



UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

Our Nation's Long-Term Fiscal Challenge

**State and Local Governments Will
Likely Face Persistent Fiscal
Challenges in the Next Decade**

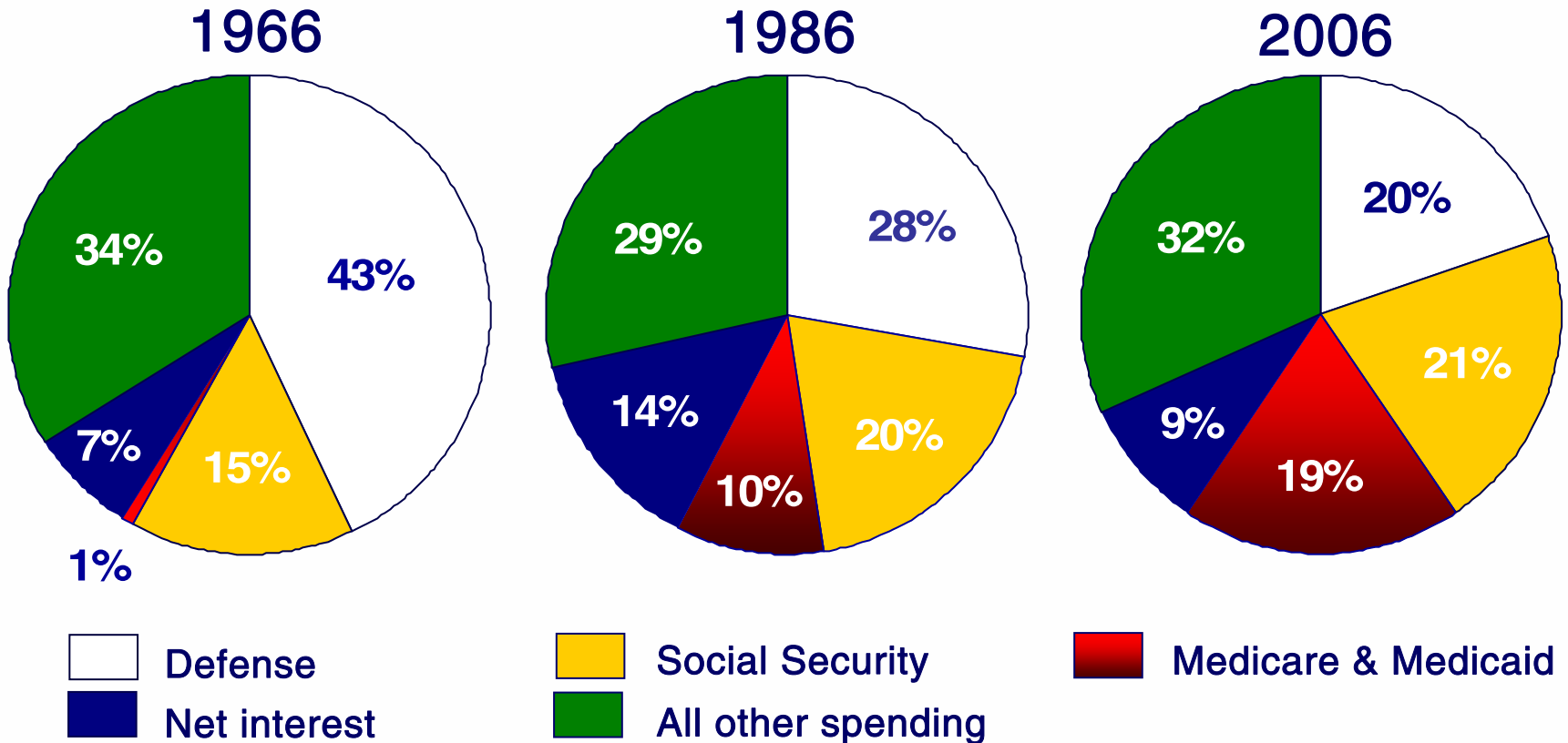
**National Press Club
July 18, 2007**

**The Honorable David M. Walker
Comptroller General of the United States**

GAO-07-1113CG



