

UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

AMERICA'S FISCAL FUTURE

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

NATIONAL CONFERENCE OF STATE LEGISLATURES

April 8, 2006

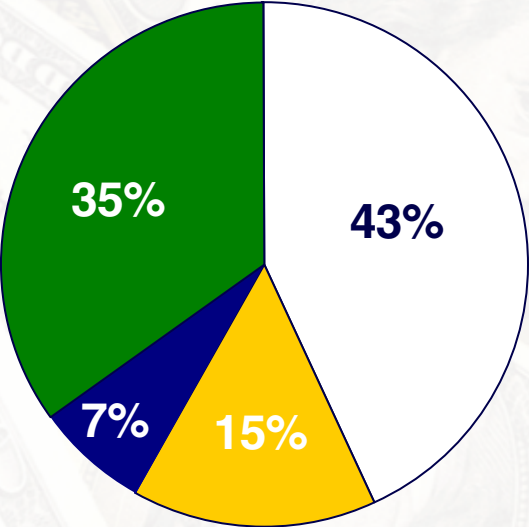


The Case for Change

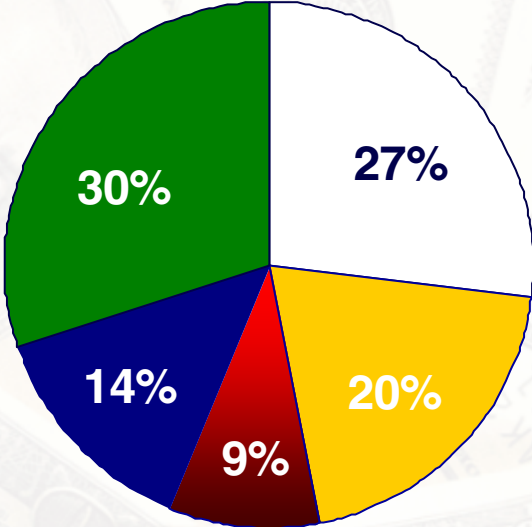
- **The federal government is on a “burning platform,” and the status quo way of doing business is unacceptable for a variety of reasons, including:**
 - Past fiscal trends and significant long-range challenges
 - Rising public expectations for demonstrable results and enhanced responsiveness
 - Selected trends and challenges having no boundaries
 - Additional resource demands due to recent terrorism events in the United States
 - Government performance/accountability and high risk challenges, including the lack of effective human capital strategies

Composition of Federal Spending

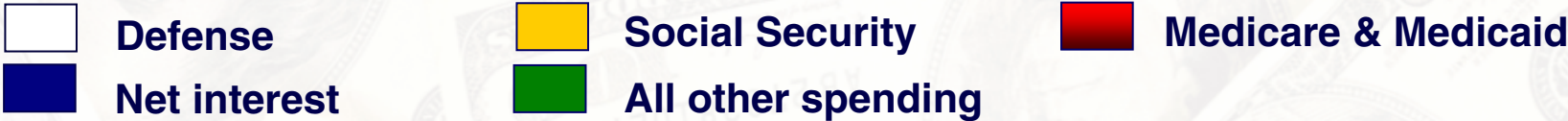
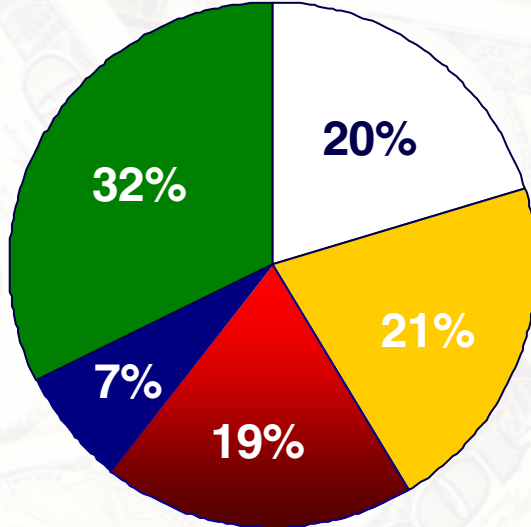
1965



