

**Saving our Nation's Future:
An Intergovernmental Challenge**

Keynote Address
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Thank you for that kind introduction and for the opportunity to speak to you today.

As a federal official speaking at this state and local conference, it is important to note at the outset that in today's world governments, institutions, and individuals are increasingly interconnected and interdependent. This trend is occurring both internationally and domestically and among different economic and social sectors. From a federal, state, and local government perspective, this interconnection and interdependence involves a range of issues, including tax policy, education, the environment, health care, homeland security, social welfare, and transportation.

I could talk about any number of intergovernmental challenges, but today I plan to brighten the lights and turn up the heat on an overarching problem that too many people seem content to put on the back burner. That problem is our nation's worsening financial condition and long-range fiscal outlook.

I'm sad to say that since I last spoke on this issue here at the National Press Club back in September of 2003, our nation's long-range fiscal imbalance has deteriorated significantly. Furthermore, as you all know, most state and local governments also have their own fiscal challenges and are having to make increasingly difficult choices.

We now confront three large and interrelated national deficits. The first is a large federal budget deficit. The second is a growing balance-of-payments deficit. And the third is an alarming personal savings deficit.

Frankly, it's easy to dismiss government deficits and debt as someone else's problem. But in my view, every American has both a personal reason and a civic responsibility to become more informed and involved in the coming debate over our collective fiscal future.

The American people need to realize that the fiscal choices being made in Washington today have profound consequences for the future of our country, and our children. In a nutshell, these fiscal choices will directly affect our future national security, economic vitality, and quality of life.

In the past, Americans have shrugged off warnings about the impending deficit and debt crises. Many Americans are too focused on today and aren't thinking enough about tomorrow. As Walter Shapiro pointed out in a recent column in *USA Today*, low interest rates and modest inflation give many Americans a false sense of security. These false perceptions are reinforced by the government's financial statements, which currently do not provide a full and fair view of our nation's current financial condition and long-term outlook. The simple truth is that our nation's financial condition is much worse than advertised. In addition, due largely to the looming retirement of the baby boomers, surging health care costs, and relatively low federal revenues as a percentage of the economy, we now face decades of red ink.

One aspect of government financial reporting in which I'm directly involved as Comptroller General of the United States is the audit of the federal government's consolidated financial statements. Every year, the federal government is required to issue a comprehensive report on its finances and operations. My agency, the U.S. Government Accountability Office (GAO), has a statutory responsibility to audit these financial statements. As the person who has to sign GAO's audit report, and a CPA, I have an official as well as a professional and personal interest in ensuring that the federal government is accountable to the taxpayers. The federal government's fiscal 2004 report was issued in record time. Unfortunately, for the eighth year in a row, GAO was unable to vouch for the accuracy and completeness of the information in the financial statements.

Recent accountability failures in the private sector underscore the importance of accurate and timely financial reporting. The scandals at Enron, Worldcom, and other corporations have led to restatements of financial statements and bankruptcies that have harmed countless shareholders, employees, pensioners, and other stakeholders, including entire communities. Here in Washington, the recently announced restatements at Fannie Mae and Freddie Mac hit uncomfortably close to home. We at GAO are committed to doing our best to ensure that such accountability failures are not repeated in the federal government.

Beyond the financial statement numbers, what does the federal government's annual report say about the results that are being achieved with the taxpayer dollars being spent? The answer is not much! It's bad enough that too few agencies adequately show the results they are getting with the taxpayer dollars they spend, but policymakers also frequently do not focus on the long-term impact of new spending and tax proposals before taking action on related legislation. Particularly troubling are the enormous commitments that we face in connection with Social Security, Medicare, Medicaid, and veteran's health care. Down the line, we could also be facing potential federal bailouts of several entities like the Pension Benefit Guaranty Corporation.

Over the years, our federal fiscal debates have gone from millions to billions to trillions. Unless you're an economist, a statistician, an actuary, or a CPA, these numbers are mind-boggling. What's a million dollars? When it comes to the federal government, a million dollars is practically pocket change. Last year, the federal government experienced a

deficit that averaged more than \$1 billion each and every day. That is more than \$750,000 a minute.

If you're honest about keeping score and include promised but unfunded Social Security and Medicare benefits along with explicit benefit and other commitments, the federal government's obligations, current liabilities and unfunded fiscal commitments are over \$43 trillion and rising. In the last year alone, this amount has risen by more than \$13 trillion, largely due to the new Medicare prescription drug benefit. Yes, that's trillions with 12 zeros rather than billions with 9 zeros. To put that number into perspective, even with the recent run up in housing prices, the estimated total net worth of every American, including Bill Gates and other billionaires, is only about \$47 trillion. That means that every American would have to fork over more than 90 percent of their net worth to cover the government's current promises. Stated differently, the current burden for every American works out to more than \$145,000. The numbers are even worse for full-time workers, whose share now exceeds \$350,000. That amount is growing every day and it isn't even tax deductible! Keep in mind that the average family income in this country is around \$42,000 a year.

