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Highlights

Highlights of GAO-11-201SP.

The Federal Government's Long-Term Fiscal Outlook

Fall 2010 Update

November 2010

GAO's Long-Term Fiscal Simulations

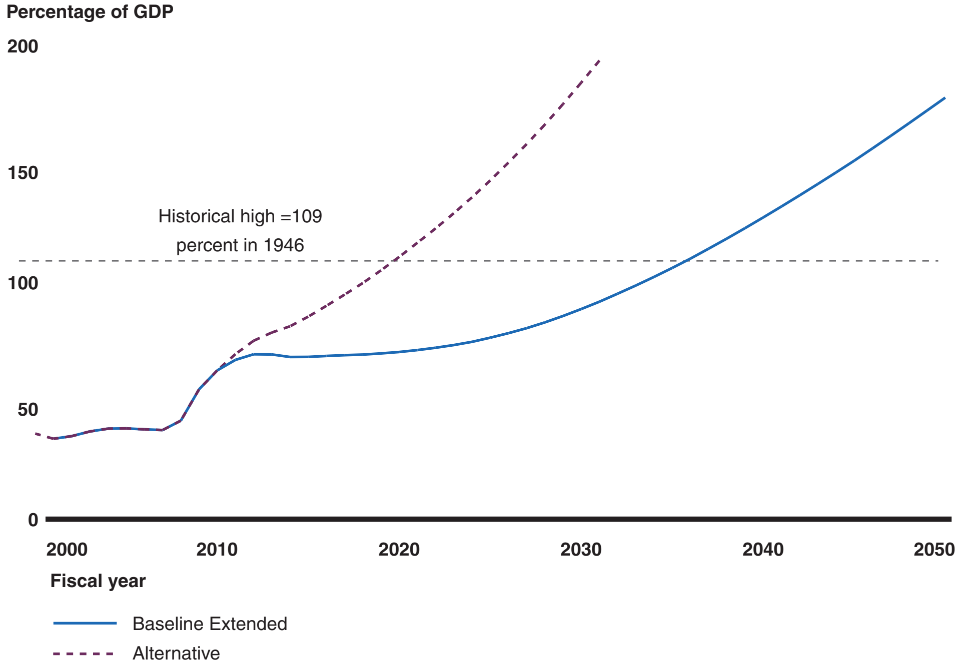
Since 1992, GAO has published long-term fiscal simulations showing federal deficits and debt levels under both "Baseline Extended" and an "Alternative" set of assumptions. GAO has regularly updated these twice a year. GAO developed its long-term model in response to a bipartisan request from Members of Congress concerned about the long-term effects of fiscal policy. GAO's simulations provide a broad context for consideration of policy options by illustrating both the importance of taking action and the magnitude of the steps necessary to change the path. They are not intended to suggest particular policy choices that are the prerogative of elected officials but rather to help facilitate a dialog on this important issue.

As in the past, GAO shows two simulations: "Baseline Extended" and an "Alternative." Each is run using two different projections for Social Security and the major health entitlements—CBO's baseline and alternative assumptions and the Social Security and Medicare Trustees' (Trustees) intermediate assumptions and projections based on the Centers for Medicare & Medicaid Services Office of the Actuary (CMS Actuary) alternative assumptions. (See below.)

"**Baseline Extended"** follows the Congressional Budget Office's (CBO) August 2010 baseline estimates for the first 10 years and then simply holds revenue and spending other than interest on the debt and the large entitlement programs (Social Security, Medicare and Medicaid) constant as a share of gross domestic product (GDP). As a share of GDP, revenue over the entire period is higher than the 20-and 40-year historical average; discretionary spending is below both the 20- and 40-year average.

GAO's annual fall update of its long-term simulations underscores the need to address the long-term sustainability of the federal government's fiscal policies. While the economy is still fragile and in need of careful attention, there is wide agreement on the need to look not only at the near-term but also at steps that begin to change the long-term fiscal path as soon as possible without slowing the recovery. With the passage of time the window to address the long-term challenge narrows and the magnitude of the required changes grows. The federal government faces long-term fiscal pressures that predate the economic downturn and are driven on the spending side largely by rising health care costs and an aging population. GAO's simulations show continually increasing levels of debt that are unsustainable over the long-term (see fig. 1). Under the Alternative simulation, debt held by the public as a share of GDP would exceed the historical high reached in the aftermath of World War II by 2020.

Figure 1: Debt Held by the Public under the Two Fiscal Policy Simulations with Different Social Security, Medicare and Medicaid Projections



Source: GAO.

Note: Data are from GAO's Fall 2010 simulations based on the Trustees' assumptions for Social Security and the Trustees' and CMS Actuary's assumptions for Medicare.