1985

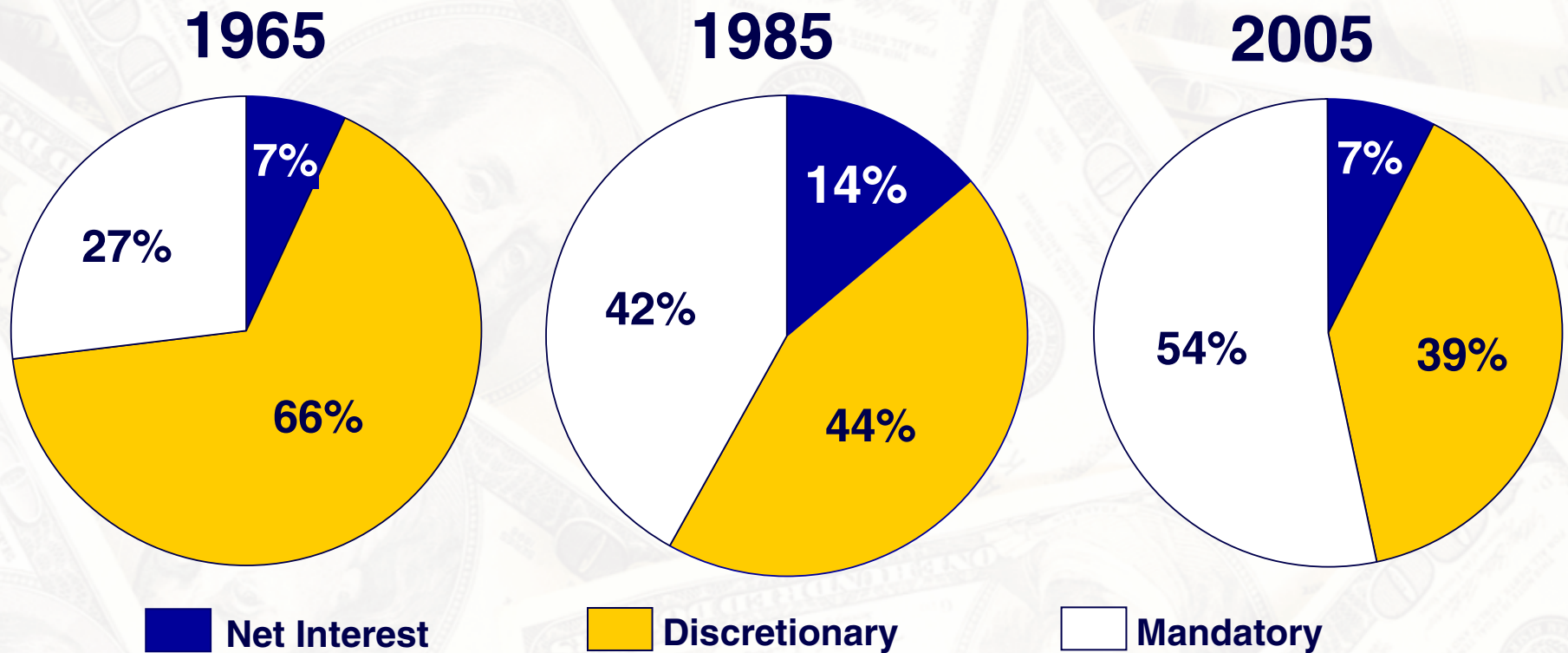


2005



Source: Office of Management and Budget.