As bad as these numbers are, it's the real-life consequences of unchecked deficits that are truly frightening. For example, if we continue as we have, higher interest rates are inevitable. It's only a matter of when and how high. As government borrows more and more money to finance its debt, less money will be available for companies to invest to stay competitive in today's global economy. Without meaningful changes, long-term economic growth will suffer, and along with it American jobs and purchasing power. And don't forget that high budget deficits can lead to slower growth, higher interest rates and higher inflation, which in many respects is the cruelest tax of all.

By continuing to run huge budget deficits, America is partially ceding control over its own destiny to others. Why? Because America's personal savings rate has reached historic lows. So guess who's been financing much of our spending spree in recent years? The answer is foreign investors. Since 1993 the share of publicly held debt owned by international investors has more than doubled, from 19% to over 40%. Last year, foreign investors purchased nearly \$399 billion in Treasury securities—just \$13 billion less than the size of the 2004 deficit! If these foreign investors lose confidence in U.S. securities as a safe haven and start to move their money elsewhere, our economy could take a serious and sudden hit. The recent decline in the value of the dollar may be a warning shot in this regard.

Mounting deficits and debt will also eventually imperil many government programs and services that Americans have come to take for granted. The reality is that government functions like national defense, homeland security, education, transportation, and our judicial system fall under the category of "discretionary spending." These programs are facing increasing budget pressures, and our ability to respond to new and emerging needs is also being constrained. If we don't get serious soon, many important programs at the state and local level will also feel the crunch. Right now, state and local governments play a key role in a range of important functions, such as educating our children, housing the poor, delivering health care, and building roads and bridges. But in

the future, state and local governments may not be able to count on as much federal help. Furthermore, states may also face additional unfunded federal mandates.

In the past, particularly in the decades since World War II, America was the world's engine of economic growth. We still are, but our long-term fiscal gap is so great today that there's no way we'll be able to grow our way out of the problem. Using plausible assumptions, closing our fiscal gap would require average real growth in double-digits for the next 75 years. By any measure, that's unrealistic. In fact, even during the boom years of the 1990s, the economy grew at an average annual real rate of only 3.2 percent.

If we continue on our present path, we'll see pressure for deep spending cuts or dramatic tax increases. GAO's long-term budget simulations paint a chilling picture. If we do nothing, by 2040 we may have to cut federal spending by more than half or raise federal taxes by more than two and half times to balance the budget. Clearly, the status quo is both unsustainable and difficult choices are unavoidable. And the longer we wait, the more onerous our options will become and the less transition time we will have.

So how do we start to turn things around? At the federal level, a crucial first step is to insist on truth and transparency in government operations, including federal financial reporting. The federal government must provide a fuller and fairer picture of existing budget deficits, the so-called "trust funds," and the growing financial burdens facing every American.

On the budget side, the current 10-year cash-flow projections are an improvement over past practices. But given known demographic trends, even these projections fail to capture the long-term consequences of today's spending and tax policy choices. In my view, elected representatives should have more explicit information on the present value dollar costs of major spending and tax bills—before they vote on them. This was not the case when Congress passed the Medicare prescription drug bill with its \$8.1 trillion price tag. The time has also come to reinstate budget controls, such as reasonable spending caps and responsible "pay-go" rules which would require any new spending increases or tax cuts to be paid for by equivalent tax increases and/or spending cuts.

Further reforms to the substance and timing of the current appropriations and authorization processes may also be needed. When considering these reforms, we should look to the states. In some ways, the states are way ahead of the federal government in dealing with fiscal imbalances. They have made hard choices in the past—partly driven by their state constitutions, partly by their inability to print money and partly by their sensitivity to their bond ratings!

From a more strategic and results based perspective, we also need to develop a set of key national performance and outcome-based indicators to measure America's position and progress on a range of economic, security, environmental, and social issues. Key indicators can help to inform strategic planning, enhance performance and accountability reporting, and improve key decision-making. Several countries, states, and localities have already adopted key indicator systems, but I'm sorry to say the United States still lacks such a system at the national level. This has meant that at times our

policymakers have been flying blind, not unlike an airplane pilot at night without an instrument panel. Importantly, we are currently looking at how states use performance information to reprioritize their budgets in tight fiscal times. We are also working with the National Academies and the OECD to help make key indicators become a reality in the U.S. and elsewhere.

