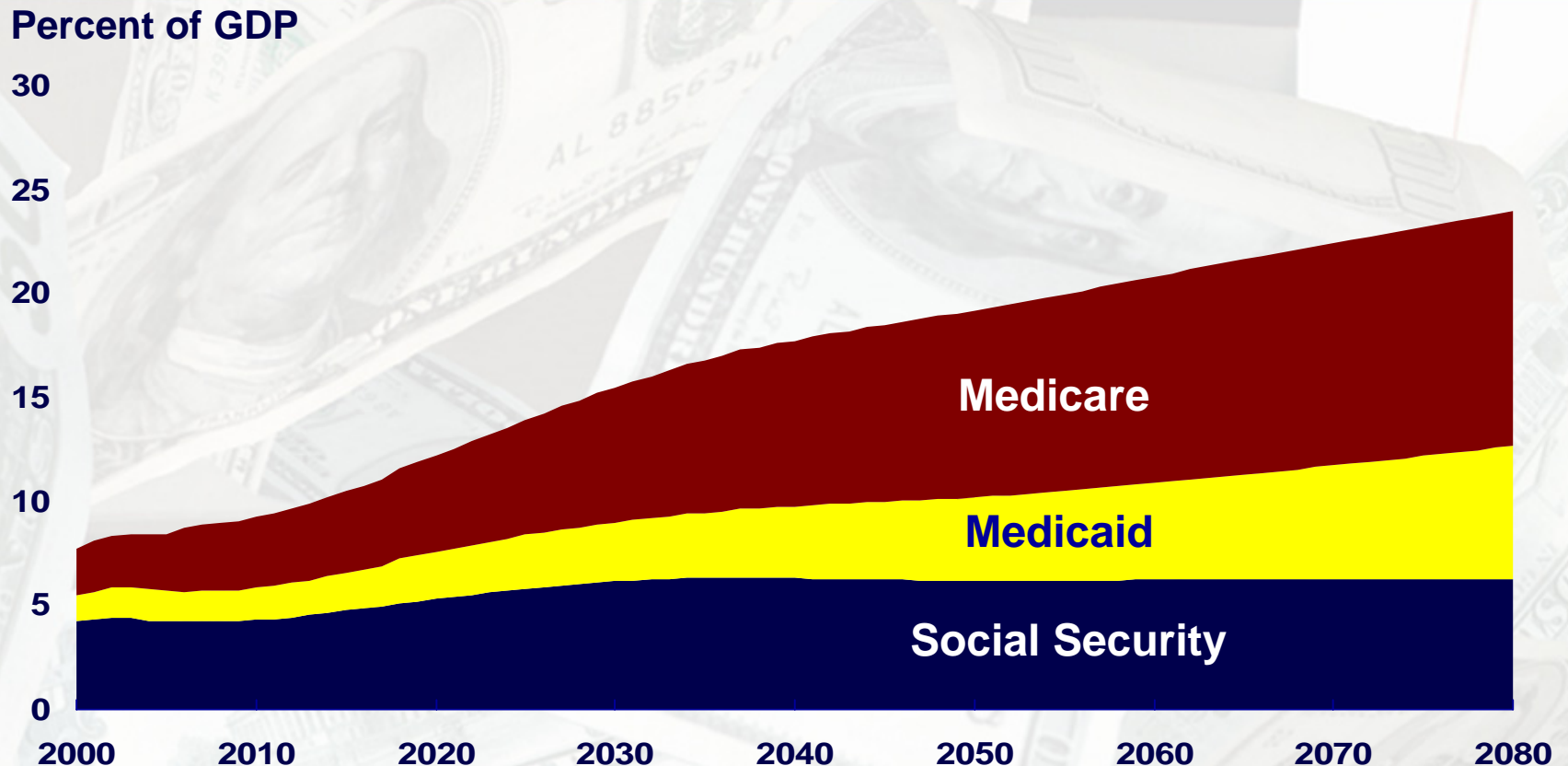
Growth in constant dollars 2007-2032



Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration; Office of the Actuary, Centers for Medicare and Medicaid Services; and the Congressional Budget Office.

Notes: Social Security and Medicare projections based on the intermediate assumptions of the 2007 Trustees' Reports. Medicaid projections based on CBO's August 2007 short-term Medicaid estimates and CBO's December 2005 long-term Medicaid projections under mid-range assumptions.