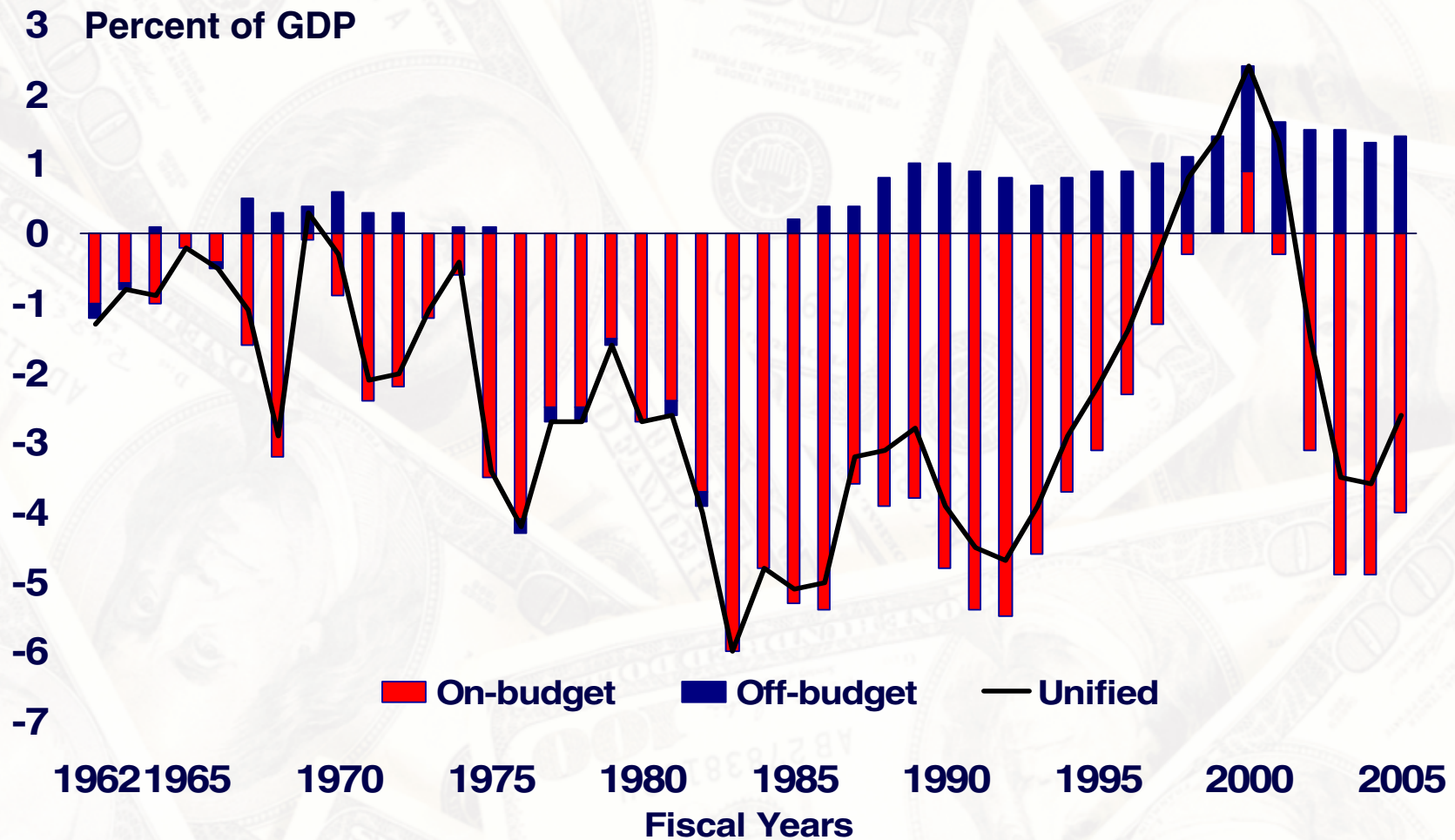
Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

Surplus or Deficit as a Share of GDP

Fiscal Years 1962-2005



Source: Office of Management and Budget

Fiscal Year 2004 and 2005 Deficits and Net Operating Costs

	Fiscal Year 2004	Fiscal Year 2005
	(\$ Billion)	
On-Budget Deficit	(568)	(494)
Off-Budget Surplus*	155	175
Unified Deficit	(413)	(318)
Net Operating Cost	(616)	(760)

*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.

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

Estimated Fiscal Exposures

(\$ trillions)

	2000	2005
• Explicit liabilities	\$6.9	\$9.9
<ul style="list-style-type: none"> • Publicly held debt • Military & civilian pensions & retiree health • Other 		
• Commitments & contingencies	0.5	0.9
<ul style="list-style-type: none"> • E.g., PBGC, undelivered orders 		
• Implicit exposures	13.0	35.6
<ul style="list-style-type: none"> • Future Social Security benefits 	3.8	5.7
<ul style="list-style-type: none"> • Future Medicare Part A benefits 	2.7	8.8
<ul style="list-style-type: none"> • Future Medicare Part B benefits 	6.5	12.4
<ul style="list-style-type: none"> • Future Medicare Part D benefits 	--	8.7
Total	\$20.4	\$46.4

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.

