



U.S. Financial Condition and Fiscal Future Briefing

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

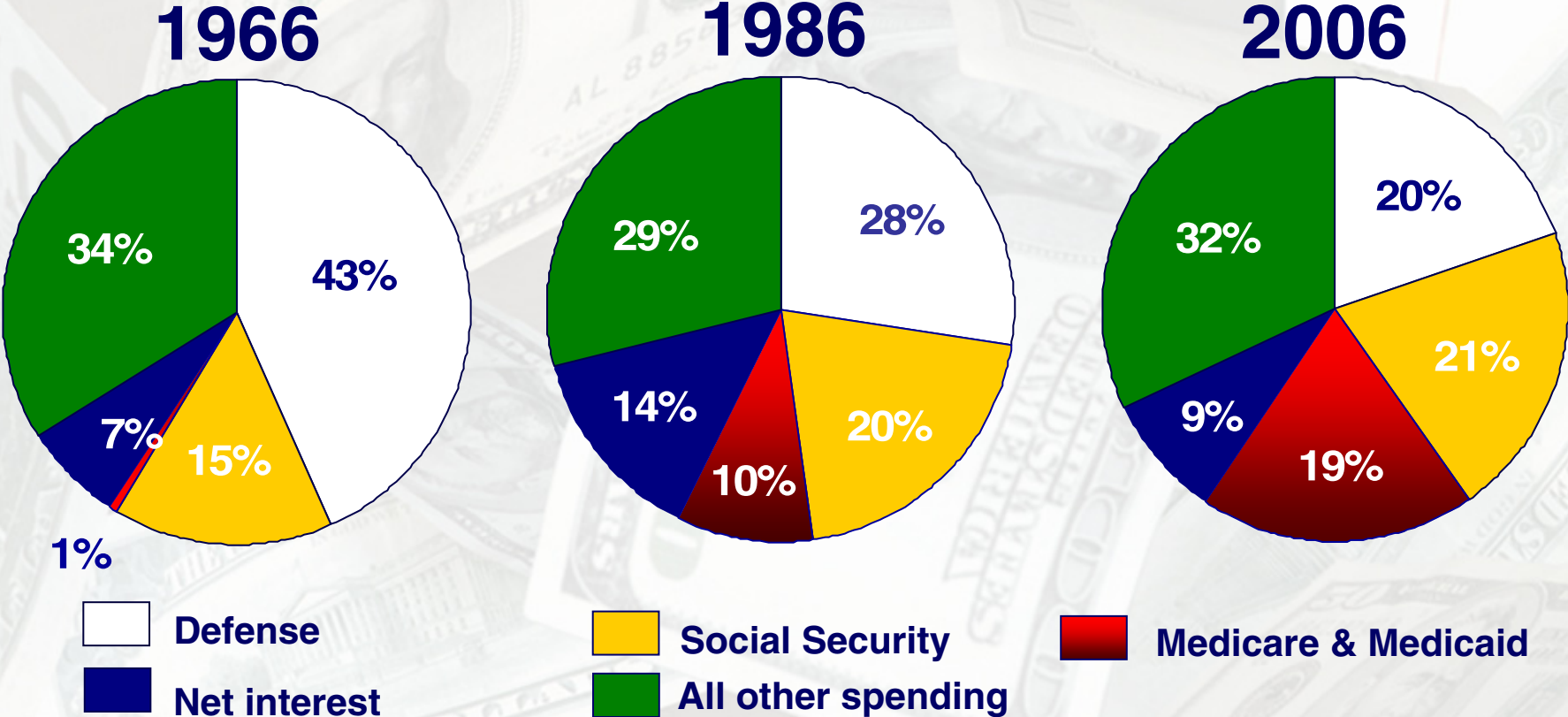
**National Press Foundation
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The Case for Change

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- Outdated federal organizational structures, policies, and practices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



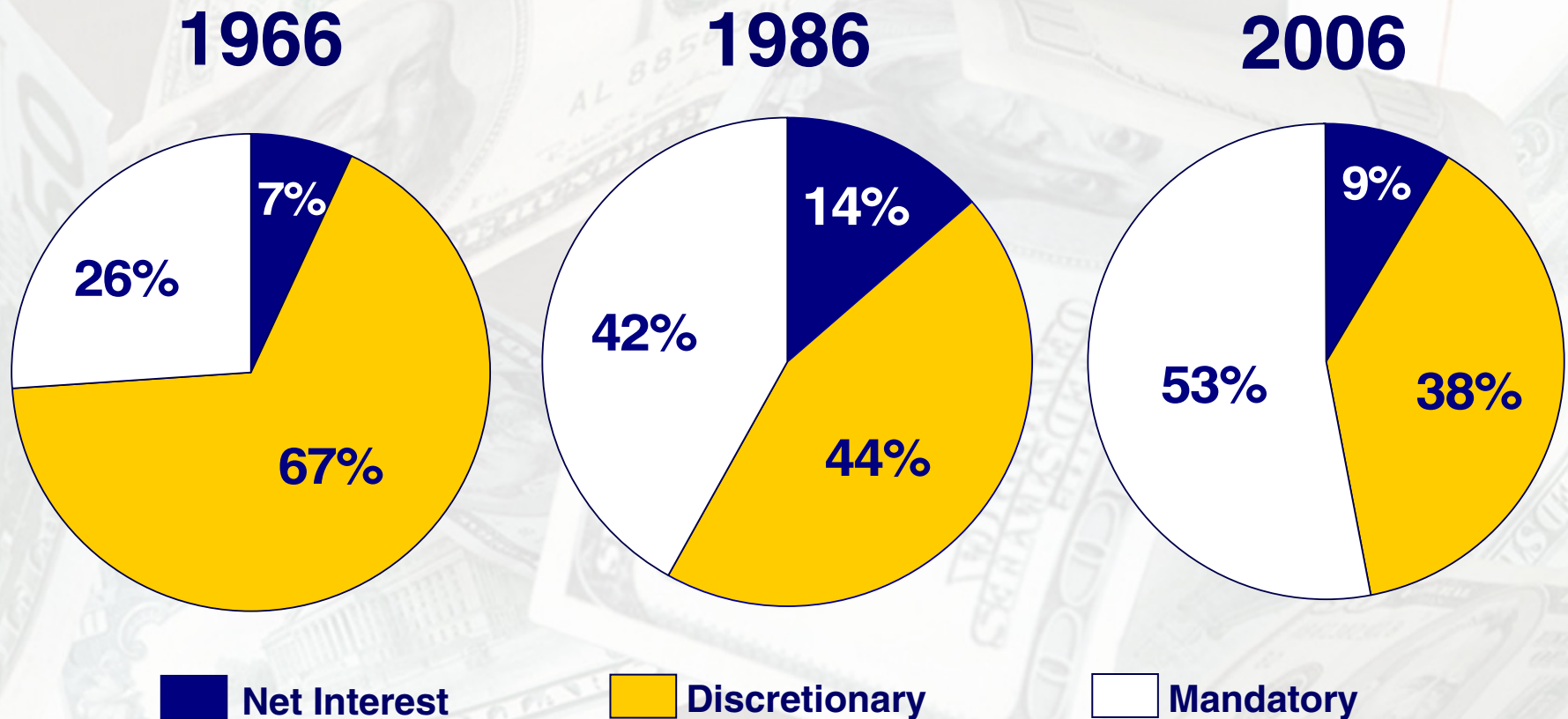
Source: Office of Management and Budget.
 Note: Numbers may not add to 100 percent due to rounding.

