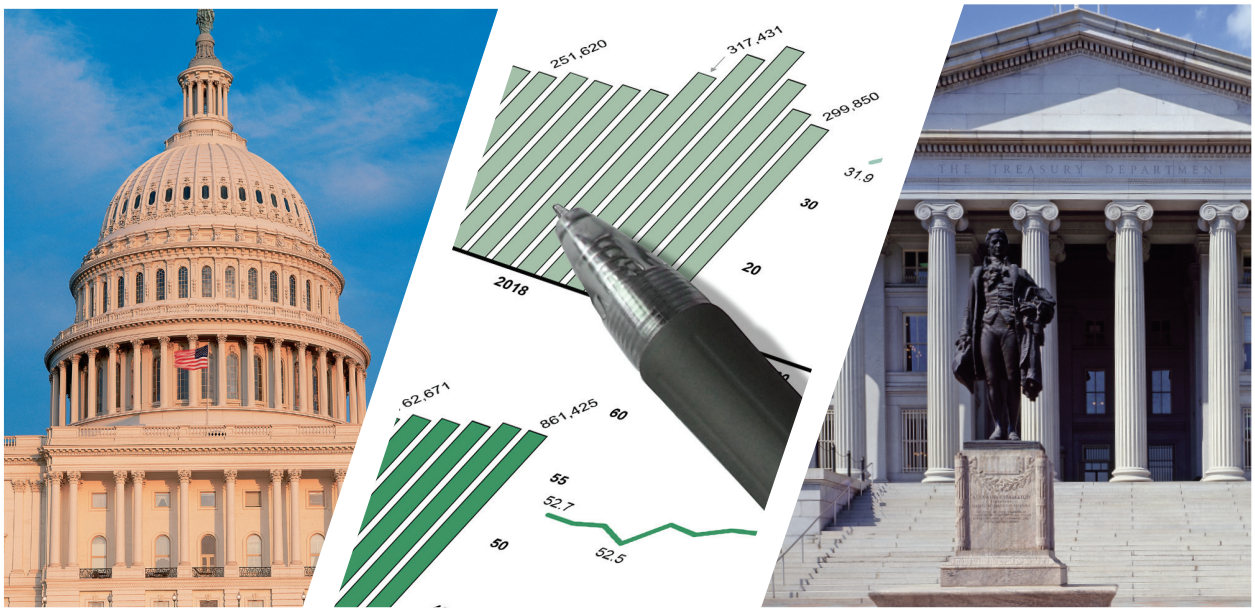
GAO UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

An Annual Report to Congress



The Nation's Fiscal Health

Action Is Needed to Address the Federal Government's Fiscal Future

March 2020 | GAO-20-403SP

GAO

Highlights

Highlights of GAO-20-403SP

An Annual Report to Congress

The Nation's Fiscal Health

Action Is Needed to Address the Federal Government's Fiscal Future

The nation faces serious economic, security, and social challenges that require difficult policy choices in the near term in setting national priorities and charting a path forward for economic growth. This will influence the level of federal spending and how the government obtains needed resources. At the same time, the federal government is highly leveraged in debt by historical norms.

A broad plan is needed to put the federal government on a sustainable long-term fiscal path and ensure that the United States remains in a strong economic position to meet its security and social needs, as well as to preserve flexibility to address unforeseen events. This report describes the fiscal condition of the U.S. government as of the end of fiscal year 2019 and its future unsustainable fiscal path absent policy changes. It draws on the *Fiscal Year 2019 Financial Report of the United States Government* (*2019 Financial Report*) and GAO's work, including its audit of the government's consolidated financial statements.

Significant Changes to the Government's Fiscal Condition in Fiscal Year 2019

According to the *2019 Financial Report*, the federal deficit in fiscal year 2019 increased to $984 billion—up from $779 billion in fiscal year 2018. Federal receipts increased by $134 billion, but that was outweighed by a $339 billion increase in spending driven by increases in Medicare and Medicaid, Social Security, defense, and interest on debt held by the public. Debt held by the public increased from $15.8 trillion (or 77 percent of gross domestic product (GDP)) at the end of fiscal year 2018 to $16.8 trillion (or 79 percent of GDP) at the end of fiscal year 2019. By comparison, debt has averaged 46 percent of GDP since 1946.

The Federal Government Is on an Unsustainable Fiscal Path

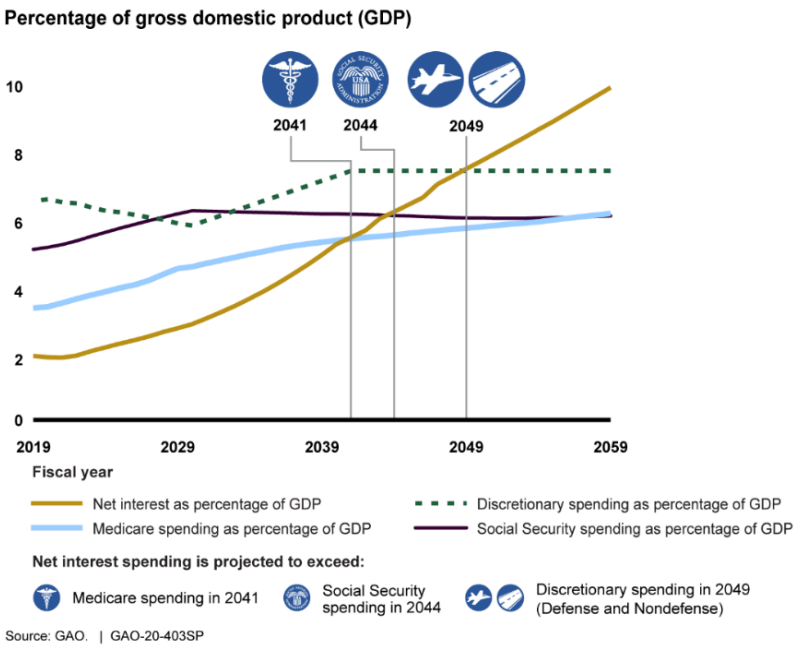
GAO, CBO, and *2019 Financial Report* projections all show that, absent policy changes, debt grows faster than GDP; this is an unsustainable path.

While spending on Social Security already exceeds $1 trillion per year, health care and net interest are expected to grow faster than GDP and be key drivers of federal spending in the future. Medicare spending is projected to reach $1 trillion per year by 2026, and net interest is projected to hit this milestone by 2032. Over the past 50 years, net interest costs have averaged 2 percent of GDP but these costs are projected to increase to 7.2 percent by 2049, when they become the largest category of spending.

GAO projects that net interest will exceed:

- Medicare spending as a share of GDP in 2041,
- Social Security spending as a share of GDP in 2044, and
- Total Discretionary spending as a share of GDP in 2049.

Projected Net Interest and Other Spending as Percentage of GDP



Source: GAO. | GAO-20-403SP

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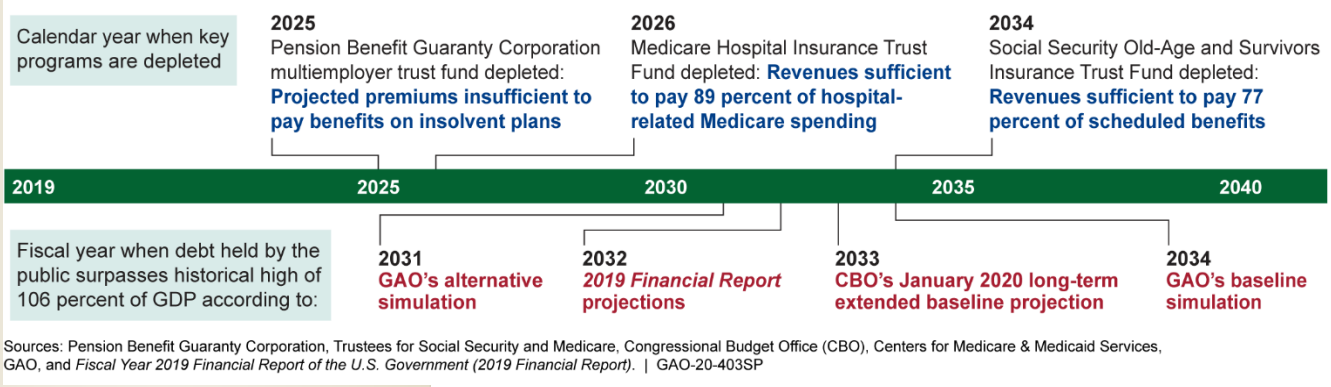
The Federal Government Is on an Unsustainable Fiscal Path

(continued)

Early Action is Important: GAO, the Congressional Budget Office (CBO), and the *2019 Financial Report* state that the longer action is delayed, the greater the changes will have to be. As shown below, major programs are projected to face financial challenges in the future.



Sources: Pension Benefit Guaranty Corporation, Trustees for Social Security and Medicare, Congressional Budget Office (CBO), Centers for Medicare & Medicaid Services, GAO, and *Fiscal Year 2019 Financial Report of the U.S. Government (2019 Financial Report)*. | GAO-20-403SP

Fiscal Risks Place Additional Pressure on the Federal Budget

Fiscal risks are responsibilities, programs, and activities that may legally commit or create expectations for future spending based on current policy, past practices, or other factors.

Risks are Not Fully Accounted for: The federal government faces certain fiscal risks that are not fully accounted for in the budget or long-term fiscal projections, and could lead to future spending increases and higher levels of debt. Examples include the need to resolve the federal government's role in the housing finance market and federal fiscal exposures resulting from natural disasters. A more complete understanding of fiscal risks can help policymakers anticipate changes in future spending and enhance oversight of federal resources.

Debt Limit Is Not a Control on Debt

The debt limit is a legal limit on the total amount of federal debt that can be outstanding at one time. It is not a control on debt but rather an after-the-fact measure that restricts the Treasury's authority to borrow to finance the decisions already enacted by Congress and the President.

An Alternative Approach to Managing Debt Is Needed: The debt limit has been suspended through July 2021. At that time, it will need to be suspended again or raised. Failure to increase or suspend the debt limit in a timely manner could undermine the perceived safety of Department of the Treasury (Treasury) securities, resulting in serious negative consequences for the Treasury market and increased borrowing costs. The full faith and credit of the United States must be preserved.

Experts have suggested instituting fiscal rules as an alternative approach to the debt limit. GAO has identified insights that can inform policy deliberations on the potential implementation of fiscal rules. Congress could consider this suggestion as part of a broader plan to put the government on a sustainable fiscal path.

Executive Agencies Have Opportunities to Contribute Toward Fiscal Health

Executive actions alone cannot put the U.S. government on a sustainable fiscal path, but it is important for agencies to act as stewards of federal resources. In prior work, GAO has identified numerous actions for executive agencies to contribute toward a sustainable fiscal future.

Address improper payments	Reducing payments that should not have been made or were made in an incorrect amount could yield significant savings. Reported improper payment estimates totaled about $175 billion for fiscal year 2019. Since fiscal year 2003, cumulative estimates have totaled almost $1.7 trillion.
Narrow persistent tax gap	Reducing the gap between taxes owed and those paid could increase tax collections by billions of dollars annually. The average annual net tax gap is estimated to be $381 billion (for tax years 2011-2013).
Improve information on programs and fiscal operations	Decision-making could be improved by ensuring the government's financial statements are fully auditable and by increasing attention to tax expenditures—tax provisions that reduce tax liabilities. Estimated to collectively reduce tax revenue by approximately $1.3 trillion in fiscal year 2019, tax expenditures are not regularly reviewed and their outcomes are not measured as closely as spending programs' outcomes.
Address duplication, overlap, and fragmentation	GAO has identified numerous areas to reduce, eliminate, or better manage fragmentation, overlap, or duplication; achieve cost savings; or enhance revenue. Actions taken so far by Congress and executive branch agencies have resulted in roughly $262 billion financial benefits since fiscal year 2010

Contents

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Figures

Abbreviations

2019 Financial Report	Fiscal Year 2019 Financial Report of the United States Government
BCA	Budget Control Act of 2011
CBO	Congressional Budget Office
CFO Act	Chief Financial Officers Act of 1990

CFO	Chief Financial Officer
CMS	Centers for Medicare & Medicaid Services
DI	Disability Insurance
DOE	Department of Energy
DOD	Department of Defense
DRRA	Disaster Recovery Reform Act of 2018
EU	European Union
Fannie Mae	Federal National Mortgage Association
FCRA	Federal Credit Reform Act of 1990
FEMA	Federal Emergency Management Agency
FHA	Federal Housing Administration
Freddie Mac	Federal Home Loan Mortgage Corporation
GDP	gross domestic product
Ginnie Mae	Government National Mortgage Association
GSE	government-sponsored enterprise
HHS	Department of Health and Human Services
IMF	International Monetary Fund
IPIA	Improper Payments Information Act of 2002
IPERA	Improper Payments Elimination and Recovery Act of 2010
IRS	Internal Revenue Service
MACRA	Medicare Access and CHIP Reauthorization Act of 2015
OASI	Old-Age and Survivors Insurance
OCO	Overseas Contingency Operations
OECD	Organization for Economic Co-operation and Development
OMB	Office of Management and Budget
PBGC	Pension Benefit Guaranty Corporation
PIIA	Payment Integrity Information Act of 2019
PPACA	Patient Protection and Affordable Care Act
SSA	Social Security Administration
Treasury	Department of the Treasury
USPS	U.S. Postal Service

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March 12, 2020

The President
The President of the Senate
The Speaker of the House of Representatives

The nation faces serious economic, security, and social challenges that require Congress and the administration to make difficult, near-term policy choices in setting national priorities and charting a path forward for economic growth. These choices will influence the level and composition of federal spending and how the government obtains needed resources.

Policymakers also face a federal government highly leveraged in debt by historical norms and on an unsustainable long-term fiscal path caused by an imbalance between revenue and spending that is built into current law and policy. Recent legislation intended to promote economic growth and address other national priorities, such as the law referred to as the Tax Cuts and Jobs Act,[1] the Bipartisan Budget Act of 2019,[2] and the fiscal year 2020 appropriations acts[3] have complicated the government's overall long-term fiscal outlook and debt burden.

Thus, decisions in the near term to enhance economic growth and address national priorities need to be accompanied by a forward-looking fiscal plan to put the federal government on a sustainable long-term path. A long-term fiscal plan is essential to ensure that the United States remains in a strong economic position to meet its security and social needs, as well as to preserve flexibility to address unforeseen events.

This annual report is intended to illuminate the need for such a long-term fiscal plan by describing the fiscal condition of the U.S. government as of the end of fiscal year 2019 and its future fiscal path absent policy

[1]To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

[2]Pub. L. No. 116-37, 133 Stat. 1049 (2019).

[3]Consolidated Appropriations Act, 2020, Pub. L. No. 116-93, 133 Stat. 2317 (2019) and Further Consolidated Appropriations Act, 2020, Pub. L. No. 116-94, 133 Stat. 2534 (2019).

changes. This report updates our April 2019 report.[4] It draws from the *Fiscal Year 2019 Financial Report of the United States Government* (*2019 Financial Report*) and our audits of the government's consolidated financial statements for fiscal years 2019 and 2018 included in the *2019 Financial Report*; from our long-term simulations and those developed by the Congressional Budget Office (CBO) and contained in the *2019 Financial Report*, and from budget information from the Department of the Treasury (Treasury), Office of Management and Budget (OMB), and CBO.[5]

Every year, the Secretary of the Treasury, in coordination with the Director of OMB, prepares the U.S. government's financial statements, which, along with related information, are presented in the Financial Report of the United States Government (Financial Report).[6] We are responsible for auditing these statements. The *2019 Financial Report* contains information on the federal government's financial position and condition, including its costs and revenues.[7]

In this report, we discuss the federal government's fiscal condition and how it changed in fiscal year 2019, the federal government's

[4]GAO, *The Nation's Fiscal Health: Action Is Needed to Address the Federal Government's Fiscal Future*, GAO-19-314SP (Washington, D.C.: Apr. 10, 2019).

[5]GAO, *Financial Audit: Fiscal Years 2019 and 2018 Consolidated Financial Statements of the U.S. Government*, GAO-20-315R (Washington, D.C.: Feb 27, 2020).The consolidated financial statements of the U.S. government are based on U.S. generally accepted accounting principles.

[6]As discussed in the *2019 Financial Report*, we were unable to provide an audit opinion on the federal government's fiscal year 2019 consolidated financial statements due to material weaknesses in internal control and uncertainties concerning the sustainability financial statements. However, with few exceptions, financial statements for the significant federal entities received unmodified or "clean" opinions. The significant entities that received a disclaimer of opinion on their fiscal year 2019 financial statements were the Department of Defense and the Railroad Retirement Board. In addition, the Department of Housing and Urban Development received a qualified opinion on its fiscal year 2019 financial statements.

[7]The *2019 Financial Report* includes statements of net costs, statements of operations and changes in net position, reconciliations of the primarily cash-based budget deficit to operating results and changes in cash balance, balance sheets (assets and liabilities), and sustainability financial statements, including long-term fiscal projections for the government as a whole and for social insurance programs (e.g., Social Security and Medicare). It also contains related unaudited financial information, such as information on the tax gap, improper payments, and tax expenditures. Also, most federal agencies prepare audited financial statements that provide more detailed information at the agency and program level.

unsustainable long-term outlook, and risks to the government's fiscal condition.[8] We also discuss actions the federal government can take to achieve a more sustainable fiscal path as well as potential consequences of not taking action.[9]

Significant Changes to the Government's Fiscal Condition in Fiscal Year 2019

Growth in Spending Outweighed Modest Revenue Growth

In fiscal year 2019, the reported federal budget deficit increased for the fourth consecutive year to $984 billion. The fiscal year 2019 budget deficit was up from $779 billion for fiscal year 2018 and $666 billion for fiscal year 2017, as shown in table 1.

Table 1: Receipts, Spending, and Deficit for Fiscal Years 2017–2019

Dollars in billions

	Fiscal year 2017	Fiscal year 2018	Fiscal year 2019
Receipts	3,315	3,329	3,462
Spending	(3,981)	(4,108)	(4,447)
Deficit	(666)	(779)	(984)

Source: Financial Reports of the United States Government. | GAO-20-403SP

Note: Fiscal year 2019 receipts and spending do not sum to deficit due to rounding.

Receipts for fiscal year 2019 increased by $134 billion (4 percent) over fiscal year 2018. This growth is attributable to increasing social insurance and retirement, individual income tax, customs duties, corporate income tax, and excise tax receipts. As a share of gross domestic product (GDP),

[8]For the purposes of this report, fiscal condition is a broad concept using both budget and financial information. The term "fiscal" is part of fiscal policy, which refers to decisions on taxes and spending that affect the level, composition, and distribution of national income and output. The budget process is a major vehicle for determining and implementing fiscal policy.

[9]For more information on our objectives, scope, and methodology, see appendix I.

however, revenues fell slightly to 16.3 percent in fiscal year 2019 from 16.4 percent in fiscal year 2018.

Outlays (spending) increased by $339 billion (8.3 percent) compared to fiscal year 2018. According to the 2019 Financial Report, this growth was driven by increases in spending on Medicare and Medicaid, Social Security, national defense, and interest on debt held by the public. Medicare and Medicaid spending rose by $62 billion (11 percent) and $20 billion (5 percent), respectively; Social Security spending rose by $57 billion (6 percent); and national defense spending rose by $56 billion (9 percent).

