



U.S. Financial Condition and Fiscal Future Briefing

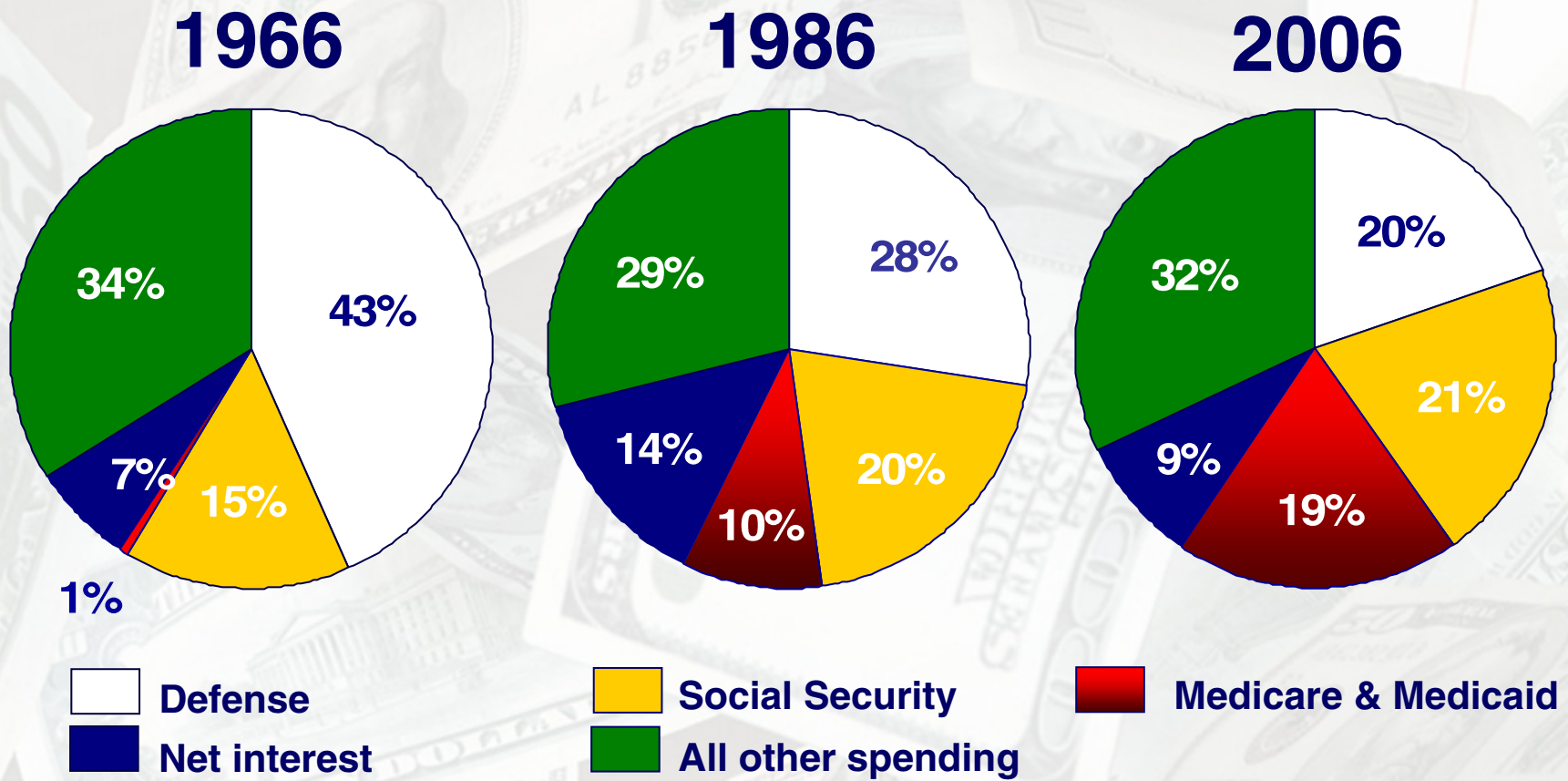
The Honorable David M. Walker
Comptroller General of the United States
The Center for Governmental Accounting
Education and Research's Annual Conference
Rutgers University
November 30, 2007

The Case for Change

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

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- Outdated federal organizational structures, policies, and practices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

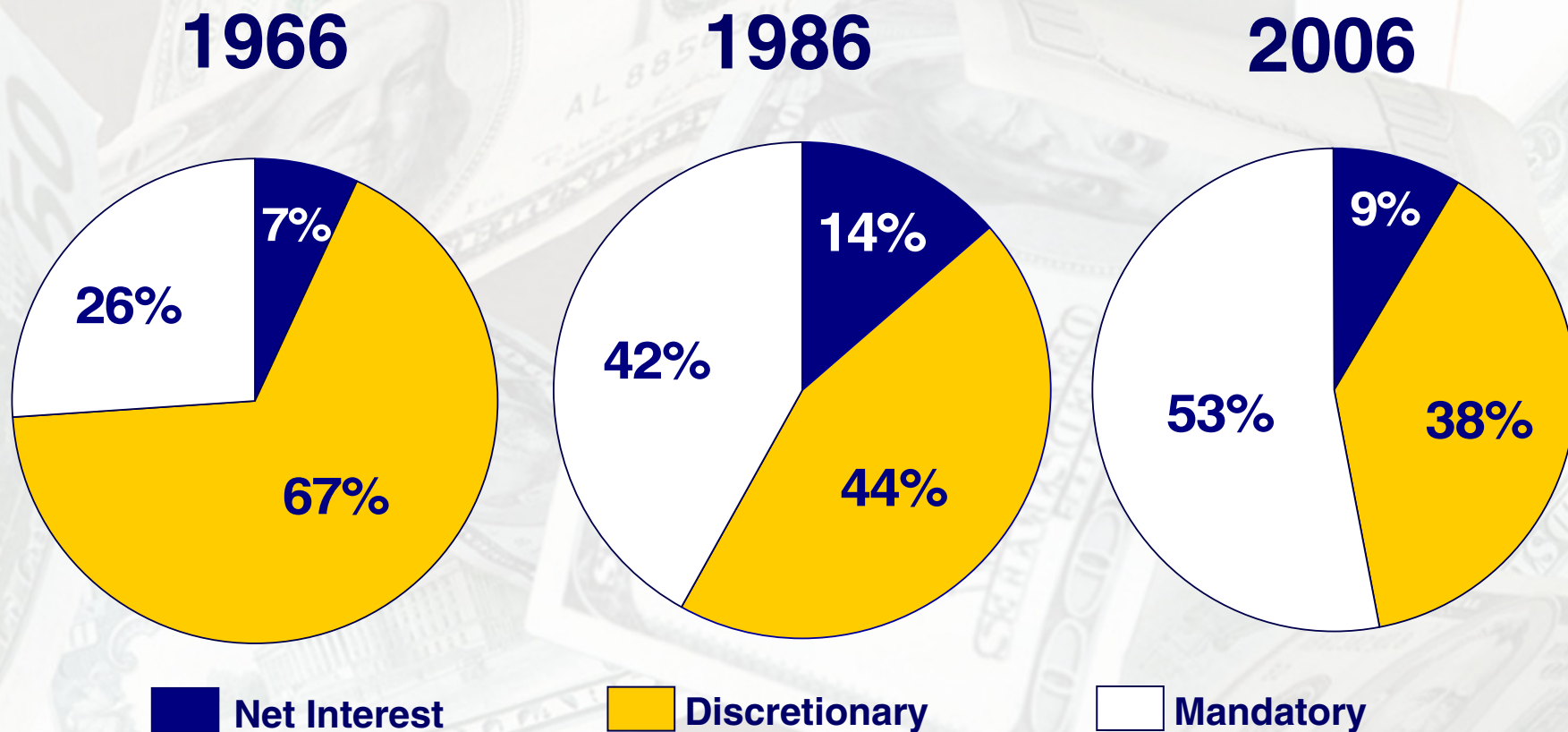
Composition of Federal Spending



Source: Office of Management and Budget.

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

Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

Fiscal Year 2005 and 2006 Deficits and Net Operating Costs

	Fiscal Year 2005	Fiscal Year 2006
	(\$ Billion)	
On-Budget Deficit	(494)	(434)
Unified Deficit^a	(318)	(248)
Net Operating Cost^b	(760)	(450)

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

^aIncludes \$173 billion in Social Security surpluses for fiscal year 2005 and \$185 billion for fiscal year 2006; \$2 billion in Postal Service surpluses for fiscal year 2005 and \$1 billion for fiscal year 2006.