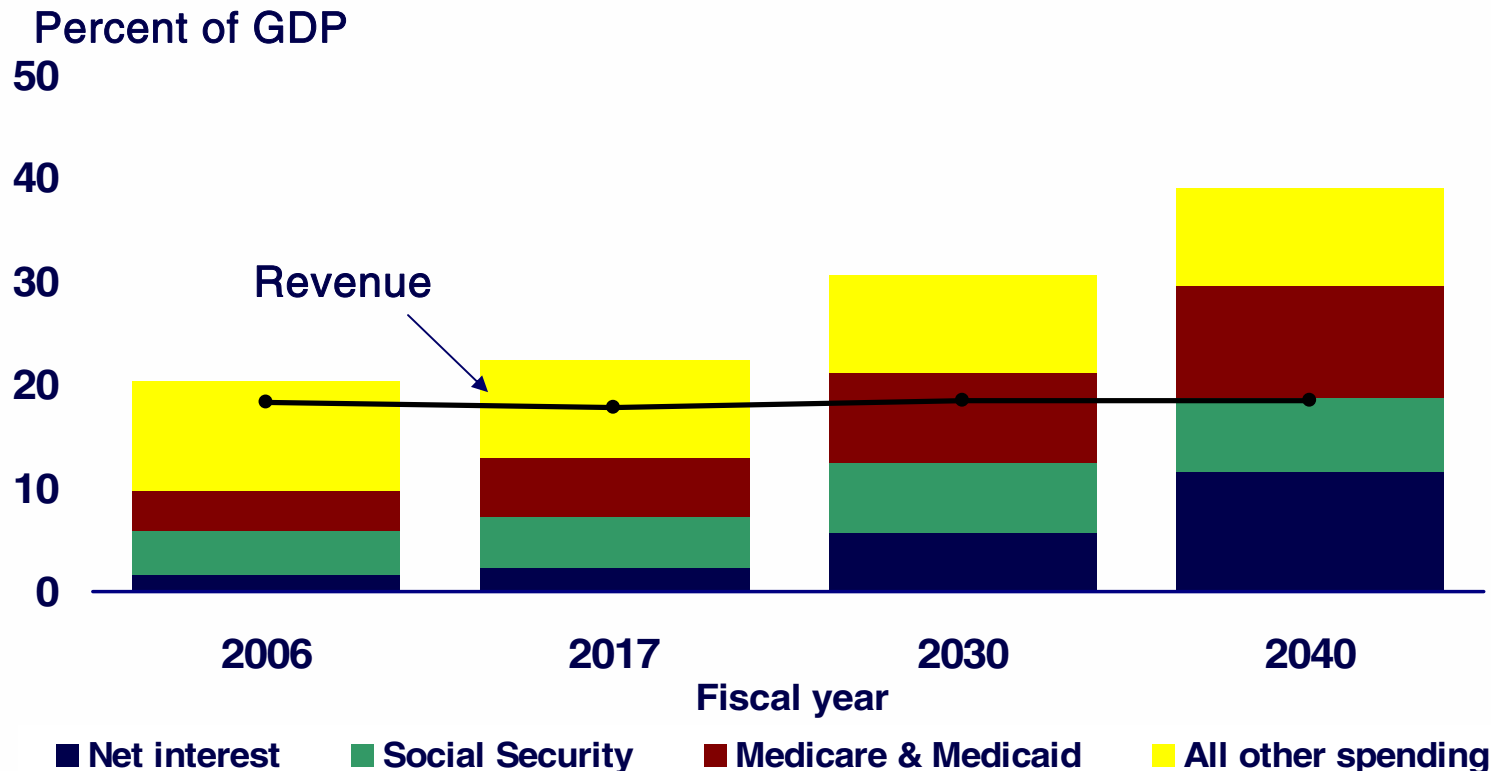
Composition of Federal Spending



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

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

Federal Discretionary Spending Grows with GDP After 2007; All Expiring Tax Provisions Extended to 2017 (Thereafter Revenue Returns to Historical Average of 18.3% of GDP plus Deferred Revenue)