A more complete picture of the government's fiscal condition emerges from looking at the Budget of the United States Government and the Financial Report together. The federal budget is the government's primary financial planning and control tool and is largely cash based, with the deficit or surplus being the difference between receipts (cash received by the U.S. government) and outlays (largely payments made by the U.S. government). In the Financial Report, the executive branch provides the government's financial position and condition, including its revenues, costs, assets, and liabilities. In the Financial Report, costs include amounts incurred but not necessarily paid yet, and revenues include amounts the government has earned but not necessarily yet received.

Net Cost

Net cost shows how much it costs to operate the federal government. It equals the gross cost of goods produced and services rendered by the government minus earned revenues generated by those goods and services (e.g., Medicare premiums and national park entry fees), and is then adjusted for gains or losses from changes in actuarial assumptions used to estimate certain liabilities.

Net Operating Cost

Net operating cost primarily represents the difference between net cost and tax revenue.

Source: GAO. | GAO-20-403SP

Net cost totaled $5.1 trillion in fiscal year 2019, increasing by $526.8 billion (11.6 percent) compared to fiscal year 2018. Similar to fiscal year 2018, 72 percent of the net cost of the federal government in fiscal year 2019 came from four agencies: the Department of Health and Human Services (HHS), Social Security Administration (SSA), Department of Defense (DOD), and Department of Veterans Affairs. Interest on Treasury securities held by the public represented 8 percent of net cost in fiscal year 2019.

In any given year, the change in net cost is the combined effect of offsetting increases and decreases across the government. Changes in legislation, populations eligible for federal benefits, liability estimates, and actuarial assumptions can contribute to changes in net cost. Contributors to the $526.8 billion total increase in net cost in fiscal year 2019 included:

- DOD reported the largest increase among federal agencies: $210.0 billion. $122.2 billion of this total is due to a loss increase from changes in assumption for benefits liabilities with the remaining amount due to increases in net costs across DOD's major programs, including military operations, readiness, support; procurement; military personnel; and research and development;
- HHS and SSA net costs increased $79.8 billion and $62.6 billion, respectively, primarily due to increases in benefit expenses from the social insurance programs they administer;
- Department of Education net cost increased $74.2 billion, largely due to updated estimates of subsidy expenses related to its direct loan programs;
- Department of Veterans Affairs net cost increased $70.7 billion primarily due to actuarial losses from experience; and
- Net interest costs related to debt held by the public increased $46.3 billion, largely due to an increase in the amount of debt and because interest rates were higher on average in fiscal year 2018 (although they remained historically low).[10]

[10]Net interest primarily encompasses government interest costs (spending) on federal debt held by the public, net of certain income recognized from loans and other sources. According to Treasury, for fiscal year 2019, interest costs on debt held by the public amounted to $404 billion, and net interest amounted to $376 billion. For fiscal year 2018, interest costs on debt held by the public amounted to $357 billion, and net interest amounted to $325 billion.

Because the increase in net cost in fiscal year 2019 exceeded the $236.7 billion increase in tax and other revenues, net operating cost rose to $1.4 trillion.[11] Net operating cost can be thought of as the Financial Report's counterpart to the budget deficit.

In the *2019 Financial Report*, the federal government reported holding about $4.0 trillion in assets at the end of fiscal year 2019, an increase from $3.8 trillion at the end of fiscal year 2018. Most of this increase is attributable to an increase in net accounts and taxes receivable.[12] More than half of the total reported assets were $1.4 trillion in net loans receivable—primarily student loans—and about $1.1 trillion in net property, plant, and equipment. The federal government also has resources beyond these assets including stewardship assets—such as national parks—as well as natural resources, the power to tax, and the ability to set monetary policy.

The *2019 Financial Report* also reported total liabilities of $26.9 trillion at the end of fiscal year 2019, an increase from $25.4 trillion at the end of fiscal year 2018. Most of this increase is attributable to an increase of $1.0 trillion in federal debt held by the public and accrued interest. The largest components of total liabilities were $16.9 trillion in federal debt securities held by the public and accrued interest and about $8.4 trillion in federal employee and veteran benefits payable (about $2.6 trillion in civilian and $5.8 trillion in military and veterans).

[11]For fiscal year 2019, net operating cost ($1.4 trillion) exceeded the budget deficit ($984 billion) by about $461 billion, primarily due to accrued costs (costs incurred but not necessarily paid) related to increases in estimated federal employee and veteran benefits liabilities that are included in net operating cost, but not the budget deficit. Over the past several fiscal years, the net operating cost has been higher than the budget deficit.

[12]The increase in taxes receivable is primarily a consequence of the law referred to as the Tax Cuts and Jobs Act of 2017 providing reduced tax rates for repatriated foreign earnings, which allowed taxpayers to elect to pay the associated tax on an 8-year installment schedule.

Federal Debt Increased in Fiscal Year 2019

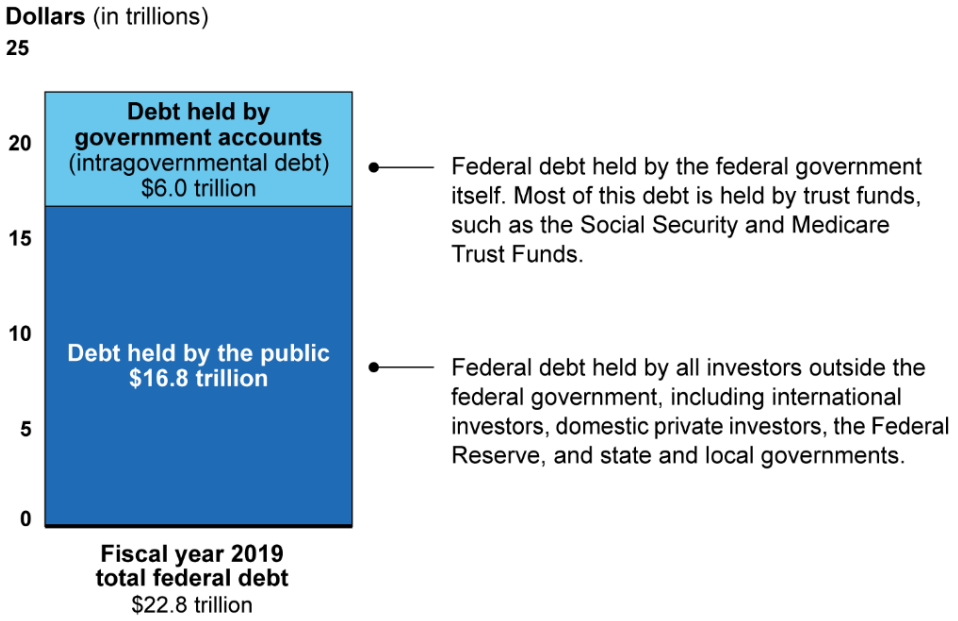
Federal Deficit
The federal deficit is the amount by which the government's spending exceeds its revenues for a given period, usually a fiscal year.

Federal Debt
Total federal debt is the amount of money that the federal government owes, either to its investors (debt held by the public) or to itself (intragovernmental debt).

Source: GAO. | GAO-20-403SP

Total federal debt rose to $22.8 trillion during fiscal year 2019, an increase of about $1.2 trillion (6 percent) from fiscal year 2018. Both debt held by the public and debt held by government accounts (known as intragovernmental debt) increased (see figure 1). Debt held by the public increased from about $15.8 trillion to $16.8 trillion, and intragovernmental debt increased from about $5.8 trillion to $6.0 trillion.

Figure 1: Fiscal Year 2019 Debt Held by the Public and Intragovernmental Debt



Source: *Fiscal Year 2019 Financial Report of the U.S. Government (2019 Financial Report).* | GAO-20-403SP

Note: Other examples of intragovernmental debt include the Civil Service Retirement and Disability Fund operated by the Office of Personnel Management and the Department of Defense's Military Retirement Fund and Medicare-Eligible Retiree Health Care Fund.

Because debt held by the public grew faster than GDP, CBO estimated that debt held by the public as a share of GDP rose from about 77 percent at the end of fiscal year 2018 to about 79 percent at the end of

fiscal year 2019.[13] Additionally, debt held by the public increased more than the reported federal deficit ($984 billion for fiscal year 2019), primarily because of increases in federal direct student loans and financing related to mortgage insurance.[14]

Over the longer term, the structural imbalance between revenue and spending that is built into current law and policy means debt held by the public is expected to grow as a share of GDP. Debt held by the public is reported as a liability on the consolidated financial statements of the U.S. government. Intragovernmental debt is debt owed by Treasury to another part of the government. It is an asset to those other federal government accounts but a liability to Treasury; they offset each other in the consolidated financial statements. However, when securities from intragovernmental debt are redeemed, Treasury usually borrows from the public to finance these redemptions, resulting in that intragovernmental debt being replaced by debt held by the public.

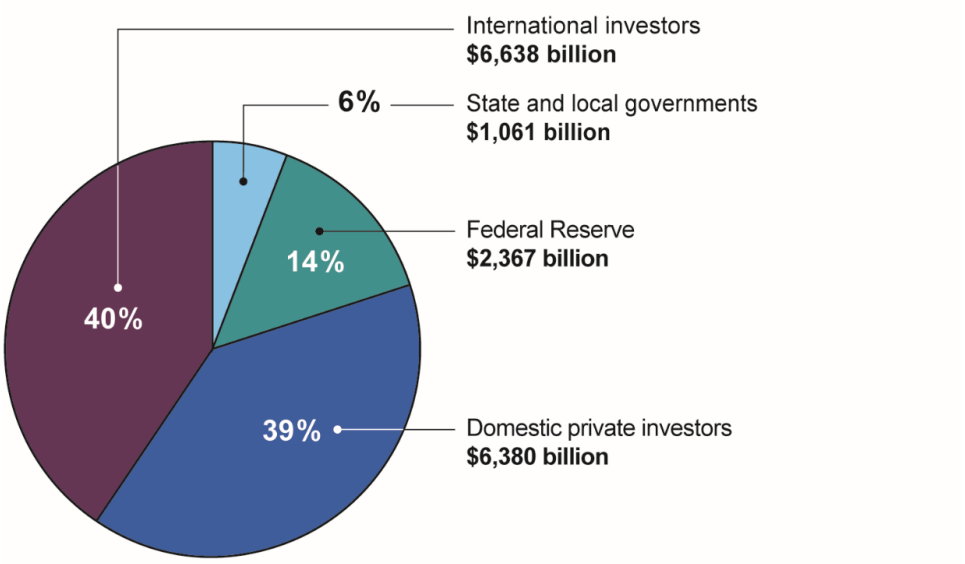
The combination of the liquidity, depth, and safety of the Treasury market is unmatched in global markets and has led to a wide range of investor

[13]GDP is the value of all goods and services produced within the borders of a country in a given period. The dollar value of debt is difficult to interpret absent some sense of the size of the economy supporting it. Therefore, the ratio of debt to GDP is used to gauge a country's ability to pay its debt. Other factors being equal, increasing GDP lowers the debt-to-GDP ratio while decreasing GDP raises this ratio. In January 2019 CBO reported the debt-to-GDP ratio was 77.8 percent in fiscal year 2018, though CBO later updated this estimate to 77.4 due to revised GDP estimates.

[14]The Federal Credit Reform Act of 1990 (FCRA) stipulates that the budget record the estimated net subsidy cost to the federal government of extending or guaranteeing credit. (See FCRA, *codified, as amended, in part at* 2 U.S.C. §661c(d).) When the federal government makes a direct loan, however, the full amount is disbursed, and if the federal government borrows the cash to be disbursed, then federal debt outstanding grows by the amount of the loan.

types in Treasury securities.[15] Figure 2 shows the distribution of the ownership of Treasury securities held by the public as of June 2019.[16]

Figure 2: Distribution of Ownership of Treasury Securities Held by the Public as of June 2019



Source: GAO analysis of Treasury and Federal Reserve data. | GAO-20-403SP

Note: Percentages do not sum to 100 percent due to rounding. Ownership information is estimated primarily because securities are continually resold among investors. Data are as of June 2019, the most recent data available at the time of this report.

Domestic investors—consisting of private investors, the Federal Reserve, and state and local governments—accounted for about 60 percent of Treasury securities held by the public. International investors accounted

[15]GAO, *Federal Debt Management: Treasury Should Strengthen Policies for Market Outreach and Analysis to Maintain Broad-Based Demand for Securities*, GAO-20-131 (Washington, D.C.: Dec. 5, 2019). In this report, we examined how Treasury monitors and uses information about the Treasury market to inform its debt issuance strategy. We recommended Treasury (1) finalize its policy for conducting bilateral market outreach, and (2) establish a policy for the documentation and assurance of analytical models. Treasury agreed with these recommendations. Taking these actions could help Treasury ensure its decisions about issuing debt are based on the best possible information.

[16]For our analysis of trends in ownership of Treasury securities held by the public, we analyzed data from the Federal Reserve's *Financial Accounts of the United States*. Data from the Federal Reserve flow of funds report are indirectly based on data in the Treasury International Capital reporting system. Due to adjustments made before being published by the Bureau of Economic Analysis and Federal Reserve, these data will vary from the data as presented in the Treasury International Capital reporting system.

for the remaining 40 percent. To achieve its goal of financing the government's borrowing needs at the lowest cost over time, Treasury must maintain strong demand from investors. However, as discussed later in this report, both impasses over the debt limit and the unsustainable long-term fiscal path could threaten the demand for securities, making it difficult to attract investors without paying higher interest rates.

Long-Term Fiscal Projections Show the Federal Government Is on an Unsustainable Fiscal Path

Because neither accrual-based financial statements nor largely cash-based budgets provide a full picture of the government's fiscal outlook, international organizations recommend reporting on the long-term sustainability of the government's fiscal policy.[17] Long-term fiscal projections by GAO, CBO, and in the *2019 Financial Report* show that, absent policy changes, the federal government continues to face an unsustainable long-term fiscal path.[18] Although each of these long-term projections uses somewhat different assumptions, their conclusions are the same: over the long term, the imbalance between spending and revenue that is built into current law and policy will lead to (1) deficits exceeding $1 trillion each year beginning in fiscal year 2020 and (2) both the annual deficit and cumulative total debt held by the public continuing to grow as shares of GDP.[19] This situation—in which debt grows faster than GDP—means the current federal fiscal path is unsustainable.

Under GAO, CBO, and Financial Report projections, spending for the major health and retirement programs will increase more rapidly than GDP in coming decades because of an aging population and projected continued increases in health care costs per beneficiary. Spending on net interest is projected to grow more quickly than any other component of the budget due to growing debt and projected growth in interest rates.

[17]See International Public Sector Accounting Standards Board, *Recommended Practice Guideline 1: Reporting on the Long-Term Sustainability of an Entity's Finances* (July 2013). The International Monetary Fund also includes fiscal sustainability as one of the principles in its "Fiscal Transparency Code," an international standard for disclosure of information about public finances.

[18]The *2019 Financial Report*'s Statement of Long-Term Fiscal Projections presents, for all the activities of the federal government, the present value of projected receipts and noninterest spending under current policy without change, the relationship of these amounts to projected GDP, and changes in the present value of projected receipts and noninterest spending from the prior year.

[19]For more information on these assumptions, see appendix I.

When Will Debt Surpass Its Historical High?

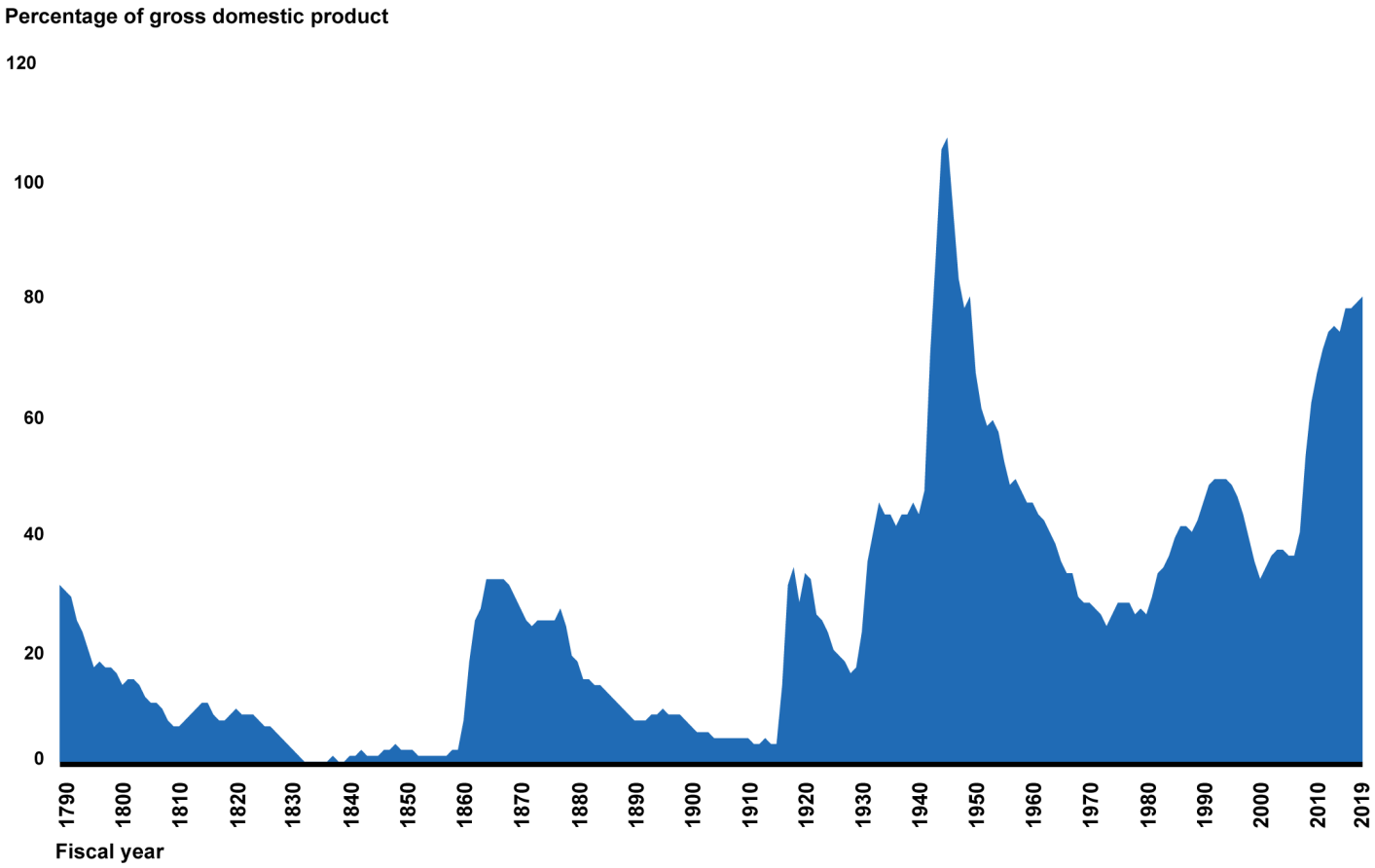
The timing and pace of debt-to-gross domestic product growth depend on the underlying assumptions made in fiscal projections and simulations.

Although they use different assumptions, GAO, the Congressional Budget Office (CBO), and the *Fiscal Year 2019 Financial Report of the United States Government* (*2019 Financial Report*) projections all show that, absent a change in policy, the debt-to-GDP ratio would surpass its historical high of 106 percent within 11 to 14 years.

