United States Government Accountability Office

Saving Our Future requires Tough Choices Today

Fiscal Wake-up Tour- Union League Club
Chicago, IL
August 24, 2006

The Honorable David M. Walker
Comptroller General
of the United States
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
- Rising public expectations for demonstrable results and enhanced responsiveness
- 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- Outdated federal organizational structures, policies, and practices
# Fiscal Year 2004 and 2005 Deficits and Net Operating Costs

<table>
<thead>
<tr>
<th></th>
<th>Fiscal Year 2004 ($ Billion)</th>
<th>Fiscal Year 2005 ($ Billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>On-Budget Deficit</td>
<td>(568)</td>
<td>(494)</td>
</tr>
<tr>
<td>Off-Budget Surplus(^a)</td>
<td>155</td>
<td>175</td>
</tr>
<tr>
<td>Unified Deficit</td>
<td>(413)</td>
<td>(318)</td>
</tr>
<tr>
<td>Net Operating Cost</td>
<td>(616)</td>
<td>(760)</td>
</tr>
</tbody>
</table>

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

\(^a\)Includes $151 billion in fiscal year 2004 and $173 billion in fiscal year 2005 in Social Security surpluses and $4 billion in fiscal year 2004 and $2 billion in fiscal year 2005 in Postal Service surpluses.
### Estimated Fiscal Exposures

($ trillions)

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Explicit liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Publicly held debt</td>
<td>$6.9</td>
<td>$9.9</td>
</tr>
<tr>
<td>Military &amp; civilian pensions &amp; retiree health</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Commitments &amp; contingencies</strong></td>
<td>0.5</td>
<td>0.9</td>
</tr>
<tr>
<td>E.g., PBGC, undelivered orders</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Implicit exposures</strong></td>
<td>13.0</td>
<td>35.6</td>
</tr>
<tr>
<td>Future Social Security benefits</td>
<td>3.8</td>
<td>5.7</td>
</tr>
<tr>
<td>Future Medicare Part A benefits</td>
<td>2.7</td>
<td>8.8</td>
</tr>
<tr>
<td>Future Medicare Part B benefits</td>
<td>6.5</td>
<td>12.4</td>
</tr>
<tr>
<td>Future Medicare Part D benefits</td>
<td>--</td>
<td>8.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$20.4</td>
<td>$46.4</td>
</tr>
</tbody>
</table>

Source: U.S. government’s consolidated financial statements (CFS).

Note: Estimates for Social Security and Medicare are at present value as of January 1 of each year as reported in the CFS and all other data are as of September 30.
How Big is Our Growing Fiscal Burden?

Our total fiscal burden can be translated and compared as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total fiscal exposures</td>
<td>$46.4 trillion</td>
</tr>
<tr>
<td>Total household net worth(^1)</td>
<td>$51.1 trillion</td>
</tr>
<tr>
<td>Burden/Net worth ratio</td>
<td>91 percent</td>
</tr>
<tr>
<td>Burden(^2)</td>
<td></td>
</tr>
<tr>
<td>Per person</td>
<td>$156,000</td>
</tr>
<tr>
<td>Per full-time worker</td>
<td>$375,000</td>
</tr>
<tr>
<td>Per household</td>
<td>$411,000</td>
</tr>
<tr>
<td>Income</td>
<td></td>
</tr>
<tr>
<td>Median household income(^3)</td>
<td>$44,389</td>
</tr>
<tr>
<td>Disposable personal income per capita(^4)</td>
<td>$30,431</td>
</tr>
</tbody>
</table>

Sources: GAO analysis.

Composition of Spending as a Share of GDP
Under Baseline Extended

Source: GAO’s May 2006 analysis.

Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2016 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2016, revenue as a share of GDP is held constant.
Composition of Spending as a Share of GDP
Assuming Discretionary Spending Grows with GDP after 2006 and All Expiring Tax Provisions are Extended

Percent of GDP

2005 2015 2030 2040

Revenue

Net Interest
Social Security
Medicare & Medicaid
All other spending

Source: GAO’s May 2006 analysis.

Note: This includes certain tax provisions that expired at the end of 2005, such as the increased AMT exemption amount.
Growth in Spending for Social Security, Medicare, and Medicaid Expected to Outpace Economic Growth

Growth in constant dollars 2005-2030

- GDP: 72%
- Social Security Spending: 147%
- Medicaid Spending: 166%
- Medicare Spending: 331%

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

Note: Social Security and Medicare projections based on the intermediate assumptions of the 2005 Trustees’ Reports. Medicaid projections based on CBO’s December 2003 long-term projections for federal spending on Medicaid under mid-range assumptions.
Social Security, Medicare, and Medicaid Spending as a Percent of GDP

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

Debt per Capita Could Exceed GDP Per Capita by 2030
Assuming Discretionary Spending Grows with GDP after 2006
and All Expiring Tax Provisions are Extended

Per capita 2005 dollars

Source: GAO’s January 2006 analysis.

