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The federal government's financial condition and long-term fiscal outlook present enormous challenges to the nation's ability to respond to emerging forces reshaping American society, the United States' place in the world, and the future role of the federal government. The near-term deficits are daunting—a \$412 billion unified budget deficit in fiscal year 2004 (including a \$567 billion on-budget deficit and a \$155 billion off-budget surplus) and a \$368 billion deficit (not including any supplemental appropriations) forecast for fiscal year 2005 by the Congressional Budget Office (CBO). If these near-term deficits represented only a short-term phenomenon prompted by such factors as economic downturn or national security crises—there would be less cause for concern. However, deficits have grown notwithstanding the relatively strong rebound of the economy from the recession in 2001, and the incremental costs of responding to the nation's global war against terrorism and homeland security represent only a relatively small fraction of current and projected deficits. Moreover, based on the U.S. Government Accountability Office's (GAO) long-range fiscal simulations, the current fiscal condition is but a prelude to a much more daunting long-term fiscal outlook.

Over the next few decades, as the baby boom generation retires, federal spending on retirement and health programs—Social Security, Medicare, Medicaid, and other federal pension, health, and disability programs—will grow dramatically. Other federal fiscal commitments, ranging from explicit liabilities, such as environmental cleanup requirements to more implicit obligations presented by lifecycle costs of capital acquisitions, will also bind the nation's fiscal future. Absent policy changes on the spending and/or revenue sides of the budget, a growing imbalance between expected federal spending and tax revenues will mean escalating and ultimately unsustainable federal deficits and debt that serve to threaten our future national security as well as the standard of living for the American people. Ultimately, the nation will have to decide what level of federal benefits and spending it wants and how it will pay for these benefits.

The nation's long-term fiscal outlook is daunting under many different policy scenarios and assumptions. For instance, under a

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fiscally restrained scenario, if discretionary spending grew only with inflation over the next 10 years and all existing tax cuts expire when scheduled under current law, spending for Social Security and health care programs would grow to consume over three-quarters of federal revenue by 2040. (See fig. 1.) On the other hand, if discretionary spending grew at the same rate as the economy in the near term and if all tax cuts were extended, federal revenues may just be adequate to pay interest on the growing federal debt by 2040. (See fig. 2.) Numerous alternative scenarios can be developed incorporating different combinations of possible policy choices and economic assumptions, but these two scenarios can be viewed as “bookends” showing a range of possible outcomes.²

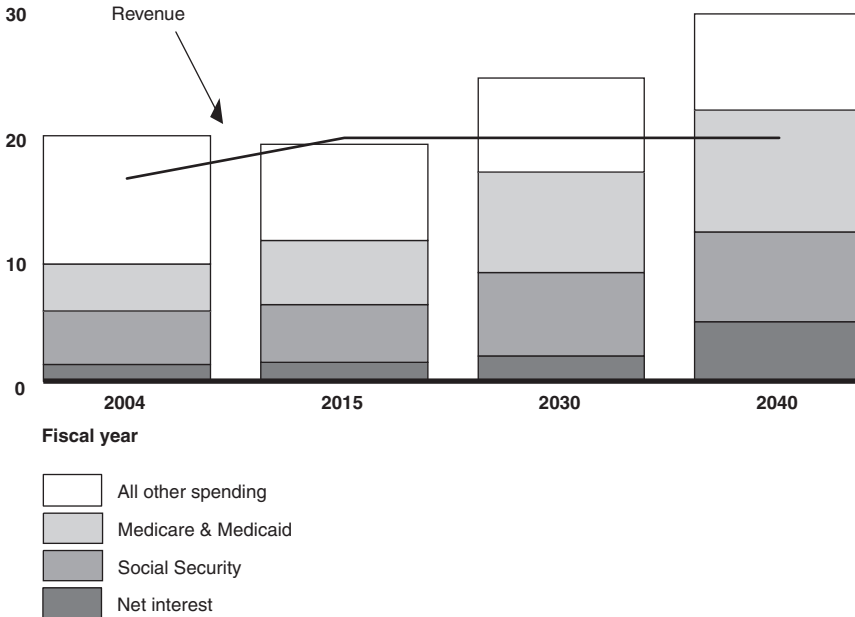
²To view alternative scenarios between these “bookends,” see the section on The Nation’s Long-Term Fiscal Challenge on GAO’s Web site (www.gao.gov/special.pubs/longterm/).