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

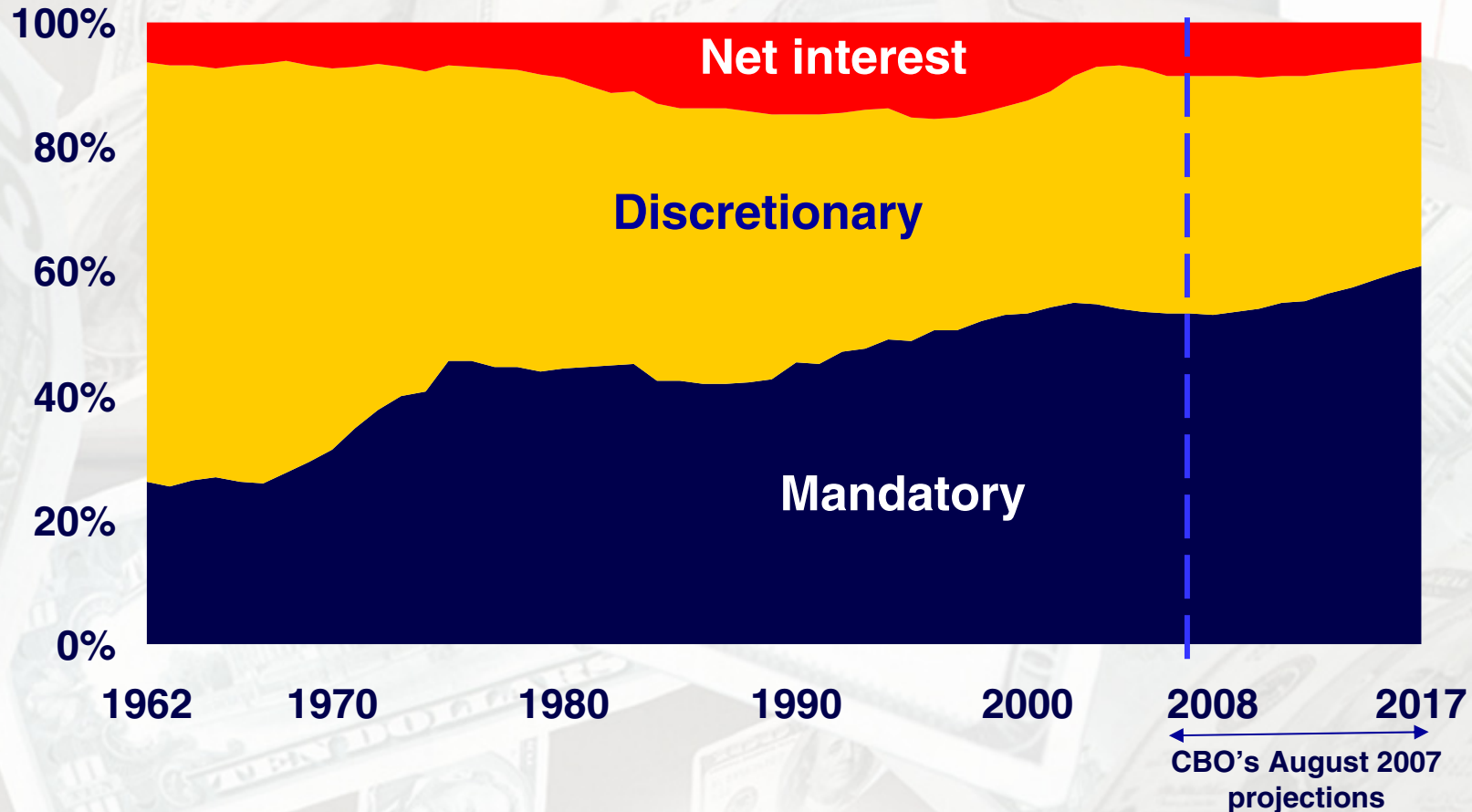
Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

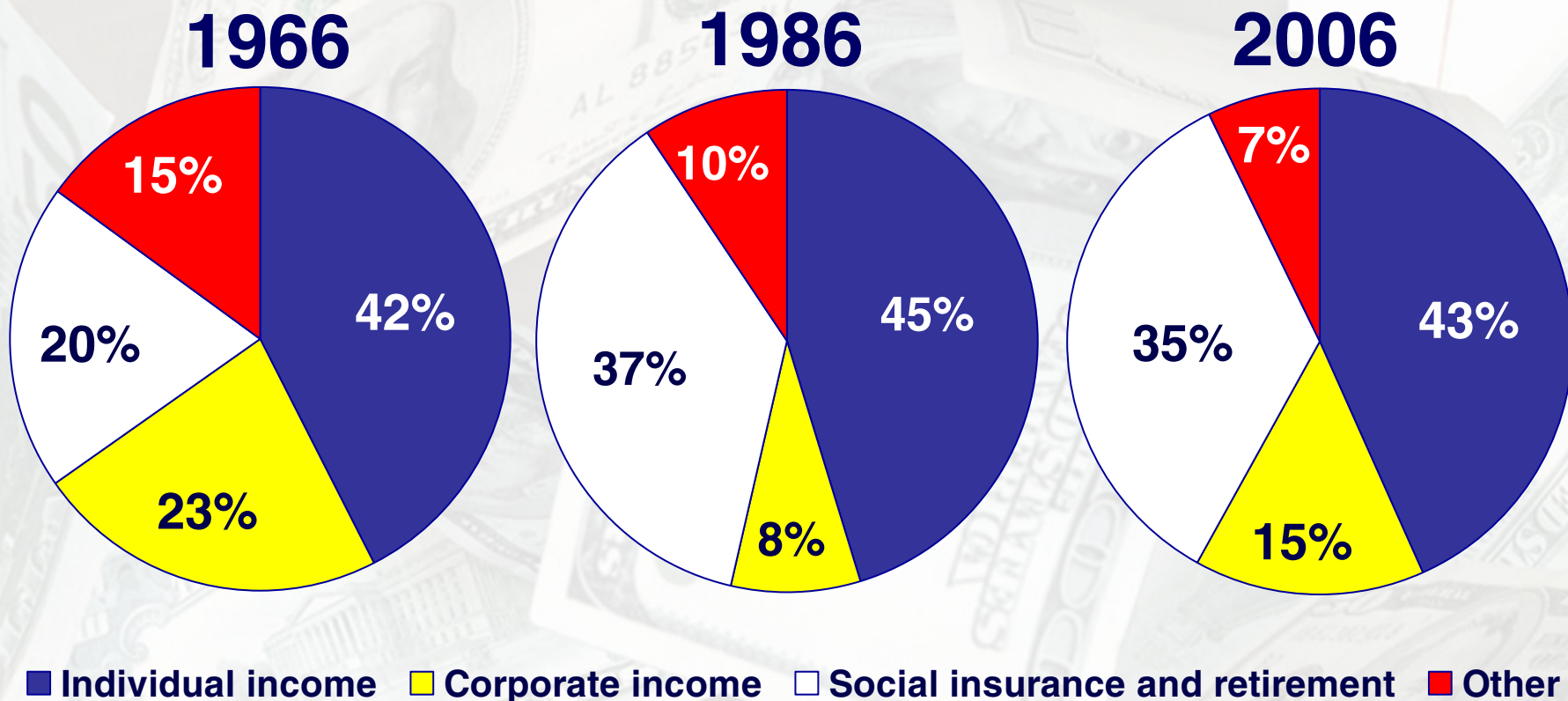
A Different View: Federal Spending for Mandatory and Discretionary Programs

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.