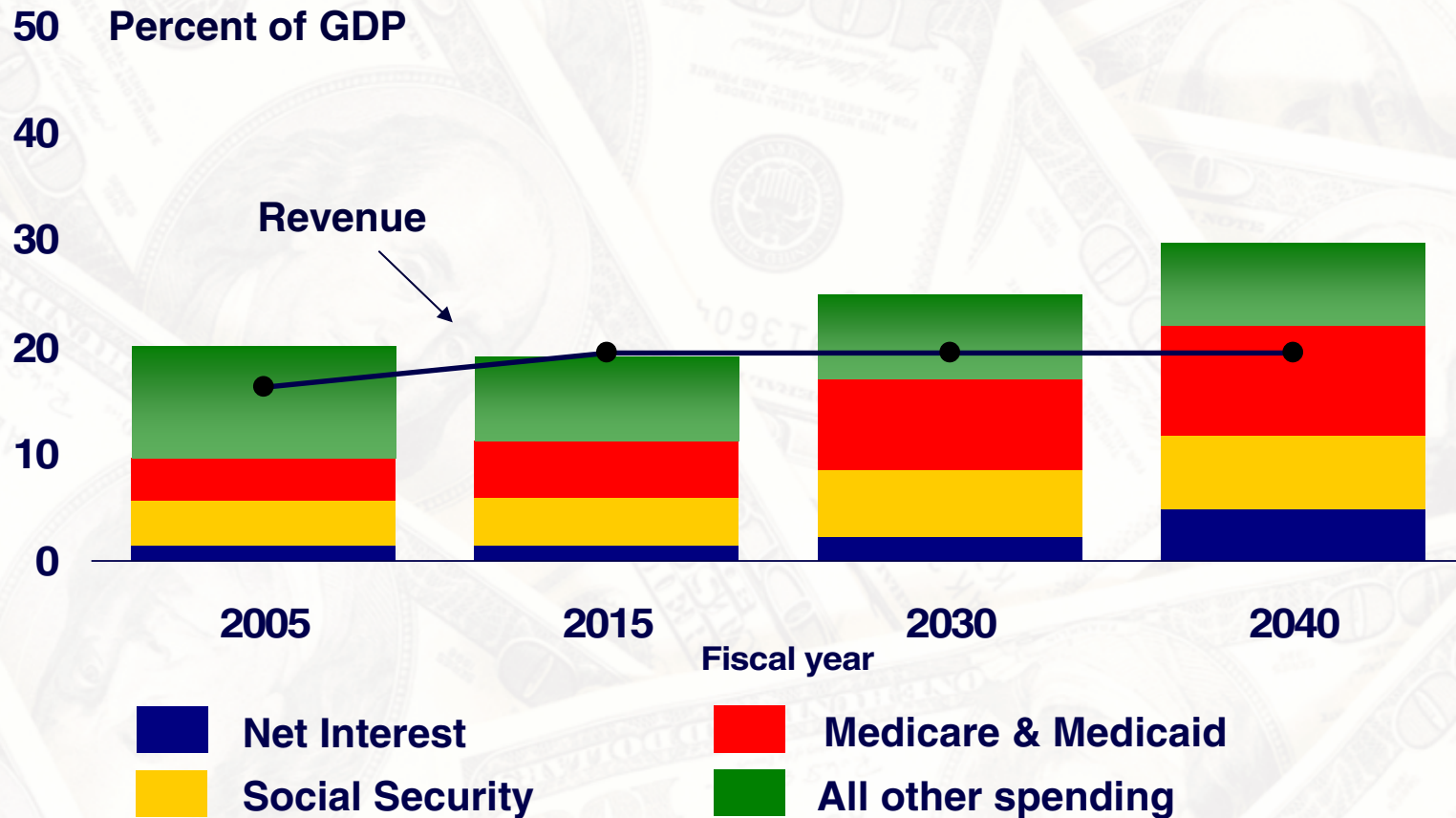
How Big is Our Growing Fiscal Burden?

