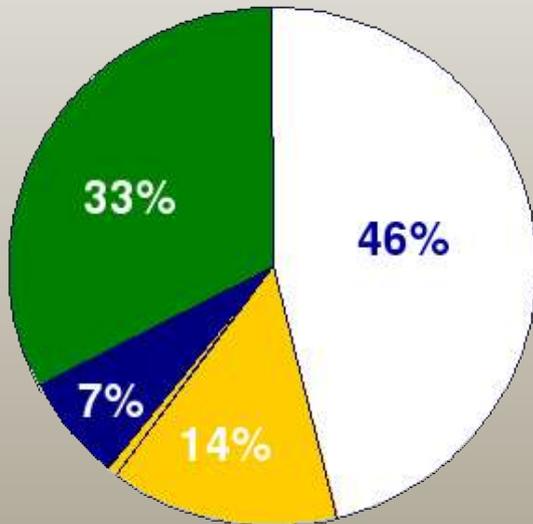


THE HERITAGE FOUNDATION

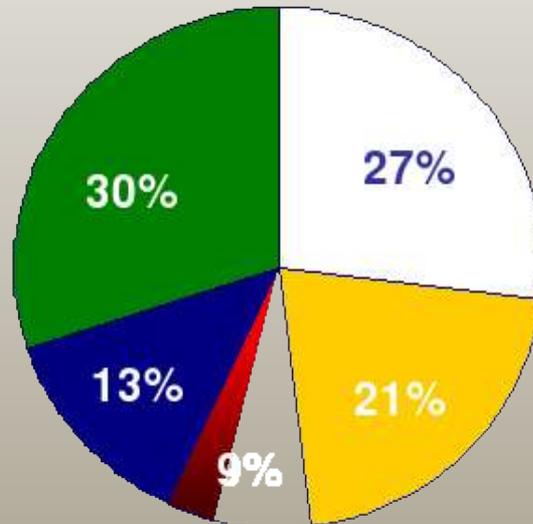
Saving
Our Future
requires
Tough Choices Today