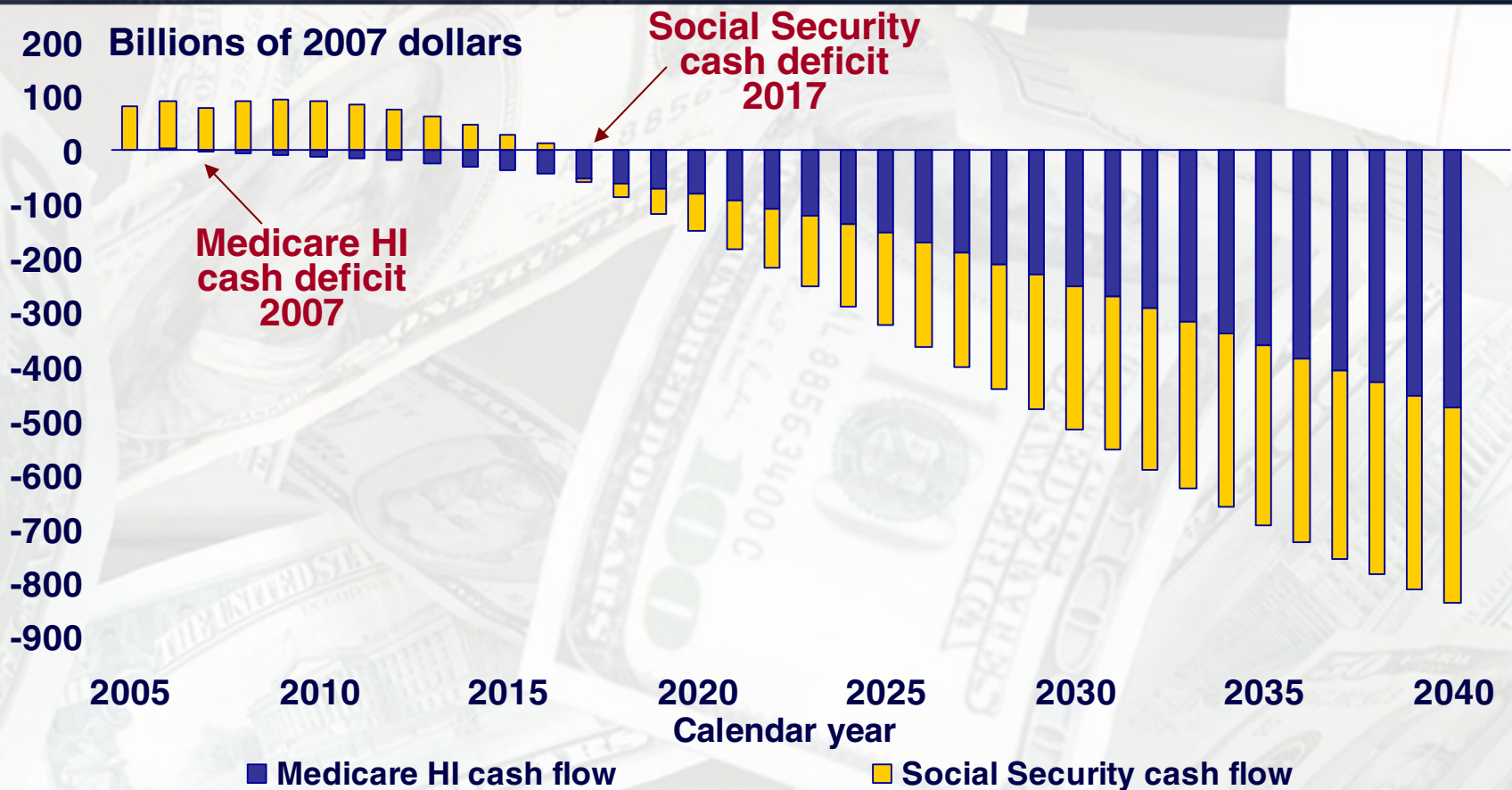
Main Measures of the Budget Deficit

- **“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

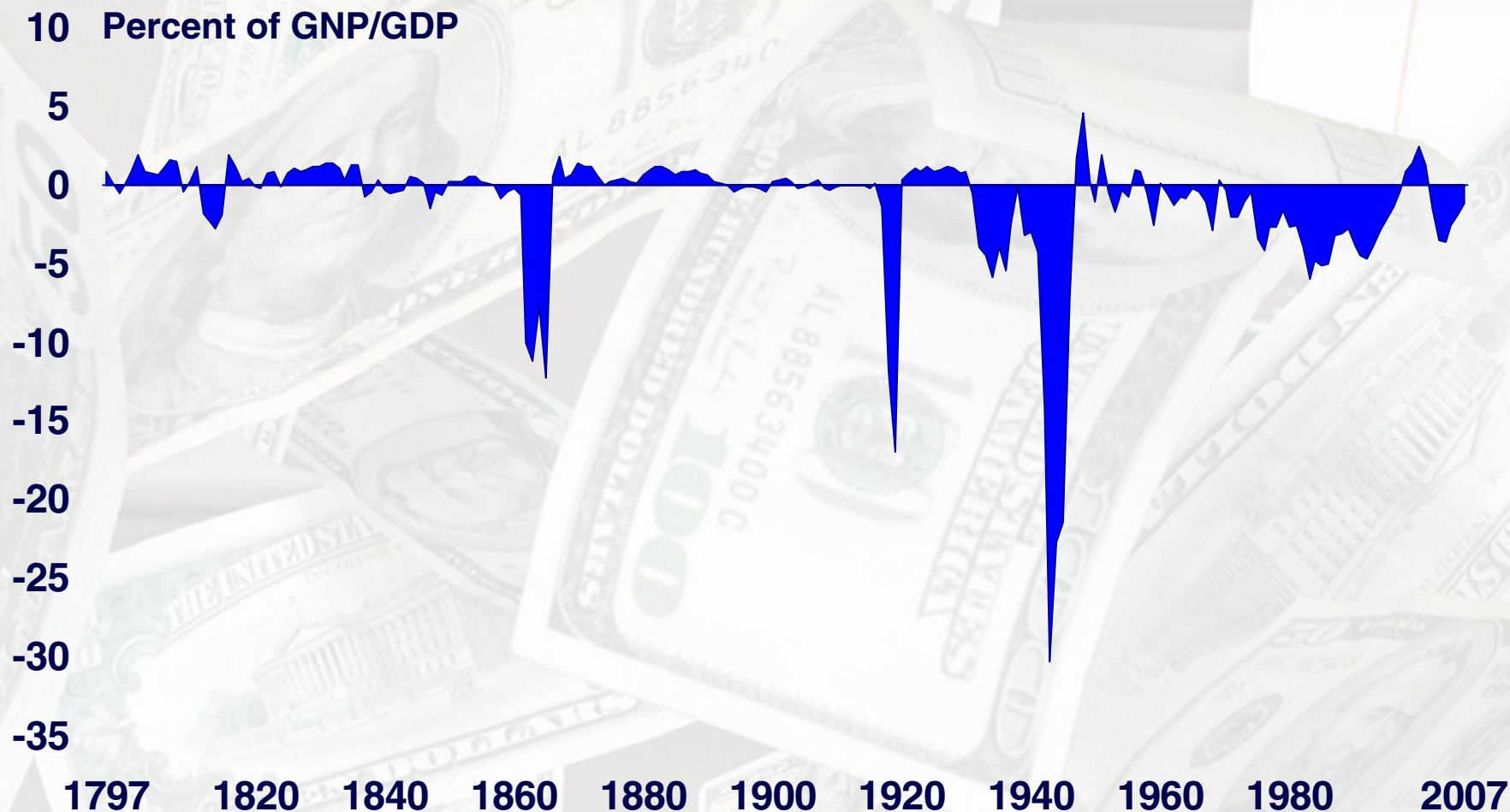
Fiscal Year 2006 and 2007 Deficits and Net Operating Costs

	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.