Source: GAO and GAO analysis of CBO and *2019 Financial Report* data. | GAO-20-403SP

For most of the nation's history, the debt-to-GDP ratio has increased during wartime and recessions and decreased during peacetime and economic expansions (see figure 3). Publicly held debt as a share of GDP peaked at 106 percent just after World War II (in 1946) but then fell rapidly. From the 1970s to the present, with the exception of the 1990s when strong economic growth and a number of fiscal decisions generated a significant decline, U.S. debt held by the public has generally grown steadily as a share of GDP. By the end of fiscal year 2019, the debt had climbed to 79 percent of GDP. By comparison, debt has averaged 46 percent of GDP since 1946. If current trends continue, the debt as a share of GDP in 2050 will be nearly twice its 1946 level and about four times its post-World War II average.

Figure 3: Federal Debt Held by the Public



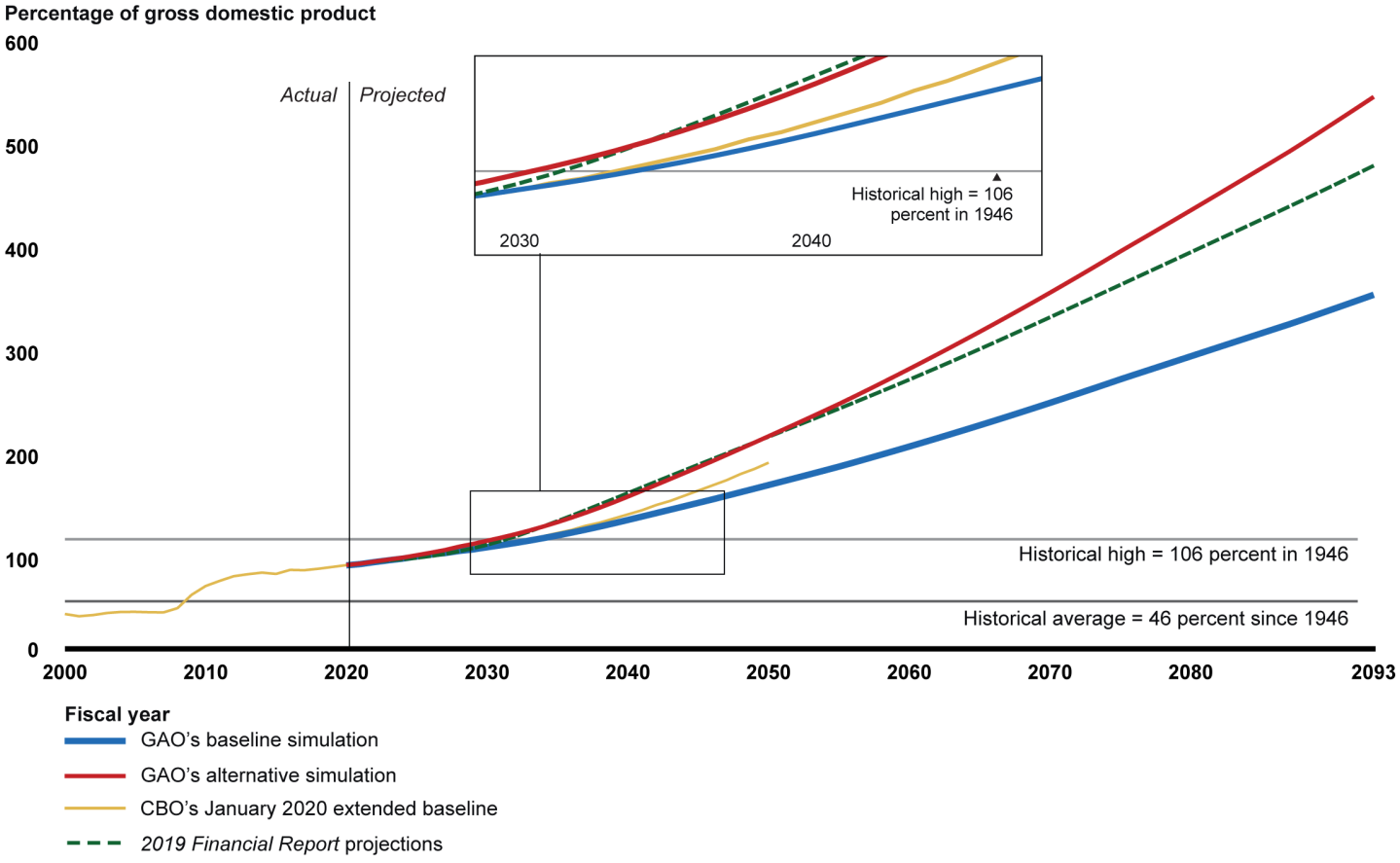
Source: GAO analysis of Congressional Budget Office data. | GAO-20-403SP

Figure 4 shows that debt held by the public grows substantially as a share of GDP over time in all the projections and simulations discussed in this report. CBO's projections and GAO's baseline simulation generally assume current law (e.g., that tax provisions expire as scheduled). Both CBO's January 2020 long-term fiscal projections and GAO's baseline simulation project future spending based on discretionary spending caps raised by the Bipartisan Budget Act of 2019. Because this increased spending is expected to contribute to increased debt, both CBO's long-term fiscal projections and GAO's baseline simulation therefore show greater long-term debt as a share of GDP than last year's projections.

GAO's alternative simulation and the *2019 Financial Report* projections draw from historical policy experiences in assuming some current laws

will change–for example, that some tax provisions scheduled to expire will be extended. Compared to last year, the *2019 Financial Report* projections show lower debt as a share of GDP over time due to the net effect of various factors including lower interest rate assumptions. GAO's alternative simulation shows moderately higher long-term debt than last year's simulation.

Figure 4: Debt Held by the Public under Projections from GAO, the Congressional Budget Office (CBO), and the *2019 Financial Report*



Sources: GAO, Congressional Budget Office, and *Fiscal Year 2019 Financial Report of the U.S. Government (2019 Financial Report).* | GAO-20-403SP

Note: GAO's baseline simulation and CBO's January 2020 long-term extended baseline projection begin by using CBO estimates and generally assume current law continues into the future. GAO's baseline simulation assumes that revenue remains a constant share of gross domestic product (GDP). The *2019 Financial Report* projections assume that the provisions of the law known as the Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017), are extended and that individual income taxes increase gradually as real taxable incomes rise over time, and an increasing share of total income is taxed at higher tax brackets. GAO's alternative simulation generally reflects historical trends, such as the extension of tax provisions scheduled to expire. Each simulation has its own GDP

projections, which affect the projected debt-to-GDP ratios. See appendix I for additional discussion on the assumptions made in GAO's model.

All projections involve some degree of uncertainty; in addition, future policy decisions about federal spending, revenues, the federal role in the delivery of health care, and other areas would change the projections. The debt-to-GDP ratio is sensitive to assumptions about projected health care costs, interest rates, spending, revenues, and economic growth.[20] The projections also do not fully account for fiscal risks or exposures discussed later in this report, such as disaster response spending.

Both the current fiscal condition and the long-term projections of fiscal sustainability are driven by the economy and by laws enacted by Congress and the President. For example, in 2018 CBO estimated that the 2017 Tax Cuts and Jobs Act would increase the total projected deficit for the period of fiscal year 2018 to 2028 by $1.9 trillion.[21] Additionally, CBO projected increases in discretionary spending associated with the Bipartisan Budget Act of 2019 would increase the projected deficit by $1.7 trillion during the period of fiscal year 2020 to 2029.[22] Including the Bipartisan Budget Act of 2019 and reductions in projected revenue associated with the Further Consolidated Appropriations Act, 2020, legislative changes between January 2019 and January 2020 increased the projected 10-year deficit by nearly $2.5 trillion.[23]

[20]To illustrate this uncertainty, GAO produces sensitivity analyses that show the effects on its simulations if selected variables are higher or lower than projected. See https://www.gao.gov/fiscal-outlook-simulations. Sensitivity analyses related to the projections in the *2019 Financial Report* are included in the Required Supplementary Information section of the *2019 Financial Report.*

[21]CBO, *The Budget and Economic Outlook: 2018 to 2028* (Washington, D.C.: April 2018). CBO's estimate takes into account the projected economic feedback from the act.

[22]The Bipartisan Budget Act of 2019 increased discretionary funding limits for fiscal years 2020 and 2021 from levels previously set under the Budget Control Act of 2011. Because CBO's projections assume that discretionary spending will continue at the level of the 2021 funding limits and grow with inflation, the increase in 2020 and 2021 funding limits resulted in higher projected discretionary spending throughout the 10-year period.

[23]The Further Consolidated Appropriations Act, 2020, repealed an excise tax on high-cost employer-sponsored health coverage that was scheduled to take effect in 2022 and an annual fee on health insurance providers that was scheduled to take effect in 2021, as well as extending other tax provisions. Because CBO's projections assume that current laws continue in the future, repealing these provisions resulted in lower projected revenues for the years after they were scheduled to take effect.

Projections of increasing federal debt run counter to a global trend reported by the International Monetary Fund (IMF). In April 2018, the IMF reported that overall deficits as a share of GDP among countries with advanced economies have been falling since 2012. The IMF also predicted in that report that the debt-to-GDP ratio would fall over the next five years in most countries with advanced economies.[24] In December 2019, the IMF reported that the United States continued to be an exception to the general trend of declining public sector debt ratios among advanced economies.[25]

Recent and projected increases in federal debt also run counter to the historical trend of decreasing debt-to-GDP ratios during periods of economic expansion. When the current economic expansion began in 2009, the debt-to-GDP ratio was about 52 percent. By the end of fiscal year 2019, the debt-to-GDP ratio had risen to 79 percent, an increase of about 27 percentage points during an expansionary period. According to CBO, federal deficits in the past have on average been smaller during times when the unemployment rate was below six percent. However, GAO, CBO, and the *2019 Financial Report* all project higher-than-average deficits over the next 10 years despite expectations that unemployment will remain significantly lower than this threshold.

State and local governments face many of the same long-term fiscal pressures—such as rising health care costs—as the federal government. GAO's most recent simulations suggest that the state and local government sector could continue to face a gap between revenue and spending over the next 50 years. Because most state and local governments are required to balance their operating budgets, they will most likely need to make policy changes involving some combination of reduced spending and increased revenue. [26]

[24]International Monetary Fund, *Fiscal Monitor: Capitalizing on Good Times* (Washington, D.C.: April 2018).

[25]M. M. Badia and P. Dudine, "New Data on World Debt: A Dive into Country Numbers", *IMFBlog*, accessed February 18, 2020. http://blogs.imf.org/2019/12/17/new-data-on-world-debt-a-dive-into-country-numbers/.

[26]GAO's simulations assume that the current set of policies in place across state and local governments and the provision of real government services per capita remain relatively constant. GAO, *State and Local Governments' Fiscal Outlook: 2019 Update*, GAO-20-269SP (Washington, D.C.: Dec. 19, 2019).

The unsustainable fiscal path is straining the federal budget and contributing to growing debt. CBO has reported that rising debt could constrain policymakers' ability to support the economy during a downturn. It could also constrain policymakers from addressing other priorities, such as national security and the nation's infrastructure.[27] The longer that action to address this issue is delayed, the more drastic changes will have to be.

Rising federal debt could have long-term consequences for the economy because, while federal borrowing can play a role in facilitating a healthy economy, persistent deficits and rising levels of debt reduce funds available for investment by the private sector or state and local governments.

What are federal experts saying about the consequences of high and rising debt?

Fiscal Year 2021 President's Budget Proposal:

High and rising debt will have serious negative consequences for the budget and the Nation. It slows economic growth, as the costs of financing the debt crowds out more productive investment and could eventually limit the federal government's ability to respond to urgent national security needs, invest in key priorities such as infrastructure. . .

Congressional Budget Office (CBO):

High debt and large deficits might also create constraints for policymakers as they contemplate making changes to fiscal policy . . . policymakers could feel restrained from using deficit-financed fiscal policy to respond to unforeseen events or for other purposes, including to promote economic activity or to further other goals. High debt could also undermine national security if policymakers felt constrained from increasing national security spending to resolve an international crisis or to prepare for such a crisis before it began.

Jerome H. Powell, Chair of the Board of Governors of the Federal Reserve System:

Over time, this outlook could restrain fiscal policymakers' willingness or ability to support economic activity during a downturn. In addition, I remain concerned that high and rising federal debt can, in the longer term, restrain private investment and, thereby, reduce productivity and overall economic growth. Putting the federal budget on a sustainable path would aid the long-term vigor of the U.S. economy and help ensure that policymakers have the space to use fiscal policy to assist in stabilizing the economy if it weakens.

***Fiscal Year 2019 Financial Report of the United States Government* (*2019 Financial Report*):**

The timing of policy changes to make fiscal policy sustainable has important implications for the well-being of future generations. . . Future generations are harmed by a policy delay.

Sources: 2021 President's Budget, CBO, 2019 Financial Report, and Federal Reserve. | GAO-20-403SP

[27]The Highway Trust Fund, the major source of federal surface transportation funding, is increasingly unable to maintain current spending levels for highway and transit programs. For more information on funding the nation's surface transportation system, see GAO-19-157SP, 86.

According to CBO, high and rising debt could erode confidence in the U.S. dollar as an international reserve currency, crowd out private investment, and lead to expectations of higher rates of inflation.[28] CBO has also said that higher levels of debt increase the risk of a fiscal crisis, in which investors would lose confidence in the U.S. government's financial position and interest rates on Treasury securities would increase abruptly. A fiscal crisis of this nature would have further negative economic effects and could trigger a global financial crisis.

Health Care Spending and Net Interest Remain Key Drivers of Long-Term Federal Spending

GAO, CBO, and the *2019 Financial Report* all project that spending will increase more rapidly than revenue, with some major categories of spending exceeding $1 trillion annually in the coming years (see table 2).

Table 2: Projections for Major Categories of Spending

Fiscal year	Spending projection
2019	Social Security spending exceeds $1 trillion annually
2026	Medicare and Medicaid[a] spending each exceed $1 trillion annually
2032	Net interest spending exceeds $1 trillion annually

Source: GAO's alternative simulation and Centers for Medicare & Medicaid Services. | GAO-20-403SP

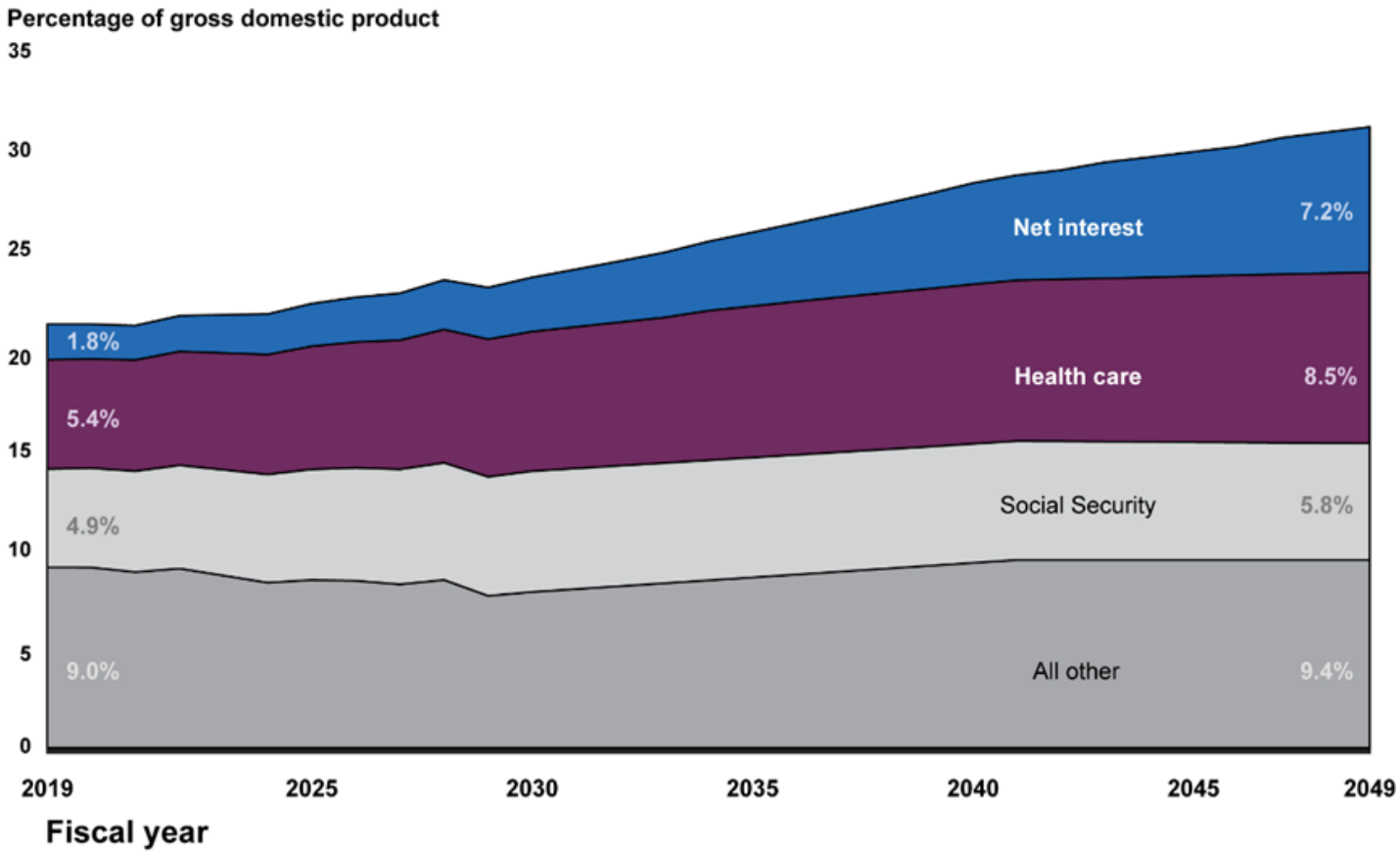
Note: CBO projects defense discretionary spending will reach $937 billion in 2030. CBO did not report defense spending projections separately from total discretionary spending in its long-term projections after 2030.

[a]Medicaid spending includes both state and federal spending.

In the long term, most of the increase in federal spending as a share of GDP is being driven by spending on federal health care programs and net interest (see figure 5). Net interest, which is a function of the amount of debt to be financed and the interest rate at which it is financed, acts as a driver of debt because increased interest costs often lead to additional borrowing.

[28]CBO, *The 2019 Long-Term Budget Outlook* (Washington, D.C.: June 2019). Treasury market participants GAO surveyed raised similar concerns about the status of the dollar as an international reserve currency; see GAO-20-131.

Figure 5: Growth in Major Areas of Federal Spending



Source: GAO. | GAO-20-403SP

Note: Data based on GAO's 2020 alternative simulations. GAO's simulation holds discretionary spending and other mandatory spending constant as a share of gross domestic product in the long term. Health care spending on major federal health care programs consists of Medicare, Medicaid, the Children's Health Insurance Program, and federal subsidies for health insurance purchased through the marketplaces established by the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010), and related spending.