Composition of Federal Spending

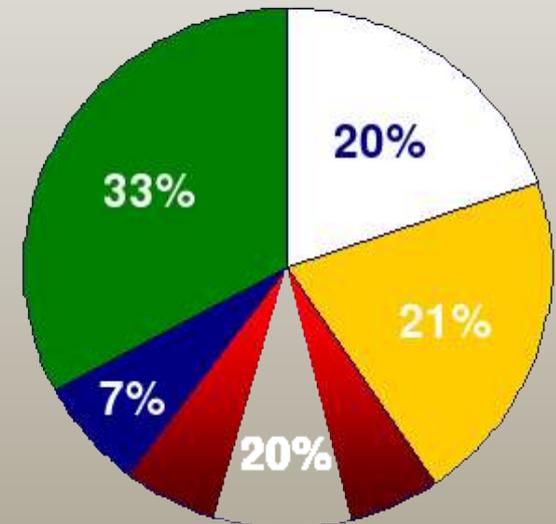
1964



1984



2004*

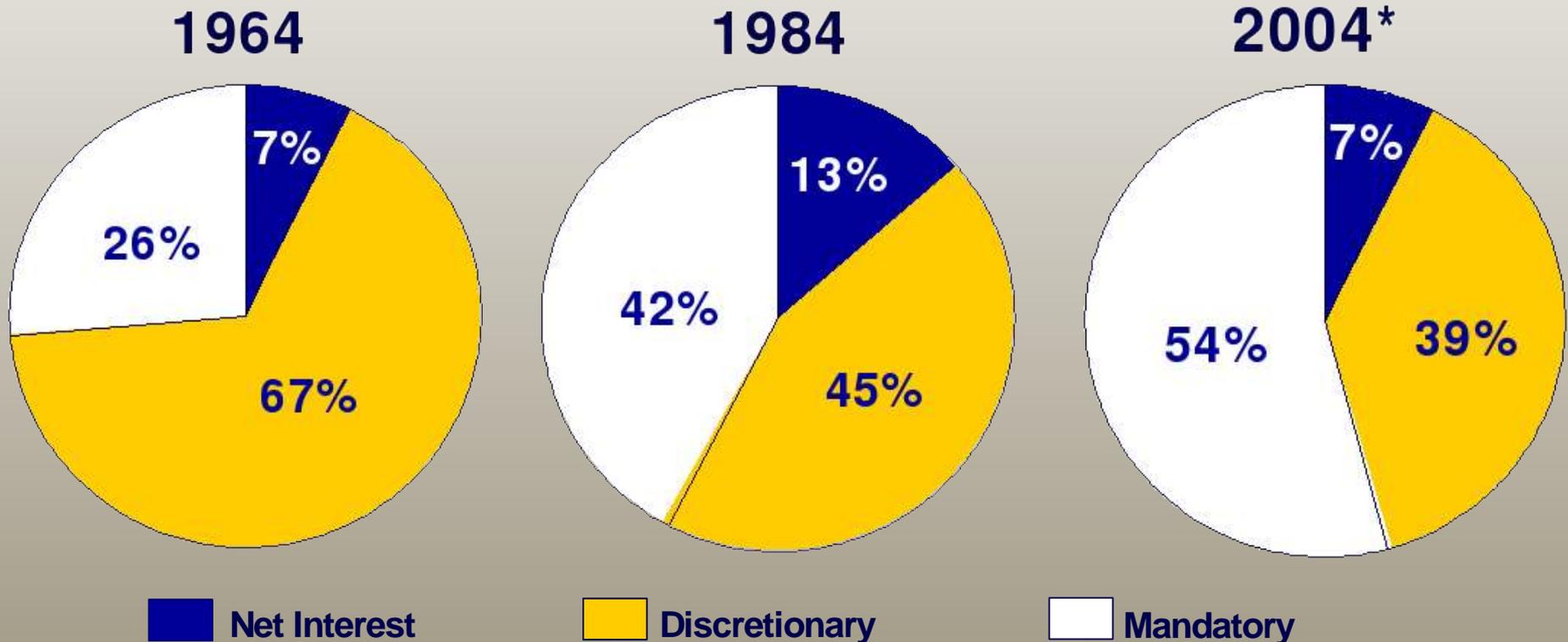


*Current services estimate.

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

Source: *Budget of the United States Government, Fiscal Year 2005* (February 2004) and *Budget of the United States Government, Fiscal Year 2005, Mid-session Review* (July 2004), Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs



*Current services estimate.

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

Source: *Budget of the United States Government, Fiscal Year 2005* (February 2004) and *Budget of the United States Government, Fiscal Year 2005, Mid-session Review* (July 2004), Office of Management and Budget.

Selected Fiscal Exposures: Sources and Examples 2004^a

Type	Example (dollars in billions)
Explicit liabilities	Publicly held debt (\$4,297)
	Military and civilian pension and post-retirement health (\$3,059)
	Veterans benefits payable (\$925)
	Environmental and disposal liabilities (\$249)
	Loan guarantees (\$43)
Explicit financial commitments	Undelivered orders (\$596)
	Long-term leases (\$39)
Financial contingencies	Unadjudicated claims (\$4)
	Pension Benefit Guaranty Corporation (\$96)
	Other national insurance programs (\$1)
	Government corporations e.g., Ginnie Mae
Exposures implied by current policies or the public's expectations about the role of government	Debt held by government accounts (\$3,071) ^b
	Future Social Security benefit payments (\$3,699) ^c
	Future Medicare Part A benefit payments (\$8,236) ^c
	Future Medicare Part B benefit payments (\$11,416) ^c
	Future Medicare Part D benefit payments (\$8,119) ^c
	Life cycle cost including deferred and future maintenance and operating costs (amount unknown)
	Government Sponsored Enterprises e.g., Fannie Mae and Freddie Mac

^a All figures are for end of fiscal year 2004, except Social Security and Medicare estimates, which are as of January 1, 2004.