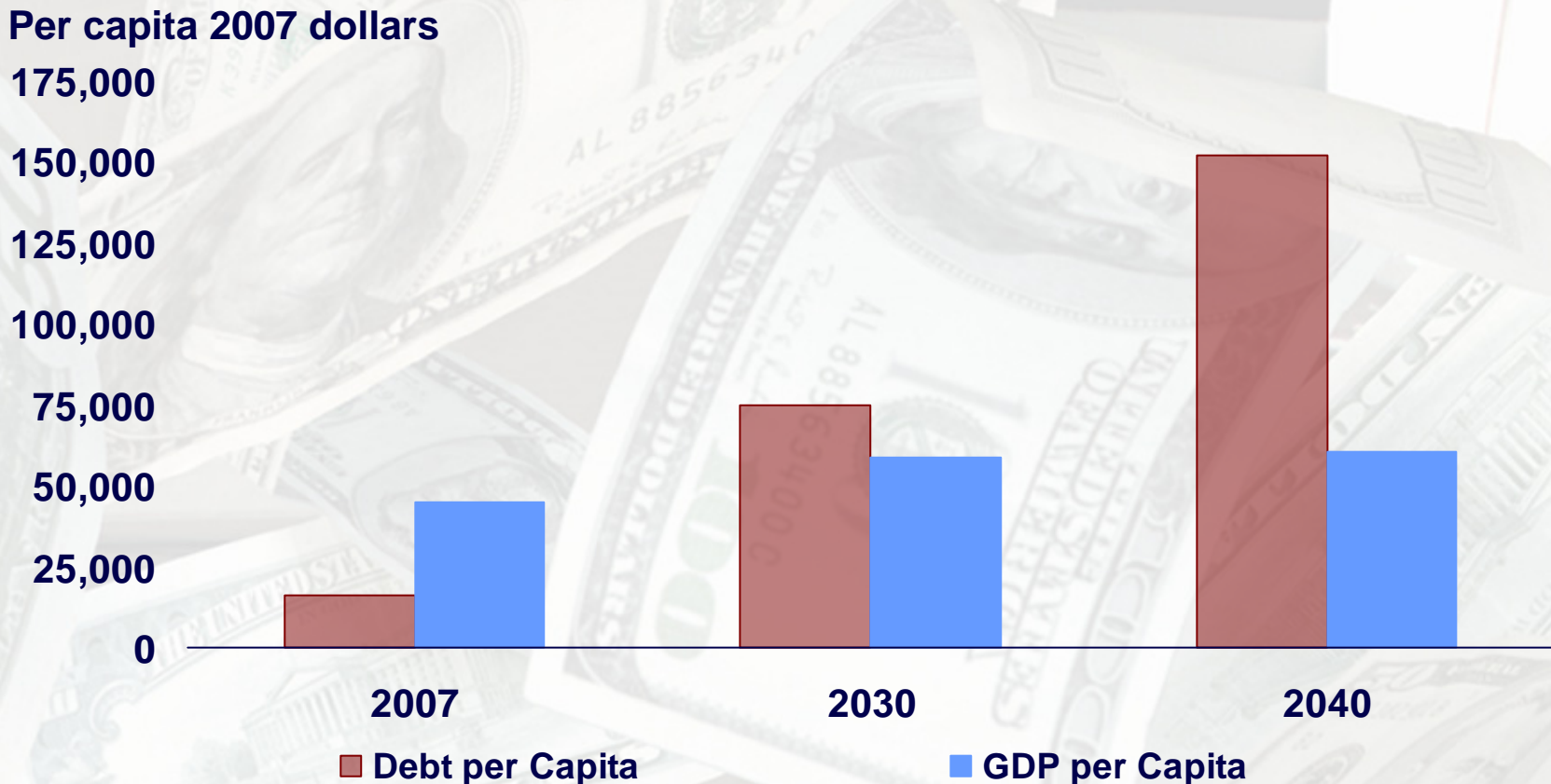
Social Security, Medicare, and Medicaid Spending as a Percent of GDP



Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration, Office of the Actuary, Centers for Medicare and Medicaid Services, and the Congressional Budget Office.

Note: Social Security and Medicare projections based on the intermediate assumptions of the 2007 Trustees' Reports. Medicaid projections based on CBO's August 2007 short-term Medicaid estimates and CBO's December 2005 long-term Medicaid projections under mid-range assumptions.

Debt per Capita Could Exceed GDP Per Capita Before 2030 Under GAO's Alternative Simulation