^bFiscal year 2005 and 2006 net operating cost figures reflect significant but opposite changes in certain actuarial costs. For example, changes in interest rates and other assumptions used to estimate future veterans' compensation benefits increased net operating cost by \$228 billion in 2005 and reduced net operating cost by \$167 billion in 2006. Therefore, the net operating costs for fiscal years 2005 and 2006, exclusive of the effect of these actuarial cost fluctuations, were (\$532) billion and (\$617) billion, respectively.

Major Fiscal Exposures

(\$ trillions)

	2000	2006	% Increase
<ul style="list-style-type: none"> • Explicit liabilities 	\$6.9	\$10.4	52
<ul style="list-style-type: none"> • Publicly held debt • Military & civilian pensions & retiree health • Other 			
<ul style="list-style-type: none"> • Commitments & contingencies 	0.5	1.3	140
<ul style="list-style-type: none"> • E.g., PBGC, undelivered orders 			
<ul style="list-style-type: none"> • Implicit exposures 	13.0	38.8	197
<ul style="list-style-type: none"> • Future Social Security benefits 	3.8	6.4	
<ul style="list-style-type: none"> • Future Medicare Part A benefits 	2.7	11.3	
<ul style="list-style-type: none"> • Future Medicare Part B benefits 	6.5	13.1	
<ul style="list-style-type: none"> • Future Medicare Part D benefits 	--	7.9	
Total	\$20.4	\$50.5	147

Source: 2000 and 2006 Financial Report of the United States Government.

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

How Big is Our Growing Fiscal Burden?

This fiscal burden can be translated and compared as follows:

Total –major fiscal exposures	\$50.5 trillion
Total household net worth¹	\$53.3 trillion
Burden/Net worth ratio	95 percent
Burden²	
Per person	\$170,000
Per full-time worker	\$400,000
Per household	\$440,000
Income	
Median household income³	\$46,326
Disposable personal income per capita⁴	\$31,519

Source: GAO analysis.

Notes: (1) Federal Reserve Board, Flow of Funds Accounts, Table B.100, 2006:Q2 (Sept. 19, 2006); (2) Burdens are calculated using estimated total U.S. population as of 9/30/06, from the U.S. Census Bureau; full-time workers reported by the Bureau of Economic Analysis, in NIPA table 6.5D (Aug. 2, 2006); and households reported by the U.S. Census Bureau, in *Income, Poverty, and Health Insurance Coverage in the United States: 2005* (Aug. 2006); (3) U.S. Census Bureau, *Income, Poverty, and Health Insurance Coverage in the United States: 2005* (Aug. 2006); and (4) Bureau of Economic Analysis, *Personal Income and Outlays: October 2006*, table 2, (Nov. 30, 2006).

Potential Fiscal Outcomes

Under Baseline Extended (January 2001)

Revenues and Composition of Spending as a Share of GDP

Percent of GDP

50

40

30

20

10

0

Revenue

2005

2015^a

2030^a

2040^a

Fiscal year

■ Net interest

■ Social Security

■ Medicare & Medicaid

■ All other spending

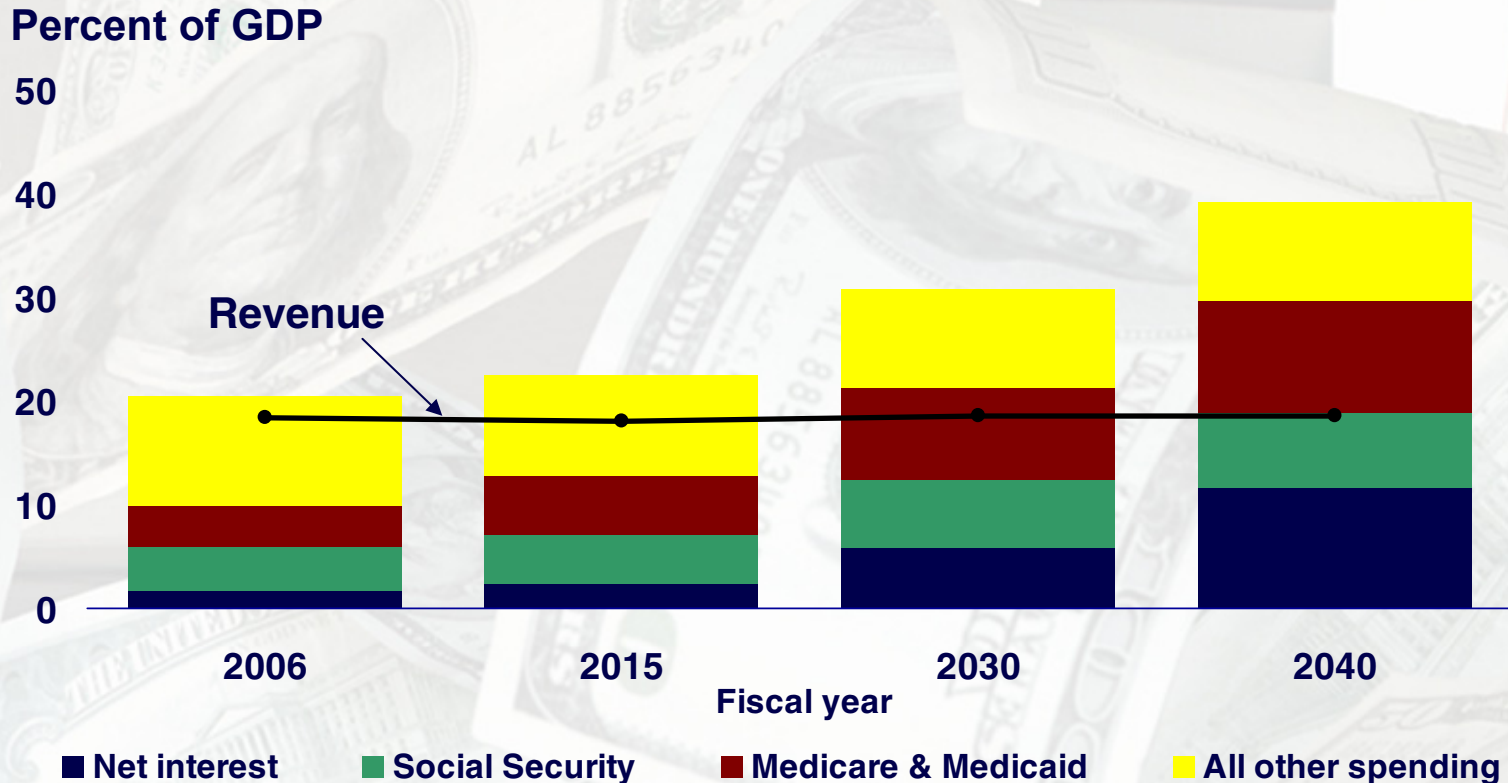
Source: GAO's January 2001 analysis.

^aAll other spending is net of offsetting interest receipts.