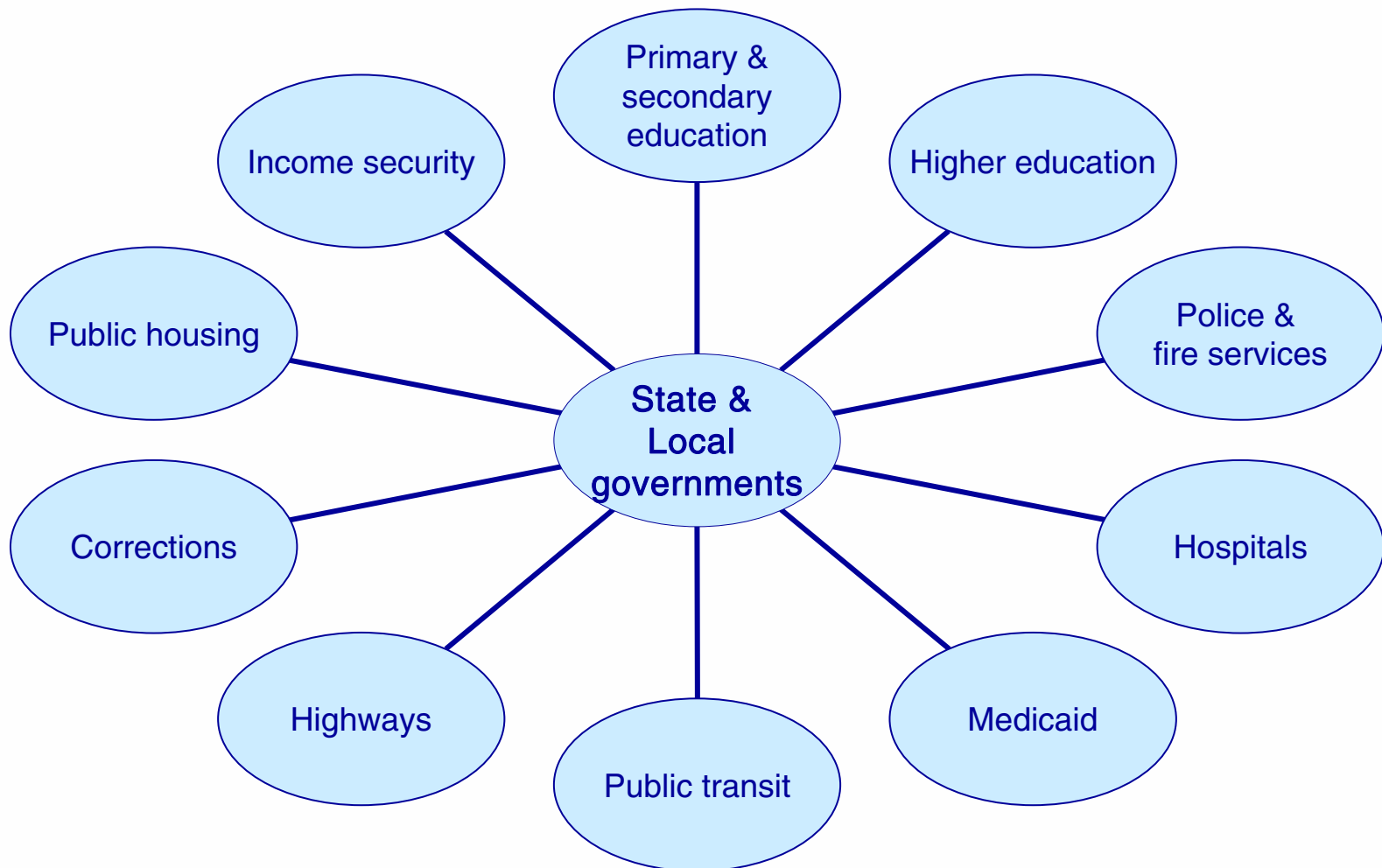
Source: GAO's April 2007 analysis.

Notes: Discretionary spending grows with GDP after 2007. 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.

Overview of State and Local Governments in U.S. Federal System

- 87,575 state and local governments
- States and localities received over \$400 billion in federal grant funds in 2006
- State and local governments collected \$1.2 trillion in tax receipts in 2006
- Other sources of funds: asset income, transfers from business and persons, and issuance of bonds
- State and local government made nearly \$2 trillion in operating and capital expenditures in 2006