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Figure 1: Composition of Spending as a Share of GDP under Baseline Extended

50 Percent of GDP

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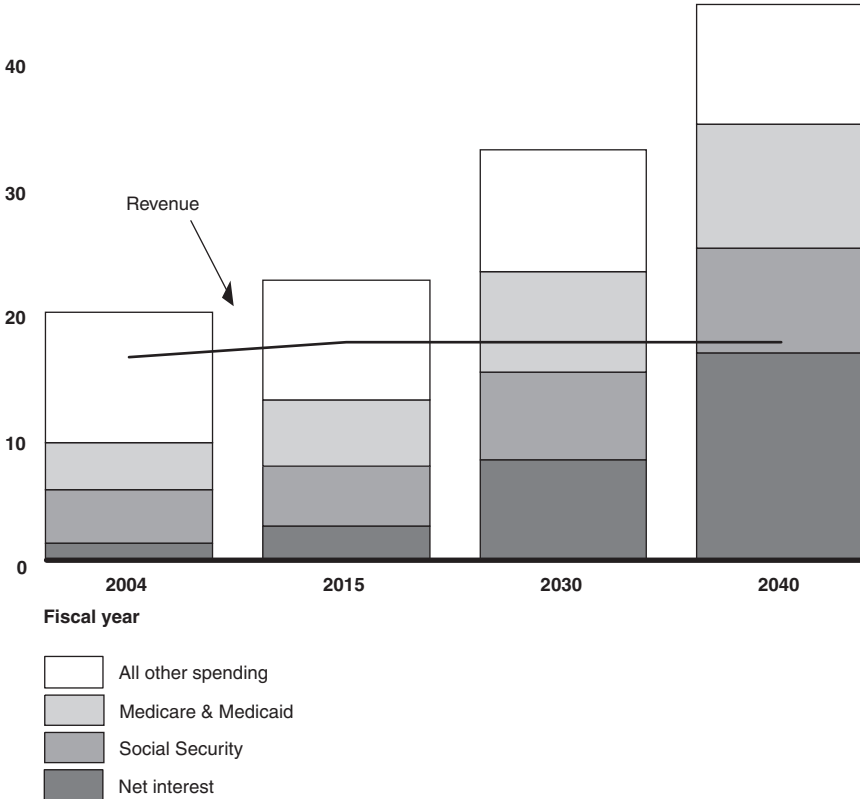
Source: GAO's January 2005 analysis.

Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the alternative minimum tax (AMT), and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

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Figure 2: Composition of Spending as a Share of GDP Assuming Discretionary Spending Grows with GDP after 2005 and All Expiring Tax Provisions Are Extended

50 Percent of GDP



Source: GAO's January 2005 analysis.

Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

Addressing the projected fiscal gaps shown here will prompt policymakers to examine the advisability, affordability, and sustainability of existing programs, policies, functions, and activities throughout the entire federal budget—spanning discretionary spending, mandatory spending, including entitlements, and tax policies and programs. Neither slowing the growth of discretionary spending nor allowing tax cuts to expire—nor both options combined—would by themselves eliminate our long-term fiscal imbalance. Additional economic growth is critical and will help to ease the burden, but the projected fiscal gap is so great that it is unrealistic to expect that we will grow our way out of the problem. Clearly, tough choices will be required. Changes in existing budget processes and financial, fiscal, and performance metrics will be necessary to facilitate these choices.

Early action to change existing programs and policies would yield the highest fiscal dividends and provide a longer period for prospective beneficiaries to make adjustments in their own planning. The longer we wait, the more painful and difficult the choices will become. By waiting, an important window is lost during which today's relatively large workforce can increase saving and begin preparing for the necessary changes in fiscal policy, Social Security, health care and other reforms that may very well be part of the solution to this coming fiscal crunch. However, the long-term challenge is fast becoming a short term one as the retirement of the baby boomers' generation will begin as early as 2008 and since overall work force growth has already begun to slow.

Emerging Forces Will Test Existing Policy Frameworks

These challenges would be difficult enough if all we had to do is fund existing commitments. But the nation and the world have and will continue to change in fundamental ways. As a result, a wide range of emerging needs and demands can be expected to compete for a share of the budget pie. Whether it be national security, homeland security, transportation, education, environmental cleanup, or public health, a society with a growing population will generate new claims for federal actions on both the spending and tax sides of the budget. For example, the nation's population itself is projected to grow by about 50 percent over the next 50 years,

generating new needs for public and private resources. Addressing the burdens of existing commitments and providing expanded economic resources are two important strategies to enable future generations to regain the fiscal flexibility to address these needs.

More broadly, major forces are at work that will require the federal government to rethink its entire approach to policy design, priorities, and management to remain relevant to our changing society. In short, government will need to change to become as dynamic as the nation and the changing environment in which it must operate.

GAO's Strategic Plan for Serving the Congress and the Nation (2004-2009), which was prepared in close consultation with the Congress, highlights some of the major forces (See fig. 3.), in addition to the large and growing fiscal imbalances that are at work to reshape our nation and the role of the federal government.