Potential Fiscal Outcomes

Under Alternative Simulation

Revenues and Composition of Spending as a Share of GDP

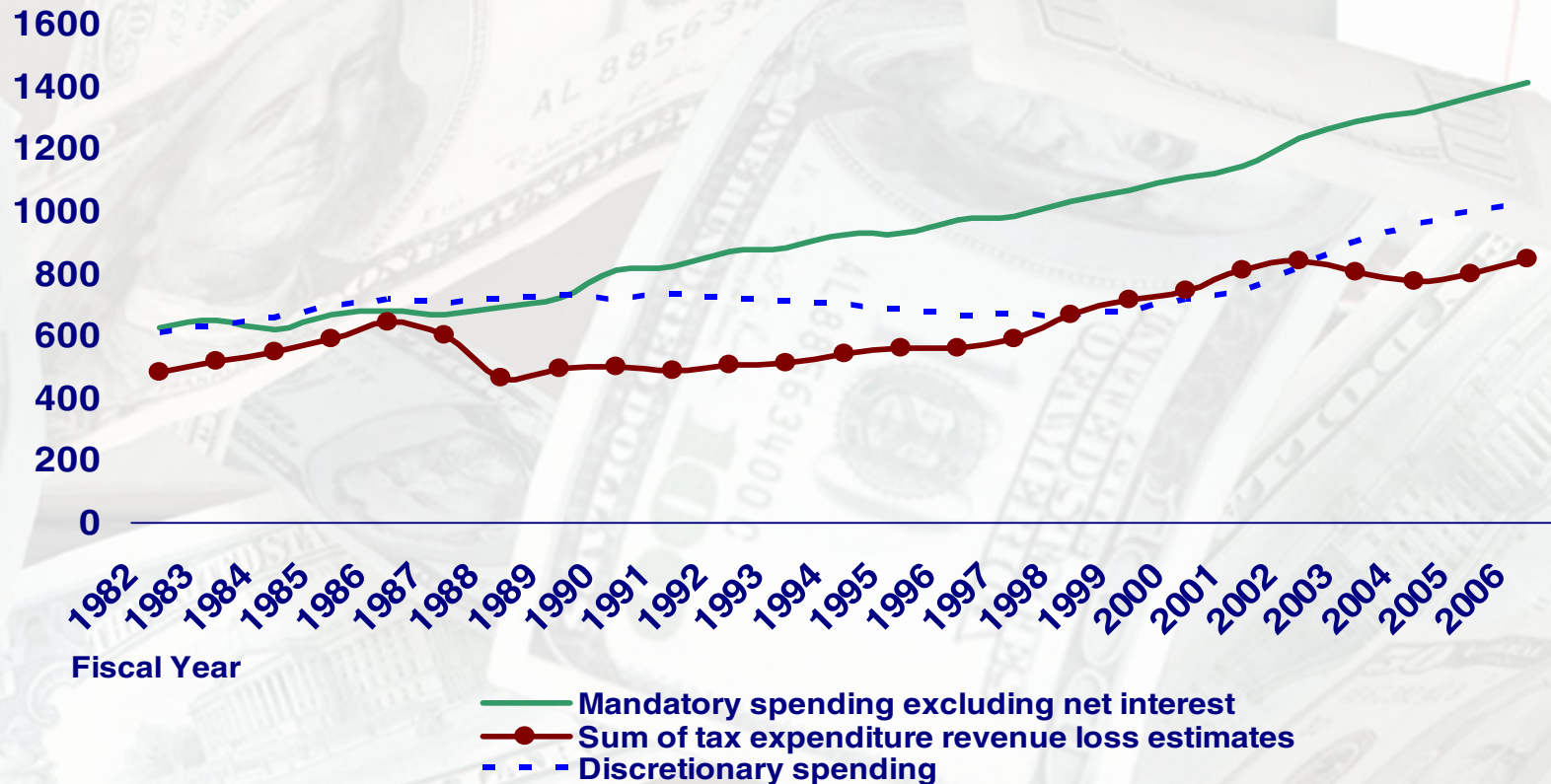


Source: GAO's August 2007 analysis.

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

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

Dollars in billions (in 2006 dollars)

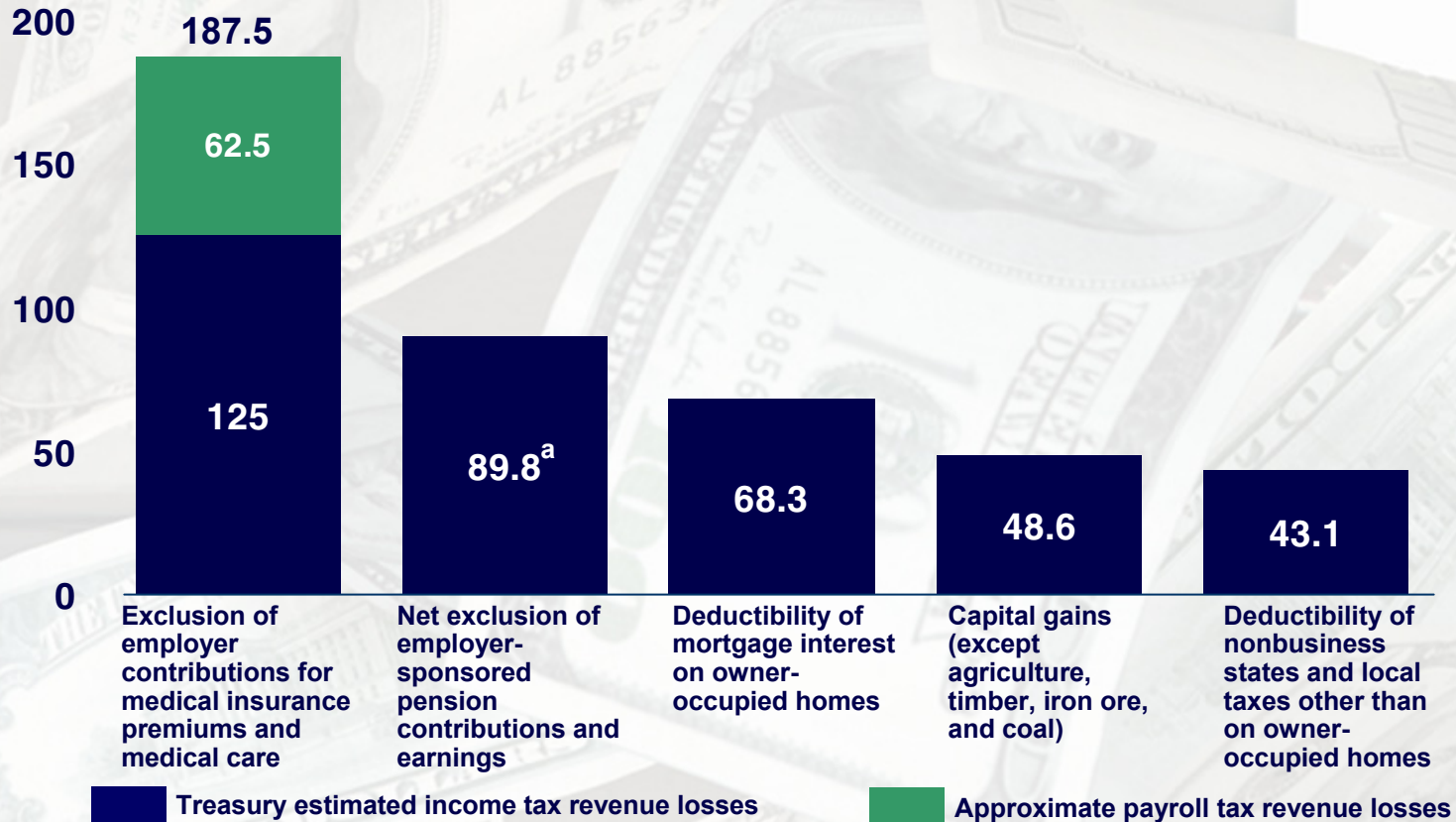


Source: GAO analysis of OMB budget reports on tax expenditures, fiscal years 1976-2008.