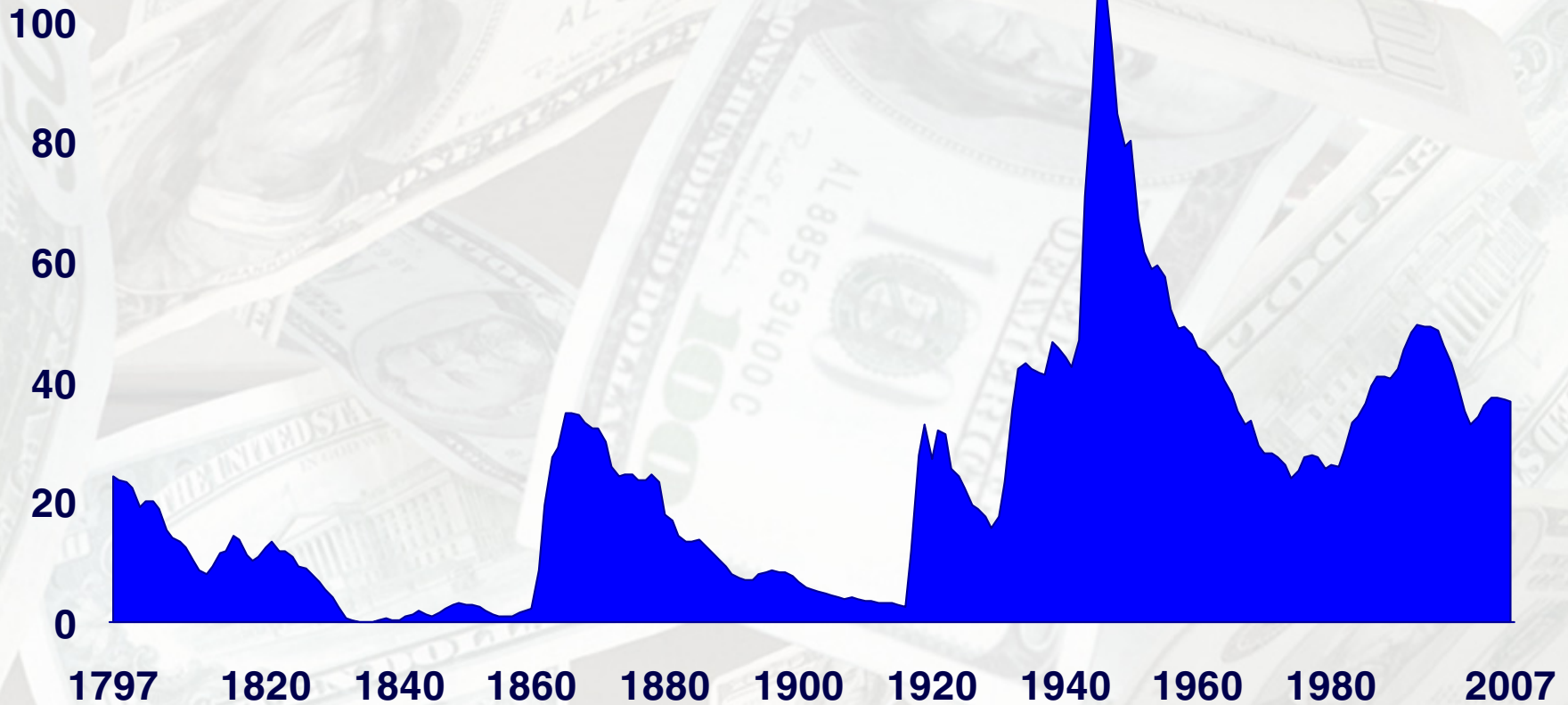
Surplus or Deficit as a Share of GDP (1797-2007)



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)

120 Percent of GNP/GDP



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.

Covering the Budget

- Remember, the budget document is a policy document that lays out the President's priorities over a short-term horizon (e.g., what the government should do, how much it should spend on which programs, how much it should raise in taxes, and how much it should borrow)
- Don't focus on a single year or even the next 5 years. Instead...
- Ask about transparency & completeness:
 - does the budget include all of the costs associated with policy initiatives?
- Ask about the future:
 - what are the long-term costs of individual proposals?
 - will the proposals help or hurt the long-term fiscal outlook?

Short-Term Versus Long-Term Perspective

While in the short term, deficits have been coming down, the long-term implications of fiscal imprudence are important:

- In 2003, former Federal Reserve Chairman Paul Volker predicted a 75 percent chance of a financial crisis within five years
- In 2005, Standard and Poor's issued a publication stating: "Notwithstanding the reform flurry of late, without further adjustment either to the current fiscal stance or to social security and health care costs, the general government debt-to-GDP ratios of France, Germany, and the U.S. will surpass the 200% of GDP mark by the middle of the current century, resulting in deficits that will be more akin to those currently associated with speculative-grade sovereigns."
- In 2008, Moody's Investors Service issued its annual report on the United States, saying: "in the very long term, the [triple-A] rating could come under pressure if reform of Medicare and Social Security is not carried out, as these two programs are the largest threats to the long-term financial health of the United States and to the government's Aaa rating."

Major Fiscal Exposures

(\$ trillions)

	2000	2007	% Increase
• Explicit liabilities	\$6.9	\$10.8	57
<ul style="list-style-type: none"> • Publicly held debt • Military & civilian pensions & retiree health • Other 			
• Commitments & contingencies	0.5	1.1	97
<ul style="list-style-type: none"> • E.g., PBGC, undelivered orders 			
• Implicit exposures	13.0	40.8	213
<ul style="list-style-type: none"> • Future Social Security benefits 	3.8	6.8	
<ul style="list-style-type: none"> • Future Medicare Part A benefits 	2.7	12.3	
<ul style="list-style-type: none"> • Future Medicare Part B benefits 	6.5	13.4	
<ul style="list-style-type: none"> • Future Medicare Part D benefits 	--	8.4	
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 income ³	\$48,201
Disposable personal income per capita ⁴	\$33,253

Source: GAO analysis.

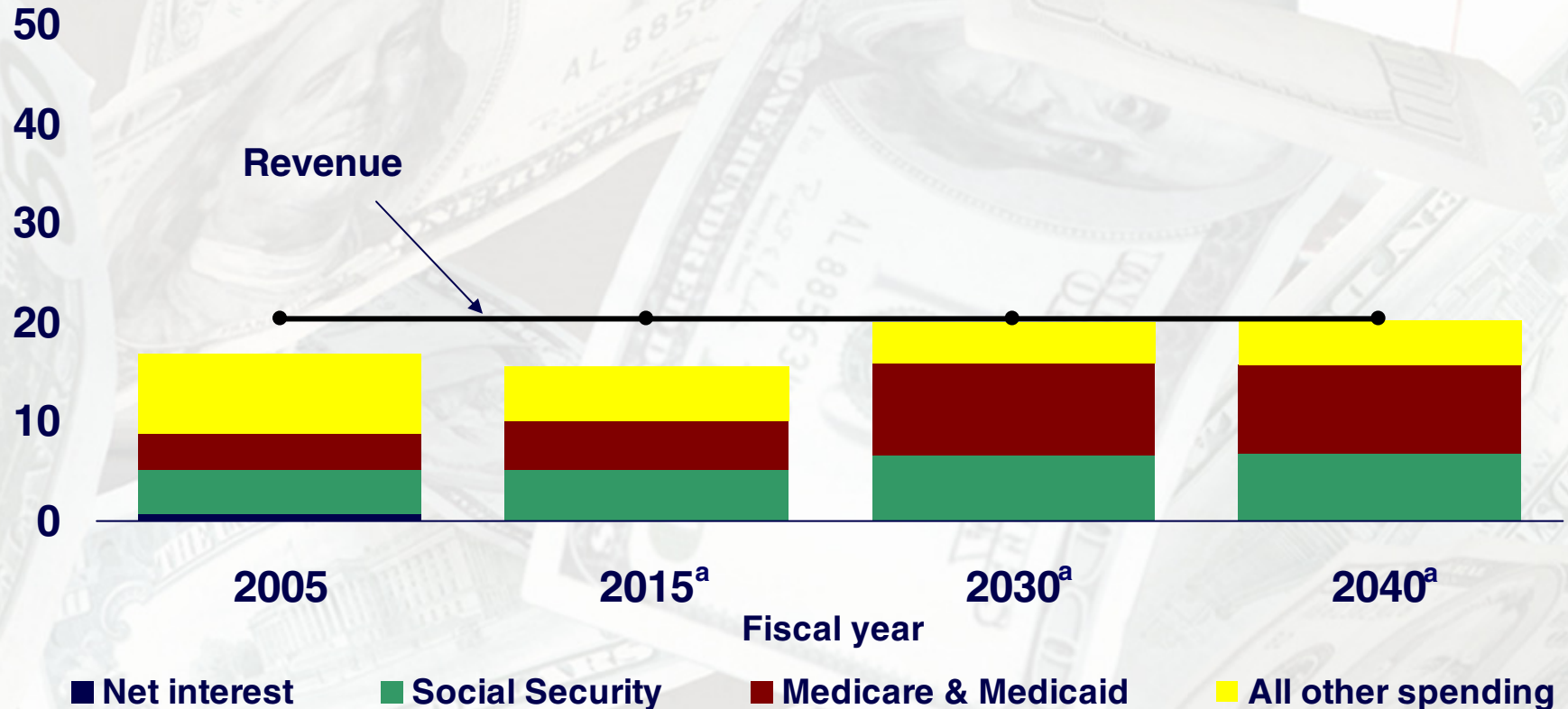
Notes: (1) Federal Reserve Board, Flow of Funds Accounts, Table B.100, 2007:Q3 (December 6, 2007); (2) Burdens are calculated using estimated total U.S. population as of 10/1/2007, from the U.S. Census Bureau; full-time workers reported by the Bureau of Economic Analysis, in NIPA table 6.5D (Aug. 1, 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