GAO's simulations project that in the coming years these two areas will continue to increase significantly as a share of GDP. In GAO's alternative simulation, federal spending on major health care programs is projected to increase from 5.4 percent of GDP in fiscal year 2019 to 8.5 percent of GDP in fiscal year 2049. In the same simulation, spending on net interest increases from 1.8 percent of GDP in fiscal year 2019 to 7.2 percent of GDP in fiscal year 2049. Similarly, CBO's January 2020 budget and economic outlook report projects that increased spending for Medicare,

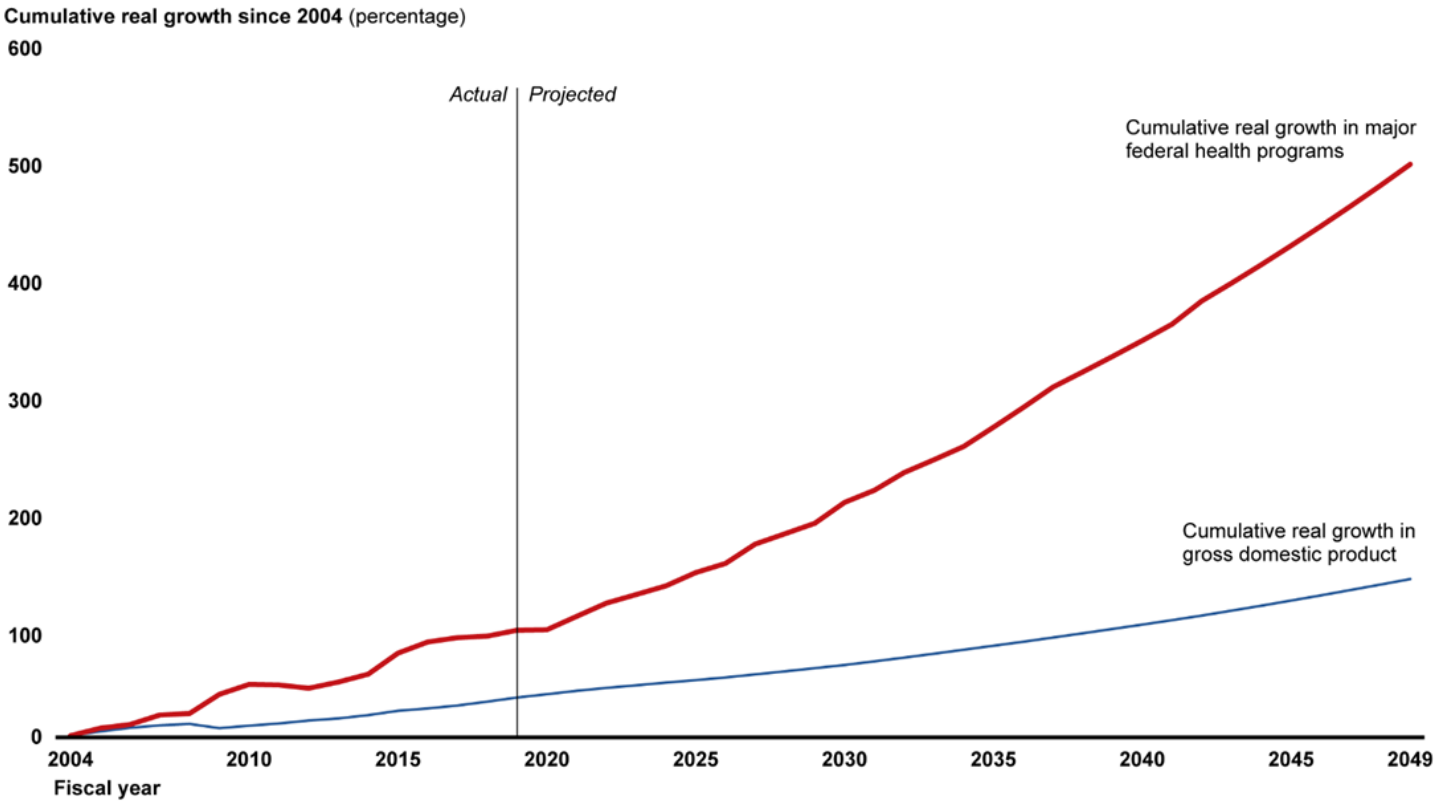
Social Security, and net interest will account for more than two-thirds of the estimated $2.8 trillion increase in total federal spending over the next 10 years.

Health Care Spending Continues to Grow Faster Than the Economy

Although growth in health care spending has slowed recently, total health care spending (public and private) in the United States continues to grow faster than the economy. Federal spending for major health care programs accounts for more than a quarter of total health care spending. As figure 6 shows, this spending has exceeded the growth of GDP historically and is projected to continue to do so. Federal health care programs include Medicare, Medicaid, and the Children's Health Insurance Program, along with federal subsidies for health insurance purchased through the marketplaces established by the Patient Protection and Affordable Care Act (PPACA) and related spending.[29]

[29]Pub. L. No. 111-148, 124 Stat. 119 (2010).

Figure 6: Federal Spending on Major Health Care Programs Grows Faster Than GDP



Source: GAO analysis of Congressional Budget Office and Bureau of Economic Analysis data. | GAO-20-403SP

Note: Cumulative growth in both GDP and federal spending on major health care programs has been adjusted for inflation. GDP is the value of all goods and services produced in a country in a given year. Major federal health care programs consist of Medicare, Medicaid, the Children's Health Insurance Program, and federal subsidies for health insurance purchased through the marketplaces established by PPACA and related spending.

CBO notes that growth in Medicare and Medicaid spending were key contributors to the increase in federal spending in 2019. According to Treasury, in fiscal year 2019, total outlays (spending) were $651 billion for Medicare and $409 billion for Medicaid. Treasury estimates that total spending also increased by about 11 percent for Medicare and about 5 percent for Medicaid between fiscal years 2018 and 2019.[30] CBO also

[30]Because fiscal year 2018 began on a weekend, some spending that would have otherwise occurred in fiscal year 2018 was instead shifted to fiscal year 2017. When adjusting for the effects of shifted payments, CBO estimates that Medicare spending increased by 6.4 percent between fiscal years 2018 and 2019.

reported that Medicaid spending increased 36 percent from fiscal years 2015 through 2019, largely because of state Medicaid expansions.[31] As of January 2020, 35 states and the District of Columbia expanded eligibility for their Medicaid programs under PPACA.[32]

Spending for subsidies for health insurance purchased through the exchanges established under PPACA rose by about $7 billion (or 13 percent) in 2019. CBO reduced its projections of spending for subsidies after premiums for 2020 were lower than anticipated, and now projects that spending for subsidies will fall by about $4 billion in 2020, then grow roughly 3 percent per year from 2020 to 2030.[33]

In the long term, growth in federal spending on health care is driven by increasing enrollment, particularly in Medicare, stemming primarily from the aging population, and by the increase in health care spending per beneficiary.

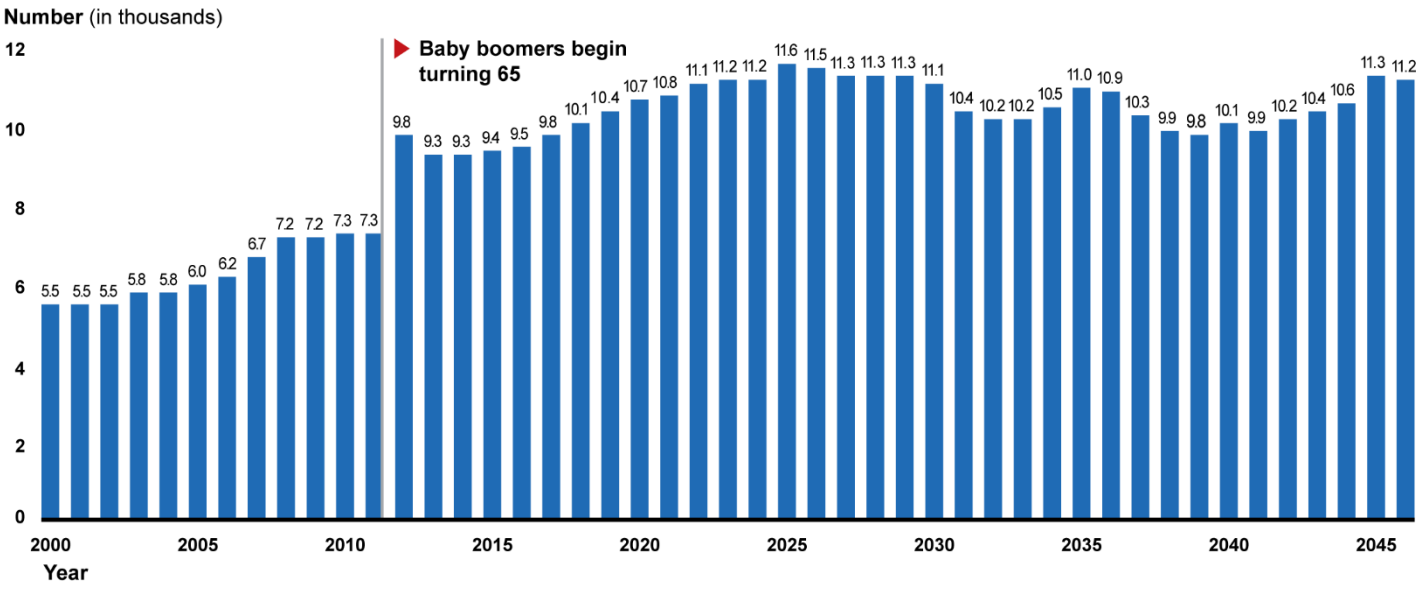
- **Aging population.** In its 2019 long-term budget outlook report, CBO projected that, by 2049, 22 percent of the population will be age 65 or older, compared to 16 percent in 2019. This demographic trend is driven largely by lower fertility rates and increases in life expectancy. This trend has been accelerated by the relatively large baby boom generation, which began turning 65 in 2011 (see figure 7). Medicare enrollment is expected to increase over the next decade as the number of people older than 65 increases.

[31]Under PPACA, states have the option to expand their Medicaid programs to cover nearly all adults under 65 with incomes up to 133 percent of the federal poverty level.

[32]Nebraska voted to expand eligibility for Medicaid, but this will not take effect until October 2020. According to the 2016 National Health Interview Survey, an estimated 5.6 million adults had incomes at or below the income threshold for expanded Medicaid eligibility but an estimated 3.7 million of these adults lived in states that did not expand eligibility for their Medicaid programs. The survey estimates also indicated that low-income adults in expansion states were less likely to report having any unmet medical needs or financial barriers to health care compared with those in nonexpansion states. See GAO, *Medicaid: Access to Health Care for Low-Income Adults in States with and without Expanded Eligibility*, GAO-18-607 (Washington, D.C.: Sept. 13, 2018).

[33]Total subsidies depend on (1) the number of enrollees, which is projected to decline slightly over time; (2) per-beneficiary spending, which is estimated to rise with the costs of providing health care; and (3) market dynamics, such as changes in participating plans affecting the benchmark premiums used in establishing the subsidy amount.

Figure 7: Daily Average Number of People Turning 65



Source: GAO analysis of U.S. Census Bureau information. | GAO-20-403SP

Note: Census data estimates of population are as of July 1 in each year.

- **Per beneficiary spending.** The amount of money spent on health care per person historically has risen faster than per capita economic output and is projected to do so in the future. In its 2019 long-term budget outlook report, CBO projected that the growth in health care spending per person will account for about two-thirds of the increase in spending for the major health care programs as a share of GDP between 2019 and 2049. During the past several years, health care spending per person grew more slowly than it has historically, but CBO and the Medicare Trustees both project that spending per enrollee in federal health care programs will grow more rapidly over the coming decade. Various factors can affect per beneficiary spending, including the emergence of new medical procedures and treatments.

Increased health care spending for major federal health care programs, especially Medicare, will continue to place a strain on the federal budget in both the near and the long term. Under GAO's alternative simulation, spending for major federal health care programs is projected to grow from 5.4 percent of GDP in 2019 to 8.5 percent of GDP in 2049. Illustrative examples of projected growth in federal health care spending include:

- **Medicare.** In its January 2020 budget and economic outlook report, CBO projected that Medicare spending net of offsetting receipts will reach $1 trillion (3.8 percent of GDP) in 2026. In their April 2019 report, the Medicare Trustees projected that Medicare's Hospital Insurance Trust Fund will be depleted by 2026, 3 years earlier than projected in the 2017 report, with income projected to cover only 89 percent of all hospital-related Medicare spending in that year.[34]
- **Medicaid**. The Centers for Medicare and Medicaid Services (CMS) Office of the Actuary projected that Medicaid spending will total $1 trillion by 2026 (3.7 percent of GDP), of which $624 billion will be federal spending.[35]
- **Federal subsidies for health insurance.** CBO projected in its January 2020 budget and economic outlook report that costs for people receiving federal subsidies for health insurance purchased through the exchanges and related spending under the provisions of PPACA will rise from $56 billion in 2019 to $71 billion by 2030.

Net Interest Is the Fastest Growing Category of Federal Spending

Both GAO's and the *2019 Financial Report's* simulations show spending on net interest growing such that over the long term it becomes the largest category of spending (see figure 8).[36] Spending on net interest means less room in the budget for federal programs to support national goals and priorities or for tax cuts. Spending on net interest totaled $376 billion in 2019 (8.4 percent of total federal spending), which increased from $263 billion in 2017. That amount was already larger than spending on agriculture, transportation, and veterans' benefits and services combined. Under GAO's alternative simulation, spending on net interest

[34]In their April 2019 report, the Medicare Trustees noted that there is substantial uncertainty as to the adequacy of future Medicare payment rates under current law. The report presents alternative projections illustrating higher Medicare spending that would result if certain statutory Medicare payment provisions were not fully implemented in all future years. For example, the Trustees project that Medicare spending would equal 6.0 percent of GDP in 2043 under current law, but would equal 6.3 percent of GDP under the illustrative alternative projections.

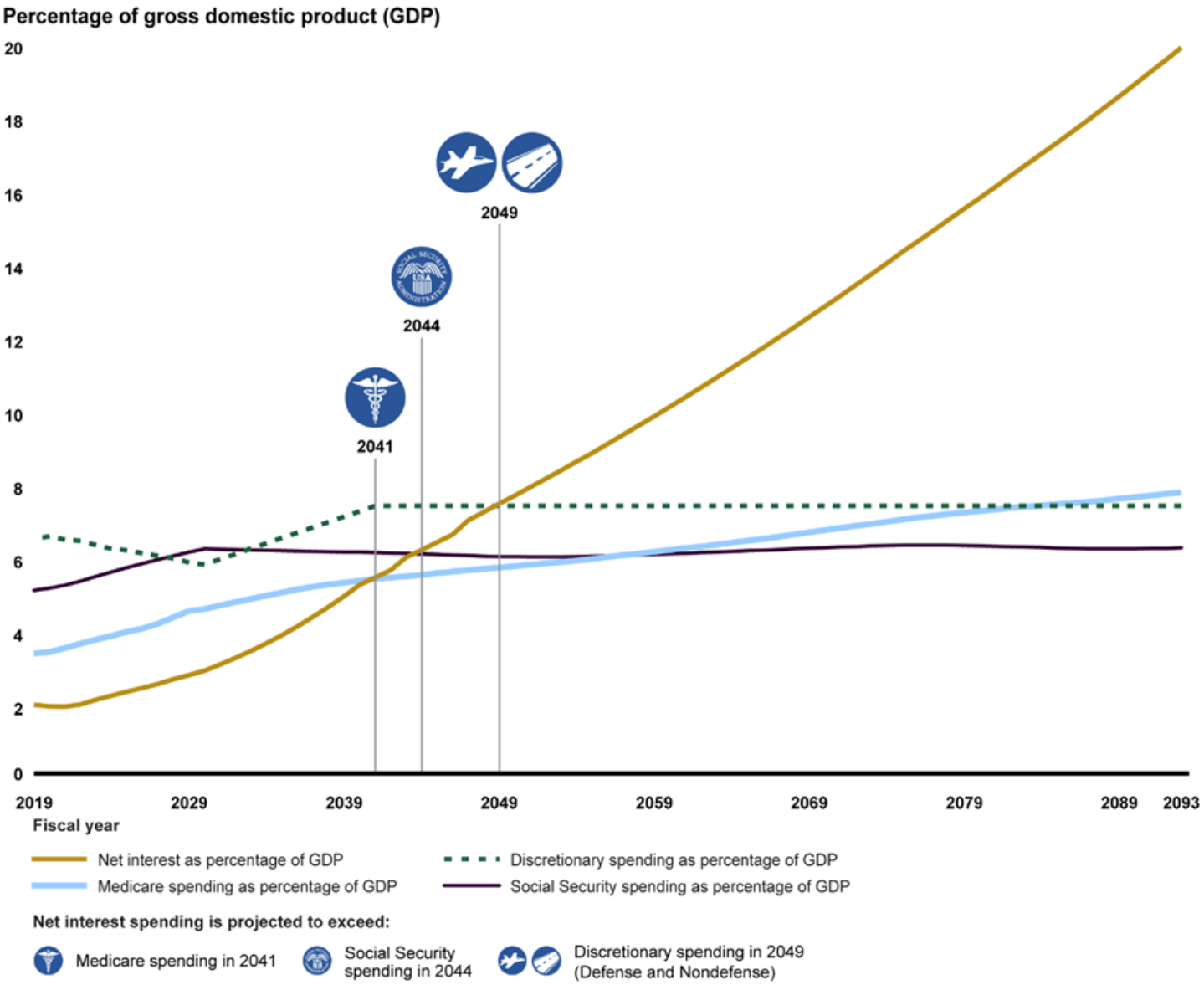
[35]The Department of Health and Human Services, Centers for Medicare & Medicaid Services (CMS), Office of the Actuary, *2017 Actuarial Report on the Financial Outlook for Medicaid*, (Washington, D.C.: 2018). In this report, the CMS Chief Actuary stated that projections of health care costs are inherently uncertain. In particular, Medicaid projections are uncertain because enrollment and costs are very sensitive to economic conditions.

[36]CBO's projections in its June 2019 long-term outlook report also show net interest growing as a percentage of total spending. However, since CBO's June 2019 extended baseline projections only go out to 2049, spending on net interest does not quite overtake Social Security spending in the projection period.

is projected to continue to grow. As a share of GDP, net interest spending is expected to surpass

- nondefense discretionary spending in 2030,
- defense discretionary spending in 2033,
- Medicare spending in 2041,
- Social Security spending in 2044, and
- total discretionary spending in 2049.

Figure 8: Projected Net Interest and Other Spending as Percentage of Gross Domestic Product



Source: GAO. | GAO-20-403SP

GAO, CBO, and the *2019 Financial Report* project that net interest will grow more quickly than any other component of the budget in the long term. Over the past 50 years, the government's net interest costs as a

share of GDP have averaged 2.0 percent. GAO's alternative simulation projects that net interest spending will grow from 1.8 percent of GDP in 2019 to 7.2 percent of GDP by 2049 and will continue to grow over the long term.

Interest spending grows for two main reasons:

- **Growing debt.** At any positive interest rate, interest payments increase as the debt grows. Debt will continue to grow if the federal government continues to both borrow money to finance the deficit and pay interest on the debt rather than pay down the total principal outstanding.
- **Growth in interest rates.** For any given level of debt, a change in interest rates changes interest costs. Interest rates also have a compounding effect on the debt, as borrowing to make interest payments adds to the debt.[37]

Persistently low interest rates have resulted in lower interest costs for the government than previously forecast. Both CBO's and GAO's long-term fiscal projections use CBO's projected interest rates. In its January 2020 *Budget and Economic Outlook*, CBO lowered its interest rate projections, estimating that the average interest rate on debt held by the public will rise from 2.5 percent in fiscal year 2019 to 2.8 percent in fiscal year 2030.[38] This projection is lower than CBO's previous projection that rates would rise to 3.5 percent in fiscal year 2029.[39] The *2019 Financial Report* projections use long-run interest rate assumptions that are consistent with those in the 2019 Social Security Trustees' report.[40] The *2019 Financial Report* projections assume that the average interest rate over the

[37]Increasing debt may also lead to higher interest rates; see CBO, *The Effect of Government Debt on Interest Rates* (Washington, D.C.: March 2019). However, CBO has stated that since the trend of increasing interest rates reflects long-term economic trends, rates would likely increase even at the current debt level.