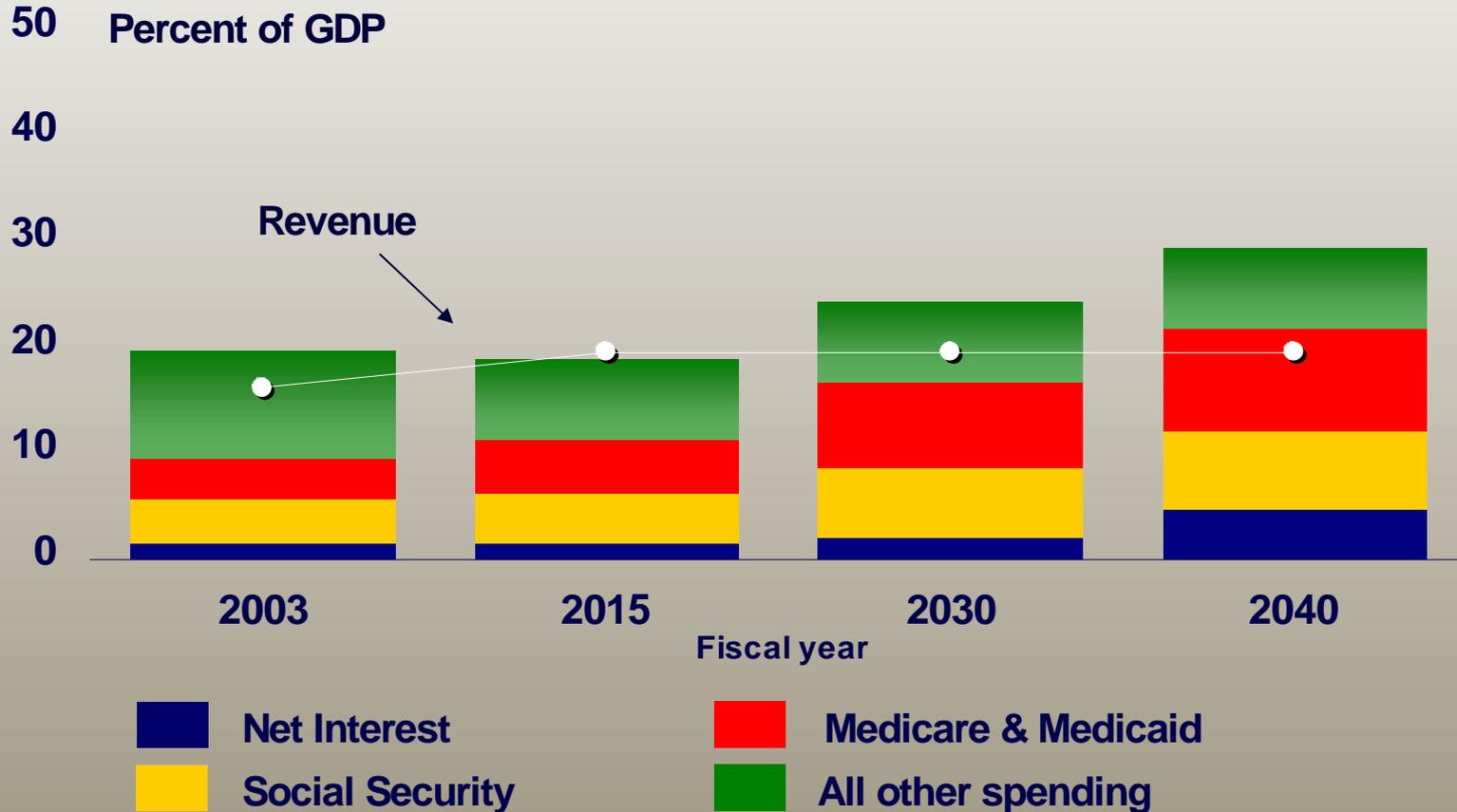
^b This amount includes \$845 billion held by military and civilian pension funds that would offset the explicit liabilities reported by those funds.

^c Figures for Social Security and Medicare are net of debt held by the trust funds (\$1,531 billion for Social Security, \$256 billion for Medicare Part A, and \$24 billion for Medicare Part B) and represent net present value estimates over a 75-year period. Over an infinite horizon, the estimate for Social Security would be \$10.4 trillion, \$21.8 trillion for Medicare Part A, \$23.2 trillion for Medicare Part B, and \$16.5 trillion for Medicare Part D.