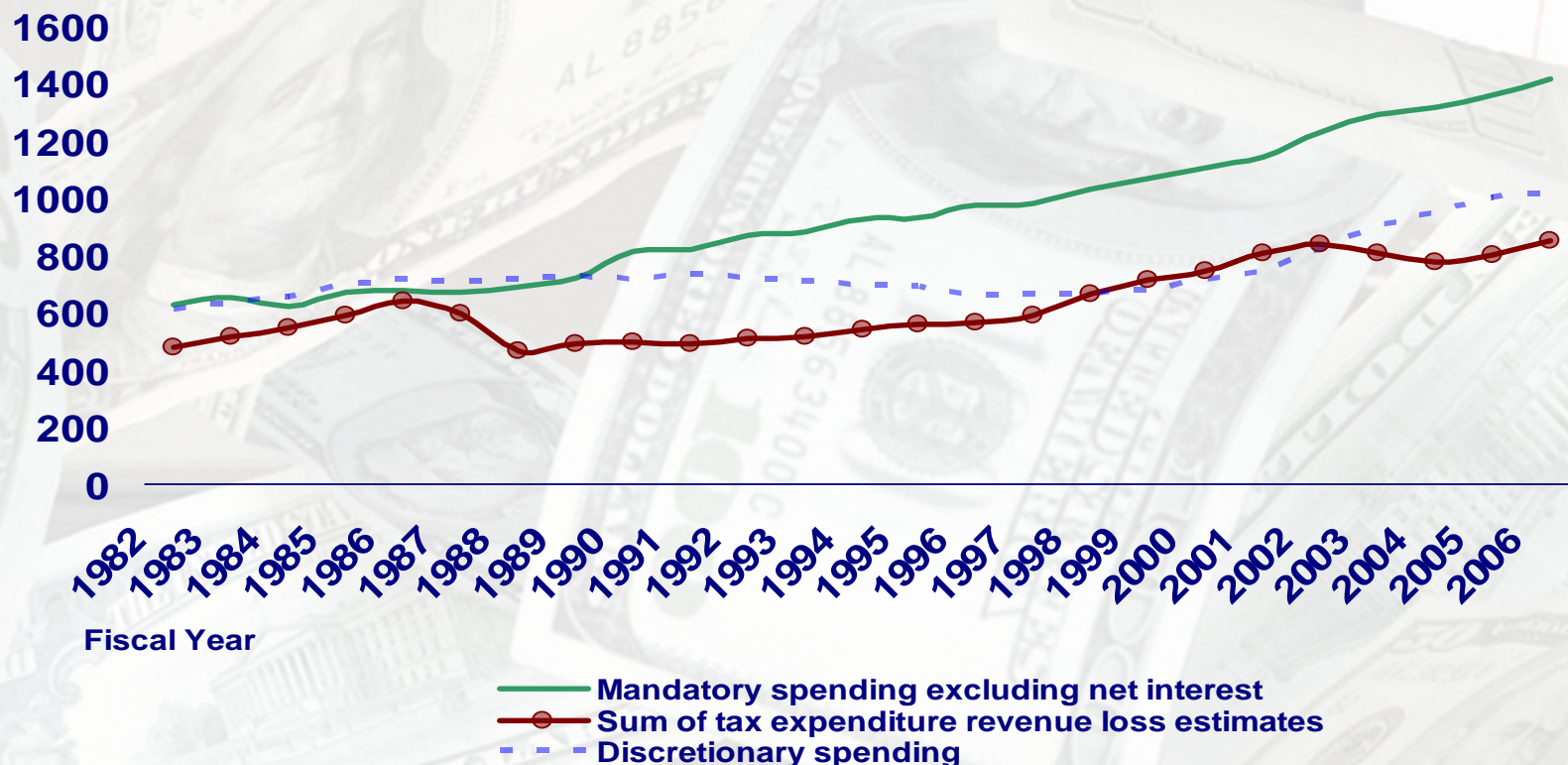


Source: GAO's August 2007 analysis.

Note: Simulation assumes discretionary spending grows with GDP after 2007. AMT exemption amount is retained at the 2006 level through 2017 and expiring tax provisions are extended. After 2017, revenue as a share of GDP returns to its historical level of 18.3 percent of GDP plus expected revenues from deferred taxes (i.e. taxes on withdrawals from retirement accounts). Medicare spending is based on the Trustees April 2007 projections adjusted for the Centers for Medicare and Medicaid Services alternative assumption that physician payments are not reduced as

Federal Tax Expenditures Exceeded Discretionary Spending for Half of the Last Decade

Dollars in billions (in 2006 dollars)