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

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

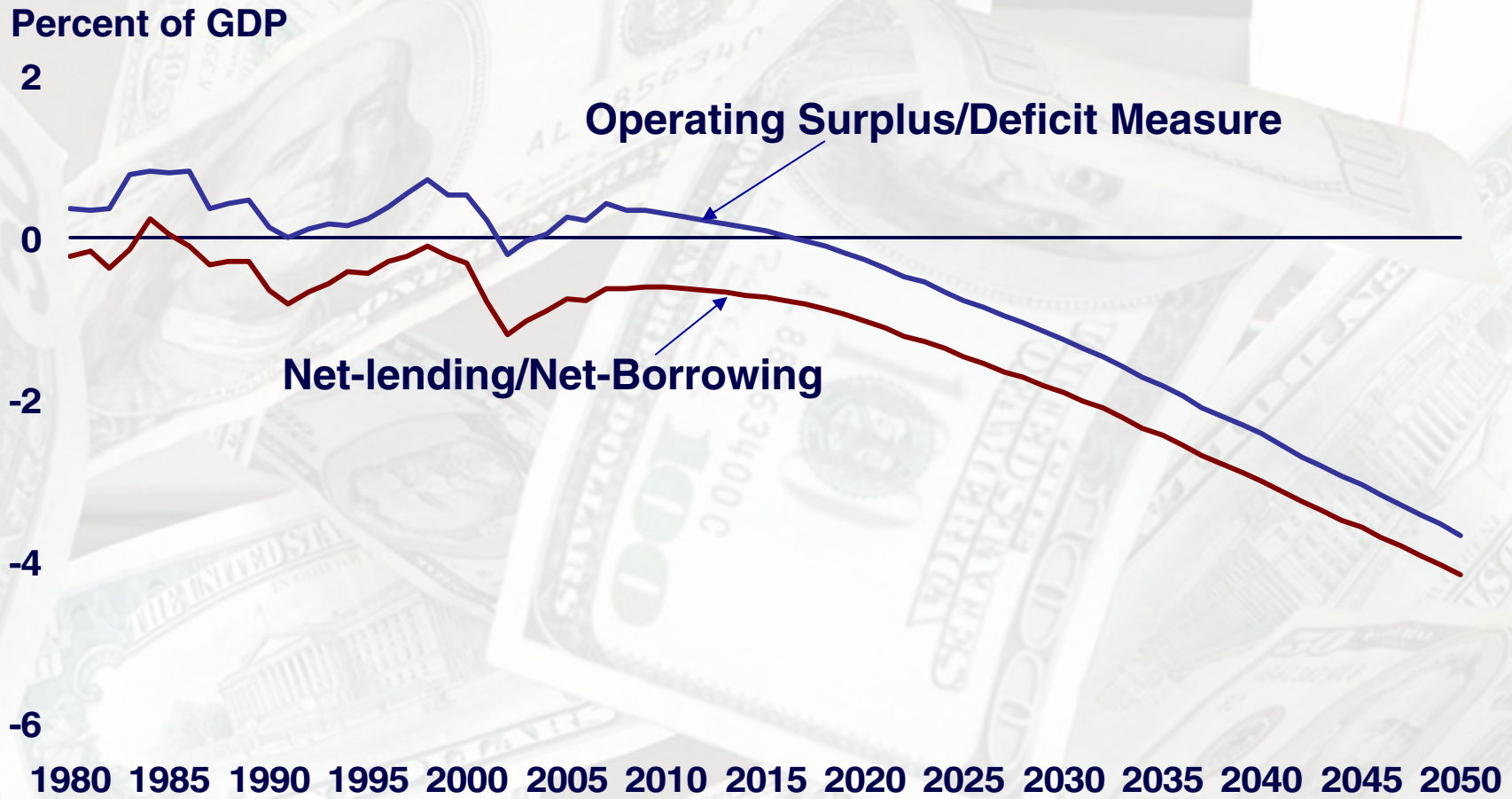
Revenue loss estimates (dollars in billions)



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

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

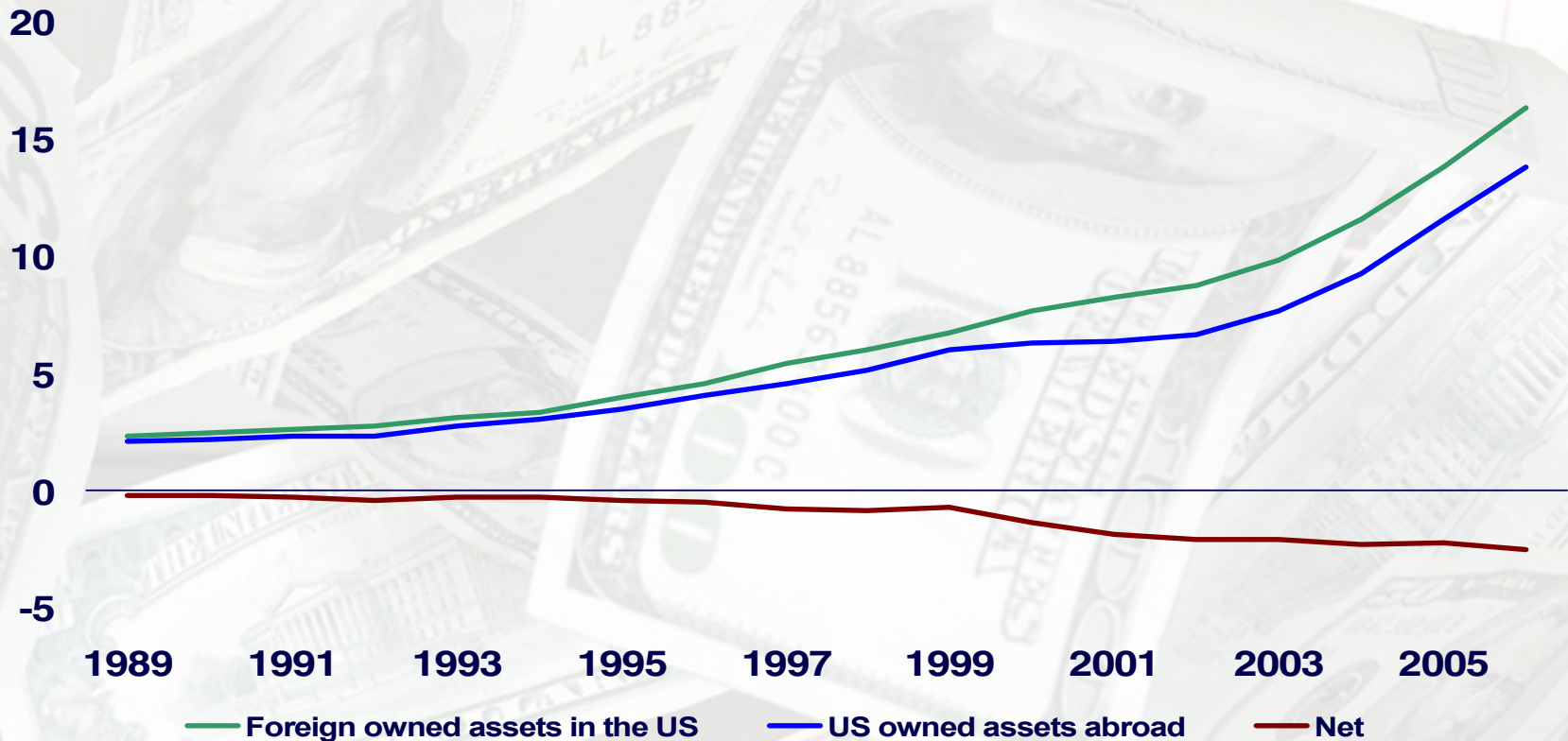
State and Local Governments Face Increasing Fiscal Challenges



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

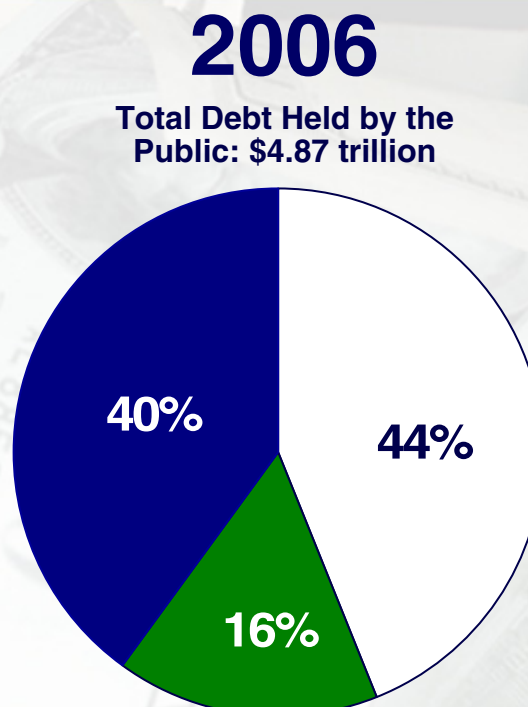
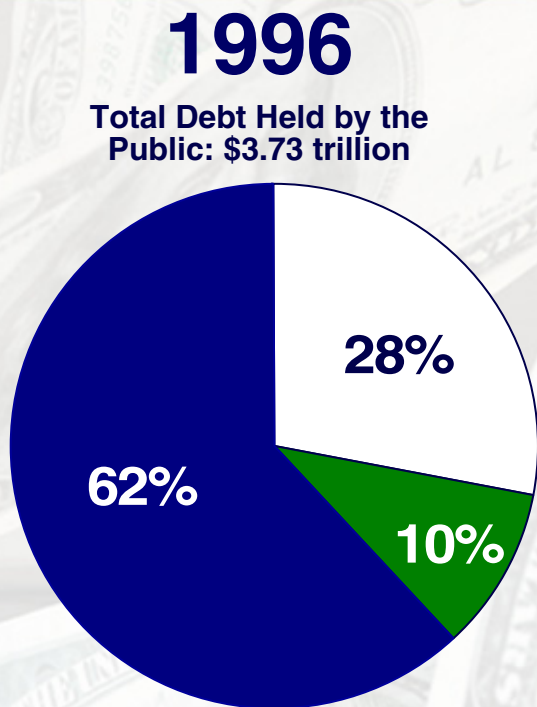
Overall, the Net International Position of the U.S. is Negative