Source: GAO analysis of data from the Department of the Treasury, the Office of the Chief Actuary, Social Security Administration, and the Office of the Actuary, Centers for Medicare and Medicaid Services.

Composition of Spending as a Share of GDP

Under Baseline Extended

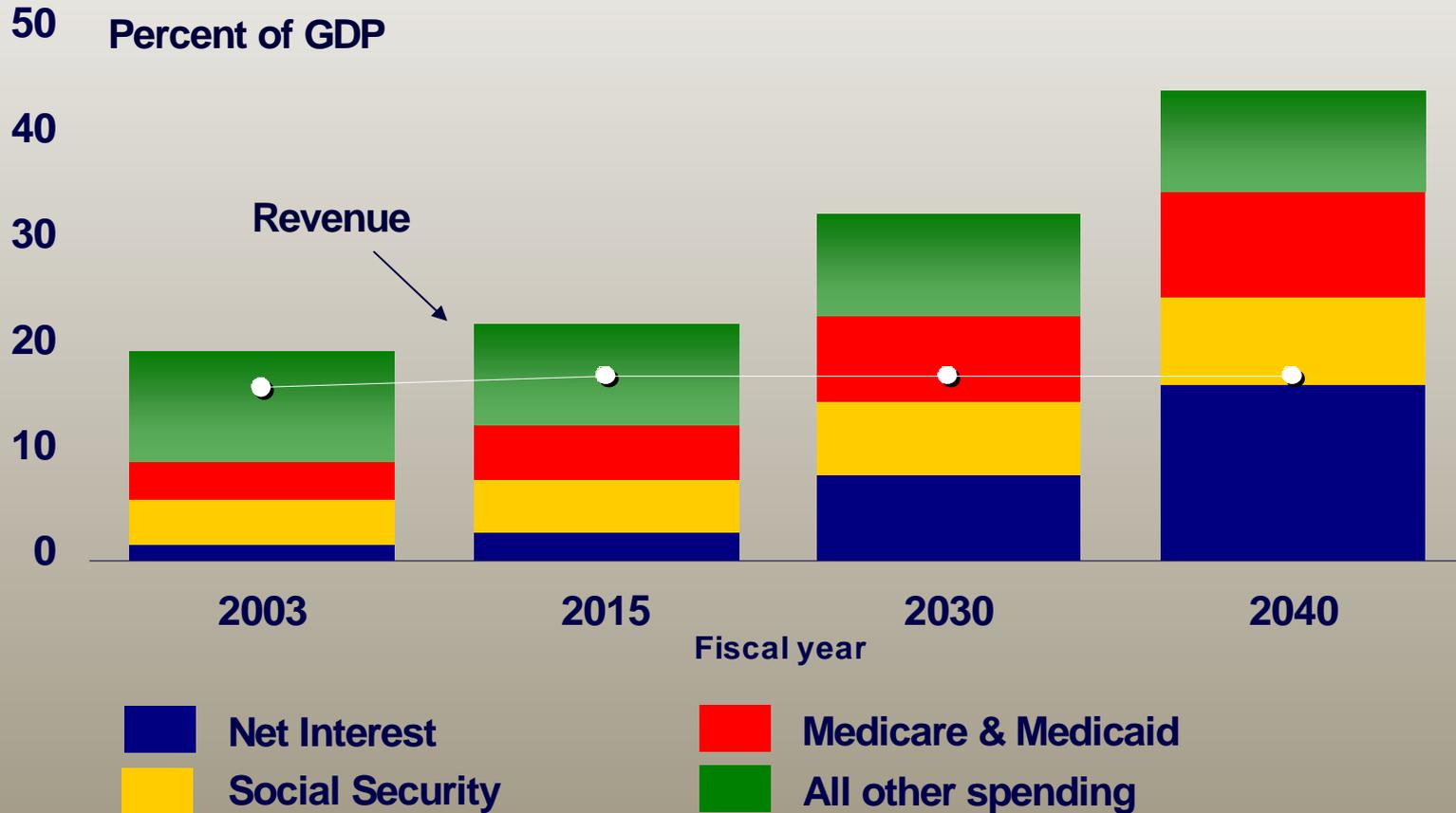


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

Source: GAO's January 2005 analysis.