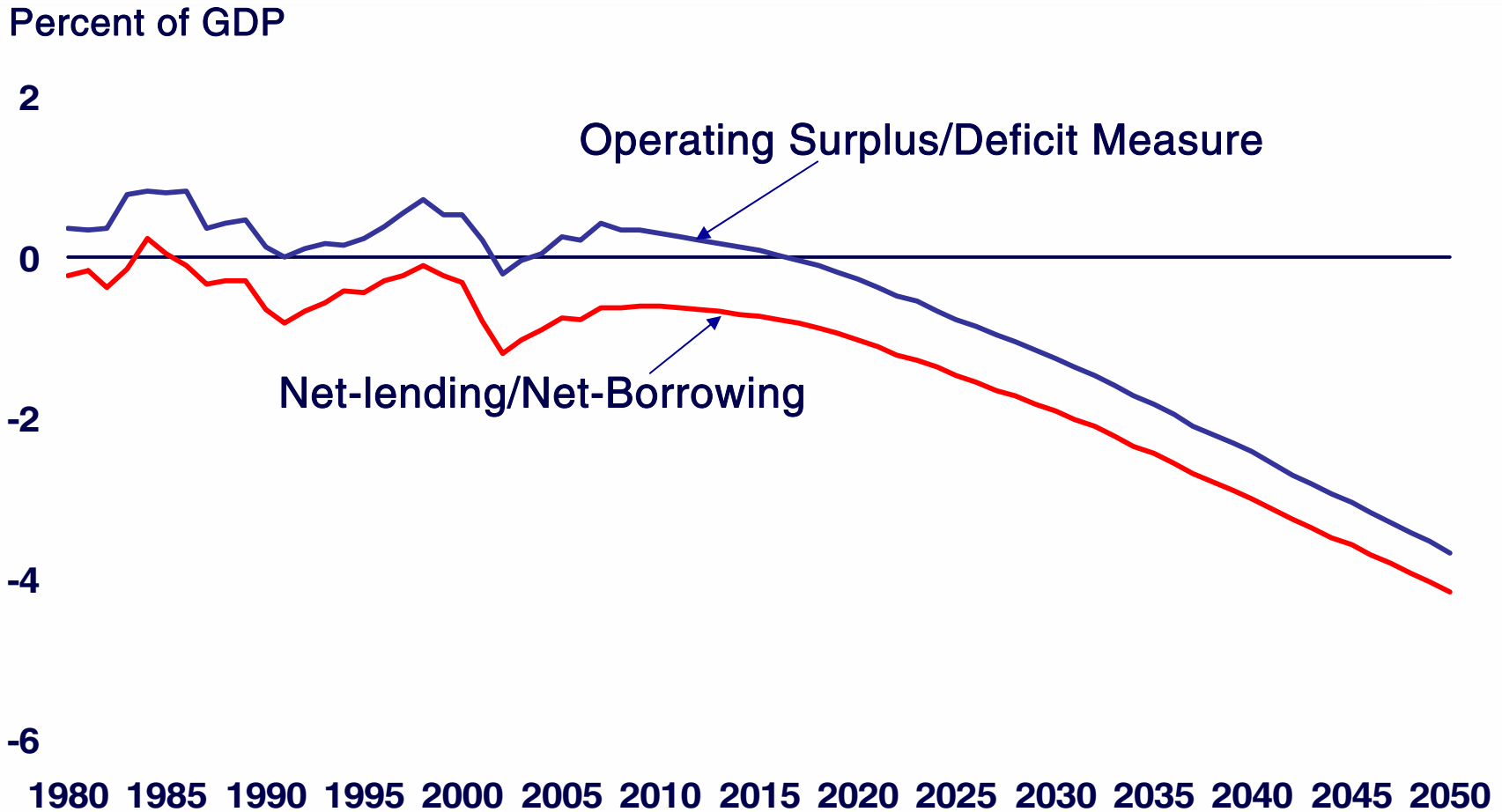
Services Provided by State and Local Governments



GAO's State and Local Fiscal Model

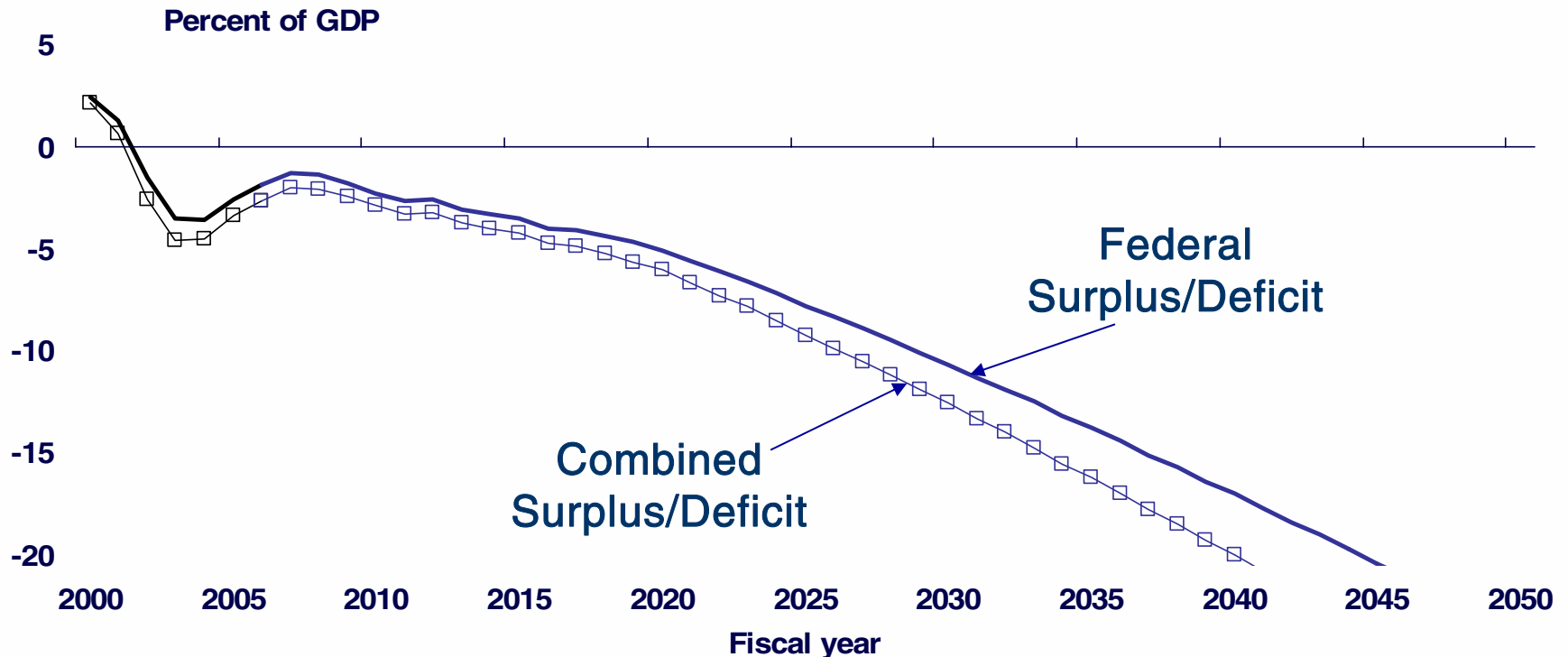
- The state and local simulations project receipts and expenditures until 2050
- The state and local simulations are based on current and historical spending and revenue patterns and assume that current policies of state and local governments remain unchanged
- The simulations aggregate fiscal outcomes for the state and local government sector
- GAO's primary data source is the National Income and Product Accounts (NIPAs)