Both of these simulations incorporate effects of health care legislation enacted in March 2010, which includes a number of provisions to control the growth of federal health care spending.[1] There is a notable improvement in the long-term outlook under the Baseline Extended simulation, which assumes full implementation and effectiveness of cost control provisions, although

[1]Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), *as amended by* Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

In the **"Alternative"** simulation, all tax provisions are extended to 2020 and the alternative minimum tax (AMT) exemption amount is indexed to inflation through 2020; revenues are then brought back to the historical average as a share of GDP; discretionary spending grows with GDP during the entire period—keeping it just below the 40-year historical average as a share of GDP; Medicare physician payment rates are not reduced as in CBO's baseline**.**

The two different sets of projections for Social Security and the major health entitlement programs are as follows: For Baseline Extended GAO uses (i) the Social Security and Medicare Trustees' intermediate projections from their most recent report issued in August and (ii) the CBO projections that are closest to current law and CBO's cost estimates for the recently enacted health care legislation. For the Alternative, projections for the major health entitlement programs are based on: (i) The CMS Actuary's alternative projections, which assume that the full cost containment in the health care legislation is not sustained and (ii) the CBO alternative which assumed some of the policies intended to restrain growth in health care spending would not continue after 2020. At this point the spending effects of the cost containment mechanisms are unknown.

GAO also calculates the Fiscal Gap—the size of action that must be taken to stabilize debt at the current share of GDP.

Additional information on the federal fiscal outlook, federal debt, and the outlook for the state and local government sector is available at: www.gao.gov/special.pubs/longterm/

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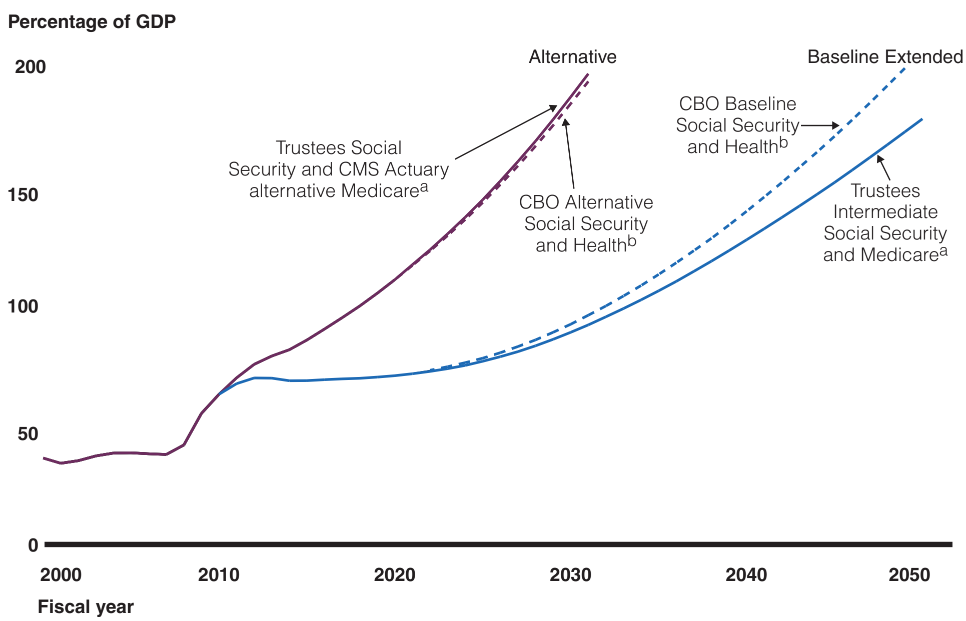
some—including the Trustees, CBO and the CMS Actuary—have raised questions about the sustainability of certain of these cost controls. These concerns are reflected in the more pessimistic Alternative scenario, which incorporates CBO and CMS alternative projections, which assume a breakdown in some of these cost control mechanisms after 2020 and a return to historical rapid health care spending growth rates. However, even in GAO's Baseline Extended simulation, debt increases continuously in future years, surpassing the historical high in the mid-2030s. More must be done even if the implementation and effectiveness of these cost containment provisions is assumed. The timing of the debt build up varies depending on the assumptions used, but the overall picture is the same: the federal government is on an unsustainable fiscal path.

As in previous updates, GAO shows the long-term outlook using two different sources—the Trustees and CBO—for the long-term projections of Social Security and major health entitlement programs (Medicare, Medicaid and others). Both CBO and the CMS Actuary offer two alternative projections for major health entitlement programs based on different assumptions about the sustainability of health care cost containment provisions (see left). As figure 2 shows, the simulation results using the Trustees and CBO assumptions are not materially different.

Figure 2: Debt Held by the Public under Two Fiscal Policy Simulations with Different Assumptions for Social Security and Major Health Entitlement Programs



Source: GAO.

Notes: [a]Medicaid, CHIP, and exchange subsidies spending is based on CBO's June 2010 projections adjusted to reflect excess cost growth consistent with Trustees' intermediate projections in the Baseline Extended and CMS Actuaries' alternative projections in the Alternative simulation.

[b]For these simulations, we use CBO's most recent long-term projections for Medicare; Medicaid, CHIP, and exchange subsidies; and Social Security from CBO's *The Long-Term Budget Outlook* (June 2010) and *2010 Long-Term Projections for Social Security: Additional Information* (October 2010).

These long-term simulations show that absent additional policy actions the federal government faces unsustainable growth in debt. Health care legislation enacted earlier this year has the potential to slow the growth of federal health care spending. However, even under the more optimistic Baseline Extended scenario, which assumes the full implementation and effectiveness of cost control provisions, debt grows continuously over the long term indicating that more needs to be done. As policymakers consider both the current economic weakness and any recommendations put forth by the National Commission on Fiscal Responsibility and Reform and other policy groups, it is clear that over the long term historical levels of spending and revenue cannot be maintained going forward.