Dollars in millions



Source: Bureau of Economic Analysis

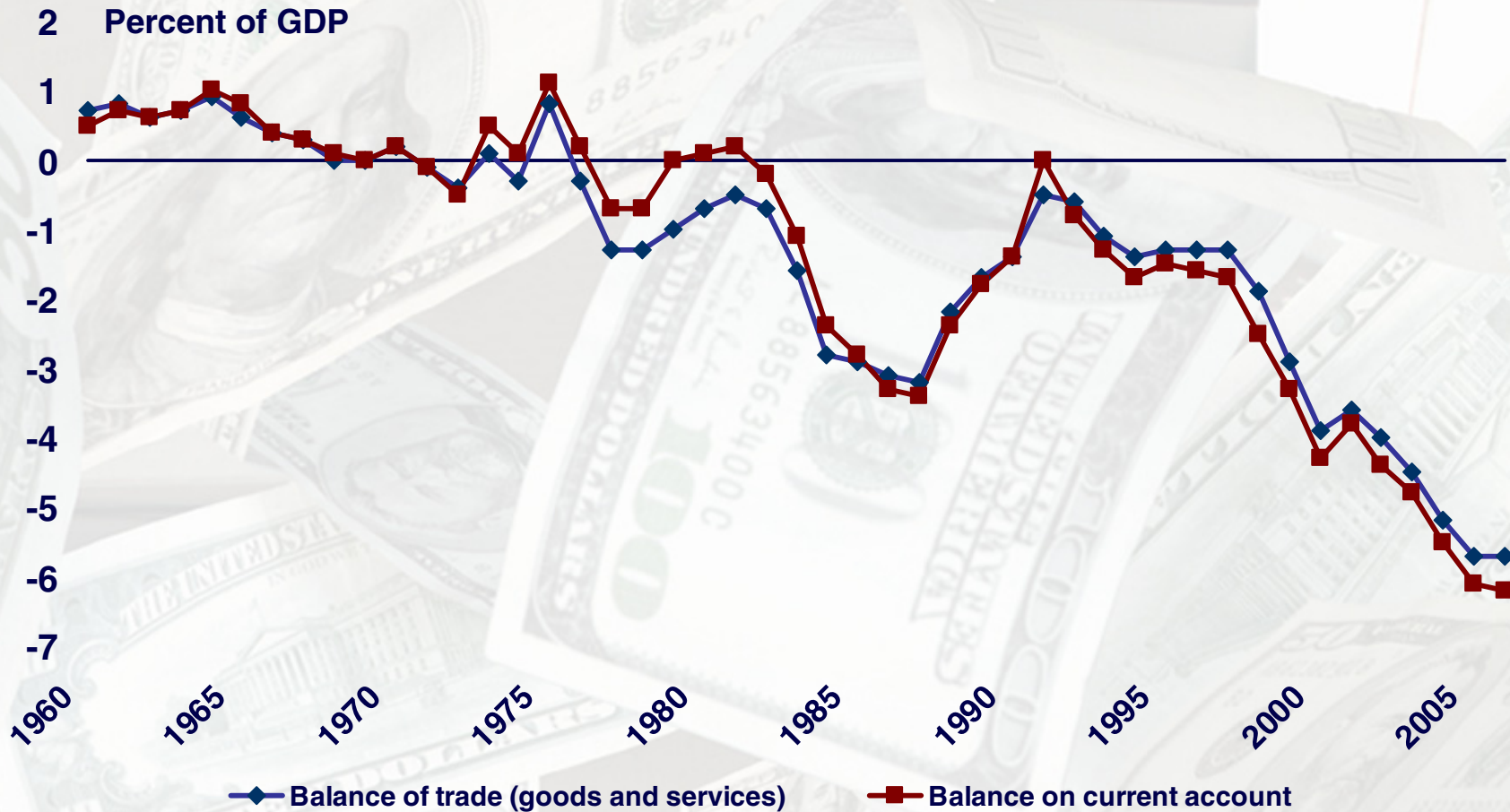
Foreign Ownership Share of Federal Debt Held by the Public Has Increased



-  Foreign and international investors
-  Federal Reserve
-  Domestic investors and state and local governments

Source: Department of the Treasury.

U.S. Trade and Current Account Balances as Percent of GDP, 1960 - 2006



Source: GAO based on U.S. Dept. of Commerce, Bureau of Economic Analysis, International Transactions Accounts Data
 Note: the Current Account Balance includes the trade balance, the balance on income (e.g. interest, dividends etc.) and net unilateral transfers.

Current Fiscal Policy Is Unsustainable

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

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The Way Forward: A Three-Pronged Approach

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

Solutions Require Active Involvement from both the Executive and Legislative Branches

The Way Forward:

Improve Financial Reporting, Public Education, and Performance Metrics

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

The Way Forward: *Strengthen Budget and Legislative Processes and Controls*

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

The Way Forward: *Fundamentally Reexamine & Transform*

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

Key National Indicators

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

Key National Indicators: Where the United States Ranks

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

16 OUT OF 28

OECD Categories for Key Indicators (2006 OECD Factbook)

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

GAO's High- Risk List 2007

Addressing Challenges in Broad-based Transformations

Year
Designated

- Strategic Human Capital Management^a 2001
- Managing Federal Real Property^a 2003
- Protecting the Federal Government's Information Systems and the Nations' Critical Infrastructures 1997

- Implementing and Transforming the Department of Homeland Security 2003
- Establishing Appropriate and Effective Information-Sharing Mechanisms to Improve Homeland Security 2005
- **DOD Approach to Business Transformation^a** 2005
 - DOD Business Systems Modernization 1995
 - DOD Personnel Security Clearance Program 2005
 - DOD Support Infrastructure Management 1997
 - DOD Financial Management 1995
 - DOD Supply Chain Management 1990
 - DOD Weapon Systems Acquisition 1990

- FAA Air Traffic Control Modernization 1995
- Financing the Nation's Transportation System^a (**New**) 2007
- Ensuring the Effective Protection of Technologies Critical to U.S. National Security Interests^a (**New**) 2007
- Transforming Federal Oversight of Food Safety^a (**New**) 2007

Managing Federal Contracting More Effectively

- **DOD Contract Management** 1992
- DOE Contract Management 1990
- NASA Contract Management 1990
- Management of Interagency Contracting 2005

Assessing the Efficiency and Effectiveness of Tax Law Administration

- Enforcement of Tax Laws^a 1990
- IRS Business Systems Modernization 1995

Modernizing and Safeguarding Insurance and Benefit Programs

- Modernizing Federal Disability Programs^a 2003
- Pension Benefit Guaranty Corporation Single-Employer Pension Insurance Program 2003
- Medicare Program^a 1990
- Medicaid Program^a 2003
- National Flood Insurance Program^a 2006

^a Legislation is likely to be necessary, as a supplement to actions by the executive branch, in order to effectively address this high-risk area.

Key Oversight Areas for the 110th Congress

Examples of targets for near-term oversight:

- Reducing the tax gap
- Addressing governmentwide acquisition and contracting issues
- Transforming the business operations of the Departments of Defense

Examples of policies and programs that are in need of fundamental reform and re-engineering:

- Reviewing U.S. and coalition efforts to stabilize and rebuild Iraq and Afghanistan
- Ensuring a strategic and integrated approach to prepare for, respond to, recover, and rebuild from catastrophic events
- Reforming the tax code

Examples of governance issues that should be addressed to help ensure an economical, efficient, ethical, and equitable federal government capable of responding to the various challenges and capitalizing on related opportunities in the 21st century:

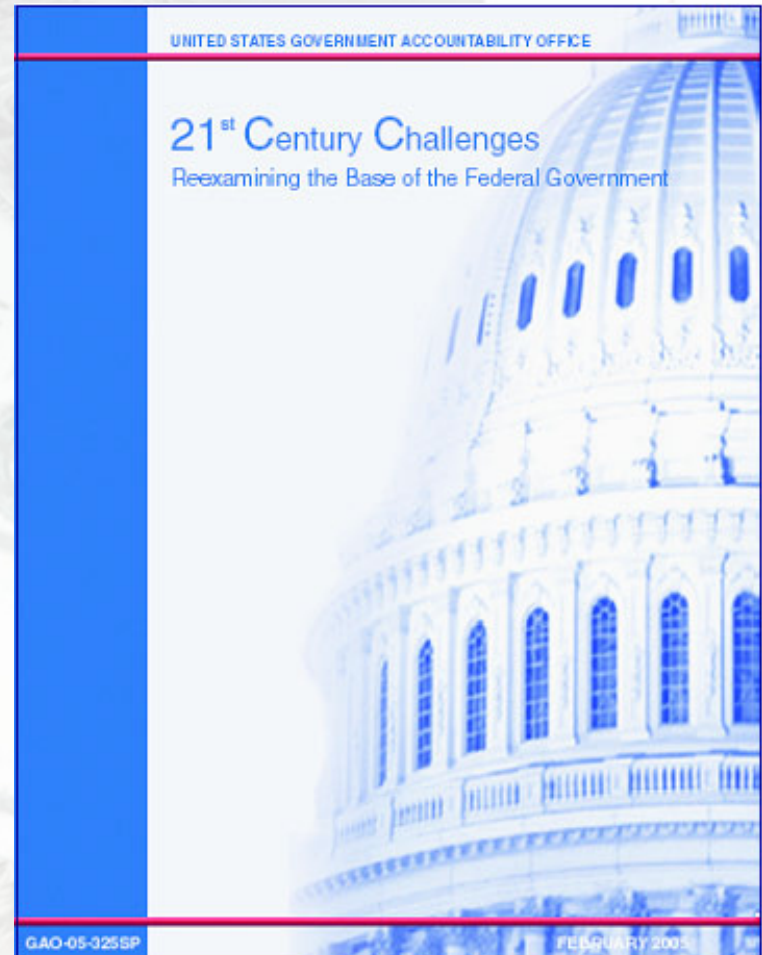
- Reviewing the need for various budget controls and legislative process revisions in light of current deficits and our long-range fiscal imbalance
- Pursuing the development of key national indicators
- Reviewing the impact and effectiveness of various management reforms

Selected Sustainability Challenges

- Fiscal Deficits and Debt Burdens
- Defense, Including Iraq, and Homeland Security Strategies
- Social Insurance Commitments
- Health Care Quality, Access, and Costs
- K-12 Education System
- Energy, Environment, and Resource Protection
- Tax Gaps and Policies
- Immigration Policies
- Infrastructure Needs

21st Century Challenges Report

- **Provides background, framework, and questions to assist in reexamining the base**
- **Covers entitlements and other mandatory spending, discretionary spending, and tax policies and programs**
- **Based on GAO's work for the Congress**



Twelve Reexamination Areas

MISSION AREAS

- Defense
- Education & Employment
- Financial Regulation & Housing
- Health Care
- Homeland Security
- International Affairs
- Natural Resources, Energy & Environment
- Retirement & Disability
- Science & Technology
- Transportation

CROSSCUTTING AREAS

- Improving Governance
- Reexamining the Tax System

Generic Reexamination Criteria and Sample Questions

■ **Relevance of purpose and the federal role**

Why did the federal government initiate this program and what was the government trying to accomplish?

Have there been significant changes in the country or the world that relate to the reason for initiating it?

■ **Measuring success**

Are there outcome-based measures? If not, why?

If there are outcome-based measures, how successful is it based on these measures?

■ **Targeting benefits**

Is it well targeted to those with the greatest needs and the least capacity to meet those needs?

■ **Affordability and cost effectiveness**

Is it using the most cost-effective or net beneficial approaches when compared to other tools and program designs?

■ **Best practices**

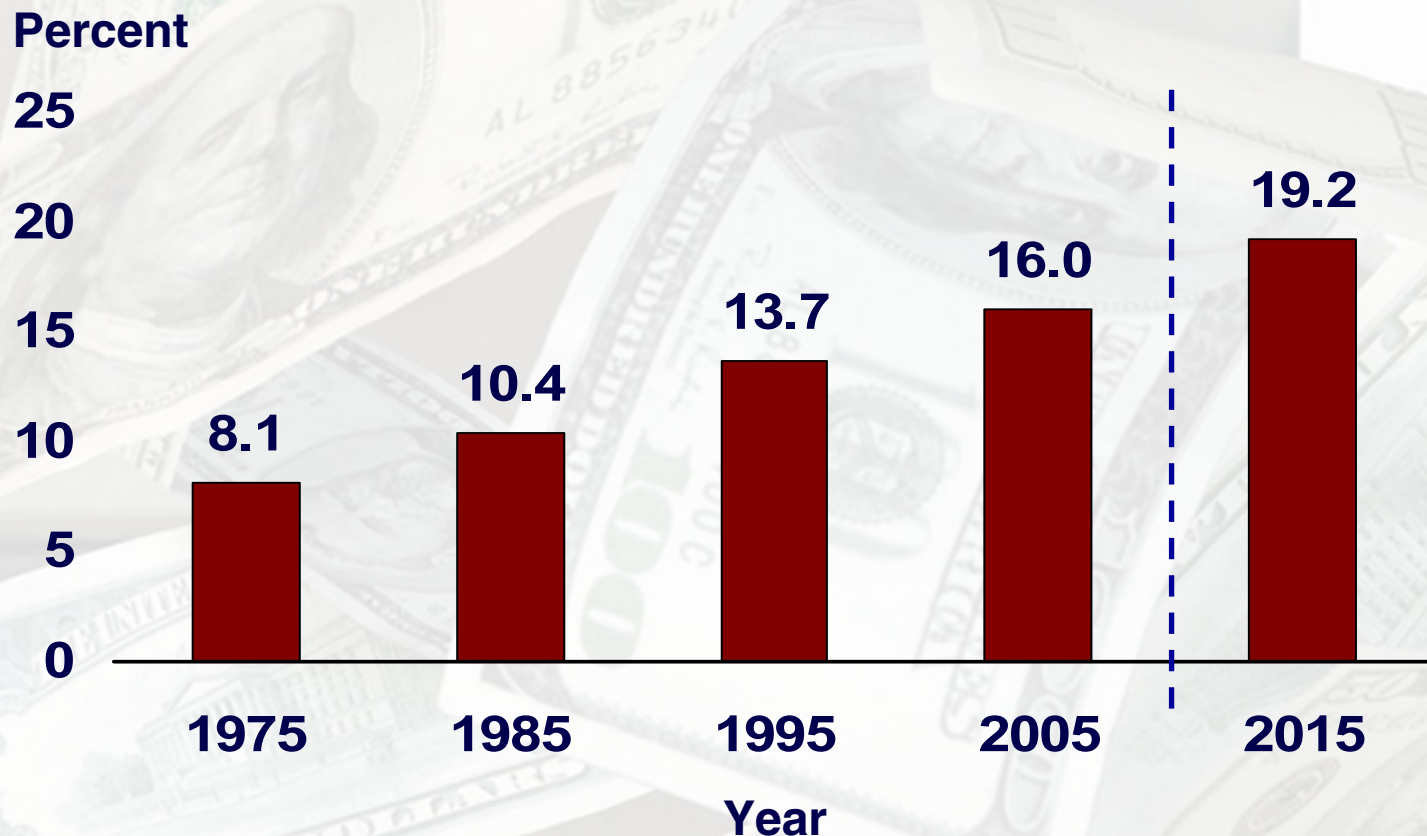
Is the responsible entity employing prevailing best practices to discharge its responsibilities and achieve its mission?

Illustrative 21st Century Questions: *Health Care*

- How can we make our current **Medicare and Medicaid** programs sustainable? For example, should the eligibility requirements (e.g., age, income requirements) for these programs be modified?
- How can we perform a **systematic reexamination of our current health care system**? For example, could public and private entities work jointly to establish formal reexamination processes that would (1) define and update as needed a minimum core of essential health care services, (2) ensure that all Americans have access to the defined minimum core services, (3) allocate responsibility for financing these services among such entities as government, employers, and individuals, and (4) provide the opportunity for individuals to obtain additional services at their discretion and cost?