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Figure 3: Forces Shaping the United States and Its Place in the World

Large and Growing Long-term Fiscal Imbalance—The U.S. government's long-term financial condition and fiscal outlook present enormous challenges to the nation's ability to respond to forces that shape American society, the United States' place in the world, and the role of the federal government. The short-term deficits are but a prelude to a projected worsening long-term fiscal outlook driven largely by known demographic trends and rising health care costs.

Evolving National and Homeland Security Policies—The dissolution of the Soviet Union in 1991 and the emergence of the more diffuse threats posed by terrorism to the nation's national and homeland security have led to major shifts in strategic threats. While these new security concerns are already prompting changes in defense postures and international relationships, preparedness and responses to these new threats also carry wide ranging and unprecedented implications for domestic policies, programs, and infrastructures.

Increasing Global Interdependence—The rapid increase in the movement of economic and financial goods, people, and information has prompted more widespread realization that the nation is no longer self-contained, either in its problems or their solutions. The growing interdependence of nations, while carrying clear economic and social benefits, also places new challenges on the national agenda and tasks policymakers to recognize the need to work in partnerships across boundaries to achieve vital national goals.

The Changing Economy—The shift to a knowledge-based economy and the adoption of new technology has created the potential for higher productivity but posed new challenges associated with sustaining the investment in human capital and research and development that is so vital to continued growth. While the sustainability of U.S. economic growth has been aided by trade liberalization and increased market competition in key sectors, the sustainability of growth over the longer term will require a reversal of the declining national savings rate that is so vital to fueling capital investment and productivity growth.

Demographic Shifts—An aging and more diverse population will prompt higher spending on federal retirement and health programs. Unless there is strength in the underlying sources of productivity—education, technology and research and development—low labor force growth will lead to slower economic growth and federal revenue growth over the longer term. As labor becomes ever more scarce, a greater share of the work force will be comprised of foreign-born workers, women, and minorities with broad-scale implications for education, training, child care, and immigration policies.

Science and Technology Advances—Rapid changes in science and technology present great opportunities to improve the quality of life and the economy, whether it be finding new sources of energy, curing diseases, or enhancing the nation's information and communications capacities. However, technologies raise their own unique vulnerabilities, risks, and privacy and equity concerns that must be addressed by policymakers.

Quality of Life Trends—Large segments of the population enjoy greater economic prosperity than ever before, and the well being of many Americans has improved dramatically thanks to breakthroughs in health care and improvements in environmental protection. However, these improvements have not been evenly distributed across the nation, as more than 40 million Americans lacking health insurance demonstrate. Prosperity has prompted its own stresses, as population growth and sprawl create demand for new transportation and communication infrastructure.

Diverse Governance Structures and Tools—To deliver on the public's needs and wants, the nation's system will be pressed to adapt its existing policy-making processes and management systems. The governance structures and management processes that emerge will be shaped by the above forces (e.g., increasing interdependency, scientific and technological changes, and security threats), and will depend on having sufficient foresight, a continuous reexamination and updating of priorities, ongoing oversight, and reliable and results-oriented national performance indicators.

Source: GAO.

As the pace of change accelerates in every aspect of American life, these forces work to present government with new and more complex challenges and demands. As the federal role has grown in addressing a wide range of needs, the public has come to expect higher levels of performance and greater responsiveness by public officials and programs.

If government is to effectively address these trends, it cannot accept all of its existing programs, policies, and activities as “givens.” Many of our programs were designed decades ago to address earlier challenges, informed by labor markets, security conditions, economic theories, life expectancies, health conditions, organizational structures, technologies, transportation systems, management models, and compensation strategies of prior eras. Outmoded commitments and operations constitute an encumbrance on the future that can erode the capacity of the nation to better align its government with the needs and demands of a changing world and society.

Accordingly, rethinking the base of existing federal spending and tax programs, policies, and activities by reviewing their results and testing their continued relevance and relative priority for a changing society is an important step in this process of fiscal responsibility and national renewal. A periodic reexamination offers the prospect of addressing emerging needs by weeding out programs and policies that are outdated or ineffective. Those programs and policies that remain relevant could be updated and modernized by improving their targeting and efficiency through such actions as redesigning allocation and cost-sharing provisions, consolidating facilities and programs, and streamlining and reengineering operations and processes. The tax policies and programs financing the federal budget can also be reviewed with an eye toward both the overall level of revenues that should be raised as well as the mix of taxes that are used.