Composition of Spending as a Share of GDP

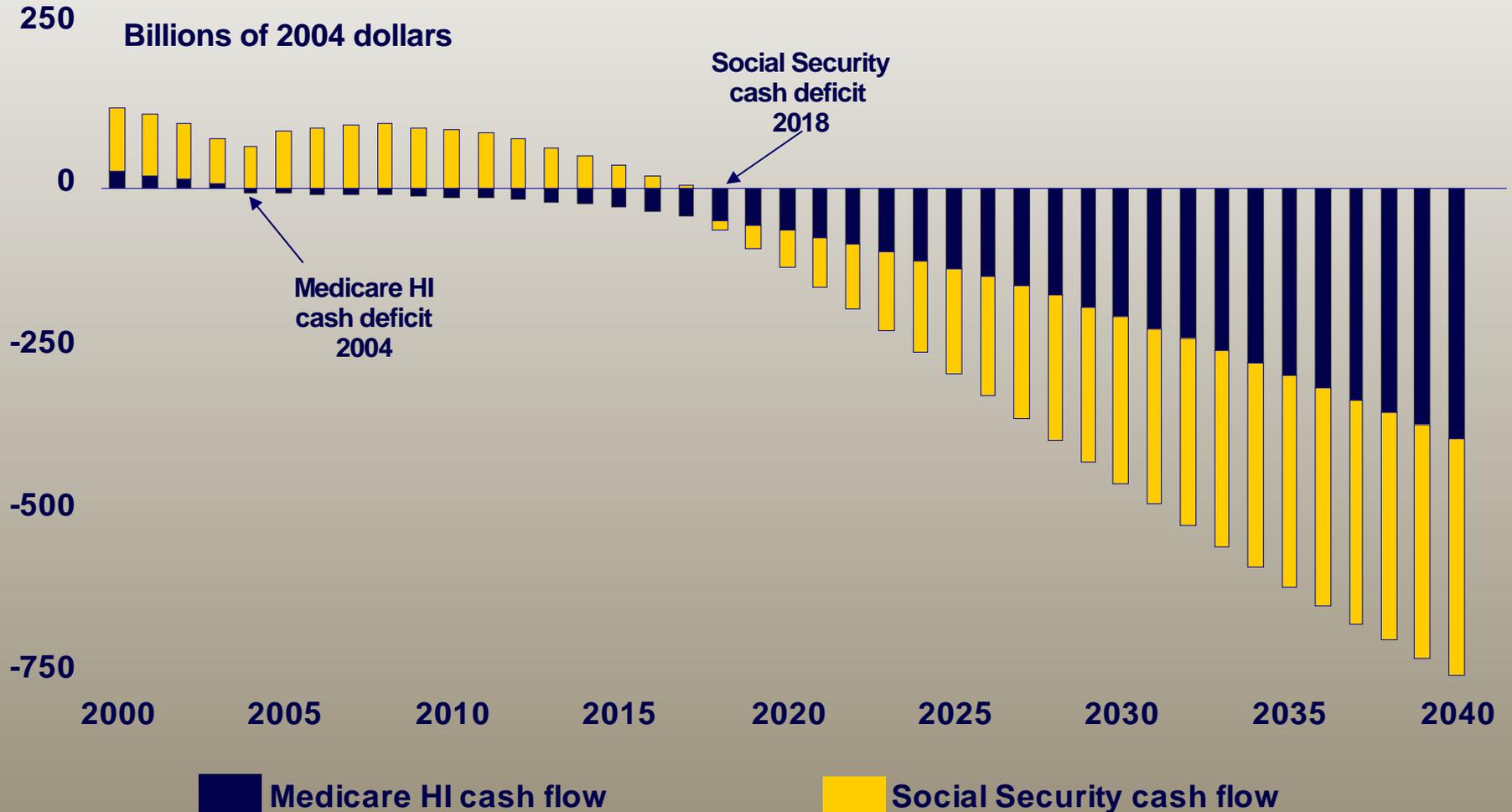
Assuming Discretionary Spending Grows with GDP after 2005
and All Expiring Tax Provisions are Extended



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

Source: GAO's January 2005 analysis.