[38]CBO, *The Budget and Economic Outlook: 2020 to 2030* (Washington, D.C.: January 2020). CBO's most recent 30-year interest rate projection shows rates rising to 4.2 percent in fiscal year 2049. CBO, *The 2019 Long-Term Budget Outlook* (Washington, D.C.: June 2019).

[39]CBO, *The Budget and Economic Outlook: 2019 to 2029* (Washington, D.C.: January 2019).

[40]*2019 Financial Report*, Note 23.

projection period will be 4.9 percent, down from the *2018 Financial* Report's 5.0 percent.

These projections are uncertain and variations in interest rates can result in significant differences in both projected interest costs and debt in the long term. For example, under GAO's alternative simulation, a 1 percentage point increase in overall interest rates throughout the projection period would result in interest costs in 2049 increasing from 7.2 percent of GDP to 10.8 percent of GDP.[41]

Interest costs will also depend in part on the outstanding mix of Treasury securities. Treasury issues securities (e.g., bills, notes, and bonds) in a wide range of maturities to appeal to a broad range of investors to support its goal of borrowing at the lowest cost over time.[42] Each year, trillions of dollars of debt mature. Treasury refinances maturing debt by issuing new debt in its place at the prevailing interest rate. At the end of fiscal year 2019, 61 percent of the outstanding amount of marketable Treasury securities held by the public (about $9.9 trillion) was scheduled to mature in the next 4 years.[43] If interest rates are higher, Treasury will have to refinance these securities at the higher interest rates, adding to the interest costs of the growing federal debt.

Social Security Is Projected to Pose Significant Financial Challenges

Social Security has remained the bedrock of retirement security—insuring workers against the loss of income because of retirement, death, or disability. Social Security provides benefits to about 63 million older Americans, survivors, dependents, and individuals with disabilities, and their families. It has helped reduce poverty among its beneficiaries, many of whom rely on it for the majority of their income.[44] According to

[41]For more information about fiscal simulations' sensitivity to interest rate assumptions, see GAO's sensitivity analyses at https://www.gao.gov/fiscal-outlook-simulations.

[42]The interest rates associated with the range of maturities of the nominal securities issued by Treasury creates a "yield curve" which represents the relationship between the maturity of an asset and its yield (the interest rate paid by Treasury or cost of borrowing).

[43]Marketable securities are securities that can be resold by whoever owns them. At the end of fiscal year 2019, 97 percent of the outstanding amount of securities that constitute debt held by the public was marketable. For more information, see GAO, *Financial Audit: Bureau of the Fiscal Service's Fiscal Years 2019 and 2018 Schedules of Federal Debt,* GAO-20-117 (Washington, D.C.: Nov. 8, 2019).

[44]GAO, *The Nation's Retirement System: A Comprehensive Re-evaluation Is Needed to Better Promote Future Retirement Security,* GAO-18-111SP (Washington, D.C.: Oct. 18, 2017).

Treasury's Final Monthly Treasury Statement for fiscal year 2019, Social Security paid about $1.03 trillion in Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) program benefits in fiscal year 2019. Looking forward, however, demographic factors such as an aging population and slower labor force growth are straining Social Security programs and contributing to a gap between program costs and revenues.

For many years, Social Security's revenues exceeded program costs and the programs built up reserves in the two trust funds: one for the OASI program and one for the DI program. By law, the Social Security trust funds must invest in interest-bearing federal government securities.[45] The trust funds invested past excess revenues in these federal government securities, helping to finance other federal programs and reducing the amount that had to be borrowed from the public.

Starting in 2005 for the DI Trust Fund and in 2010 for the OASI Trust Fund, this situation reversed: Social Security began paying out more in benefits than it received in noninterest revenue.[46] Absent any changes, both trust funds are projected to deplete their assets and have insufficient income to pay benefits in full on a timely basis. In their 2019 annual report, the Social Security Trustees estimated that the OASI Trust Fund would deplete its assets by 2034 with income sufficient to pay only 77 percent of scheduled benefits in that year.[47] They also estimated that the DI Trust Fund would deplete its assets by 2052 with income sufficient to

[45]The Social Security Act requires that trust fund assets be invested in interest-bearing obligations of the United States or in obligations guaranteed as to both principal and interest by the United States. We are using the term "federal government securities" to refer to these obligations. 42 U.S.C. § 401(d).

[46]According to the Social Security Trustees, in 2016, 2017, and 2018 noninterest income and total income for the DI Trust Fund exceeded benefit payments due primarily to the temporary reallocation of the payroll tax rate from OASI to DI for years 2016 through 2018. This temporary reallocation was authorized in the Bipartisan Budget Act of 2015, Pub. L. No. 114-74, title VIII, subtit. C, § 833, 129 Stat. 584, 613-14 (2015).

[47]These projections are from *The 2019 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* and reflect the Trustees' intermediate assumptions. Because the future is uncertain, the Trustees use three sets of assumptions to show a range of possible outcomes. The Trustees' intermediate assumptions represent the Trustees' best estimate of the trust funds' future financial outlook. The Trustees also present estimates using low cost and high cost sets of assumptions.

pay only 91 percent of scheduled benefits in that year.[48] Acting soon would allow any adjustments to be smaller and spread across more generations of participants. The actions could also be phased in to give affected individuals time to adjust their retirement planning.

Fiscal Exposures Place Additional Pressure on the Federal Budget

Beyond the spending and revenue trends discussed in the long-term fiscal projections, the federal government faces certain additional fiscal exposures or risks that could affect its future fiscal condition and are not fully accounted for in the GAO, CBO, and *2019 Financial Report* fiscal projections. Fiscal risks are responsibilities, programs, and activities that may legally commit the federal government to future spending or create expectations for future spending based on current policy, past practices, or other factors.[49] While the projections in this report estimate future spending levels based on current spending—including those related to some of the fiscal risks identified in this section—they do not account for unforeseen future increases in spending associated with these risks. A more complete understanding of fiscal risks can help policymakers anticipate changes in future spending and can enhance oversight of federal resources. The following are examples of key additional fiscal risks and exposures that are not fully accounted for in the projections discussed in this report but could significantly affect the federal government's fiscal outlook:

- **The Pension Benefit Guaranty Corporation.** The Pension Benefit Guaranty Corporation (PBGC), which insures benefits, up to statutory limits, in private-sector defined benefit pension plans, faces an uncertain financial future because of both short-term and long-term challenges. PBGC's liabilities exceeded its assets by more than $56 billion as of the end of fiscal year 2019. PBGC's single-employer program covers defined benefit pension plans that are generally sponsored by individual employers, while the multiemployer program covers defined benefit pension plans created through collective bargaining agreements generally between labor unions and two or more employers. The single-employer program, which covered about 24,000 plans in fiscal year 2019, reported a surplus of $8.7 billion at

[48]In their 2019 report, the Social Security Trustees revised the DI Trust Fund's estimated year of depletion from 2032 to 2052. According to the Trustees, the change is mainly due to fewer DI applications and benefit awards, both of which fell well below levels projected in last year's report for 2018.

[49]See our infographic on federal fiscal risks at https://www.gao.gov/assets/670/668649.pdf.

the end of fiscal year 2019—an improvement of about $28 billion since 2014. The multiemployer program, which covered about 1,400 plans in fiscal year 2019, reported a deficit of about $65 billion at the end of fiscal year 2019, a record negative net position.

PBGC reports that while the financial position of the single-employer program has improved, the multiemployer program continues to face solvency challenges in the near future.[50] PBGC projects that without legislative reforms, there is a high likelihood the multiemployer program will become insolvent during fiscal year 2025 and that insolvency is a near certainty by the end of fiscal year 2026.[51] When the program becomes insolvent, PBGC financial assistance to multiemployer plans will be limited to the premiums collected by the program and insufficient to pay the current level of guaranteed benefits.[52]

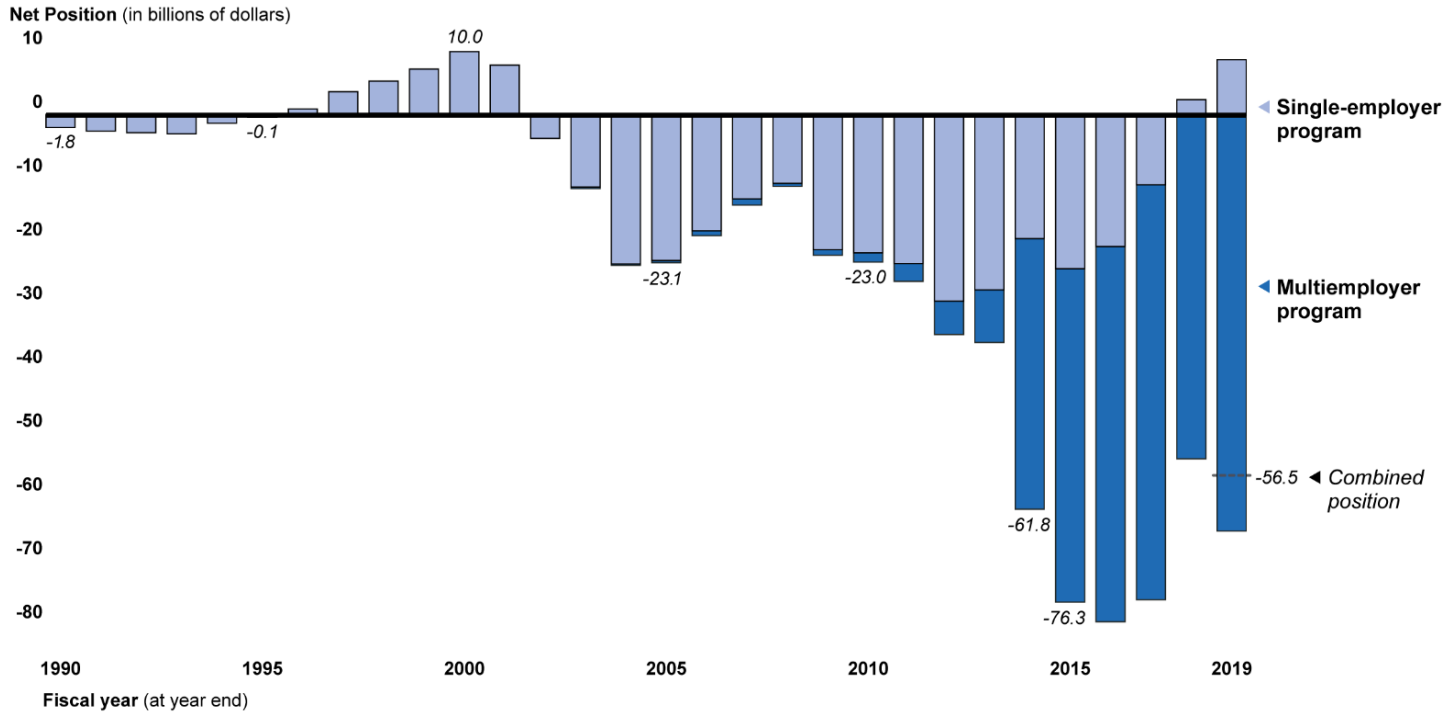
In addition to these probable losses, PBGC estimated that its exposure to potential additional future losses for underfunded plans in both the single and multiemployer programs was nearly $166 billion, of which the single-employer program accounts for $155 billion of this amount. Although the single-employer program is currently in surplus, its financial position is highly sensitive to prevailing economic conditions and past experience with large claims shows that its condition can change quickly and precipitously.

[50]Pension Benefit Guaranty Corporation, *Annual Report 2019* (Washington, D.C.: Nov. 15, 2019).

[51]For more information on Pension Benefit Guaranty Corporation insurance programs, see GAO, *High-Risk Series: Substantial Efforts Needed to Achieve Greater Progress on High-Risk Areas,* GAO-19-157SP (Washington, D.C.: Mar. 6, 2019), 267.

[52]In December 2019, the enactment of the Bipartisan American Miners Act of 2019, Pub. L. No. 116-94, div. M, 133 Stat. 2534, provided additional funding for future annual Treasury transfers to the 1974 United Mine Workers of America Pension Plan (included in PBGC's multiemployer program). PBGC is currently assessing the effect of the legislation on its liabilities and contingency disclosures (including the estimated insolvency date for the multiemployer program).

Figure 9: Pension Benefit Guaranty Corporation's Net Financial Position of the Single-Employer and Multiemployer Programs Combined, Fiscal Years 1990 through 2019



Source: Pension Benefit Guaranty Corporation (PBGC). | GAO-20-403SP

- **Housing finance.** Federal support of the housing finance market remains significant despite the fact that the market has largely recovered since the 2007 to 2009 financial crisis. In 2008, the federal government placed the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) under conservatorship and entered into preferred stock purchase agreements with these government-sponsored enterprises (GSE) to help ensure their financial stability.

  Effective September 30, 2019, the agreements under which the GSEs agreed to pay dividends to the Treasury were modified to permit the GSEs to retain additional earnings. At the end of fiscal year 2019, the federal government reported about $112 billion of investments in the GSEs, which is net of about $98 billion in valuation losses.

  The ultimate role of the GSEs could affect the financial condition of other federal entities, including the Federal Housing Administration

(FHA), which in the past expanded its lending role in distressed housing and mortgage markets. In December 2019, the Government National Mortgage Association (Ginnie Mae) guaranteed the performance of approximately $2.1 trillion in securities backed by federally insured mortgages—of which the majority were insured by FHA and the remainder by other federal entities, such as the Department of Veterans Affairs. We have reported on the need for Congress to consider legislation to address the structure of the GSEs and establish clear, specific, and prioritized goals while considering all relevant federal entities, such as FHA and Ginnie Mae.[53]

- **The U.S. Postal Service.** The U.S. Postal Service (USPS) continues to be in poor financial condition. USPS cannot fund its current level of services and financial obligations from its current level of revenues.[54] USPS's net loss of $8.8 billion in fiscal year 2019 marked its 12th consecutive year of net losses totaling $78 billion. In addition, USPS has missed $55.4 billion in required funding payments for postal retiree health and pension benefits through fiscal year 2019, including $47.2 billion in missed funding payments for retiree health benefits since fiscal year 2010 and $8.2 billion for pension benefits since fiscal year 2014. Looking forward, USPS has growing unfunded liabilities and debt—totaling almost $161 billion at the end of fiscal year 2019. USPS has stated that it missed these payments to minimize the risk of running out of cash, citing its precarious financial condition and the need to cover current and anticipated costs and any contingencies.[55]
- **Military Conflicts.** According to DOD, since September 2001, Congress has appropriated approximately $1.9 trillion to DOD for Overseas Contingency Operations (OCO), primarily in Iraq and

[53]GAO, *Housing Finance: Prolonged Conservatorships of Fannie Mae and Freddie Mac Prompt Need for Reform*, GAO-19-239 (Washington, D.C.: Jan. 18, 2019). For more information on resolving the federal role in housing finance, see GAO-19-157SP, 95.

[54]An obligation is a definite commitment that creates a legal liability of the government to make a payment for goods and services received or a legal duty that could mature into a legal liability by virtue of actions beyond the control of the federal government.

[55]For more information on USPS's financial viability, see GAO-19-157SP, 99.

Afghanistan.[56] Spending on future military conflicts is not only difficult to budget for but can also result in enduring costs even after those conflicts end. Since 2007, we have reported on multiple issues associated with OCO funds, including DOD's efforts to transition the enduring costs of overseas operations to its base budget.[57] In January 2017, we recommended that DOD develop a complete and reliable estimate of enduring costs to report in future budget requests.[58] In April 2018, DOD produced an estimate of the funds that would be shifted from OCO to the base budget request from fiscal years 2020 through 2023. These amounts ranged from $53 billion to $45.8 billion. The administration's fiscal year 2021 budget request includes $69 billion for OCO, consistent with the amount established in the Bipartisan Budget Act of 2019.[59] According to DOD budget documents, this amount funds not only direct war requirements, but enduring requirements that will remain after combat operations end, as well as some base budget requirements. The budget request further states that after fiscal year 2021—the final year of the discretionary spending caps in current law—OCO amounts for fiscal years 2022 and 2023 would be $20 billion in each year, while proposing the base discretionary funding level be set at $739 billion for fiscal year 2022 and $755 billion for fiscal year 2023. Future military conflicts could pose similar fiscal risks and lead to unexpected increases in DOD spending over time.

[56]DOD defines "contingency operations" as small-, medium-, or large-scale campaign-level military operations, including but not limited to support for peacekeeping operations, foreign disaster relief efforts, noncombatant evacuation operations, and international disaster relief efforts. In contrast, regular or "base" activities include, for example, operating support for installations, training and education, and civilian personnel pay, which are costs that would be incurred, regardless of contingency operations. Appropriated amounts designated for overseas contingency operations that would otherwise exceed the annual limits established for defense spending will instead result in an adjustment to the overall defense spending limit established for a particular fiscal year, and will not trigger a sequestration, which is an automatic cancellation of budgetary resources provided by discretionary appropriations or direct spending laws. From 2001 to 2009, overseas contingency amounts were designated for the Global War on Terror. Since 2009, contingency amounts have been designated for overseas contingency operations.

[57]Enduring costs refer to costs that would continue in the absence of contingency operations.

[58]GAO, *Overseas Contingency Operations: OMB and DOD Should Revise the Criteria for Determining Eligible Costs and Identify the Costs Likely to Endure Long Term*, GAO-17-68 (Washington, D.C.: Jan. 18, 2017).

[59]Pub. L. No. 116-37, 133 Stat. 1049 (2019).

Natural Disasters and Climate Change Also Create Fiscal Exposures

Another example of a fiscal exposure facing the nation is the rising number of natural disasters and increasing state, local, and tribal reliance on federal disaster assistance. Such assistance can come from federal responsibilities, programs, and activities, such as the National Flood Insurance Program, that may legally commit or create the expectation for future federal spending. Federal agencies can become involved in responding to a disaster when effective response and recovery are beyond the capabilities of the state and affected local governments. In such cases, the Robert T. Stafford Disaster Relief and Emergency Assistance Act permits the President to declare a major disaster in response to a request by the governor of a state or territory or by the chief executive of a tribal government.[60] Overall, the number of disaster declarations has fluctuated over the years, reaching a high of 98 disasters in fiscal year 2011. There were 61 major disaster declarations in calendar year 2019.

Since 2005, federal funding for disaster assistance has totaled at least $460 billion, which consists of obligations for disaster assistance from 2005 through 2014 totaling about $278 billion[61] and select appropriations for disaster assistance from 2015 through 2019 totaling $183 billion.[62] In 2019 alone, 14 weather and climate disaster events had losses exceeding $1 billion each, with total costs of at least $45 billion, according to the National Oceanic and Atmospheric Administration.