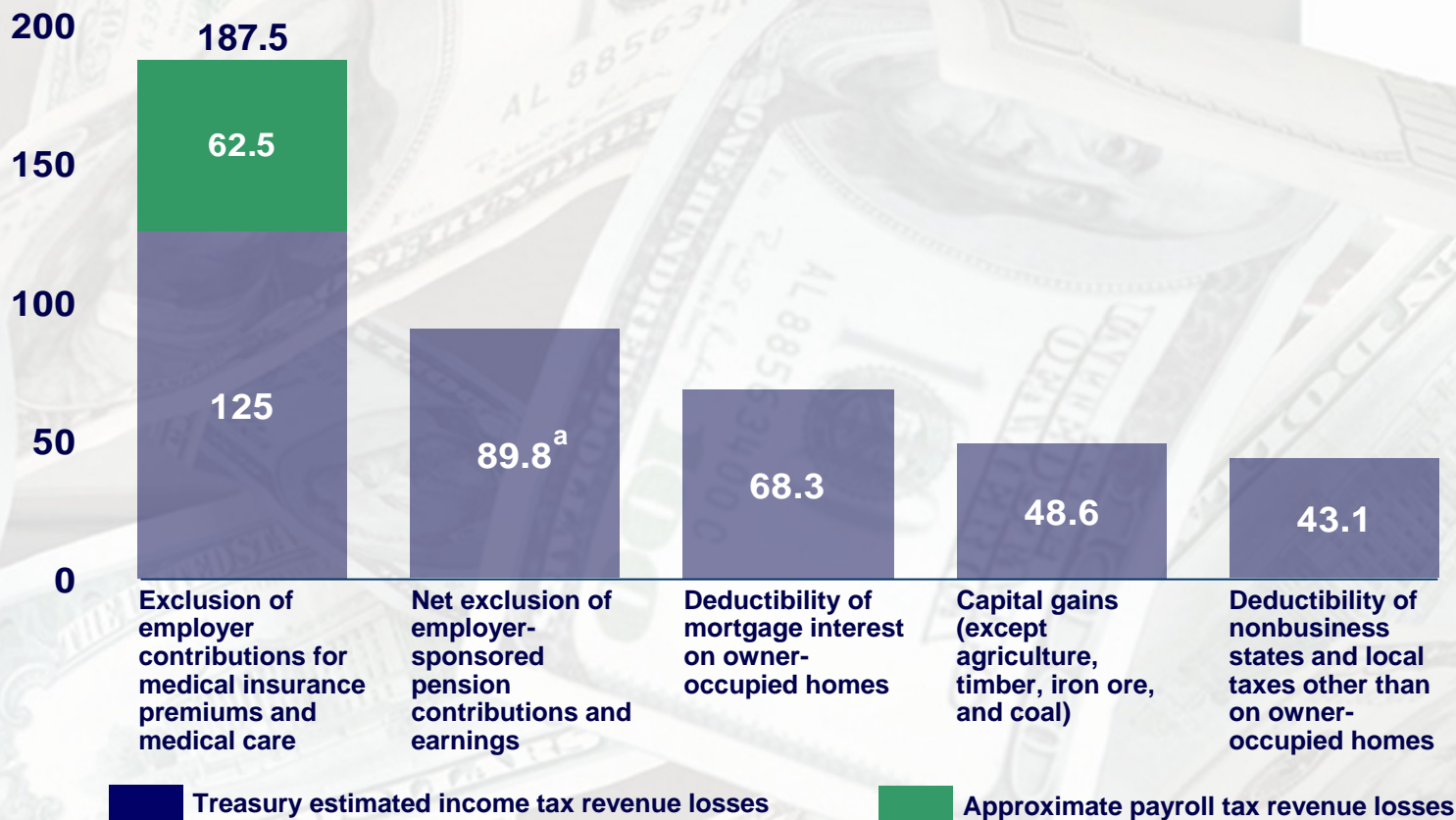


Source: GAO analysis of OMB budget reports on tax expenditures, fiscal years 1976-2008.

Note: Summing tax expenditure estimates does not take into account interactions between individual provisions. Outlays associated with refundable tax credits are included in mandatory spending.

Revenue Loss Estimates for the Largest Tax Expenditures Reported for Fiscal Year 2006