	2000	2005
Total Fiscal Exposures	\$20.4 trillion	\$46.4 trillion
Burden		
Per Person	\$72,000	\$156,000
Per Full-time Worker	\$165,000	\$375,000
Per Household	\$189,000	\$411,000

Source: GAO analysis.

Composition of Spending as a Share of GDP

Under Baseline Extended

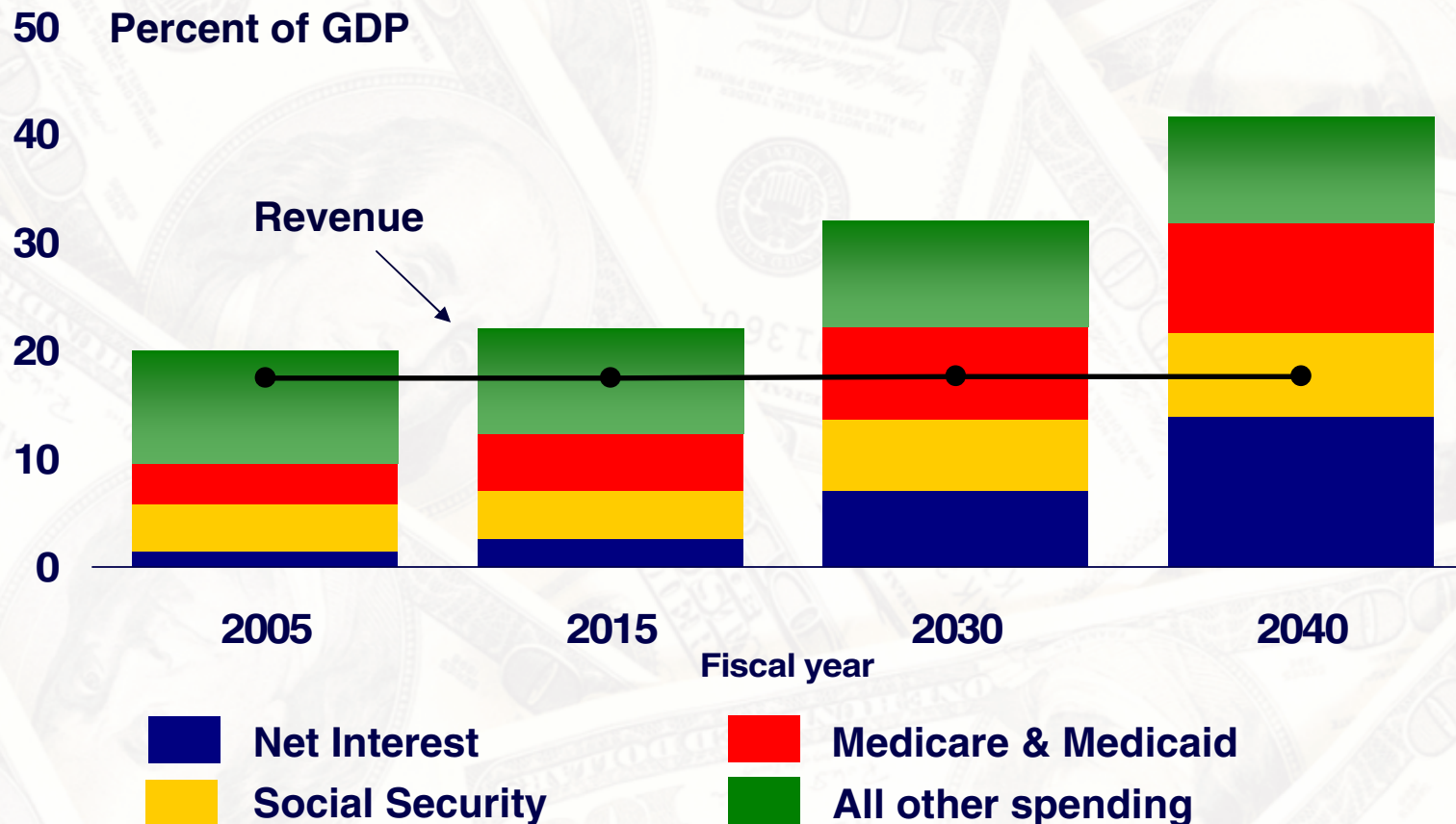


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2016 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2016, revenue as a share of GDP is held constant.