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.

State and Local Fiscal Challenges Add to the Federal Government's Fiscal Challenge

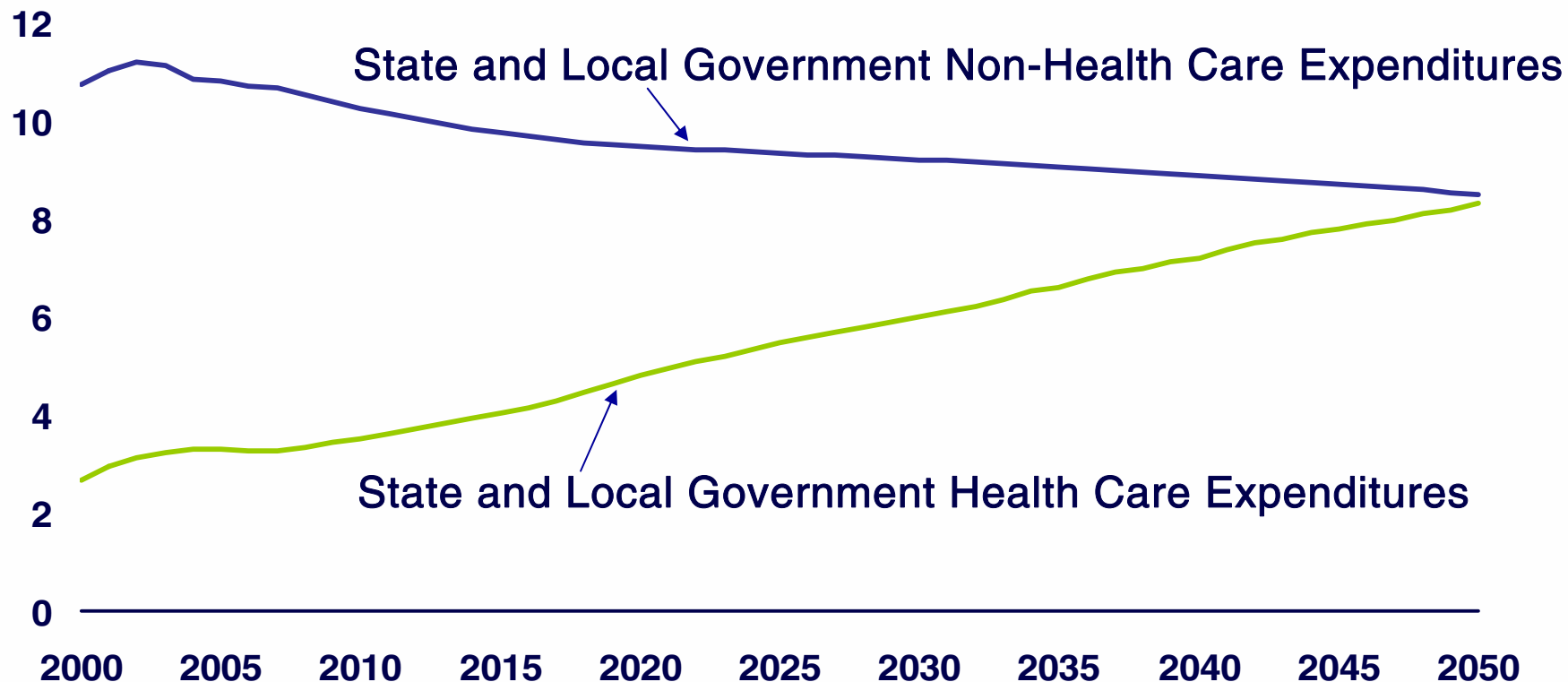


Sources: Historical data from National Income and Product Accounts, GAO Analysis

Note: Historical data from 2000 – 2006, projections from 2007 – 2050; state and local balance measure is similar to the federal unified budget measure. Federal Simulation Assumptions: Discretionary spending grows with GDP after 2007. 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.