Social Security and Medicare's Hospital Insurance Trust Funds Face Cash Deficits



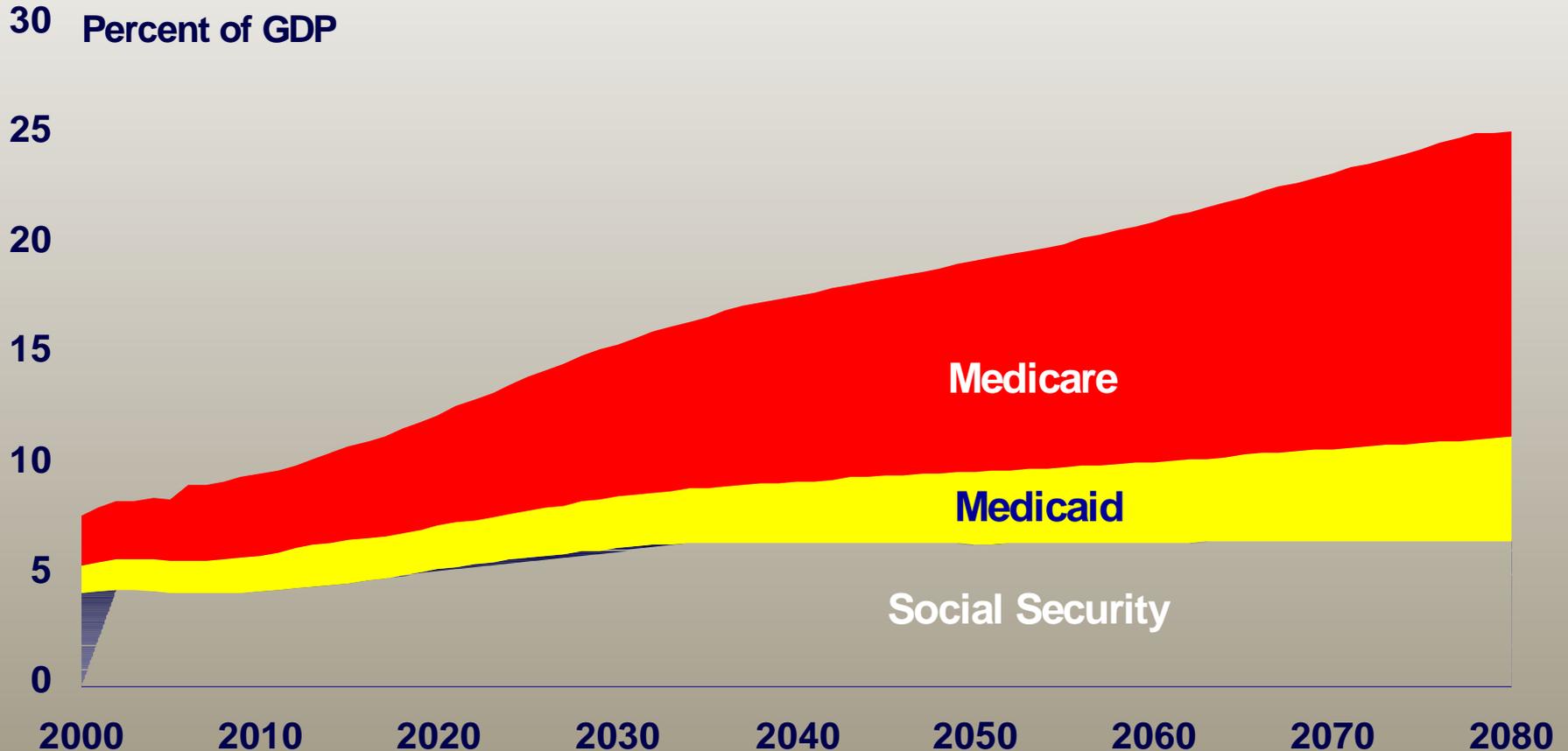
Source: GAO analysis based on the intermediate assumptions of *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and the Federal Disability Insurance Trust Funds* and *The 2004 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*. The above excludes Medicare Part B and the newly enacted Medicare Part D benefit.