Source: GAO's January 2006 analysis.

Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP after 2006
and All Expiring Tax Provisions are Extended

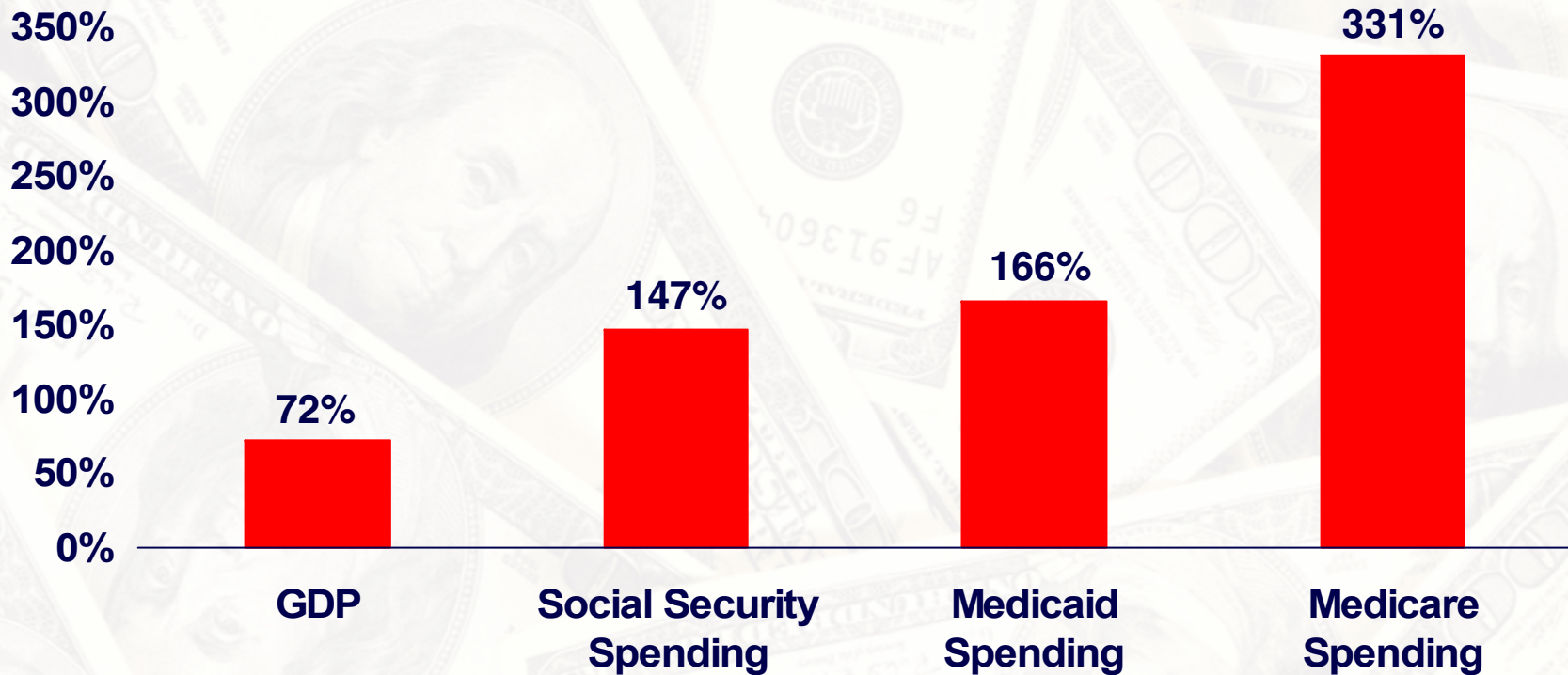


Note: This includes certain tax provisions that expired at the end of 2005, such as the increased AMT exemption amount.

Source: GAO's January 2006 analysis.