The Disaster Relief Fund is the primary source of federal disaster assistance for state, local, territorial, and tribal governments when a major disaster or emergency is declared. Although the Disaster Relief Fund receives funding through the annual appropriations process, the federal government does not budget fully for the costs of disaster assistance. According to Congressional Research Service data, since 1964 more than 82 percent of overall net appropriations for disaster relief has been

[60] 42 U.S.C. § 5170.

[61] See GAO, *Federal Disaster Assistance: Federal Departments and Agencies Obligated at Least $277.6 Billion during Fiscal Years 2005 through 2014*, GAO-16-797 (Washington, D.C.: Sept. 22, 2016).

[62] This total includes, for fiscal years 2015 through 2019, $143 billion in supplemental appropriations to federal agencies for disaster assistance and approximately $40 billion in annual appropriations to the Disaster Relief Fund. It does not include other annual appropriations to federal agencies for disaster assistance.

provided through supplemental appropriations on an ad hoc basis.[63] These disaster relief supplemental appropriations, as well as most annual appropriations to the Disaster Relief Fund, generally do not count toward existing discretionary budget limits.[64]

The federal government also owns and operates hundreds of thousands of facilities and manages millions of acres of land that could be affected by both natural disasters and a changing climate and represent a significant federal fiscal exposure. For example, DOD owns and operates domestic and overseas infrastructure with an estimated replacement value of about $1 trillion. In September 2018, Hurricane Florence damaged Camp Lejeune and other Marine Corps facilities in North Carolina, with a preliminary Marine Corps repair estimate of $3.6 billion.

Disaster costs are projected to increase as extreme weather events become more frequent and intense because of climate change as observed and projected by the U.S. Global Change Research Program and the National Academies of Sciences, Engineering, and Medicine. OMB has reported that the federal government has spent more than $154 billion on activities related to climate change since 1993—primarily for technologies to reduce emissions and for scientific research on climate change impacts.[65] OMB's reporting does not, however, include information on relevant federal fiscal exposures.

Limiting the federal government's fiscal exposures to climate change has been on GAO's High-Risk List since 2013, in part because of concerns about the increasing costs of disaster response and recovery efforts.[66] For example, as currently structured, the National Flood Insurance Program's premiums and dedicated resources are not, over the long

[63]Congressional Research Service, *The Disaster Relief Fund: Overview and Issues*, R45484 (Washington, D.C.: Nov. 22, 2019).

[64]The Budget Control Act of 2011 allows spending limits to be adjusted upward to accommodate appropriations for disaster relief. Pub. L. No. 112-25, tit. I, § 101, 125 Stat. 240, 244-45 (2011).

[65]OMB has reported federal climate change funding in three main categories since 1993—clean energy technology to reduce emissions; science to better understand climate change; and international assistance for adaptation, clean energy, and sustainable landscapes. Most federal funding since 1993 has been dedicated to technology efforts. See GAO, *Climate Change: Analysis of Reported Federal Funding*, GAO-18-223 (Washington, D.C.: Apr. 30, 2018).

[66]GAO-19-157SP, 110.

term, sufficient to cover expected costs without borrowing from Treasury.[67] As of September 30, 2019, the Federal Emergency Management Agency (FEMA), which administers the National Flood Insurance Program, owed about $21 billion to Treasury for money borrowed to pay claims and other expenses. The amount owed does not include $16 billion of debt that was canceled in October 2017 by the Additional Supplemental Appropriations for Disaster Relief Requirements Act, 2017.[68] We have reported that FEMA is unlikely to collect enough in premiums in the future to repay the National Flood Insurance Program's remaining debt.[69] Due to its financial challenges, the National Flood Insurance Program has been on GAO's High-Risk List since 2006.[70]

More complete information on programs for which costs are likely to increase due to climate change, such as disaster assistance, could help policymakers better understand the long-term effects of decisions and the trade-offs between spending with long-term benefits, such as resilience investments, and short-term benefits, such as post-disaster repairs. This information could also help the federal government develop a government-wide strategy for addressing climate change that focuses on reducing federal fiscal exposure.

We have identified a number of ways to reduce the federal fiscal risk related to natural disasters. For example:

> **Updating the methodology for major disaster declarations.** In 2012, we recommended that FEMA develop and implement an updated methodology that provides a more comprehensive assessment of a jurisdiction's capacity to respond to and recover

[67]We have suggested an alternative way to record insurance commitments in the budget such that the federal government's commitment would be more fully recognized. See GAO, *Fiscal Exposures: Federal Insurance and Other Activities that Transfer Risk or Losses to the Government*, GAO-19-353 (Washington, D.C.: Mar. 27, 2019).

[68]Additional Supplemental Appropriations for Disaster Relief Requirements Act, 2017, Pub. L. No. 115-72, § 308, 131 Stat. 1224, 1228-29 (2017). For more information on the National Flood Insurance Program, see GAO-19-157SP, 272.

[69]GAO, *Flood Insurance: Comprehensive Reform Could Improve Solvency and Enhance Resilience*, GAO-17-425 (Washington, D.C.: Apr. 27, 2017).

[70]GAO-19-157SP, 272.

from a disaster without federal assistance.[71] FEMA has not implemented our recommendation, but the Disaster Recovery Reform Act of 2018 (DRRA) requires FEMA to initiate rulemaking to (1) update the factors considered when evaluating requests for major disaster declarations, including reviewing how FEMA estimates the cost of major disaster assistance; and (2) consider other impacts on the capacity of a jurisdiction to respond to disasters, by October 2020.[72] Until FEMA implements a new methodology, the agency will not have an accurate assessment of a jurisdiction's capabilities and runs the risk of recommending that the President award Public Assistance to jurisdictions that have the capacity to respond and recover on their own.

Strengthening resilience efforts. As we reported in October 2019, the federal government could reduce future costs by investing in climate resilience projects to help communities prepare for hazards such as sea-level rise.[73] However, the federal government does not have a strategy for prioritizing climate-adaptation projects with the most impact. For example, as we reported in April 2018, OMB reported only minimal funding since 1993 directed specifically at climate resilience projects.[74] Instead, most of the federal government's efforts to reduce disaster risk are reactive, and many revolve around disaster recovery. In response to our 2015 recommendation, a federal interagency body has created a strategy to help coordinate and align federal hazard mitigation efforts before and after disasters occur.[75] However, no federal agency, government-wide coordinating body, or other organizational arrangement has been established to periodically identify and prioritize climate resilience projects for federal

[71]GAO, *Federal Disaster Assistance: Improved Criteria Needed to Assess a Jurisdiction's Capability to Respond and Recover on Its Own*, GAO-12-838 (Washington, D.C.: Sept. 12, 2012).

[72]Pub. L. No. 115-254, div. D, § 1239, 132 Stat. 3186, 3466 (2018).

[73]GAO, *Climate Resilience: A Strategic Investment Approach for High-Priority Projects Could Help Target Federal Resources*, GAO-20-127 (Washington, D.C.: Oct. 23, 2019).

[74]GAO, *Climate Change: Analysis of Reported Federal Funding*, GAO-18-223 (Washington, D.C.: Apr. 20, 2018).

[75]In GAO-15-515 we recommended that the Mitigation Framework Leadership Group establish an investment strategy to identify, prioritize, and implement federal investments in disaster resilience.

investment that have the greatest expected net benefits and address the most significant climate risks.

Our past work and other sources highlight the importance of taking a broad, strategic, iterative, and risk-informed approach to managing this risk.[76] The federal government, however, has made little measurable progress on limiting its fiscal exposure to climate change.[77] Our Disaster Resilience Framework also provides information that can help federal agencies and policymakers consider opportunities across the government to promote and facilitate disaster risk reduction.[78]

Pre-disaster hazard mitigation. We also found that the bulk of federal disaster resilience funding provided to states and localities comes after they have experienced a disaster, particularly a large or catastrophic disaster.[79] The DRRA allows the President to set aside, with respect to each major disaster, 6 percent of certain Disaster Relief Fund grants to use for predisaster hazard mitigation.[80] In May 2019, FEMA announced that it is seeking public comments on the new program. FEMA anticipates issuing the first Notice of Funding Opportunity for this new program before the end of 2020. This new grant program will provide additional funding to make resilience investments before disaster strikes and could potentially help to reduce future risk.

[76]For more information on limiting the federal government's fiscal exposure by better managing climate change risks, see GAO-19-157SP, 110; GAO-20-317T; *Climate Change: Potential Economic Costs and Opportunities to Reduce Federal Fiscal Exposure*, GAO-20-338T (Washington, D.C.: Dec. 19, 2019).

[77]In GAO-20-127, we assessed the federal government's progress since 2017 related to climate change strategic planning against five criteria and found that the federal government had not met any of the criteria for removal from the high-risk list.

[78]GAO, *Disaster Resilience Framework: Principles for Analyzing Federal Efforts to Facilitate and Promote Resilience to Natural Disasters*, GAO-20-100SP (Washington, D.C.: Oct. 23, 2019).

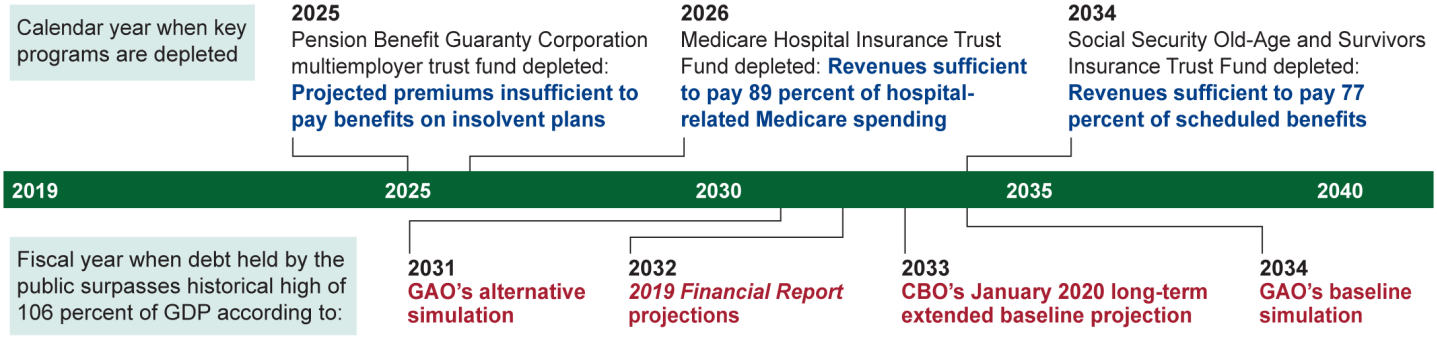
[79]GAO, *An Investment Strategy Could Help the Federal Government Enhance National Resilience for Future Disasters*, GAO-15-515 (Washington, D.C.: July 30, 2015).

[80]Pub. L. No. 115-254, div. D, § 1234, 132 Stat. at 3461-63.

Action Is Needed to Address an Unsustainable Fiscal Path

Impending financial challenges for major programs and fiscal risks are both straining the federal budget and contributing to the growing debt. Sustaining key programs will require changes (see figure 10).[81]

Figure 10: Key Dates for Major Programs and Future Debt



Sources: Pension Benefit Guaranty Corporation, Trustees for Social Security and Medicare, Congressional Budget Office (CBO), Centers for Medicare & Medicaid Services, GAO, and *Fiscal Year 2019 Financial Report of the U.S. Government (2019 Financial Report)*. | GAO-20-403SP

To change the long-term fiscal path, policymakers will need to consider policy changes to the entire range of federal activities, both revenue (including tax expenditures) and spending (entitlement programs, other mandatory spending, and discretionary spending).[82] One way to quantify the magnitude of the needed policy changes is by calculating the fiscal gap. The fiscal gap represents the difference between revenue and program spending (i.e., spending other than interest payments) that would need to be closed immediately and permanently to hold debt as a

[81]For more information on the general size, scope, and fiscal sustainability of federal trust funds and dedicated funds, see GAO, *Federal Trust Funds and Other Dedicated Funds: Fiscal Sustainability Is a Growing Concern for Some Key Funds,* GAO-20-156 (Washington, D.C.: Jan. 16, 2020).

[82]Tax expenditures are provisions of the tax code that reduce taxpayers' tax liability and therefore the amount of tax revenue paid to the government. Examples include tax credits, deductions, exclusions, exemptions, deferrals, and preferential tax rates.

share of GDP at the end of a given period the same as at the beginning of the period.

To close the gap, policymakers would need to reduce program spending, increase revenue, or, more likely, do both.[83] To illustrate this point, table 3 shows what it would take to maintain the debt held by the public as a share of GDP at the end of the 75-year projection period at its fiscal year 2019 level of 79 percent.

Table 3: Spending and Revenue Changes Needed to Close the Fiscal Gap over 75 Years

	Change needed to close fiscal gap over 75 years	
	Immediate program spending cut (no revenue increase)	**Immediate revenue increase (no spending cut)**
GAO alternative simulation	27.2 percent	37.8 percent
GAO baseline simulation	17.3 percent	21.2 percent
2019 Financial Report projections	17.4 percent	20.3 percent

Source: GAO and GAO analysis of Congressional Budget Office and *2019 Financial Report of the U.S. Government* data. | GAO-20-403SP

GAO, CBO, and the *2019 Financial Report* all note that the longer action is delayed, the greater and more drastic the changes will have to be, placing an additional burden on future generations.

Debt Limit Is Not a Control on Debt and Presents Risks to Treasury Securities: An Alternative Approach Is Needed

As Congress considers changes in revenue and spending policies to improve the federal government's long-term fiscal path, it will also need to consider alternative approaches for managing the level of debt. As currently structured, the debt limit is a legal limit on the total amount of federal debt that can be outstanding at one time. In other words, it only restricts Treasury's authority to borrow and finance the decisions already enacted by Congress and the President. It does not restrict Congress's ability to pass spending and revenue legislation that affects the level of debt, nor does it otherwise constrain fiscal policy. Without legislation to suspend or raise the debt limit, Treasury cannot continue issuing debt to finance the decisions already enacted by Congress and the President.[84]

[83]Program spending (also referred to as noninterest spending) includes both discretionary spending and mandatory spending, but does not include spending on interest on debt held by the public.

[84]The Bipartisan Budget Act of 2019 has suspended the debt limit through July 31, 2021. Pub. L. No. 116-37, § 301, 133 Stat. 1049, 1057 (2019).

Delays in raising the debt limit have occurred in each of the last 9 fiscal years, resulting in Treasury deviating from its normal cash and debt management operations and taking extraordinary actions to avoid exceeding the debt limit, such as suspending investments to some federal employees' retirement funds.[85] Once all of the extraordinary actions are exhausted, Treasury may not issue debt without further action from Congress and could be forced to delay payments until sufficient funds become available. Treasury could eventually be forced to default on legal debt obligations. A default would have devastating effects on U.S. and global economies and the public. It is generally recognized that a default would prevent the government from honoring all of its obligations to pay for such things as program benefits; contractual services and supplies; employees' salaries, wages, and retirement benefits; and principal on maturing securities.

One cannot overstate the importance of preserving investors' confidence that debt backed by the full faith and credit of the U.S. government will be honored. The perceived safety of Treasury securities supports broad-based demand for U.S. government debt. Many investors accept low yields on Treasury securities because they are considered one of the safest assets in the world. This enables Treasury to keep borrowing costs low. Failure to increase (or suspend) the debt limit in a timely manner could undermine investors' perception of the safety of Treasury securities, resulting in serious negative consequences for the Treasury market and increase borrowing costs.

Our work has shown that, in the past, uncertainty around whether the debt limit would be raised or suspended has increased Treasury's borrowing costs, decreased demand for Treasury securities, and constrained Treasury's ability to manage its operating cash balance. We estimated the total increased borrowing costs incurred through September 30, 2014 on securities issued by Treasury during the 2013 debt limit impasse ranged from roughly $38 million to more than $70 million.[86] Investors reported that during this impasse they took the unprecedented action of systematically avoiding certain Treasury

[85]Extraordinary actions are actions that Treasury takes as it nears the debt limit to avoid exceeding the limit. These actions are not part of Treasury's normal cash and debt management operations. For more information, see GAO, *Debt Limit: Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, GAO-15-476 (Washington, D.C.: July 9, 2015).

[86]GAO-15-476.

securities—those that matured around the dates when Treasury projected it would exhaust extraordinary actions. For these securities, interest rates increased dramatically and liquidity declined in the secondary market, where securities are traded among investors. In 2019, 48 out of 67 (72 percent) of investors we surveyed reported that they would take similar action to manage potential market disruptions caused by any future debt limit impasses.[87]

We have reported numerous times that the full faith and credit of the United States must be preserved. We have recommended that Congress consider alternative approaches to the current debt limit to avoid seriously disrupting the Treasury market and increasing borrowing costs and to allow it to better manage the federal government's level of debt.[88]

In July 2015, through a forum with experts in the field, we identified three options that would enable Congress to delegate its borrowing authority, avoid impasses on the debt limit, and minimize disruptions to the Treasury securities market:

- Option 1: Link action on the debt limit to the budget resolution.
- Option 2: Provide the administration with the authority to propose a change in the debt limit that would take effect absent enactment of a joint resolution of disapproval within a specified time frame.
- Option 3: Delegate broad authority to the administration to borrow as necessary to fund enacted laws.[89]

Each of these options has strengths and weaknesses but would maintain Congressional control and oversight of federal borrowing and better align decisions about the level of debt with decisions on spending and revenue.

[87]The survey sample represented the following 10 sectors: commercial banks; broker-dealers; casualty insurance providers; life insurance providers; state and local government retirement funds; private pension funds; state and local governments; mutual funds and exchange-traded funds; money market funds; and nonfinancial corporations. For more information see GAO-20-131.

[88]See most recently GAO-20-131 and GAO, *The Nation's Fiscal Health: Actions Needed to Achieve Long-Term Fiscal Sustainability*, GAO-19-611T (Washington, D.C.: June 26, 2019).

[89]More detail about these ideas and a discussion of the advantages and challenges to each can be found in GAO-15-476.

We did not endorse a specific option, but we suggested Congress consider such approaches.

As of March 2020, Congress is considering legislation that, if enacted, could help avoid impasses on the debt limit. For example, Senate Bill 2765 includes a provision that would automatically adjust the debt limit to conform to levels established in the budget resolution. It also includes provisions to require budget resolutions ever 2 years rather than annually and to allow budget resolutions that meet certain criteria to be considered in the Senate using expedited procedures. This bill has been reported out of committee but has not passed the Senate.[90]

Other legislation has been introduced that, if enacted, could help avoid impasses on the debt limit, but these bills have not been voted out of committee. For example, Senate Bill 444 would allow the President to increase the debt limit unless a joint resolution of disapproval is both passed by Congress and becomes law,[91] and Senate Bill 623 would allow Treasury to issue debt in excess of the debt limit under certain circumstances.[92]

Fiscal Rules Can Help Control Debt

A long-term plan is needed to put the government on a sustainable fiscal path. Such a step would provide a focus on the fiscal impacts of budget decisions and would help maintain the status of Treasury securities as one of the safest assets in the world.

As part of this long-term plan, fiscal rules can support efforts to achieve fiscal sustainability by imposing numerical limits on the budget (known as targets) to guide fiscal policy. In contrast to the debt limit, fiscal rules are intended to influence decisions about spending and revenue as they are made. Fiscal rules have been used at both the national government level in the United States and other countries, as well as at the supranational level, such as the European Union (EU), to help promote fiscal responsibility and sustainability. Congress could consider additional fiscal

[90]Bipartisan Congressional Budget Reform Act, S. 2765, title II, § 202(e)(5), 116th Cong. (2019).