Growth in Health Care Spending:

Health Care Spending as a Percentage of GDP

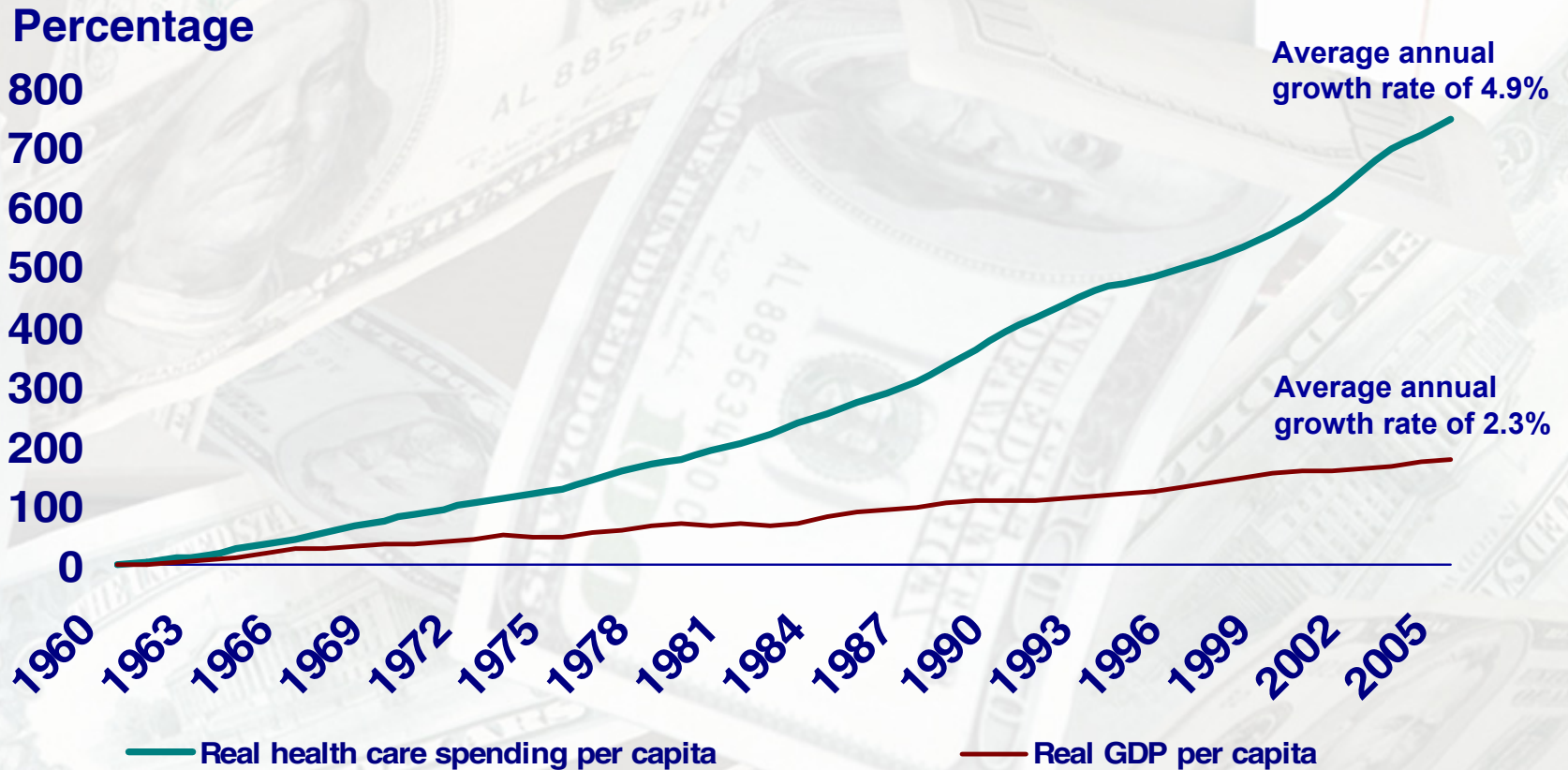


Source: The Centers for Medicare & Medicaid Services, Office of the Actuary.

Note: The figure for 2015 is projected.

Growth in Health Care Spending:

Cumulative Growth in Real Health Care Spending Per Capita and Real GDP Per Capita, 1960-2005

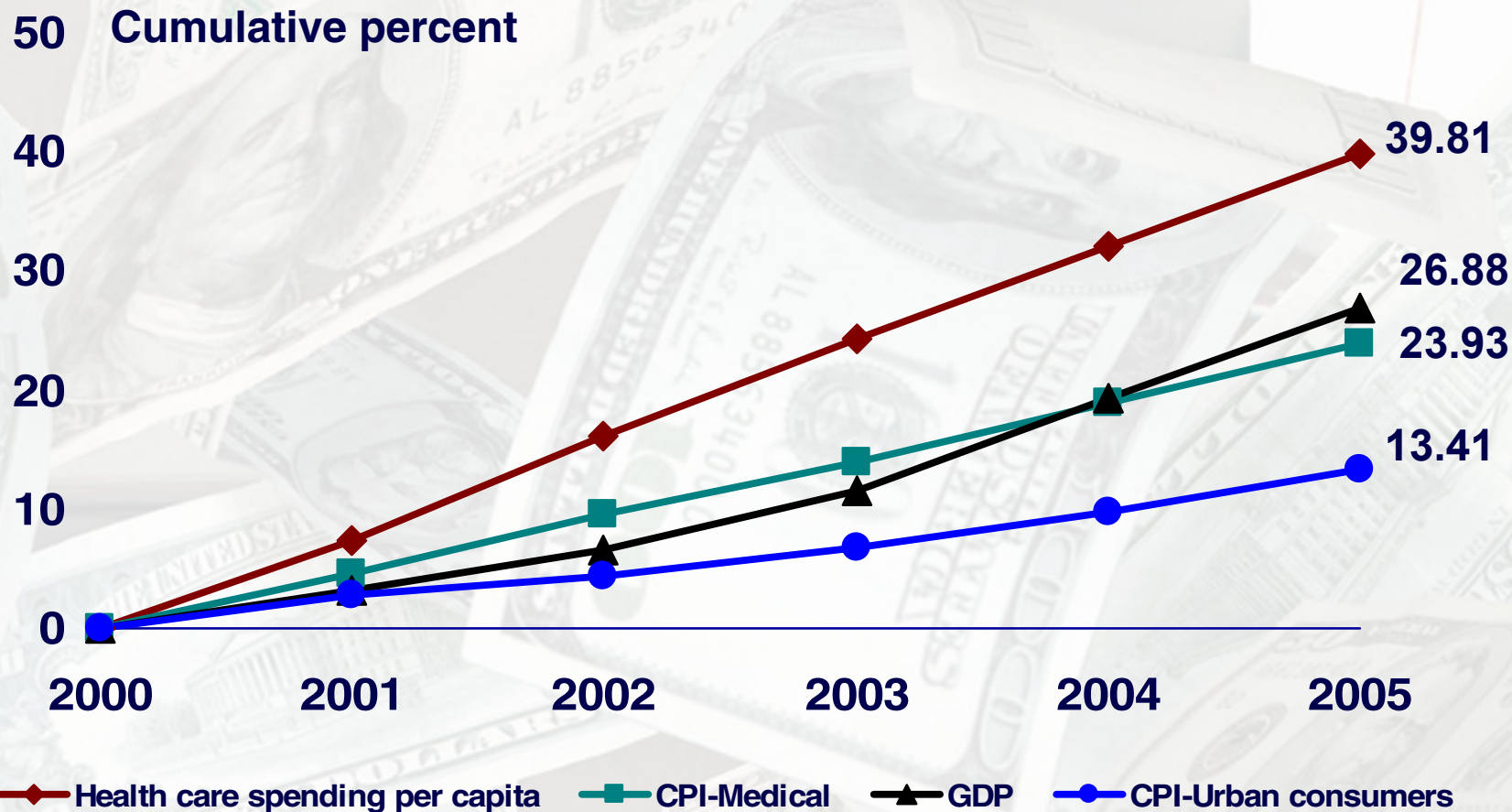


Source: GAO analysis of data from the Centers for Medicare & Medicaid Services, Office of the Actuary, and the Bureau of Economic Analysis.

Note: The most current data available on health care spending per capita are for 2005.