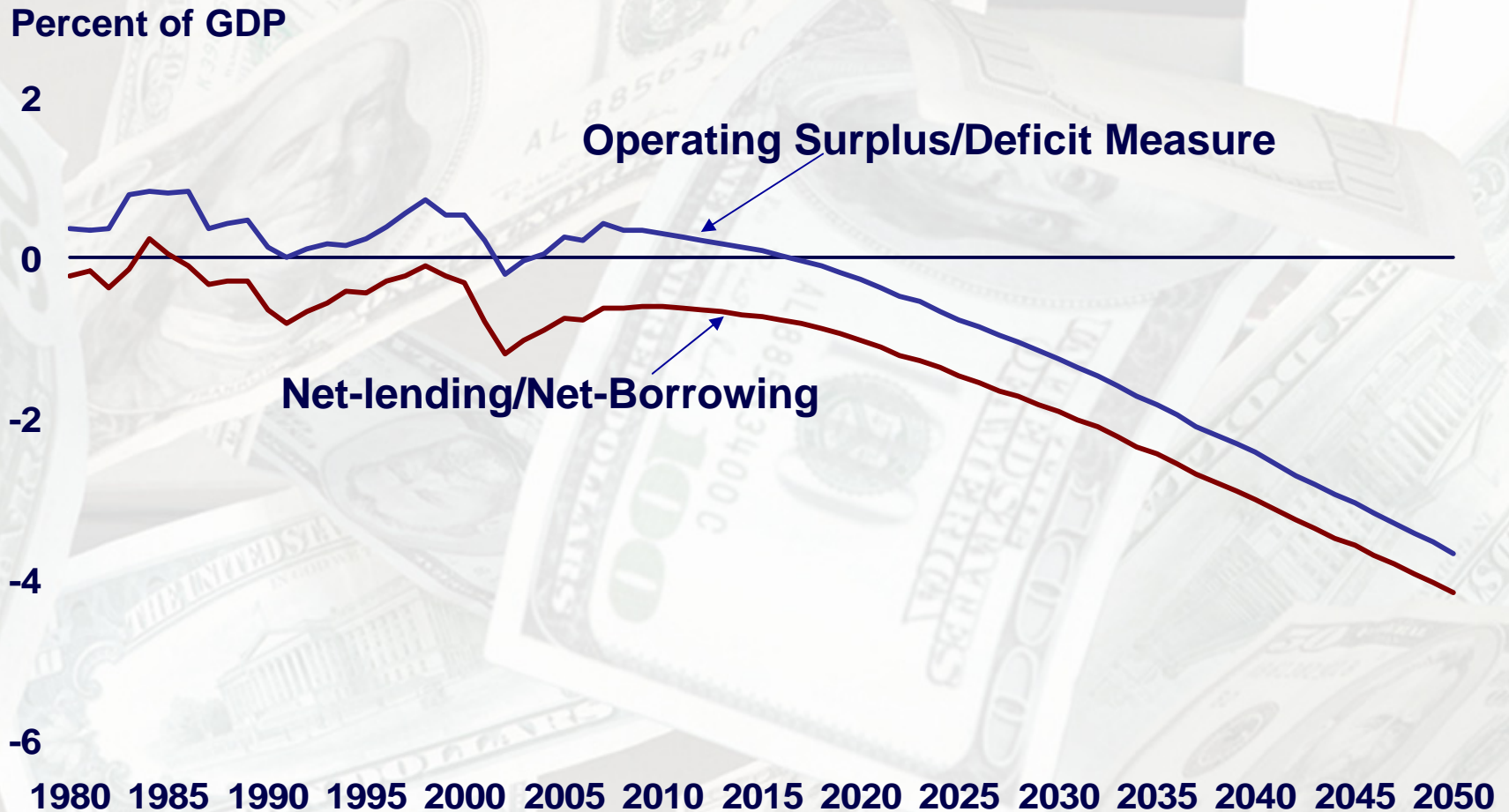
Revenue loss estimates (dollars in billions)



Source: GAO analysis of OMB, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2008*.

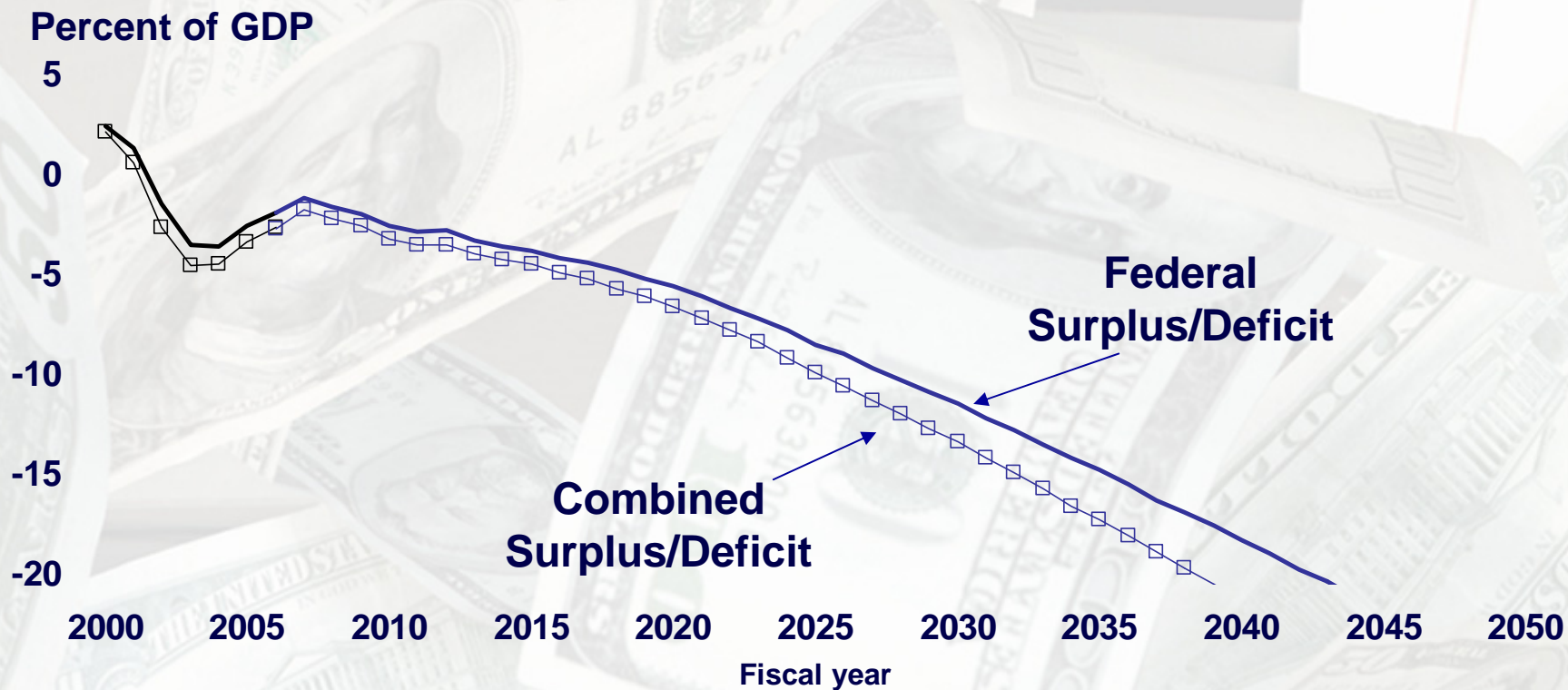
^aThe value of employer-provided health insurance is excluded from Medicare and Social Security payroll taxes. Some researchers have estimated that payroll tax revenue losses amounted to more than half of the income tax revenue losses in 2004, and we use this estimate for 2006. The research we are aware of dealt only with health care, therefore the 50 percent figure may not apply to other items that are excluded from otherwise applicable income and payroll taxes.