[91]Protect our CREDIT Act, S. 444, 116th Cong. (2019).

[92]Default Prevention Act, S. 623, 116th Cong. (2019).

rules as part of a broader, long-term plan to put the government on a sustainable fiscal path.[93]

Other Countries' Experiences with Fiscal Rules

According to experts at the International Monetary Fund (IMF) and the Organization for Economic Co-operation and Development (OECD), several types or combinations of fiscal rules have the potential to contribute to fiscal sustainability (see table 4).

Table 4: Types of Fiscal Rules

Type of rule[a]	Description
Budget balance rule	Constrains deficit levels and specifies that the debt-to-gross domestic product (GDP) ratio converges to a defined finite level.
Debt rule	Sets an explicit limit or target for debt held by the public as a share of GDP.
Revenue rule	Sets ceilings or floors on revenues and aims to increase revenue collection or prevent excessive tax burdens.
Expenditure rule	Limits spending, typically in absolute terms or growth rates and occasionally as a percent of GDP.

Source: GAO analysis of the Organization for Economic Co-operation and Development (OECD) and International Monetary Fund (IMF) reports. | GAO-20-403SP

[a]Types of rules are identified by the OECD and IMF. OECD researchers identified an additional type of rule, but we chose to highlight the four rules that both organizations have in common.

Governments can use a combination of fiscal rules to address shortcomings of any one individual rule. According to the IMF, as of 2015, more than 70 countries had combined two or more fiscal rules, and most countries that use fiscal rules today have more than one in place. For example, at the supranational level, the EU's stability and growth pact combines an expenditure rule, budget balance rule, and a debt rule (e.g., debt-to-GDP), which are designed to ensure that countries in the EU pursue sound public finances and coordinate their fiscal policies. The pact permits sanctions against member states that fail to comply with these fiscal rules. In recent years, however, several EU nations have struggled to meet the targets set forth in the agreement.

Economic literature notes that governments have designed mechanisms to enhance the flexibility or enforceability of fiscal rules. For example:

[93]At the request of the Chairman of the Senate Budget Committee and Ranking Member of the House Budget Committee, we are examining the design, implementation, and enforcement of fiscal rules and targets in other countries.

- Many fiscal rules include escape clauses, which allow for a level of flexibility in responding to fiscal risks or unexpected events like recessions or natural disasters.
- Other fiscal rules include features such as independent fiscal councils, which are institutions that can help formulate and implement sound fiscal policy, and constitutional mandates, which codify the rule in a country's constitution with the intent of making it more difficult to reverse or abandon.
- Some countries choose to use automatic correction mechanisms, which are designed to trigger automatically to respond to past deviations from a rule.

International economic organizations have found that fiscal rules can be associated with successful efforts to stabilize debt. However, empirical evidence on national fiscal rules suggests that while fiscal rules may improve balance sheets, the correlation is weaker between fiscal rules and reductions in the debt-to-GDP ratio. U.S. state and local governments have also used fiscal rules.

In general, observers and budget experts have noted that success depends on effective enforcement of fiscal rules and sustained commitment by both policymakers and the public. Experts believe that, if governments try to subvert fiscal rules through creative accounting, it could undermine credibility or transparency.

The Federal Government's Experience with Fiscal Rules

The federal government has previously enacted fiscal rules in the form of laws that constrain and enforce fiscal policy decisions. These experiences illustrate the challenge in designing rules that are both achievable and effective in addressing the key drivers of the nation's growing debt. For example, the Statutory Pay-As-You-Go Act of 2010 prohibits the net effect of new direct spending and revenue laws from increasing the deficit but does not control discretionary spending or the growth in spending resulting from previously enacted laws.[94] In addition, the Budget Control Act of 2011 (BCA) imposes caps on annual discretionary spending through 2021, although the caps exclude emergencies and overseas contingency operations.[95] However, since 2013 Congress and the President have enacted legislation that resulted in raised discretionary

[94]Pub. L. No. 111-139, 124 Stat. 8 (2010).

[95]Pub. L. No. 112-25, 125 Stat. 240 (2011).

spending caps every year and have not reached agreement on required deficit reductions.[96] A number of other previously enacted fiscal rules similarly placed limits on the deficit and spending but are no longer in effect.

The federal government's experience with these fiscal rules provides insights that can inform fiscal policy deliberations:

- **Targeting the right factors.** To reduce the deficit and debt effectively, policymakers will need to examine the factors that have the greatest impact on the government's fiscal condition and structure any fiscal rules and targets to reflect these factors. For example, in the long term, the spending trajectory is driven by federal spending on health care programs and on interest on debt held by the public, which results from previously enacted laws. Since the fiscal gap is driven by both spending and revenue laws, it is important for future fiscal rules to target all spending (entitlement programs, other mandatory spending, and discretionary spending) and revenues.
- **Enforcing budget agreements.** Budget procedures are more effective at enforcing deficit reduction agreements than at forcing Congress to reach those agreements.
- **Limiting exemptions.** Since the BCA has been in effect, hundreds of billions of dollars in discretionary budget authority have been provided in areas that do not count toward BCA spending limits. Specifically, the BCA allows its spending limits to be adjusted for certain categories such as emergency appropriations and appropriations for overseas contingency operations.[97] While the government needs flexibility to address unforeseen events, it is important to design fiscal rules that can be adhered to absent a crisis.

During the current Congress, legislation has been proposed that, if enacted, would change the Congressional budget process. Senate Bill 2765 would specify target ratios for debt as a share of GDP and enforce

[96]For example, the Bipartisan Budget Act of 2019 raised discretionary spending caps for fiscal years 2020 and 2021.

[97]For more information on overseas contingency operations spending, see GAO, *Overseas Contingency Operations: Alternatives Identified to the Approach to Fund War-Related Activities,* GAO-19-211 (Washington, D.C.: Jan. 28, 2019).

these targets through a reconciliation process.[98] Specifically, Congress would set targets in the budget resolution, and CBO would evaluate adherence to the targets. If CBO determines that deficits as a share of GDP in the final year of the budget resolution will not be achieved, then Congress would be required to develop and consider expedited reconciliation procedures, so the projected deficit as a share of GDP adheres to the target.[99]

Executive Agencies Have Opportunities to Contribute toward Fiscal Health

Changes in spending and revenue to ensure long-term fiscal sustainability require legislative actions to alter fiscal policies, but in our prior work we have also identified numerous actions for executive agencies to contribute toward a sustainable fiscal future. Although executive actions alone cannot put the U.S. government on a sustainable fiscal path, it is important for agencies to act as stewards of federal resources.

Reduce Improper Payments: Agencies Need to Curtail Billions in Improper Payments

Improper payments—payments that should not have been made or that were made in an incorrect amount[100]—have consistently been a

[98]Bipartisan Congressional Budget Reform Act, S. 2765, title I, § 104, 116th Cong. (2019).

[99]Bipartisan Congressional Budget Reform Act, S. 2765, title IV, § 401, 116th Cong. (2019).

[100]Under the Improper Payments Information Act of 2002 (IPIA), as amended, an improper payment is statutorily defined as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. OMB guidance also provides that when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment.

government-wide issue.[101] Since fiscal year 2003—when certain agencies were required by statute to begin reporting estimated improper payments for certain programs and activities—cumulative improper payment estimates have totaled almost $1.7 trillion.[102]

For fiscal year 2019, agencies reported total improper payment estimates of about $175 billion, compared to about $151 billion for fiscal year 2018. For example, for fiscal year 2019, the Medicaid program reported an increase of estimated improper payments in excess of $21 billion. For fiscal year 2019, 79 programs and activities across 17 agencies reported improper payment estimates and 22 of those programs and activities reported improper payment rates estimated at 10 percent or greater. In addition, 15 programs and activities across 7 agencies reported improper payment estimates greater than $1 billion (see table 5):

[101]We have reported improper payments as a material deficiency or material weakness in internal control in our audit reports on the U.S. government's consolidated financial statements since fiscal year 1997. See GAO-20-315R for our audit report on the fiscal year 2019 statements. Since the conclusion of our audit work, Congress and the President have enacted the Payment Integrity Information Act of 2019 (PIIA). Pub. L. No. 116-117, __ Stat. __ (Mar. 2, 2020). This statute repealed IPIA, the Improper Payments Elimination and Recovery Act of 2010 (IPERA), and the Improper Payments Elimination and Recovery Improvement Act of 2012; instead, it enacted a new Subchapter in Title 31 of the U.S. Code that contains enhancements to improper payments law. Enhancements include more detailed requirements for agency risk assessments and improper payment estimates, a requirement that OMB report an annual government-wide estimate, and a process for clearer and more consistent reporting on programs that do not comply with improper payments criteria. This law also establishes an interagency working group on payment integrity.

[102]Not all agencies are subject to IPIA, as amended; the law only applies to departments, agencies, or instrumentalities in the executive branch of the U.S. government. Prior-year improper payment estimates have not been adjusted for inflation.

Table 5: Programs and Activities with Estimates of Improper Payments Exceeding $1 Billion in Fiscal Year 2019

Agency	Program(s) and Activities
Department of Health and Human Services	Medicaid, Medicare Fee-for-Service, Medicare Part C, and Children's Health Insurance Program
Department of Veterans Affairs	Community Care, and Purchased Long-Term Services and Support
Social Security Administration	Old-Age, Survivors, and Disability Insurance; and Supplemental Security Income
Department of the Treasury	Earned Income Tax Credit, Additional Child Tax Credit, and American Opportunity Tax Credit
Department of Agriculture	Supplemental Nutrition Assistance Program, and National School Lunch Program
Department of Labor	Unemployment Insurance
Department of Defense	Military Pay

Source: GAO analysis of Office of Management and Budget data and agency financial reports for fiscal year 2019. | GAO-20-403SP

To address the issue of improper payments, agencies should first identify the root causes of improper payments and then implement internal controls aimed at both prevention and detection. However, the government's ability to understand the scope of the issue is hindered by incomplete, unreliable, or understated estimates; risk assessments that may not accurately assess the risk of improper payment; and noncompliance with criteria listed in the Improper Payments Elimination and Recovery Act of 2010 (IPERA).[103] In addition, certain federal programs and activities determined by the agencies, OMB, or federal law[104] as risk-susceptible did not report estimates of improper payments

[103]Pub. L. No. 111-204, § 3, 124 Stat. 2224, 2232 (2010). As noted above, PIIA has repealed IPERA. PIIA's provision regarding compliance with improper payments criteria is codified at 31 U.S.C. § 3353.

[104]For fiscal year 2019, the Department of Labor reported that it did not report an improper payment estimate for the National Disaster Workforce Grants program and the Department of Homeland Security reported that it did not report improper payment estimates for 10 disaster relief programs. These programs were subject to improper payment reporting because in fiscal year 2017 or 2018, or both, they received supplemental appropriations for disaster relief and expended more than $10 million of such funds in one fiscal year, thus meeting the appropriations' criteria for determining programs' susceptibility to significant improper payments for the purposes of IPIA. See Additional Supplemental Appropriations for Disaster Relief Requirements Act, 2017, Pub. L. No. 115-72, div. A, § 305(b), 131 Stat. 1224, 1228 (Oct. 26, 2017), as amended by the Further Additional Supplemental Appropriations for Disaster Relief Requirements Act, 2018, Pub. L. No. 115-123, div. B, §§21207, 21208(a)(2), (b), 132 Stat. 64, 108 (Feb. 9, 2018).

for fiscal year 2019, including the Premium Tax Credit and Temporary Assistance for Needy Families, among others.

In addition, DOD lacks quality assurance procedures to ensure the completeness and accuracy of the payment populations from which it develops improper payment estimates.[105] Further, various inspectors general reported their respective agencies had deficiencies related to compliance with the criteria listed in IPERA.[106] Our work has identified a number of strategies and specific actions agencies can take to reduce improper payments, which could yield significant savings and help ensure that taxpayer funds are adequately safeguarded. For example,

- **Amendments to the Social Security Act.** We have suggested that Congress consider amending the Social Security Act to explicitly allow the Social Security Administration to share its full death data with Treasury's Do Not Pay working system for data matching.[107] As of February 2020, no relevant legislation has been enacted to amend the Social Security Act in this manner.
- **Improvements to agency estimates**. In May 2018, we recommended OMB develop guidance to help ensure agencies' estimating processes for identifying improper payments reflect key risks, for example whether a payee is ineligible for a payment.[108] As of February 2020, OMB has not implemented this recommendation.

[105]In May 2013, we reported on major deficiencies in DOD's process for estimating fiscal year 2012 improper payments in the Defense Finance and Accounting Service Commercial Pay program, including deficiencies in identifying a complete and accurate population of payments; see GAO, *DOD Financial Management: Significant Improvements Needed in Effort to Address Improper Payment Requirements*, GAO-13-227 (Washington, D.C.: May 13, 2013). The foundation of reliable statistical sampling estimates is a complete, accurate, and valid population from which to sample. As of June 2019, DOD's efforts to establish and implement key quality assurance procedures to ensure the completeness and accuracy of sampled populations were still in progress.

[106]The most recent inspectors general reports on compliance with the criteria listed in IPERA were issued in 2019 for fiscal year 2018.

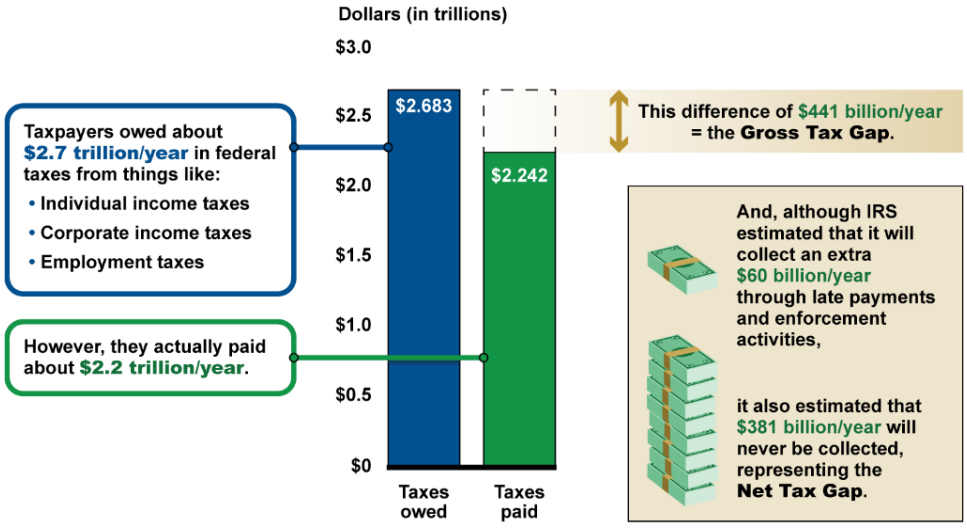
[107]GAO, *Improper Payments: Strategy and Additional Actions Needed to Help Ensure Agencies Use the Do Not Pay Working System as Intended*, GAO-17-15 (Washington, D.C.: Oct. 14, 2016).

[108]GAO, *Improper Payments: Actions and Guidance Could Help Address Issues and Inconsistencies in Estimation Processes*, GAO-18-377 (Washington, D.C.: May 31, 2018).

Address the Persistent Tax Gap: Opportunities to Increase Revenues Require Strategies on Multiple Fronts

The tax gap is the difference between tax amounts that taxpayers owe and what they actually pay voluntarily and on time (see figure 11). Given the size of the tax gap, even modest reductions would yield significant financial benefits and help improve the government's fiscal condition.

Figure 11: The Internal Revenue Service (IRS) Average Tax Gap Estimate for Tax Years 2011–2013

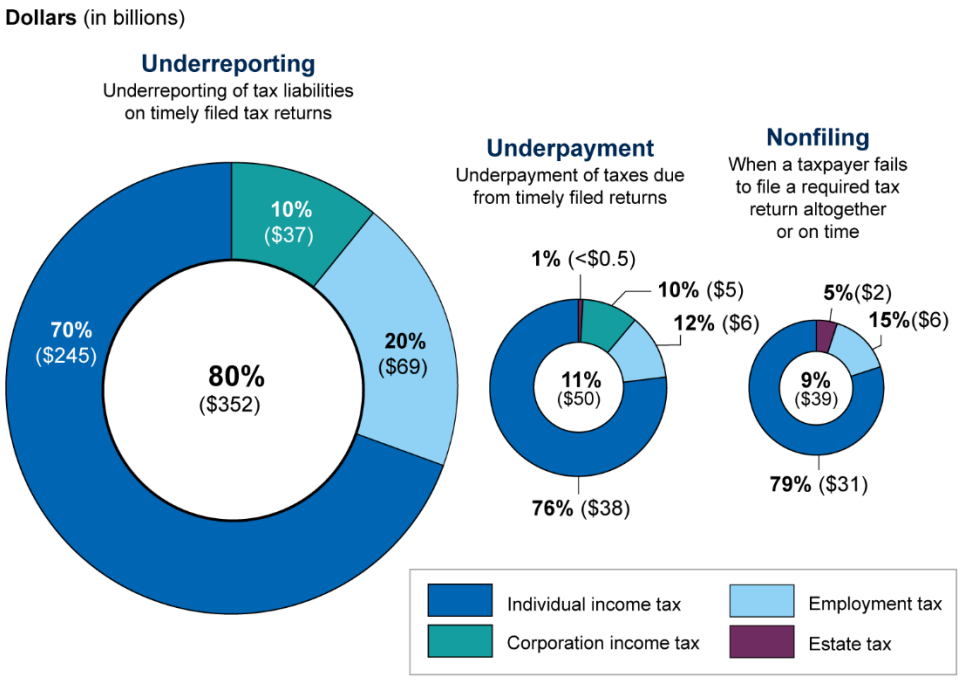


Source: GAO analysis of Internal Revenue Service (IRS) data. | GAO-20-403SP

Note: IRS released its most recent tax gap estimate in September 2019 for tax years 2011 to 2013.

The tax gap arises when taxpayers, whether intentionally or inadvertently, fail to (1) accurately report tax liabilities on tax returns (underreporting), (2) pay taxes due from filed returns (underpayment), or (3) file a required tax return altogether or on time (nonfiling). Underreporting accounted for 80 percent of the tax gap across tax years 2011 to 2013, as shown in figure 12.

Figure 12: Estimated Average Annual Gross Tax Gap by Type of Noncompliance and Tax, Tax Years 2011-2013



Source: GAO analysis of Internal Revenue Service (IRS) data. | GAO-20-403SP

Note: Data may not sum to totals because of rounding. Individual income tax includes individual business income tax. Estate tax underreporting noncompliance is not shown in this graphic because it represents less than one-half percent of total underreporting noncompliance. Excise tax is not shown in this graphic because the IRS does not have excise tax underreporting noncompliance or nonfiling noncompliance estimates, and its estimate for excise tax underpayment noncompliance represents less than one-half percent of total underpayment noncompliance. In addition, IRS does not have a corporation income tax estimate for nonfiling noncompliance.

This persistent issue has been on our High-Risk List since its inception in 1990.[109] Key factors that contribute to the tax gap include limited third-party reporting, challenges with customer service, and tax code complexity. For example, the extent to which individual taxpayers accurately report their income is correlated with the extent to which the income is reported to them and IRS by third parties. Where there is little or no information reporting, such as with business income, taxpayers tend to significantly misreport their income.

[109]For more information on addressing the tax gap, see GAO-19-157SP, 235.