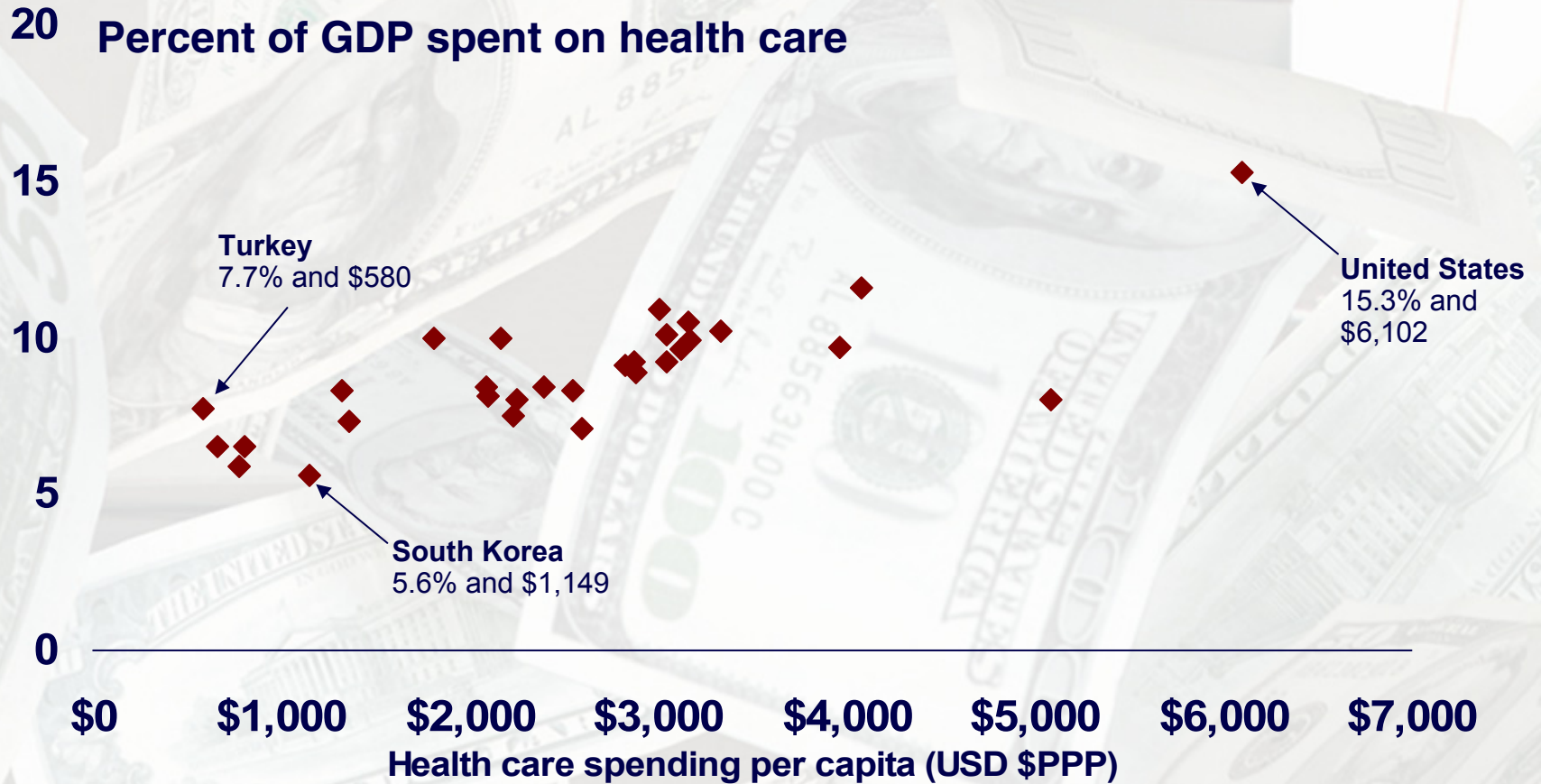
Growth in Health Care Spending:

Cumulative Growth in Health Care Spending Per Capita, Medical Inflation, GDP, and General Inflation, 2000-2005



Source: Bureau of Labor Statistics, The Centers for Medicare & Medicaid Services, Office of the Actuary, and the Bureau of Economic Analysis.

Growth in Health Care Spending: U.S Compared to Other OECD Countries, 2004

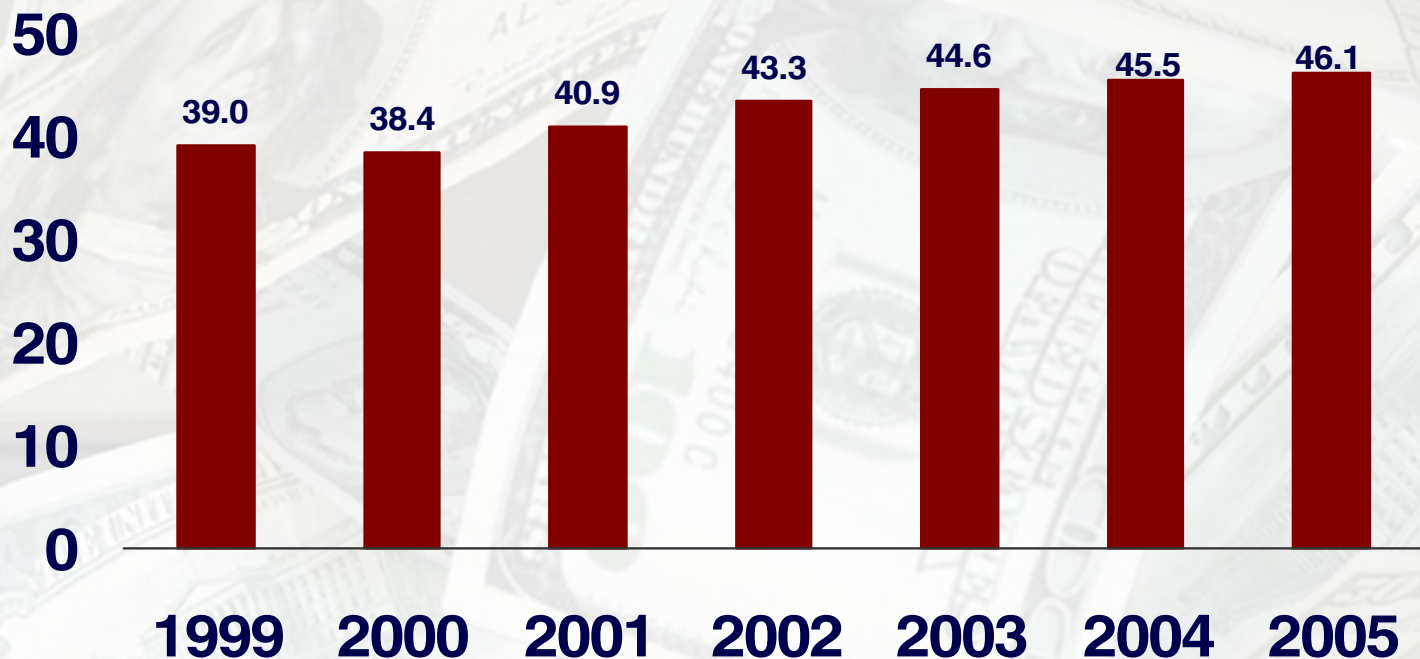


Source: *OECD Health Data, 2006*

Notes: All of the data on per capita spending and GDP have been translated into U.S. dollar equivalents, with exchange rates based on purchasing power parities (PPPs) of the national currencies

Number of Non-elderly Uninsured Americans, 1999-2005

Population in millions



Sources: GAO and Urban Institute and Kaiser Commission on Medicaid and the Uninsured analyses.

Notes: Figures for 1999-2000 are from Urban Institute and Kaiser Commission on Medicaid and the Uninsured. The figures for 2001-2005 are from GAO analyses of the Bureau of the Labor Statistics and the Bureau of the Census Current Population Survey, Annual Social and Economic Supplement.

Where the United States Ranks on Selected Health Outcome Indicators

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

Source: *OECD Health Data 2006 and 2007*

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

Key Dates Highlight Long Term Challenges of the Medicare Program

Date	Event
2007	Medicare Part A outlays exceed cash income
2007	“Medicare funding warning” triggered
2013	Projected date that annual “general revenue funding” for Part B will exceed 45 percent of total Medicare outlays
2019	Part A trust fund exhausted, annual income sufficient to pay about 80% of promised Part A benefits

Source: 2007 Annual Report of The Boards of Trustees of The Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds (Washington, DC, April 2007).

Issues to Consider in Examining Our Health Care System

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

Selected Potential Health Care Reform Approaches

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

Selected Potential Health Care Reform Approaches

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

Moving the Debate Forward

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

Three Key Illnesses

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

Four National Deficits

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

Key Leadership Attributes Needed for These Challenging and Changing Times

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

Three Key Groups That Need to Increase Their Influence and Involvement

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

On the Web

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

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