State and Local Governments Face Increasing Fiscal Challenges



Sources: Historical data from National Income and Product Accounts. Historical data from 1980 – 2006, GAO projections from 2007 – 2050 using many CBO projections and assumptions, particularly for next 10 years.

State and Local Fiscal Challenges Add to the Federal Government's Fiscal Challenge



Source: Historical data from National Income and Product Accounts, GAO Analysis.

Note: Historical data from 2000 – 2006, projections from 2007 – 2050; state and local balance measure is similar to the federal unified budget measure. Federal Simulation Assumptions: Discretionary spending grows with GDP after 2007. AMT exemption amount is retained at the 2006 level through 2017 and expiring tax provisions are extended. After 2017, revenue as a share of GDP returns to its historical level of 18.3 percent of GDP plus expected revenues from deferred taxes, i.e. taxes on withdrawals from retirement accounts. Medicare spending is based on the Trustees' April 2007 projections adjusted for the Centers for Medicare and Medicaid Services' alternative assumption that physician payments are not reduced as specified under current law.

Current Fiscal Policy Is Unsustainable

- **The “Status Quo” Is Not an Option**
 - We face large and growing structural deficits largely due to known demographic trends and rising health care costs
 - GAO’s simulations show that balancing the budget in 2040 could require actions as large as
 - Cutting total federal spending by 60 percent or
 - Raising federal taxes to two times today’s level
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
 - Closing the current long-term fiscal gap based on reasonable assumptions would require real average annual economic growth in the double-digit range every year for the next 75 years
 - During the 1990s, the economy grew at an average 3.2 percent per year
 - As a result, we cannot simply grow our way out of this problem. Tough choices will be required

The Way Forward: A Three-Pronged Approach

- 1. Improve Financial Reporting, Public Education, and Performance Metrics**
- 2. Strengthen Budget and Legislative Processes and Controls**
- 3. Fundamentally Reexamine & Transform for the 21st Century (i.e., entitlement programs, other spending, and tax policy)**

Solutions Require Active Involvement from both the Executive and Legislative Branches

Key National Indicators

- **WHAT:** A portfolio of economic, social, and environmental outcome-based measures that could be used to help assess the nation's and other governmental jurisdictions' position and progress
- **WHO:** Many countries and several states, regions, and localities have already undertaken related initiatives (e.g., Australia; New Zealand; Canada; United Kingdom; Oregon; Silicon Valley (California); Jacksonville (Florida); Boston (Massachusetts))
- **WHY:** Development of such a portfolio of indicators could have a number of possible benefits, including
 - Serving as a framework for related strategic planning efforts
 - Enhancing performance and accountability reporting
 - Informing public policy decisions, including much needed baseline reviews of existing government policies, programs, functions, and activities
 - Facilitating public education and debate as well as an informed electorate
- **WAY FORWARD:** Key players working through a consortium within a nonprofit organization receiving technical assistance from the National Academies domestically and OECD and others providing assistance internationally on related efforts

Key National Indicators: Where the United States Ranks

The United States may be the only superpower, but compared to most other OECD countries on selected key economic, social, and environmental indicators, on average, the U.S. ranks