We recognize that this will not be a simple or easy process. Such a process reverses the focus of traditional incremental reviews, where disproportionate scrutiny is given to proposals for new programs or activities, not those that are already in the base. Taking a hard look at existing programs and carefully reconsidering their goals and their

financing is a challenging task. Reforming programs and activities leads to winners and losers, notwithstanding demonstrated shortfalls in performance and design. Given prior experience and political tendencies, there is little real “low-hanging fruit” in the federal budget. Moreover, given the wide range of programs and issues covered, the process of rethinking government programs and activities may take a generation to unfold.

We are convinced, however, that reexamining the base offers compelling opportunities to both redress our current and projected fiscal imbalance while better positioning government to meet the new challenges changing expectations of this new century. In this regard, the management and performance reforms enacted by the Congress in the past 15 years have provided new tools to gain insight into the financial, program, and management performance of federal agencies and activities. The information being produced as a result can provide a strong basis to support the review and reprioritization being suggested in this report.

GAO’s 21st Century Questions

This report is intended to help the Congress address current fiscal demands as well as future fiscal challenges by providing a series of illustrative questions that could help support a fundamental and broad-based reexamination initiative. Drawing on GAO’s institutional knowledge and extensive program evaluation and performance assessment work for the Congress, we present over 200 specific 21st century questions illustrating the types of hard choices our nation needs to face as it reexamines what the federal government does and how it does it.

In developing the 21st century questions, we reflected on the inventory of future forces working to reshape American society, our place in the world, and the various roles and responsibilities of the federal government that were presented in GAO’s latest Strategic Plan for Serving the Congress and the Nation (2004-2009). This plan outlines specific trends, as described above, that have no geopolitical boundaries and are expected to challenge what the federal government does and how it does business in the future. These trends, along with GAO’s institutional knowledge and issued

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work, helped us identify those federal program areas, activities and policy frameworks whose relevance, rationale, and relative priority are likely to be tested in the future. This process was carried out in 12 broad areas, discussed in section 2. We also drew on the collective knowledge and experiences of many others familiar with the various program areas discussed in the next section. We made a concerted effort to solicit input from within the accountability community, including various inspectors general as well as consult with various congressional members, officials, and staff.

The specific questions raised for each area were informed by a set of generic evaluation criteria that are useful to evaluate any government program, policy, function or activity. The criteria are framed as questions in table 1 and are designed to address the legislative basis for the program, its purpose and continued relevance, its effectiveness in achieving goals and outcomes, its efficiency and targeting, its affordability, its sustainability, and its management. We used these criteria to generate specific 21st century questions about those programs and priorities already identified. The resultant 21st century questions illustrate the kinds of issues that a reexamination and review initiative needs to address.

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Table 1: Illustrative Generic Reexamination Criteria

Relevance of purpose and the federal role	Does it relate to an issue of nationwide interest? If so, is a federal role warranted based on the likely failure of private markets or state and local governments to address the underlying problem or concern? Does it encourage or discourage these other sectors from investing their own resources to address the problem?
	Have there been significant changes in the country or the world that relate to the reason for initiating it?
	If the answer to the last question is ‘yes,’ should the activity be changed or terminated, and if so, how? If the answer is unclear as to whether changes make it no longer necessary, then ask, when, if ever, will there no longer be a need for a federal role? In addition, ask, “would we enact it the same way if we were starting over today?” Has it been subject to comprehensive review, reassessment, and re-prioritization by a qualified and independent entity? If so, when? Have there been significant changes since then? If so, is another review called for?
	Is the current mission fully consistent with the initial or updated statutory mission (e.g., no significant mission creep or morphing)? Is the program, policy, function, or activity a direct result of specific legislation?
Measuring success	How does it measure success? Are the measures reasonable and consistent with the applicable statutory purpose? Are the measures outcome-based, and are all applicable costs and benefits being considered? If not, what is being done to do so?
	If there are outcome-based measures, how successful is it based on these measures?
Targeting benefits	Is it well targeted to those with the greatest needs and the least capacity to meet those needs?
Affordability and cost effectiveness	Is it affordable and financially sustainable over the longer term, given known cost trends, risks, and future fiscal imbalances?
	Is it using the most cost-effective or net beneficial approaches when compared to other tools and program designs?
	What would be the likely consequences of eliminating the program, policy, function, or activity? What would be the likely implications if its total funding was cut by 25 percent?
Best practices	If it fares well after considering all of these questions, is the responsible entity employing prevailing best practices to discharge its responsibilities and achieve its mission (e.g., strategic planning, organizational alignment, human capital strategy, financial management, technology management, acquisitions/sourcing strategy, change management, knowledge management, client/customer service, risk management)?

Source: GAO.

When taken together, these questions can usefully illustrate the breadth of issues that can be addressed through a systematic reexamination process. Importantly, the questions cover the three major areas—discretionary spending, mandatory spending including entitlements, and tax policies.