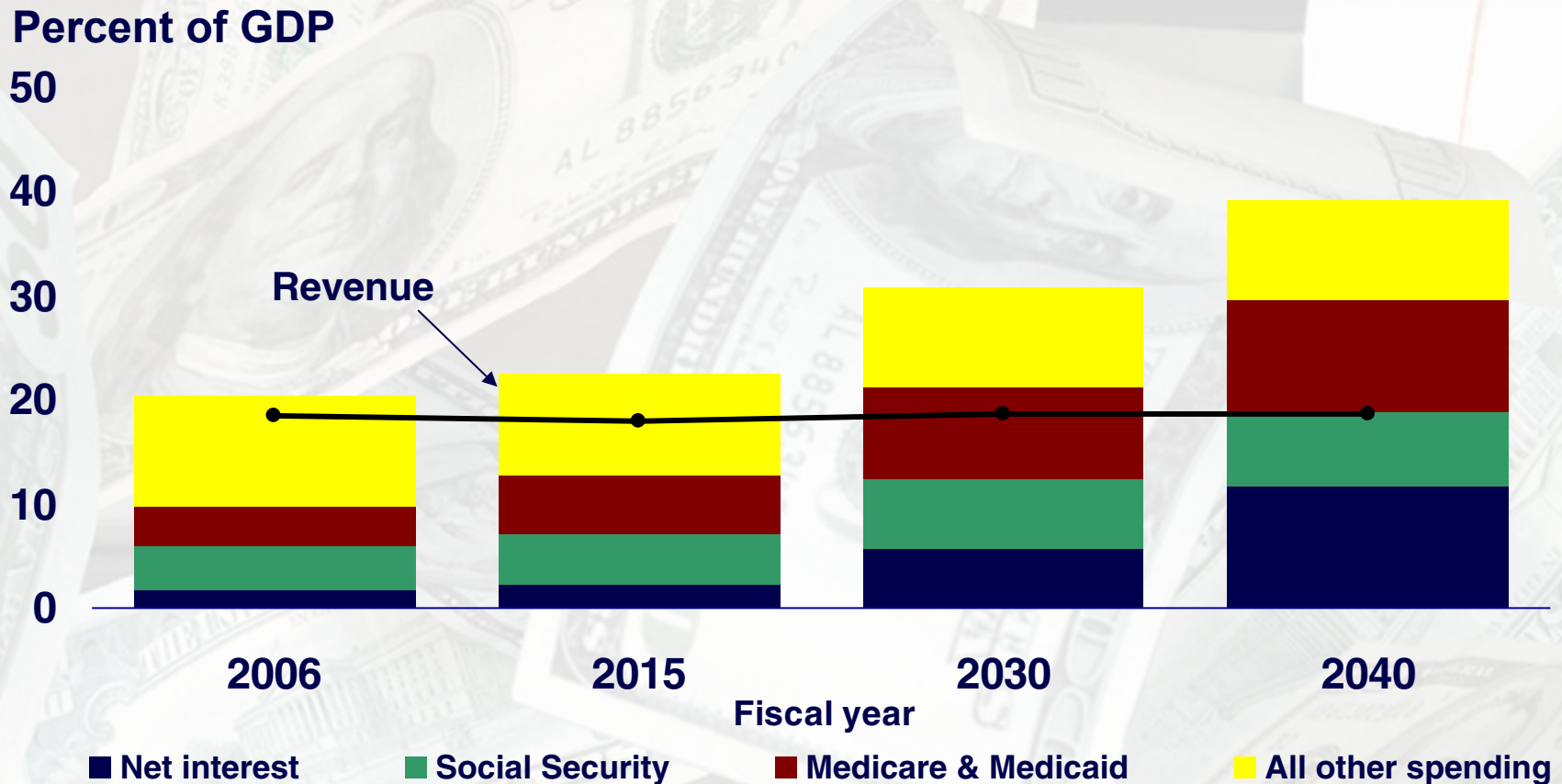
Source: GAO's January 2001 analysis.

^aAll other spending is net of offsetting interest receipts.

Potential Fiscal Outcomes

Under Alternative Simulation

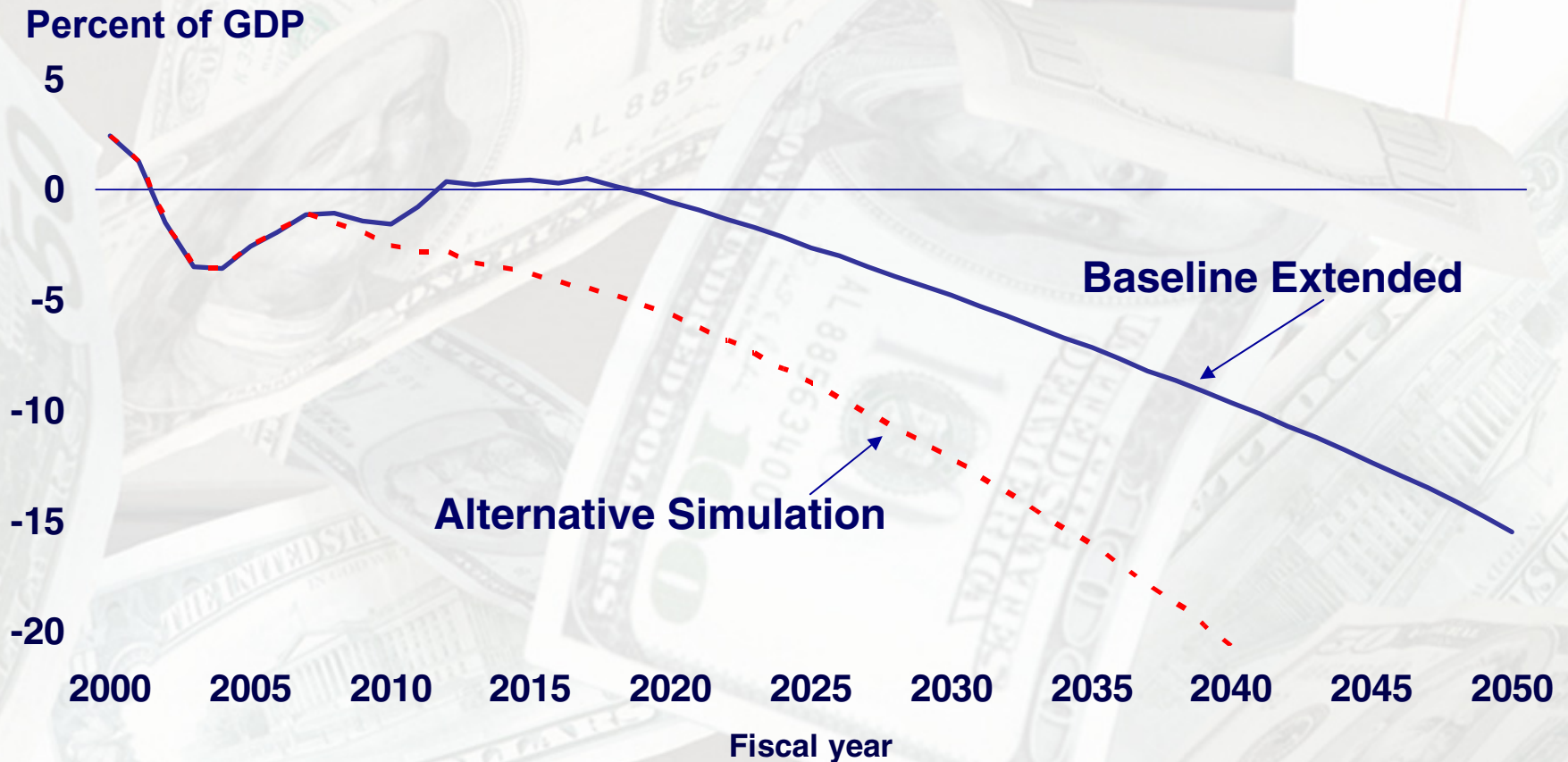
Revenues and Composition of Spending as a Share of GDP