16 OUT OF 28

OECD Categories for Key Indicators (2006 OECD Factbook)

• Population/Migration	• Energy	• Environment	• Quality of Life
• Macroeconomic Trends	• Labor Market	• Education	• Economic Globalization
• Prices	• Science & Tech.	• Public Finance	

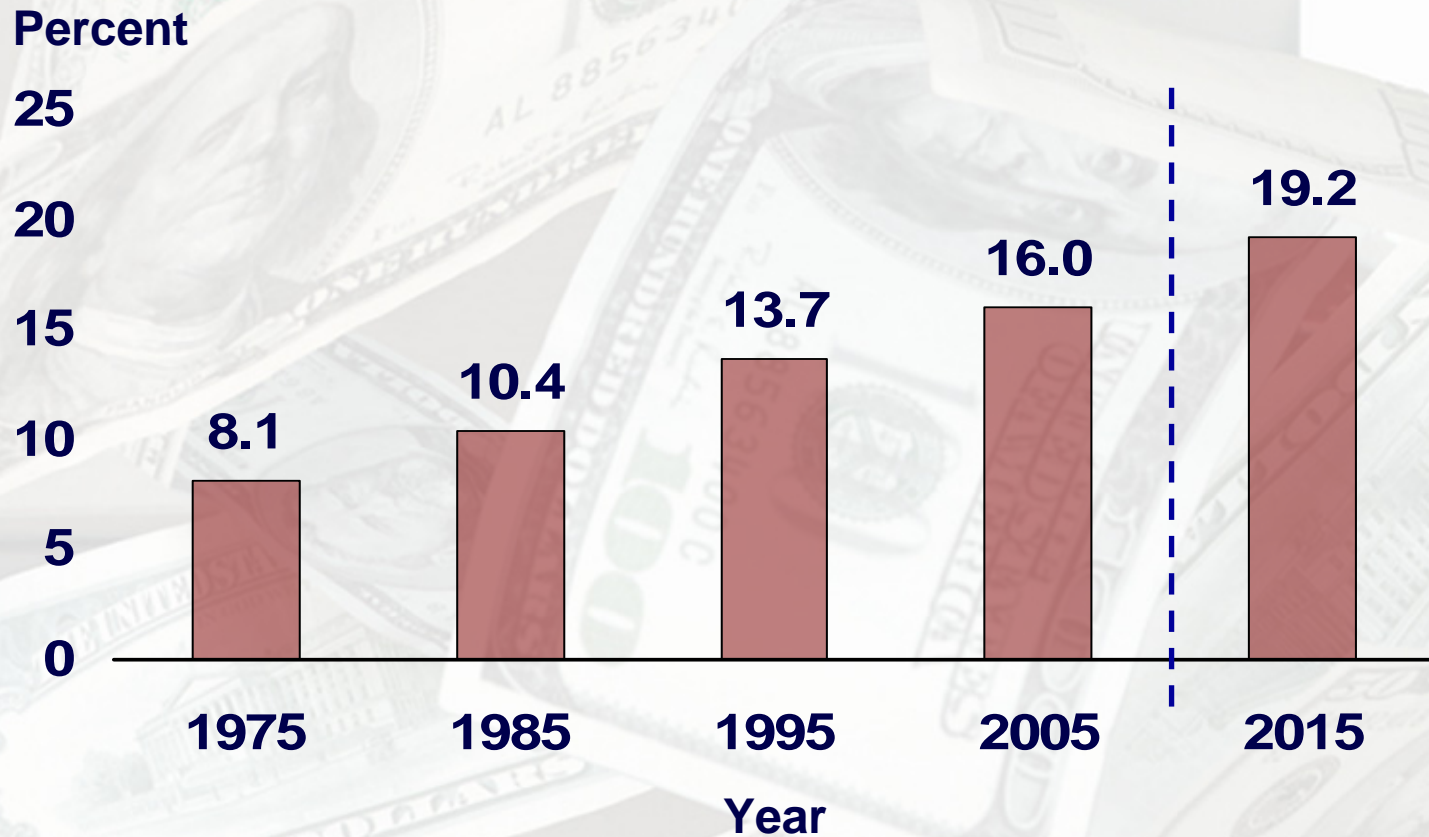
Source: 2006 OECD Factbook.

Key Sustainability Challenges

- Fiscal deficits and public debt burdens
- Social insurance commitments
- Health care quality, access, and costs
- K-12 education system
- Energy, environment, and resource protection
- Tax gaps and policies
- Immigration policies
- Infrastructure needs
- Governance, political reforms, and citizen engagement
- Security strategies, including defense and homeland issues, as well as Iraq
- Foreign policy strategies
- Federal workforce and related policies and practices

Growth in Health Care Spending:

Health Care Spending as a Percentage of GDP



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

Note: The figure for 2015 is projected.