GAO-06-1084CG
Measured on an Outlay Equivalent Basis, Tax Expenditures Exceeded Discretionary Spending for Most Years in the Last Decade

Dollars in billions (in constant 2004 dollars)


Note: Outlay-equivalent estimates represent the amount of budget outlays that would be required if the government were to provide taxpayers with the same after-tax income they receive through the tax expenditure. Outlay-equivalent estimates are useful to compare tax expenditures and other parts of the federal budget. Summing tax expenditure estimates does not take into account interactions between individual provisions.
Health Care Is the Nation’s Top Tax Expenditure in Fiscal Year 2005

Estimated dollars in billions

- Exclusion of employer contributions for insurance premiums and medical care
- Deductibility of mortgage interest on owner-occupied dwellings
- Exclusion of pension contributions and earnings: employer-sponsored defined benefit plans
- Child tax credit
- Exclusion of pension contributions and earnings: employer-sponsored 401(K) plans

Source: Office of Management and Budget (OMB), *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2007.*

Note: “Tax expenditures” refers to the special tax provisions that are contained in the federal income taxes on individuals and corporations. OMB does not include forgone revenue from other federal taxes such as Social Security and Medicare payroll taxes.

*aIf the payroll tax exclusion were also counted here, the total tax expenditure for employer contributions for health insurance premiums would be about 50 percent higher or $177.6 billion.

*bThis is the revenue loss and does not include associated outlays of $14.6 billion.
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 2 times today’s level
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
  - Closing the current long-term fiscal gap based on reasonable assumptions would require real average annual economic growth in the double digit range every year for the next 75 years.
  - During the 1990s, the economy grew at an average 3.2 percent per year.
  - As a result, we cannot simply grow our way out of this problem. Tough choices will be required.
The Way Forward: A Three-Pronged Approach

1. Strengthen Budget and Legislative Processes and Controls

2. Improve Financial Reporting and Performance Metrics

3. Fundamental Reexamination & Transformation for the 21st Century

Solutions Require Active Involvement from Both the Executive and Legislative Branches
The Way Forward: Strengthen Budget and Legislative Processes and Controls

- Restore discretionary spending caps & PAYGO rules on both 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 present value cost estimates 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: 
Improve Financial Reporting 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 a path to on-budget balance within 10-year window or explain the selection of an alternative deadline
- Require annual OMB report on existing fiscal exposures (liabilities, obligations, explicit & implied commitments)
- Require periodic fiscal sustainability reporting, as has been done in some other countries (e.g., New Zealand, Australia)
- Require enhanced financial statement presentation and preparation of summary annual report that is both useful and used
- Develop key national (outcome-based) indicators to chart the nation’s position, progress, and position relative to the other major industrial countries
The Way Forward: 
Fundamental Reexamination & Transformation

• Restructure existing entitlement programs

• Reexamine and restructure the base of all other spending

• Review & revise existing tax policy, including tax preferences & enforcement programs

• Expand scrutiny of all proposed new programs, policies, or activities

• Strengthen internal agency structures & processes

• Strengthen and systematize Congressional oversight processes
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) and Boston)

- **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**: Consortium of key players housed by the National Academies domestically and related efforts by the OECD and others internationally
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

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<table>
<thead>
<tr>
<th>OECD Categories for Key Indicators (2006 OECD Factbook)</th>
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<tbody>
<tr>
<td>• Population/Migration</td>
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<td>• Macroeconomic Trends</td>
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<tr>
<td>• Prices</td>
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<tr>
<td>• Energy</td>
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<tr>
<td>• Labor Market</td>
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<tr>
<td>• Science &amp; Tech.</td>
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<tr>
<td>• Environment</td>
</tr>
<tr>
<td>• Education</td>
</tr>
<tr>
<td>• Public Finance</td>
</tr>
<tr>
<td>• Quality of Life</td>
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<tr>
<td>• Economic Globalization</td>
</tr>
</tbody>
</table>

Source: 2006 OECD Factbook.
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
These Challenges Go Beyond Numbers and Dollars—It’s About VALUES & PEOPLE

Source: GAO.
Learning from the Past and Others while Preparing for Future

- Roman Republic
- British Empire
- New Zealand vs. Argentina
Key Leadership Attributes Needed for These Challenging and Changing Times

- Courage
- Integrity
- Creativity
- Stewardship
...NOW WE COVER IT WITH STICKS AND LEAVES SO THEY WON'T NOTICE IT UNTIL IT'S TOO LATE.

SOMEHOW, YOU DON'T EXPECT PARENTS TO BEHAVE LIKE THAT.

The Deficit

CHECK THE CLIMATE FORECAST.
Saving Our Future requires Tough Choices Today

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