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.

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

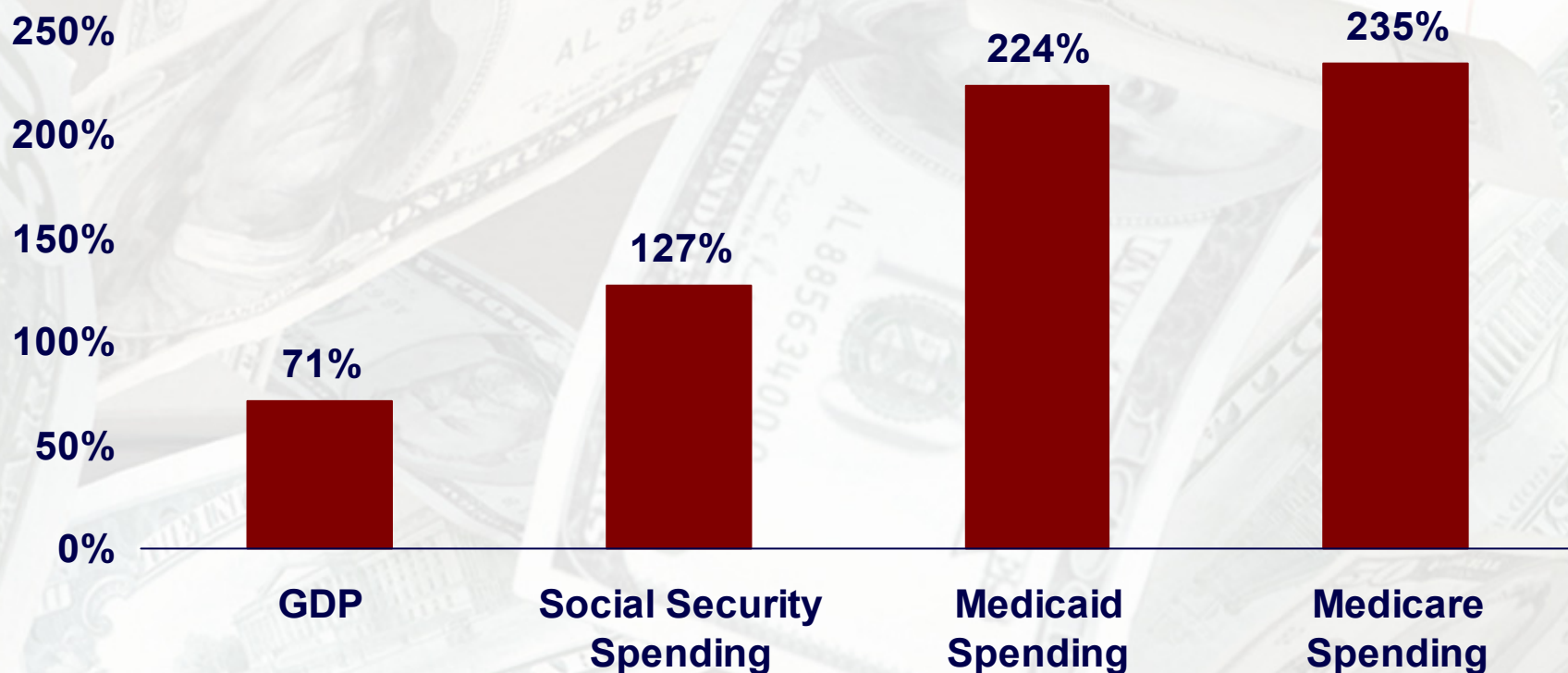


Source: GAO's August 2007 analysis.

Note: Assume currently scheduled Social Security benefits are paid in full throughout the simulation period.

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

Growth in constant dollars 2007-2032

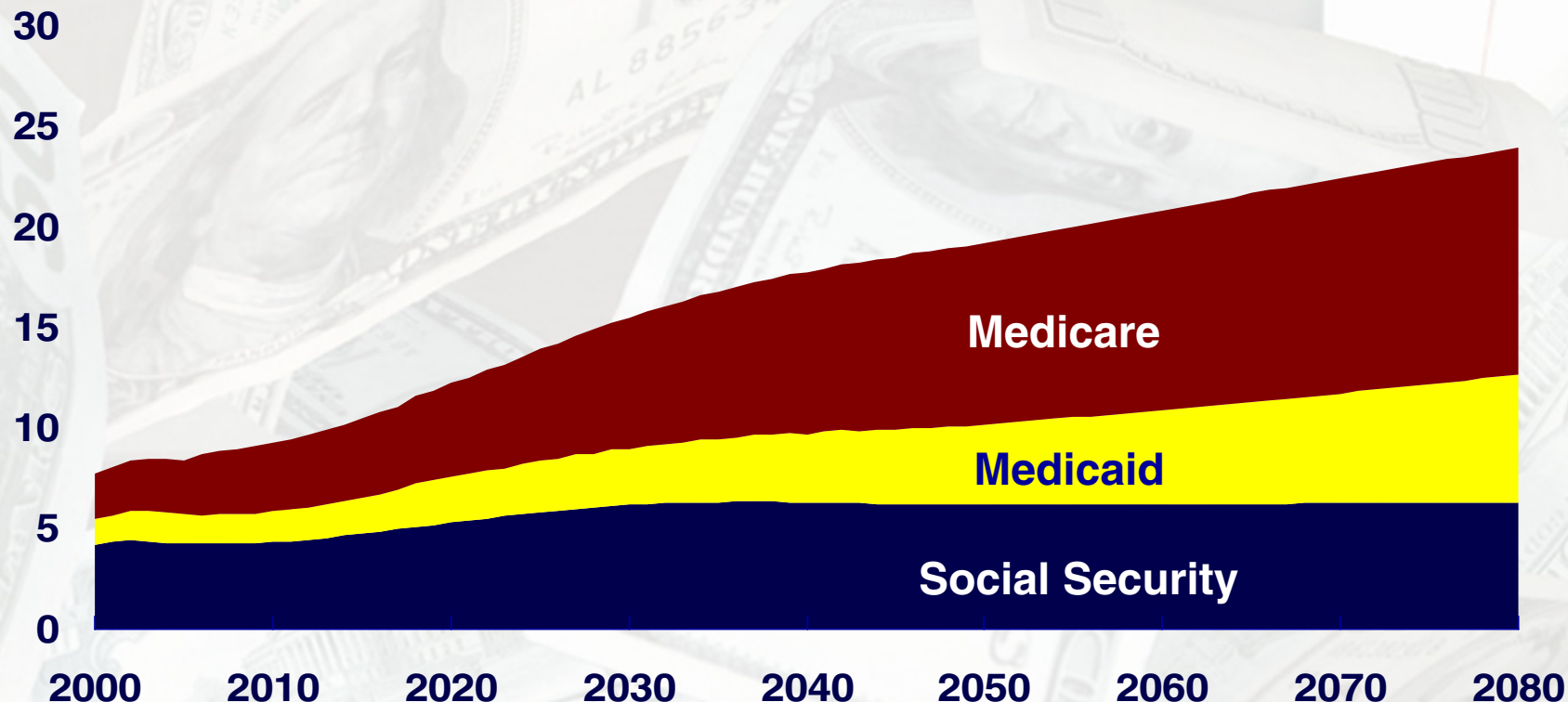


Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration; Office of the Actuary, Centers for Medicare and Medicaid Services; and the Congressional Budget Office.