Key Dates Highlight Long Term Challenges of the Social Security System

Date	Event
2008	Social Security cash surplus begins to decline
2018	Annual benefit costs exceed cash revenue from taxes
2028	Trust fund ceases to grow because even taxes plus interest fall short of benefits
2042 (SSA) 2052 (CBO)	Trust fund exhausted, annual revenues sufficient to pay about 73% – 81% of promised benefits

Sources: Social Security Administration, *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*. Washington, DC, March 2004. Congressional Budget Office, *The Outlook for Social Security: Potential Range of Social Security Outlays and Revenues Under Current Law*. Washington, DC, June 2004.

Social Security, Medicare, and Medicaid Spending as a Percent of GDP



Note: Social Security and Medicare projections based on the intermediate assumptions of the 2004 Trustees' Reports. Medicaid projections based on CBO's January 2004 short-term Medicaid estimates and CBO's December 2003 long-term Medicaid projections under mid-range assumptions.

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.

Another Way to Think About These Numbers

- Debt held by the public—\$4.3T
- Trust fund debt—\$3.1T
- Gross debt—\$7.4T
- Gross debt per person—about \$25,000
- If we add everything on the previous slide that is not included in gross debt, the burden rises to more than \$145,000 per person or more than \$350,000 per full-time worker. Alternatively, it amounts to a total unfunded burden of more than \$43 trillion in current dollars, which is about 19 times the current annual federal budget or about 4 times the current annual GDP.

Note: The calculations are based on 75-year projections for Social Security and Medicare.

Updated 12/17/04

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 about 60 percent or
 - Raising taxes to about 2.5 times today's level
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
 - Closing the current long-term fiscal gap based on responsible 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 Sooner We Get Started, the Better**
 - Less change would be needed, and there would be more time to make adjustments.
 - The miracle of compounding would work with us rather than against us.
 - Our demographic changes will serve to make reform more difficult over time.

We Need a Multifaceted Approach to Close the Long-Term Fiscal Gap

Policy:

- Restructure existing entitlement programs
- Reexamine the base of discretionary and other spending
- Review and revise our tax policy and enforcement programs

Operations:

- Reassess and revise how the government does business (e.g., management, planning and operational issues)
- Consider who should provide government services (e.g., sourcing strategy)

21st Century Challenges Report

- Report to be issued February 16
- Based on GAO work for the Congress
- Provides framework and questions to assist in reexamining the base
- Covers entitlements & other mandatory spending, discretionary spending, and tax policy and programs

Strategic Plan Themes

- Long-Range Fiscal Challenges
- Changing Security Threats
- Increasing Global Interdependence
- The Changing Economy
- Demographic Shifts
- Science and Technology Advances
- Quality of Life Trends
- Changing Governance Structures

Generic Reexamination Criteria with Sample Questions

Relevance of purpose and the federal role

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

Measuring success

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?

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

Selected 21st Century Questions

- Do we need all three elements of the current triad nuclear deterrent strategy and if so, do we need to reconsider the size and nature of each component?
- What opportunities exist to dispose of excess federal facilities or better leverage surplus in private sector capacity to make the federal portfolio more relevant to current mission and less costly?
- How should Social Security be reformed to make it both solvent and sustainable while better aligning it with 21st century economic, demographic and fiscal realities?
- Do tax incentives and preferences need to be reconsidered? For example, can adequate health care coverage be achieved at less cost and greater equity through fundamental redesign of the current health tax preferences?

Where Do We Go from Here?

- Reexamining the base of government will take many years
- Various reexamination approaches already exist and have been used by the federal government
- Some states and other nations offer models of reexamination
- Early action on reexamination has significant benefits

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