State and Local Fiscal Difficulties Are Largely Driven by Rising Health Costs

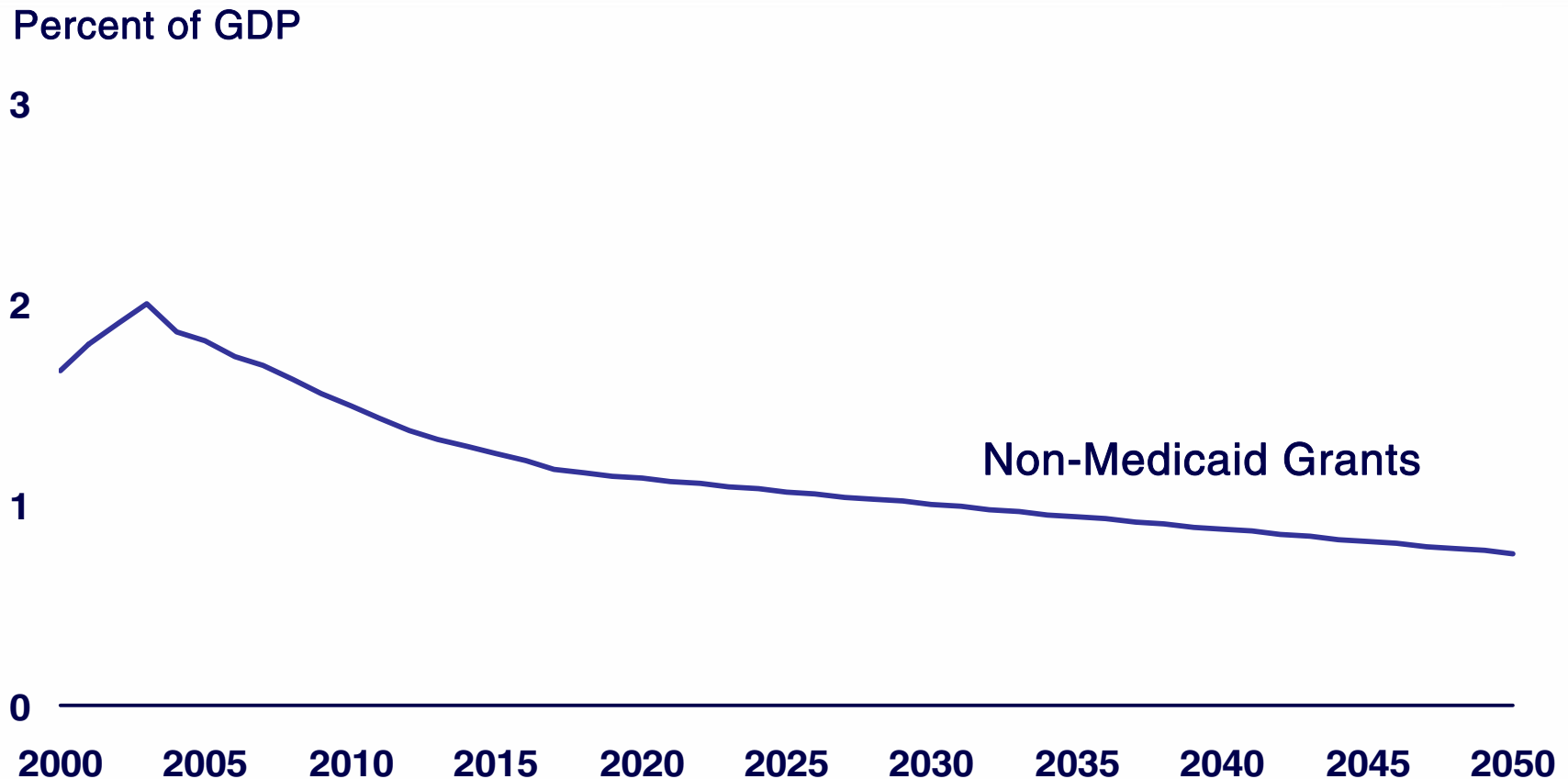
Percent of GDP



Sources: Historical data from National Income and Product Accounts. Historical data from 2000 – 2006, projections from 2007 – 2050.

Note: Health care expenditures include health care benefits for employees and retirees and medical spending on behalf of individuals, such as Medicaid and SCHIP; Non-Health care Expenditures includes all expenditures with the exception of health care and interest payments.