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

Percent of GDP

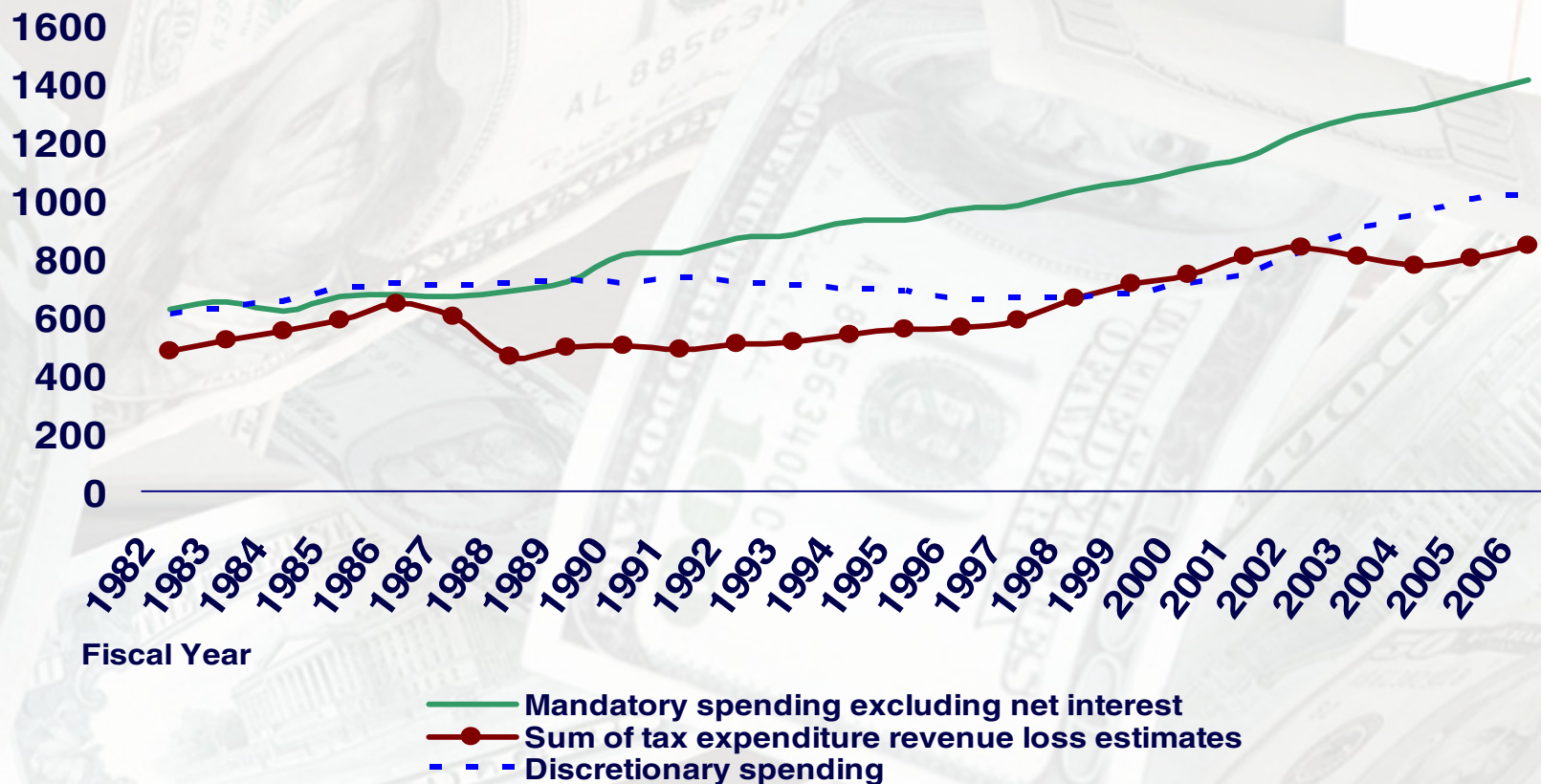


Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration, Office of the Actuary, Centers for Medicare and Medicaid Services, and the Congressional Budget Office.

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.

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

Dollars in billions (in 2006 dollars)

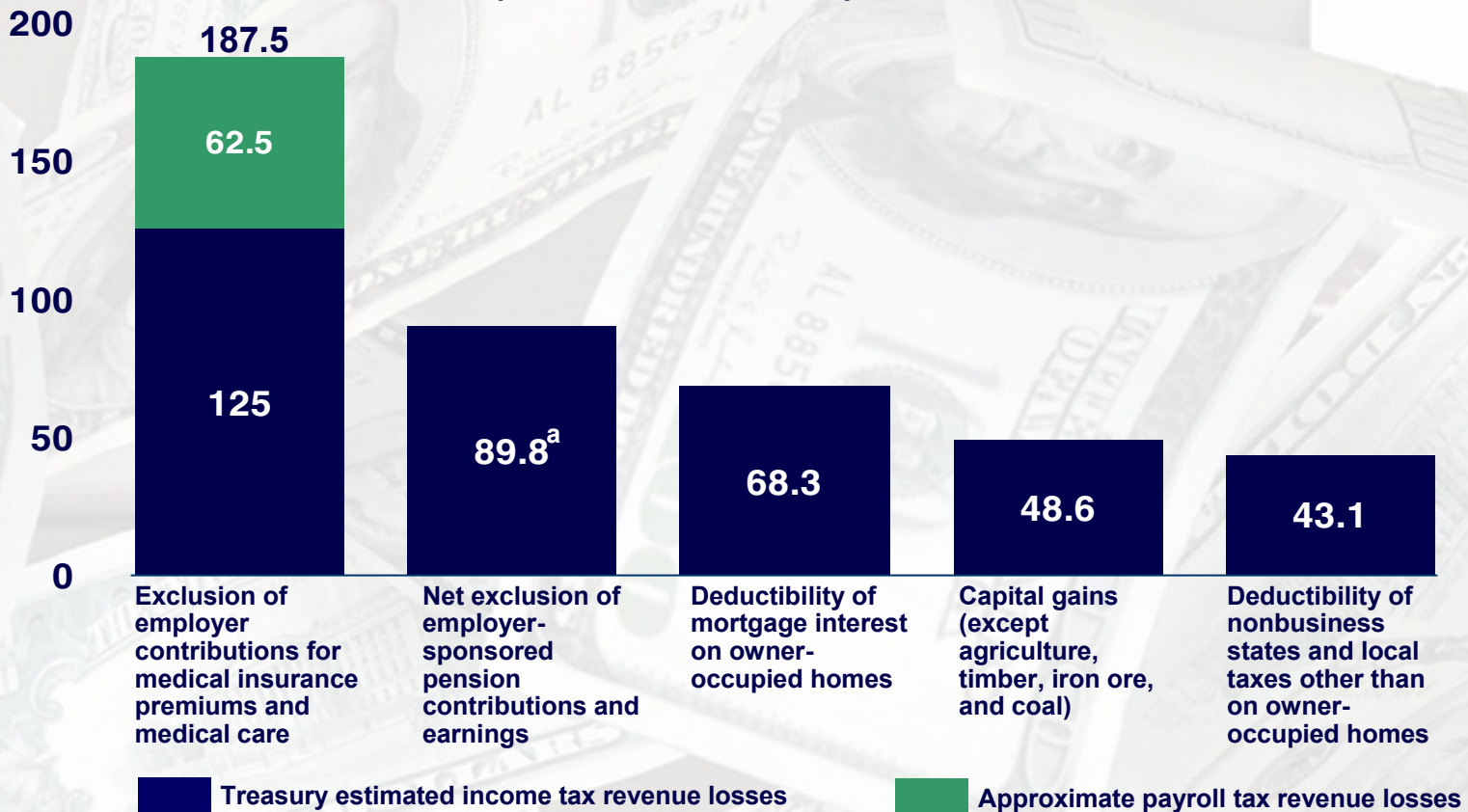


Source: GAO analysis of OMB budget reports on tax expenditures, fiscal years 1976-2008.