Think about it. Each year, the federal government spends more than \$2 trillion on a wide range of programs and operations, provides hundreds of billions of dollars in tax preferences, and issues thousands of pages of regulations. And it does all this without having enough knowledge about whether federal policies, programs, and activities are making a real difference. Based on where we are headed, we need to engage in a baseline review of the entire federal government that encompasses three key dimensions.

First, we need to undertake a top-to-bottom review of government programs, policies, functions, and activities to ensure their relevance for the 21st century. This includes both discretionary and mandatory spending. Today, many if not most government policies and programs are based on conditions that existed when Harry Truman or Dwight Eisenhower were President. We cannot afford to spend increasingly limited taxpayer dollars on government policies and programs that were designed to deal with the problems of the past or can't show they're that making a meaningful difference today. Congress and the President need to decide which programs and policies remain priorities, which should be overhauled, and which have outlived their usefulness. Importantly, increases in targeted earmark spending combined with across-the-board cuts are not substitutes for making tough and informed choices about the base of government. These trends can result in adding fat and protecting ineffective programs while cutting muscle from high-priority and high-performing programs.

Second, we need to revisit existing tax policy and enforcement efforts. Every year, our government forgoes hundreds of billions of revenue because of existing tax preferences, significant uncollected back taxes, and tax evasion. In fact, in some years, the cost of tax preferences exceeds total discretionary spending. Our complex tax system distorts decisions to work, save, and invest—and that dampens economic growth. Complexity also creates opportunities for tax evasion through vehicles such as tax shelters. All of this raises questions about fairness with taxpayers wondering whether their friends, neighbors and business competitors are paying their fair share. Clearly, comprehensive tax reform is needed. Reform could also better position the United States to compete in today's global economy—one that is increasingly knowledge-based and subject to fast-paced technological change. It's important to recognize that the ripple effects of comprehensive tax reform will be felt at all levels of government.

Third, entitlement reform is essential. We need to put Social Security and Medicare on a sound footing and make them solvent, sustainable, and secure for both current and future generations. Actually, the problems with Social Security are not that difficult to solve. In fact, we now have a window of opportunity to exceed the expectations of all Americans—whether they'll be retiring 30 days or 30 years from now. I'd be happy to tell you more about how we can do this during the question and answer period.

On the other hand, it seems clear that the biggest single domestic challenge is health care, of which Medicare and Medicaid are a big part. Mounting health care costs are a problem for governments, employers, and individuals. Despite repeated efforts to rein in health care spending, costs continue to climb. Between 1990 and 2000, U.S. health care spending rose from \$696 billion to \$1.3 trillion. Spending on health care is projected to more than double again by the end of this decade. Clearly, such growth is unsustainable, and it's one of the main reasons why both the Medicare and Medicaid programs are on GAO's high-risk list. It's also one of the reasons that Medicaid costs represent the fastest growing and one of the largest budget items—second only to education—for states.

The problems affecting Medicare and Medicaid will be much more difficult to solve than Social Security. More broadly, we need to reconsider how we define, deliver, and finance health care in this country—both in the public and the private sectors. We need to weigh unlimited individual wants against specific societal needs and decide how responsibility for health care should be divided among employers, individuals, and governments.

Despite the huge amounts of money we're spending on medical care, broad access to basic coverage remains an elusive goal. The rising cost of government health care programs increases budget pressures at both the federal and state levels. Rising health care costs are also discouraging additional pension coverage, constraining wage increases, and reducing the tax base because an increasing percentage of employee compensation is coming in the form of nontaxable benefits like health insurance. Some reports suggest that rising health care premiums are also causing companies to move jobs offshore, cut overall employment levels, and hire part-time rather than full-time workers.

As you may have heard about in news stories, GAO recently released its new high-risk report, which deals primarily with the here and now. GAO's high-risk report lists current government programs and functions that need special focus and immediate attention. In addition, yesterday we issued a report on the results of a GAO forum on our long-range fiscal challenges.

In the next couple of weeks, GAO will be issuing its 21st Century Challenges Report, which will discuss where we are and where we're headed as a nation. This report will include a number of illustrative questions that policymakers should consider in examining the base of government. Frankly, it's going to take many years to get us back on a prudent and sustainable long-term fiscal track but the time to start is now.

There's clearly a real payoff for prompt action. By acting now, both America and Americans can minimize the need for drastic measures and give all of us more time to adjust to any changes. By acting now, we can help to ensure that the miracle of compounding eventually works for us rather than against us—as it is today. By acting now, we can also avoid a dangerous upward spiral of deficits and debt that will ultimately harm America and every American family. By acting now, we can enhance our credibility with investors and improve public confidence in the government's ability to deal with large, complex and controversial fiscal issues before a crisis is upon us.