Federal Non-Medicaid Grants Are Projected to Decline as Percentage of GDP

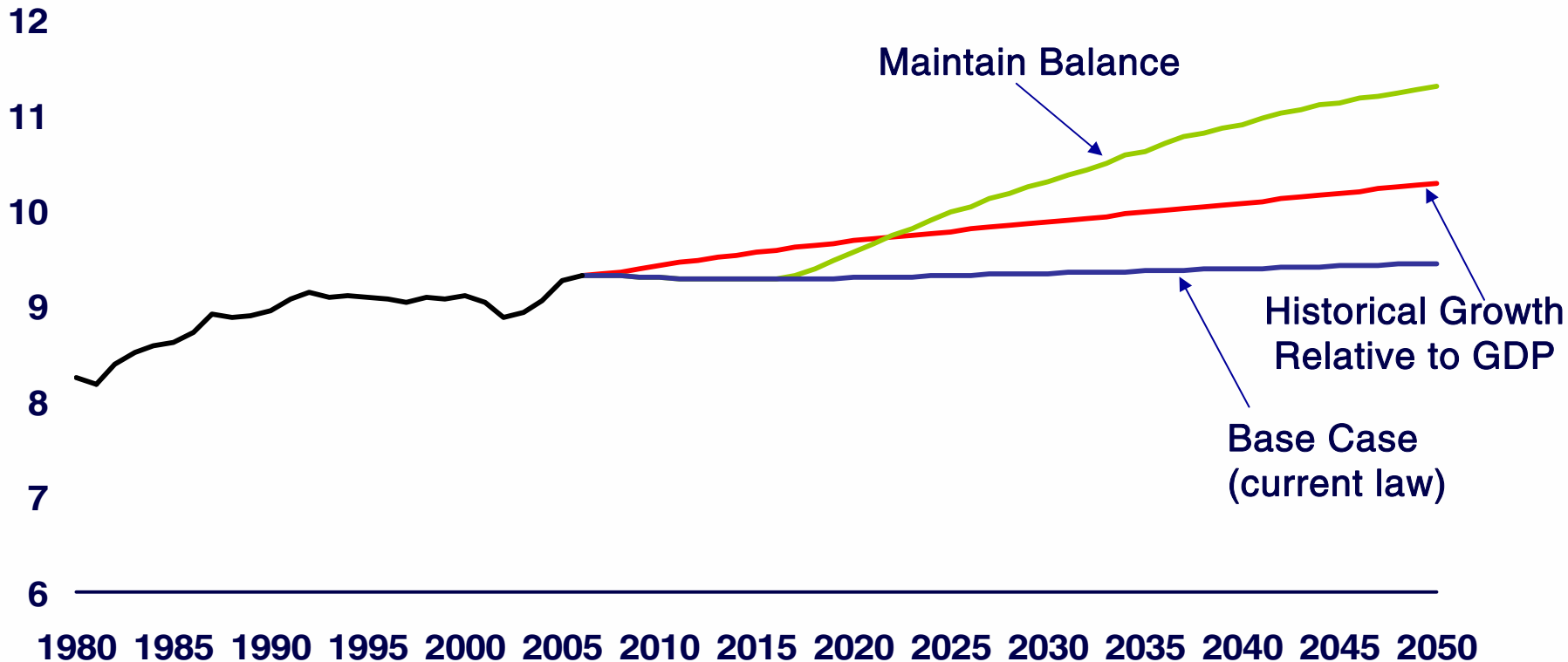


Sources: Historical data from National Income and Product Accounts. Historical data from 2000 – 2006, projections from 2007 – 2050.

Note: Non-Medicaid grants includes investment and other non-Medicaid grants.

State and Local Tax Receipts Would Have to Rise Well Above Projections under Current Law to Maintain Balance