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

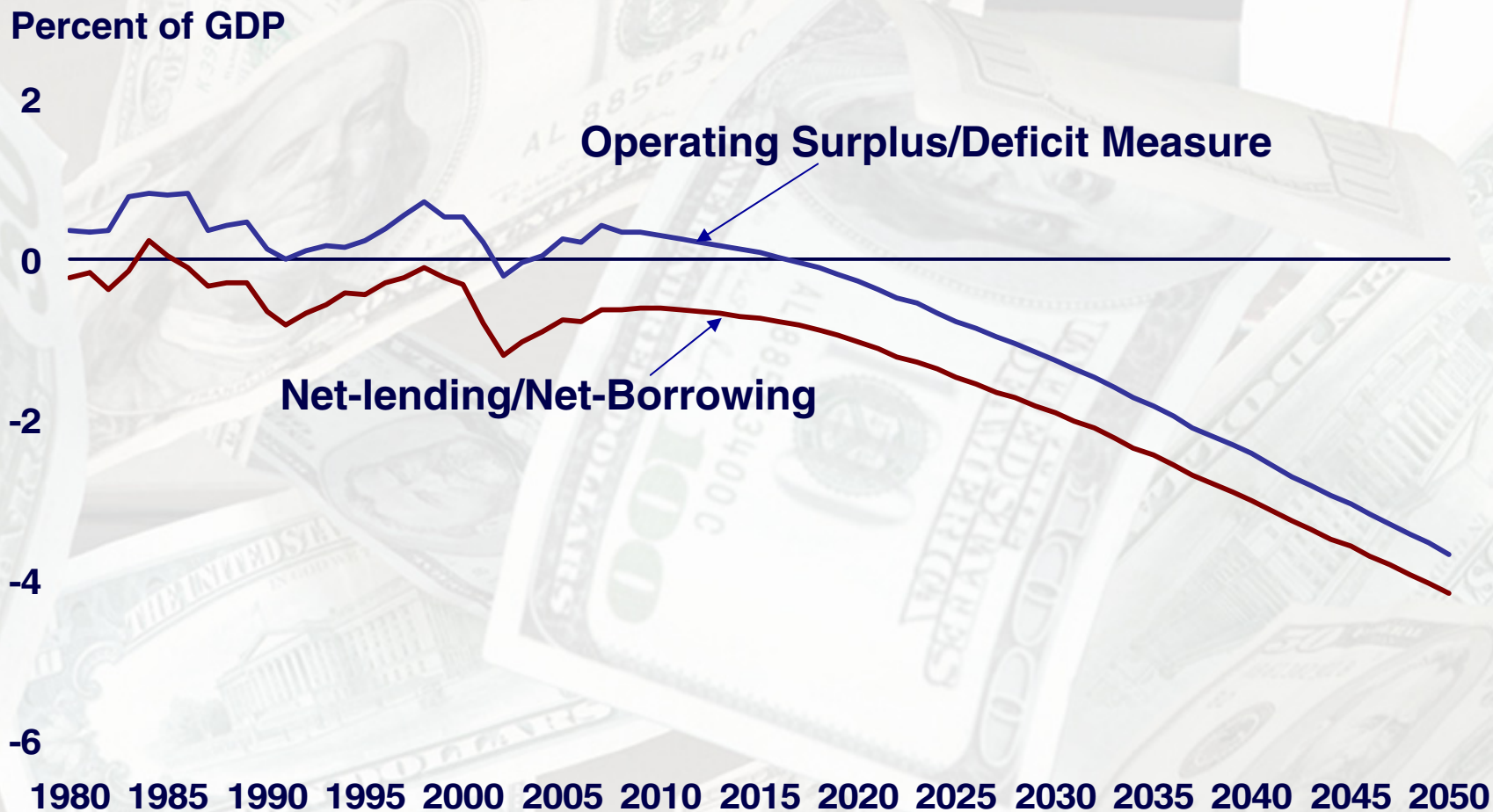
Revenue loss estimates (dollars in billions)



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.

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*

The Way Forward:

Improve Financial Reporting, Public Education, and Performance Metrics

- Improve transparency & completeness of President's budget proposal:
 - Return to 10-year estimates in budget both for current policies and programs and for policy proposals
 - Include in the budget estimates of long-term cost of policy proposals & impact on total fiscal exposures.
 - Improve transparency of tax expenditures
- Consider requiring President's budget to specify & explain a fiscal goal and a path to that goal within 10-year window—or justify an alternative deadline
- Require annual OMB report on existing fiscal exposures [liabilities, obligations, explicit & implied commitments]
- Require enhanced financial statement presentation to address fiscal sustainability and intergenerational equity issues
- Prepare and distribute a summary annual report that is both useful and used
- Increase information on long-range fiscal sustainability issues in Congressional Budget Resolution & Budget Process
- Develop key national (outcome-based) indicators (e.g. economic, security, social, environmental) to chart the nation's posture, progress, and position relative to the other major industrial countries

The Way Forward:

Strengthen Budget and Legislative Processes and Controls

- Restore discretionary spending caps & PAYGO rules on both spending and tax sides of the ledger
- Develop mandatory spending triggers [with specific defaults], and other action-forcing provisions (e.g., sunsets) for both direct spending programs and tax preferences
- Develop, impose & enforce modified rules for selected items (e.g., earmarks, emergency designations, and use of supplementals)
- Require long-term cost estimates (e.g. present value) for any legislative debate on all major tax and spending bills, including entitlement programs. Cost estimates should usually assume no sunset
- Extend accrual budgeting to insurance & federal employee pensions; develop techniques for extending to retiree health & environmental liabilities
- Consider biennial budgeting
- Consider expedited line item rescissions from the President that would only require a majority vote to override the proposed rescission(s)

The Way Forward:

Fundamentally Reexamine & Transform

- Restructure existing entitlement programs
- Reexamine and restructure the base of all other spending
- Review & revise existing tax policy, including tax preferences and enforcement programs
- Expand scrutiny of all proposed new programs, policies, or activities
- Reengineer internal agency structures and processes, including more emphasis on long-term planning, integrating federal activities, and partnering with others both domestically and internationally
- Strengthen and systematize Congressional oversight processes
- Increase transparency associated with government contracts and other selected items
- Consider a capable, credible, bi-partisan budget, entitlement, and tax reform commission

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)

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**

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

Can There be Progress in 2008 and Beyond?

- Do presidential candidates recognize the problem?
- What is the scope and substance of the candidates' platforms on the issue?
- What is the status of previously proposed initiatives (e.g., Congressional commissions or task forces sponsored by Cooper/Wolf and Conrad/Gregg)?

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***

GAO References Available to You

- <http://www.gao.gov/financial/fy2007financialreport.html>
- <http://www.gao.gov/special.pubs/longterm/wakeuptour.html>
- <http://www.gao.gov/special.pubs/longterm/>



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On the Web

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

Contact

Chuck Young, Managing Director, Public Affairs
YoungC1@gao.gov (202) 512-4800
U.S. Government Accountability Office
441 G Street NW, Room 7149
Washington, D.C. 20548

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