Finally, by acting now, we can reduce the burdens that will otherwise be imposed on our children and grandchildren and give them more freedom of choice over what role they would like for government to play in the future.

As a member of the Sons of the American Revolution, I sometimes wonder what the Founding Fathers would think if they came back today. George Washington, Thomas Jefferson, Benjamin Franklin, Alexander Hamilton, and the other founders can seem larger than life, but most of them earned a living as farmers and businessmen. They understood first hand both the value of thrift and the perils of personal and public debt. Theirs was, after all, a world with debtors' prisons. With good reason, Ben Franklin said, "He who goes a borrowing goes a sorrowing."

At the same time, our first Secretary of the Treasury, Alexander Hamilton, was a realist who recognized that adding debt in times of war or economic recession may be a temporary necessity. It seems clear, however, that our Founding Fathers did not believe that adding debt in the normal course of events was either prudent or appropriate.

No less than the father of our country, George Washington felt that the most important personal value was courage and the most important institutional value was fiscal responsibility. His views are particularly timely at this point in our nation's history.

Somehow, in the last 200 years we seem to have forgotten the sound advice from Washington, Hamilton and Franklin. If the Founding Fathers were to return today, I have no doubt they'd be justifiably proud of many things our nation has accomplished, as we are. But I suspect many of them would be shocked and saddened by our willingness to forgo fiscal discipline and pile on both personal and public debt. It's likely that our Founding Fathers would see our mounting debt as a violation of our stewardship responsibility to future generations of Americans.

This is at the heart of my message. For the debate about our fiscal future is, ultimately, not about numbers but about values. The debate we are really having is about the kind of world we're prepared to pass on to our children and grandchildren. The time has come for responsible public officials to heed George Washington's words by demonstrating more individual courage and recommitting to institutional fiscal responsibility.

It's very important to emphasize here that the nation's fiscal imbalance is not a partisan issue. There are many players we could blame for our current financial situation. After all, it's been many years in the making. The point is that while we can't change the past, we can and must do something about our future.

Overcoming our fiscal challenges will take the combined efforts of both sides of the aisle in Washington and in every state capital. Right now, what we need are leaders who will acknowledge that we have a problem and are willing do something about it. In this regard, actions speak louder than words.

In my judgment, the worst thing that could happen is to continue on our present path and do nothing. Because once a crisis is upon us, we face terrible choices. And while it's true that other nations also have long-range fiscal challenges, who wants to be the best looking horse in the glue factory?

Although my message is sobering and I want you to take our situation seriously, I don't want you to go away thinking that things are hopeless or that I am pessimistic. That's far from true and those who know me will attest to the fact that I am a results oriented optimistic by nature. After all, America has overcome much more serious challenges in the past. Furthermore, in America, anything is possible with leadership, vision, commitment, and persistence. But we need to get serious and we need to act soon. Keep in mind, the passengers on the Titanic had a smooth ride and a great time until the very moment the ship hit the iceberg.

Today, every American needs to be part of the solution. In my view, our best hope for change is for people who live on Main Street to recognize the magnitude of our challenge and appreciate the risks posed by these deficits to them, their children and their grandchildren.

If the folks who live on Main Street remain silent, significant and sustainable change is unlikely. After all, why should any elected official stick his or her neck out on a complex and controversial issue if no one cares? Younger Americans especially need to become active in this discussion because they and their children will bear the heaviest burden if today's leaders fail to act.

State and local governments need to play a strong role in our fiscal challenge debate, because in the end, every government entity and public servant, myself included, is in the same boat. After all, bad news eventually flows down hill. This means we've got to start paddling together, or we'll surely sink separately.

My hope is that when you leave here today, you will spread the word among your friends and colleagues at the state and local level. We have to start doing something about America's triple deficits. Everyone from governors and mayors to rank-and-file state and local employees have a stake in this cause, and they need to become more informed and involved in demanding change and suggesting constructive and realistic solutions.

In closing, one of my favorite Presidents is Theodore Roosevelt. As a person of strong character who was trustbuster, environmentalist, internationalist and a winner of both the Medal of Honor and the Nobel Peace Prize, he showed that if you put your mind to something, anything is possible. TR said, "Fighting for the right [cause] is the noblest sport the world affords." When it comes to our current fiscal challenges, I hope you'll join me in working together as modern-day patriots to insist on the facts, speak the truth, and help save our nation's future.

Thank you for your time and attention. I'd be happy to answer any questions that you may have.