Taxes as a percent of GDP

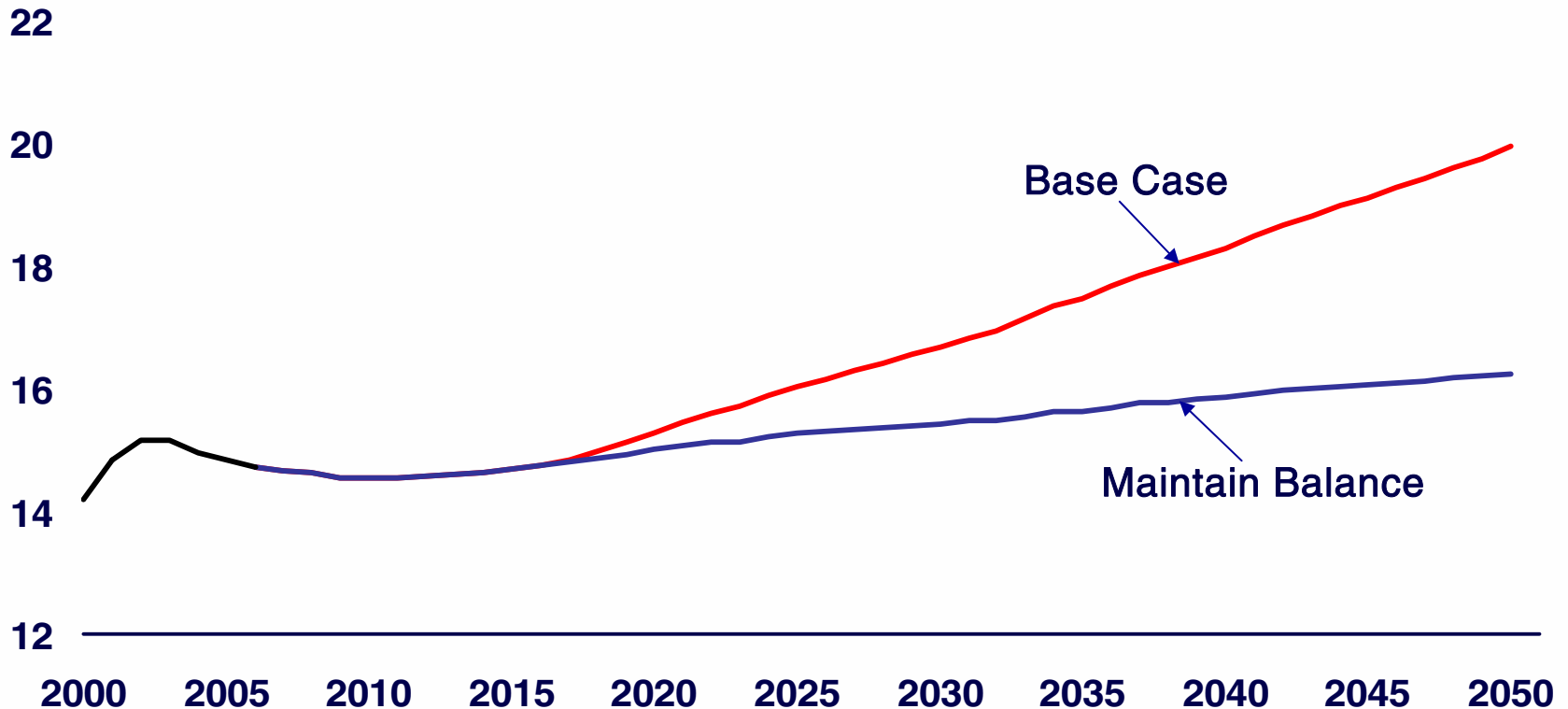


Sources: Historical data from National Income and Product Accounts

Note: Historical data from 2000 – 2006, projections from 2007 – 2050

State and Local Expenditures Would Have to Be Cut Substantially Relative to Base Case to Maintain Balance

Expenditures as a percent of GDP



Sources: Historical data from National Income and Product Accounts

Note: Historical data from 2000 – 2006, projections from 2007 – 2050

State and Local Fiscal Gap Represents a Substantial Portion of Taxes and Spending

- To keep the debt to GDP ratio from rising above the current level:
 - State and local tax levels would have to rise immediately and permanently by 16.8 percent, or
 - State and local spending financed by own revenues would have to decrease immediately and permanently by 14.1 percent
- Fiscal gap in trillions of 2007 dollars: \$11.5 trillion
- Fiscal gap as share of the present value of GDP: 1.6%

State and Local Fiscal Gap and Federal Fiscal Gap

- Calculated in a similar fashion, federal fiscal gap is:
 - \$54.5 trillion in 2007 dollars, or
 - 7.4 percent of the present value of GDP
- The combined fiscal gap for all of the nation's governments is:
 - \$66 trillion in 2007 dollars, or
 - 9 percent of the present value of GDP

No Easy Solutions

- Expected rise in health care costs is problem faced by all levels of government
- State and local tax receipts would need to grow substantially faster than tax receipts have historically grown (and much faster than our base case simulations) to solve the potential fiscal problems
- It does not appear that the sector can look to the federal government for increased assistance AND the federal government can not look to the state and local sector for assistance
- It would take very substantive cuts in sector expenditures on basic services to avert the potential fiscal problems
- All levels of government will need to engage in serious and substantive transformation efforts to address their respective fiscal challenges

All Levels of Government Face Fiscal Challenges

- Federal, State and Local Fiscal Challenges Combine to Pose a Serious National Fiscal Sustainability Challenge
- Interdependence Necessitates National Discussion and Debate
 - Role of government in the 21st Century
 - Reexamination of roles and responsibilities
 - Prioritization of critical reforms
- Shared Burdens Require Shared Solutions
- Federal and State/Local Annual Budget Challenges Escalate Beginning in About 10 Years
- The Time to Start is Now



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On the Web

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

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