Where the United States Ranks on Selected Health Outcome Indicators

Outcome	Rank
Life expectancy at birth <i>U.S. = 77.8 years in 2004</i>	23 out of 30 in 2004
Infant Mortality <i>U.S. = 6.8 deaths in 2004</i>	26 out of 30 in 2004
Potential Years of Life Lost <i>U.S. = 5,066 in 2002</i>	23 out of 26 in 2002

Source: *OECD Health Data 2006 and 2007.*

Notes: Data are the most recent available for all countries. Life expectancy at birth for the total population is estimated by the OECD Secretariat for all countries, as the unweighted average of the life expectancy of men and women. Infant mortality is measured as the number of deaths per 1,000 live births. Potential years of life lost (PYLL) is the sum of the years of life lost prior to age 70, given current age-specific death rates (e.g., a death at 5 years of age is counted as 65 years of PYLL).

Issues to Consider in Examining Our Health Care System

- The public needs to be educated about the differences between **wants**, **needs**, **affordability**, and **sustainability** at both the individual and aggregate level
- Ideally, health care reform proposals will:
 - **Align Incentives** for providers and consumers to make prudent decisions about the use of medical services,
 - **Foster Transparency** with respect to the value and costs of care, and
 - **Ensure Accountability** from insurers and providers to meet standards for appropriate use and quality.
- Ultimately, we need to address four key dimensions: **access**, **cost**, **quality**, and **personal responsibility**

Selected Potential Health Care Reform Approaches

Reform Approach	Short-term action	Long-term action
Revise the government's payment systems and leverage its purchasing authority to foster value-based purchasing for health care products and services	✓	
Consider additional flexibility for states to serve as models for possible health care reforms	✓	
Consider limiting direct advertising and allowing limited importation of prescription drugs	✓	
Foster more transparency in connection with health care costs and outcomes	✓	
Create incentives that encourage physicians to utilize prescription drugs and other health care products and services economically and efficiently	✓	
Foster the use of information technology to increase consistency, transparency, and accountability in health care	✓	
Encourage case management approaches for people with chronic and expensive conditions to improve the quality and efficiency of care delivered and avoid inappropriate care	✓	
Reexamine the design and operational structure of the nation's health care entitlement programs—Medicare and Medicaid, including exploring more income-related approaches	✓	✓

Selected Potential Health Care Reform Approaches

Reform Approach	Short-term action	Long-term action
Revise certain federal tax preferences for health care to encourage more efficient use of health care products and services.	✓	✓
Foster more preventative care and wellness services and capabilities, including fighting obesity and encouraging better nutrition	✓	✓
Promote more personal responsibility in connection with health care	✓	✓
Limit spending growth for government-sponsored health care programs (e.g., percentage of the budget and/or economy)		✓
Develop a core set of basic and essential services. Create insurance pools for alternative levels of coverage, as necessary		✓
Develop a set of evidence-based national practice standards to help avoid unnecessary care, improve outcomes, and reduce litigation		✓
Pursue multinational approaches to investing in health care R&D		✓

Possible Way Forward on Social Security Reform

Make little or no changes to those who are near retirement or already retired and make a number of adjustments that would affect younger workers:

- Phase-in an increase in the **normal** retirement age and index it to life expectancy
- Consider phasing-in an increase in the **early** retirement age and index it to life expectancy with a modified disability access provision
- Modify income replacement and/or indexing formulas for middle and upper income earners
- Strengthen the minimum benefit
- Consider a modest adjustment to the COLA formula
- Increase the taxable wage base, if necessary
- Consider supplemental individual accounts and mandatory individual savings on a payroll deduction basis (e.g., a minimum 2 percent payroll contribution and a program designed much like the Federal Thrift Savings Plan with a real trust fund and real investments)

Moving the Debate Forward

- **The Sooner We Get Started, the Better**
 - The miracle of compounding is currently working against us
 - Less change would be needed, and there would be more time to make adjustments
- Our demographic changes will serve to make reform more difficult over time
- **Need Public Education, Discussion, and Debate**
 - The role of government in the 21st Century
 - Which programs and policies should be changed and how
 - How government should be financed

Three Key Illnesses

- ***Myopia***
- ***Tunnel Vision***
- ***Self-Centeredness***

Four National Deficits

- ***Budget***
- ***Balance of Payments***
- ***Savings***
- ***Leadership***

Key Leadership Attributes Needed for These Challenging and Changing Times

- ***Courage***
- ***Integrity***
- ***Creativity***
- ***Partnership***
- ***Stewardship***

Three Key Groups That Need to Increase Their Influence and Involvement

- *The Business and Professional Community*
- *Young Americans*
- *The Media*



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On the Web

Web site: www.gao.gov/cghome.htm

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