Reducing the gap will be a challenging task requiring action on multiple fronts. Our work has identified a number of strategies and specific actions IRS and Congress can take to reduce the tax gap. For example, we recommended that IRS develop and document a strategy that outlines how IRS will use data to update compliance strategies.[110] We have also previously made recommendations to IRS aimed at enhancing taxpayer services and determining resource allocation strategies for its enforcement efforts, among others.[111] IRS has not yet fully implemented many of these recommendations. We have also previously suggested targeted legislative actions such as expanding third-party information reporting and regulating paid preparers.[112]

Agencies Could Aid Fiscal Decision-Making by Providing Improved Information on Programs and Fiscal Operations

As we reported in October 2019, the federal government has made significant strides in improving financial management since enactment of

[110]See GAO, *Tax Gap: Multiple Strategies Are Needed to Reduce Noncompliance,* GAO-19-558T (Washington, D.C.: May 9, 2019) and *Tax Gap: IRS Needs Specific Goals and Strategies for Improving Compliance*, GAO-18-39 (Washington, D.C.: Oct. 31, 2017). Likewise, we recommended that IRS develop and document plans to use employment tax compliance data to estimate the current state of the employment tax portion of the tax gap. See GAO, *Employment Taxes: Timely Use of National Research Program Results Would Help IRS Improve Compliance and Tax Gap Estimates,* GAO-17-371 (Washington, D.C.: Apr. 18, 2017).

[111]See GAO, *Tax Fraud and Noncompliance: IRS Could Further Leverage the Return Review Program to Strengthen Tax Enforcement,* GAO-18-544 (Washington, D.C.: July 24, 2018); *2016 Filing Season: IRS Improved Telephone Service but Needs to Better Assist Identity Theft Victims and Prevent Release of Fraudulent Refunds*, GAO-17-186 (Washington, D.C.: Jan. 31, 2017); *IRS Website: Long-Term Strategy Needed to Improve Interactive Services*, GAO-13-435 (Washington, D.C.: Apr. 16, 2013); *2012 Tax Filing: IRS Faces Challenges Providing Service to Taxpayers and Could Collect Balances Due More Effectively*, GAO-13-156 (Washington, D.C.: Dec. 18, 2012); and *Tax Gap: IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources*, GAO-13-151 (Washington, D.C.: Dec. 5, 2012).

[112]See GAO-14-453; *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors*, GAO-14-467T (Washington, D.C.: Apr. 8, 2014); *Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements*, GAO-09-238 (Washington, D.C.: Jan. 28, 2009); and *Tax Gap: Actions That Could Improve Rental Real Estate Reporting Compliance*, GAO-08-956 (Washington, D.C.: Aug. 28, 2008).

the Chief Financial Officers Act of 1990 (CFO Act).[113] Substantial progress has occurred in areas such as improved internal controls, reliable agency financial statements, and establishment of Chief Financial Officer (CFO) leadership positions. However, agencies also need to take action to provide decision makers with additional or improved information on the performance and costs of policies or programs. In particular, decision-making could be improved by increasing attention to tax expenditures and strengthening internal controls over financial reporting.

Increased attention to tax expenditures. Tax expenditures are provisions of the tax code that reduce taxpayers' tax liability and therefore the amount of tax revenue paid to the government. Examples include tax credits, deductions, exclusions, exemptions, deferrals, and preferential tax rates. Tax expenditures seek to advance goals that may be similar to the goals of mandatory or discretionary spending programs. In fiscal year 2019, tax expenditures reduced income tax revenues by approximately $1.32 trillion based on our calculation summing Treasury estimates for each tax expenditure.[114] According to unaudited information in the *2019 Financial Report*, the largest tax expenditure was related to employer-provided health insurance and represented an estimated $202 billion in reduced income tax revenue in fiscal year 2019.[115]

Although they are routinely used as a policy tool, tax expenditures are not regularly reviewed and their outcomes are not measured as closely as spending programs' outcomes. In September 2005, we recommended that OMB take actions to develop a framework for evaluating tax expenditure performance and to regularly review tax expenditures in

[113]GAO, *Federal Financial Management: Substantial Progress Made since the CFO Act of 1990 and Preliminary Observations on Opportunities for Enhancement*, GAO-20-203T (Washington, D.C.: Oct. 30, 2019).

[114]The sum of the specific tax expenditure estimates is useful for gauging the general magnitude of reduced revenue through provisions of the tax code, but aggregate tax expenditure estimates must be interpreted carefully. Summing revenue loss estimates does not take into account possible interactions between individual provisions or potential behavioral responses to changes in these provisions on the part of taxpayers. Additionally, Treasury's tax expenditure estimates include the effect of certain tax credits on receipts only and not the effect of the credits on outlays, which Treasury reports separately, but does not take into account interactions between individual provisions.

[115]Employees generally pay no income taxes on their employers' contributions to their health insurance premiums. The value of employer-provided health insurance and medical care expenses is also excluded from Medicare and Social Security payroll taxes, and Treasury estimated that the payroll tax revenue losses were $136.7 billion in 2019.

executive branch budget and performance review processes.[116] However, OMB has not reported progress on this action since the President's fiscal year 2012 budget.

In July 2016, we recommended that OMB work with agencies to identify which tax expenditures contribute to agency goals. OMB generally agreed but had taken no action as of December 2019.[117] Absent such analysis, policymakers have little way of knowing whether these tax provisions support achieving the intended federal outcomes. Policymakers also lack information to compare their cost and efficacy with other policy tools.[118]

Eliminating material weaknesses in internal control over financial reporting. Eliminating these weaknesses would improve the reliability of financial information and improve financial decision-making. The U.S. government's consolidated financial statements are intended to present the results of operations and the financial position and condition of the federal government as if the government were a single enterprise. Since the federal government began preparing consolidated financial statements more than 20 years ago, three major impediments have continued to prevent us from rendering an opinion on the federal government's accrual-based consolidated financial statements over this period: (1) serious financial management problems at DOD, (2) the federal government's inability to adequately account for intragovernmental activity and balances between federal entities, and (3) weaknesses in the federal government's process for preparing the consolidated financial statements.[119] Over the years, we have made a

[116]GAO, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, GAO-05-690 (Washington, D.C.: Sept. 23, 2005).

[117]GAO, *Tax Expenditures: Opportunities Exist to Use Budgeting and Agency Performance Processes to Increase Oversight,* GAO-16-622 (Washington, D.C.: July 7, 2016).

[118]For more information on our work on tax expenditures, see GAO, *Key Issues: Tax Expenditures*, accessed on March 11, 2019, https://www.gao.gov/key_issues/tax_expenditures/issue_summary.

[119]Bipartisan legislation has been introduced in both houses that, if enacted, would require the Congressional budget committees to conduct an annual joint hearing to receive a presentation from the Comptroller General of the United States regarding our audit of the financial statements of the U.S. government, and the financial position and condition of the federal government. As of February 2020, this legislation has not been voted out of committee. Fiscal State of the Nation Resolution, S. Con. Res. 35, 116th Cong. (2020); Fiscal State of the Nation Resolution, H. Con. Res. 68, 116th Cong. (2019).

number of recommendations to OMB, Treasury, and DOD to address these issues.[120] Generally, these entities have taken or plan to take actions to address these recommendations.

The material weaknesses in internal control underlying these three major impediments continue to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; (2) affect the federal government's ability to reliably measure the full cost, as well as the financial and nonfinancial performance, of certain programs and activities; (3) impair the federal government's ability to adequately safeguard significant assets and properly record various transactions; and (4) hinder the federal government from having reliable financial information to operate in an efficient and effective manner.

There are also a number of other areas where federal financial management could be enhanced as it relates to the CFO Act. These areas include modernizing the role of CFOs, preparing government-wide and agency-level financial management plans, and better linking performance and cost information for decision-making.[121] In February 2020, a bill was introduced in the Senate that would address these and other areas.[122]

Continue to Address Duplication, Overlap, and Fragmentation: Agencies Have the Potential to Achieve Billions in Financial Benefits for the Government

Since 2011, we have reported on federal programs, agencies, offices, and initiatives that have duplicative goals or activities as well as opportunities to achieve greater efficiency and effectiveness that result in cost savings or enhanced revenue collection. In our nine annual reports from 2011 through 2019, we presented about 900 actions for executive branch agencies or Congress to reduce, eliminate, or better manage fragmentation, overlap, or duplication; achieve cost savings; or enhance revenue. Actions taken by the executive branch and Congress on these issues have resulted in roughly $262 billion financial benefits since fiscal

[120]GAO, *Management Report: Improvements Needed in Controls over the Processes Used to Prepare the U.S. Consolidated Financial Statements*, GAO-19-624 (Washington, D.C.: Sept. 4, 2019). In addition, see GAO, *DOD Financial Management – High Risk Issue*, accessed on March 11, 2020, http://www.gao.gov/key_issues/dod_financial_management/issue_summary. Further, other auditors have made recommendations to DOD to improve DOD's financial management.

[121]See GAO-20-203T.

[122]CFO Vision Act of 2020, S. 3287, 116th Cong. (2019).

year 2010.[123] As of March 2019, about 54 percent of the actions were fully addressed, about 23 percent were partially addressed, and about 14 percent were not addressed.[124] We estimate that tens of billions of dollars in additional financial benefits are possible by fully implementing our recommended actions. See appendix II for more information on actions needed in these areas.

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Comptroller General of the United States

[123]The $262 billion includes about $216 billion from 2010 through 2018 and $46 billion projected to accrue in 2019 or later. In calculating these totals, we relied on individual estimates from a variety of sources, which considered different time periods and utilized different data sources, assumptions, and methodologies. These totals represent a rough estimate of financial benefits and have been rounded down to the nearest $1 billion.

[124]Nine percent of the actions have been consolidated or other—replaced or subsumed by new actions based on additional audit work or other relevant information—or closed as not addressed because the action is no longer relevant due to changing circumstances. For more information on our work on duplication, overlap, and fragmentation including cost-savings and revenue enhancements, see GAO, *2019 Annual Report: Additional Opportunities to Reduce Fragmentation, Overlap, and Duplication and Achieve Billions in Financial Benefits*, GAO-19-285SP (Washington, D.C.: May 21, 2019) and *Duplication & Cost Savings: Action Tracker*, updated on May 21, 2019, https://www.gao.gov/reports-testimonies/action-tracker.

Appendix I: Objectives, Scope, and Methodology

This report summarizing the fiscal health of the federal government was conducted under the authority of the Comptroller General. In this report, we discuss the federal government's fiscal condition and how it changed in fiscal year 2019, the federal government's unsustainable long-term outlook, and risks to the government's fiscal condition. We also discuss actions the federal government can take to achieve a more sustainable fiscal path as well as the potential consequences of not taking action.

To summarize the current fiscal condition and how it changed in fiscal year 2019, we reviewed:

- The *Fiscal Year 2019 Financial Report of the United States Government* (*2019 Financial Report*) prepared by the Secretary of the Treasury in coordination with the Director of the Office of Management and Budget,
- Congressional Budget Office (CBO) reports on the effects of legislation on its projections of the federal deficit, and
- Our prior work on federal debt.

For the federal government's long-term outlook, we reviewed projections from CBO's June 2019 long-term budget outlook report, CBO's January 2020 budget and economic outlook report, the Statements of Long-Term Fiscal Projections in the *2019 Financial Report*, and our long-term simulations of federal revenues and spending. Our two simulations are the extended baseline and the alternative. To conduct our simulations, we primarily used data from CBO and the Medicare and Social Security Trustees.

We chose the data and assumptions for our simulations to illustrate the nation's potential fiscal path under current law and current policy, and to complement CBO and *2019 Financial Report* projections included in this report.

- CBO's baseline (10-year) and extended baseline (30-year) projections generally reflect current law. For example, CBO assumes current tax provisions will generally remain unchanged, tax provisions will expire as scheduled, and provisions of the Patient Protection and Affordable

Care Act (PPACA)[1] and Medicare Access and CHIP Reauthorization Act of 2015 (MACRA) designed to control health care cost growth will be achieved and sustained over the long term.[2]

- GAO's extended baseline simulation uses CBO's estimates for the first 10 years and generally assumes current law continues into the future. For years beyond the 10th, the simulation assumes that revenues and discretionary spending remain at their 10th-year levels as shares of gross domestic product. It also uses health care spending projections from the Center for Medicare and Medicaid Services and Social Security spending projections from the Social Security Trustees.
- GAO's alternative simulation generally assumes historical and current policy conditions will continue in the future. For example, the simulation assumes some tax provisions do not expire as scheduled, PPACA and MACRA provisions to control health care cost growth are not sustained, and, in the long term, revenues and discretionary spending return to their historical averages as shares of gross domestic product.[3]
- *2019 Financial Report* projections generally assume that current policy will continue into the future. For example, individual income tax projections accord with current policy, including the extension of some expiring tax provisions of the law known as Tax Cuts and Jobs Act.[4] Projections also assume PPACA and MACRA cost growth provisions are sustained and remain effective.

[1]PPACA, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

[2]MACRA, Pub. L. No. 114-10, title I, § 101, 129 Stat. 87, 89 (Apr. 16, 2015).

[3]GAO's alternative simulation assumptions draw from the Centers for Medicare and Medicaid Services Office of the Actuary's 2019 illustrative alternative assumptions for health care cost growth. These assumptions assume that Medicare cost containment measures provided under PPACA and the physician payment rate methodology provided under MACRA are not sustained over the long term, leading to a substantial increase in health care costs.

[4]To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

For a more complete description of the assumptions and data for GAO's simulations, see https://www.gao.gov/assets/700/698366.pdf.[5]

To describe the risks to the federal government's fiscal condition, we drew from our audit report on the U.S. government's consolidated financial statements included in the 2019 Financial Report, our 2019 High-Risk List, our bodies of work in a number of areas, and relevant laws.

To identify actions the federal government can take to achieve a more sustainable fiscal path, we reviewed our prior work on the debt limit and the use of fiscal rules by both the United States and other countries. We also reviewed our prior reports on improper payments; the tax gap; tax expenditures; our audit report on the U.S. government's consolidated financial statements included in the *2019 Financial Report*; and our work on duplication, overlap, and fragmentation.

We conducted our work from October 2019 to March 2020 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this product.

[5]A description of CBO's methodology for its baseline projections is available in CBO, *How CBO Prepares Baseline Budget Projections* (Washington, D.C.: February 2018). A description of the assumptions and data for the *2019 Financial Report* projections is available in the *2019 Financial Report*, Note 23.

Appendix II: Near-Term Opportunities to Contribute Toward Fiscal Health from Addressing Fragmentation, Overlap, and Duplication

Since 2011, we have reported annually on federal programs, agencies, offices, and initiatives that have duplicative goals or activities as well as opportunities to achieve greater efficiency and effectiveness that result in cost savings or enhanced revenue collection.[1] We estimate tens of billions more dollars could be saved by fully implementing our open actions.[2] See table 6 for examples of areas with open actions with potential financial benefits of $1 billion or more.

Table 6: Examples of Areas with Open Actions with Potential Financial Benefits of $1 Billion or More

Area name and description (year-number links to Action Tracker)	Mission	Potential financial benefits[a] (source)
***Department of Energy's Treatment of Hanford's Low-Activity Waste** (2018-17): The Department of Energy (DOE) may be able to reduce certain risks by adopting alternative approaches to treating a portion of its low-activity radioactive waste. (GAO-17-306)	Energy	**Tens of billions** (GAO)
***Medicaid Demonstration Waivers** (2014-21): Federal spending on Medicaid demonstrations could be reduced if the Department of Health and Human Services were required to improve the process for reviewing, approving, and making transparent the basis for spending limits approved for Medicaid demonstrations. (GAO-08-87, GAO-13-384)	Health	**Tens of billions** (Centers for Medicare & Medicaid Services (CMS) and GAO)
***Advanced Technology Vehicles Manufacturing Loan Program** (2014-13): Unless DOE can demonstrate demand for new Advanced Technology Vehicles Manufacturing loans and viable applications, Congress may wish to consider rescinding all or part of the remaining credit subsidy appropriations. (GAO-14-343SP)	Energy	**Up to $4.3 billion** (DOE)
***Crop Insurance** (2013-19): Congress could consider limiting the subsidy for premiums that an individual farmer can receive each year from the Federal Crop Insurance program, reducing the subsidy, or some combination of limiting and reducing these subsidies and making changes to the program to reduce its delivery costs. (GAO-17-501, GAO-12-256)	Agriculture	**Up to $1.4 billion annually** (GAO)

[1]See GAO's Duplication and Cost Savings webpage for links to our annual reports: https://www.gao.gov/duplication/overview.

[2]In calculating our total estimated realized and potential financial benefits, we relied on individual estimates from a variety of sources, which considered different time periods and utilized different data sources, assumptions, and methodologies. These totals represent a rough estimate of financial benefits. Realized benefits have been rounded down to the nearest $1 billion. Estimated potential benefits are subject to increased uncertainty, depending on whether, how, and when they are addressed, and are presented using a notional statement of magnitude.

Area name and description (year-number links to Action Tracker)	Mission	Potential financial benefits[a] (source)
Medicare Clinical Laboratory Payments (2019-25): CMS should take steps to avoid paying more than necessary for clinical laboratory tests. (GAO-19-67)	Health	**Over $1 billion, or billions** (GAO)
***Medicare Payments by Place of Service** (2016-30): Medicare could have cost savings if Congress were to equalize the rates Medicare pays for certain health care services, which often vary depending on where the service is performed. (GAO-16-189)	Health	**Billions annually** (GAO)
Department of Energy Environmental Liability (2019-20): DOE could develop a program-wide strategy to improve decision-making on cleaning up radioactive and hazardous waste. (GAO-19-28)	Energy	**Billions** (GAO)
***Internal Revenue Service Enforcement Efforts** (2012-44): Enhancing the Internal Revenue Service enforcement and service capabilities can help reduce the tax gap between taxes owed and paid by collecting billions in tax revenue and facilitating voluntary compliance. (GAO-08-956, GAO-09-238, GAO-11-493, GAO-12176)	General government	**Billions** (GAO)
Tax Expenditures (2011-17): Periodic reviews could help identify ineffective tax expenditures and redundancies in related tax and spending programs, potentially reducing revenue losses. (GAO-16-622, GAO-15-83)	General government	**Billions** (GAO)

Legend: * = Legislation is likely to be necessary to fully address all actions in this area.

Source: GAO. | GAO-20-403SP

Note: All estimates of potential financial benefits are dependent on various factors, such as whether action is taken and how it is taken. Actual benefits may be less, depending on costs associated with implementing the action, unintended consequences, and the impact of other factors that could and should be controlled for. The individual estimates in this table should be compared with caution, as they come from a variety of sources, which consider different time periods and utilize different data sources, assumptions, and methodologies.

[a]GAO developed the notional estimates, which are intended to provide a sense of potential magnitude of financial benefits. Notional estimates have been developed using broad assumptions about potential benefits which are rooted in previously identified losses, the overall size of the program, previous experience with similar reforms, and similar rough indicators of potential benefits. GAO generally determine the notional label ("millions" vs. "tens of millions" vs. "hundreds of millions") using a risk-based approach that takes into account such factors as the possible minimum and maximum values of the financial benefits estimate (where available), the quality of the data underlying those values, the certainty of those values, and/or the rigor of the estimation method used.

Appendix III: GAO Contacts and Staff Acknowledgments

GAO Contacts

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