Growth in Spending for Social Security, Medicare, and Medicaid Expected to Outpace Economic Growth

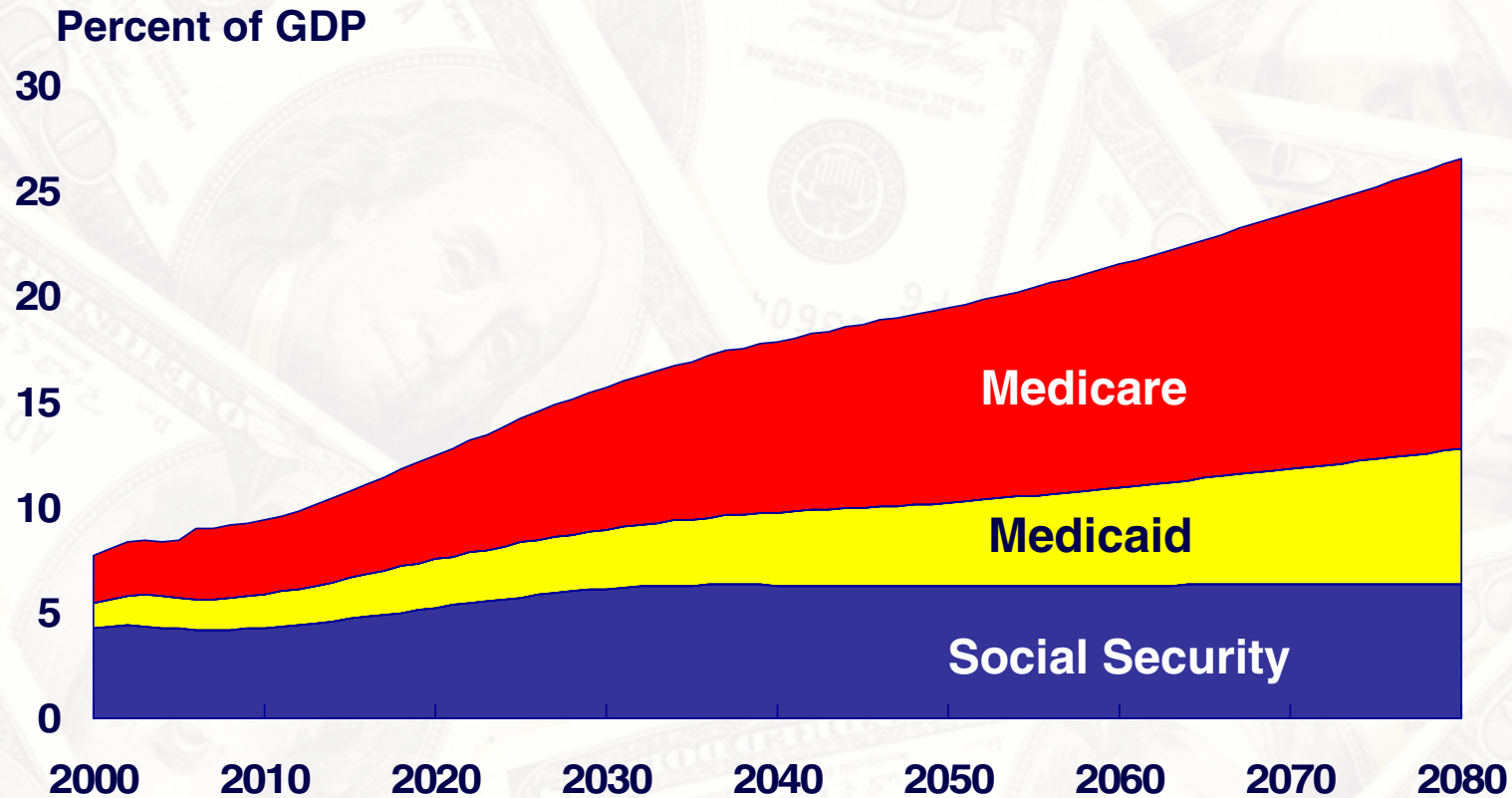
Growth in constant dollars 2005-2030



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.

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.

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.

Note: Social Security and Medicare projections based on the intermediate assumptions of the 2005 Trustees' Reports. Medicaid projections based on CBO's January 2006 short-term Medicaid estimates and CBO's December 2005 long-term Medicaid projections under mid-range assumptions.

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

200,000
175,000
150,000
125,000
100,000
75,000
50,000
25,000
0

2005

2030

2040

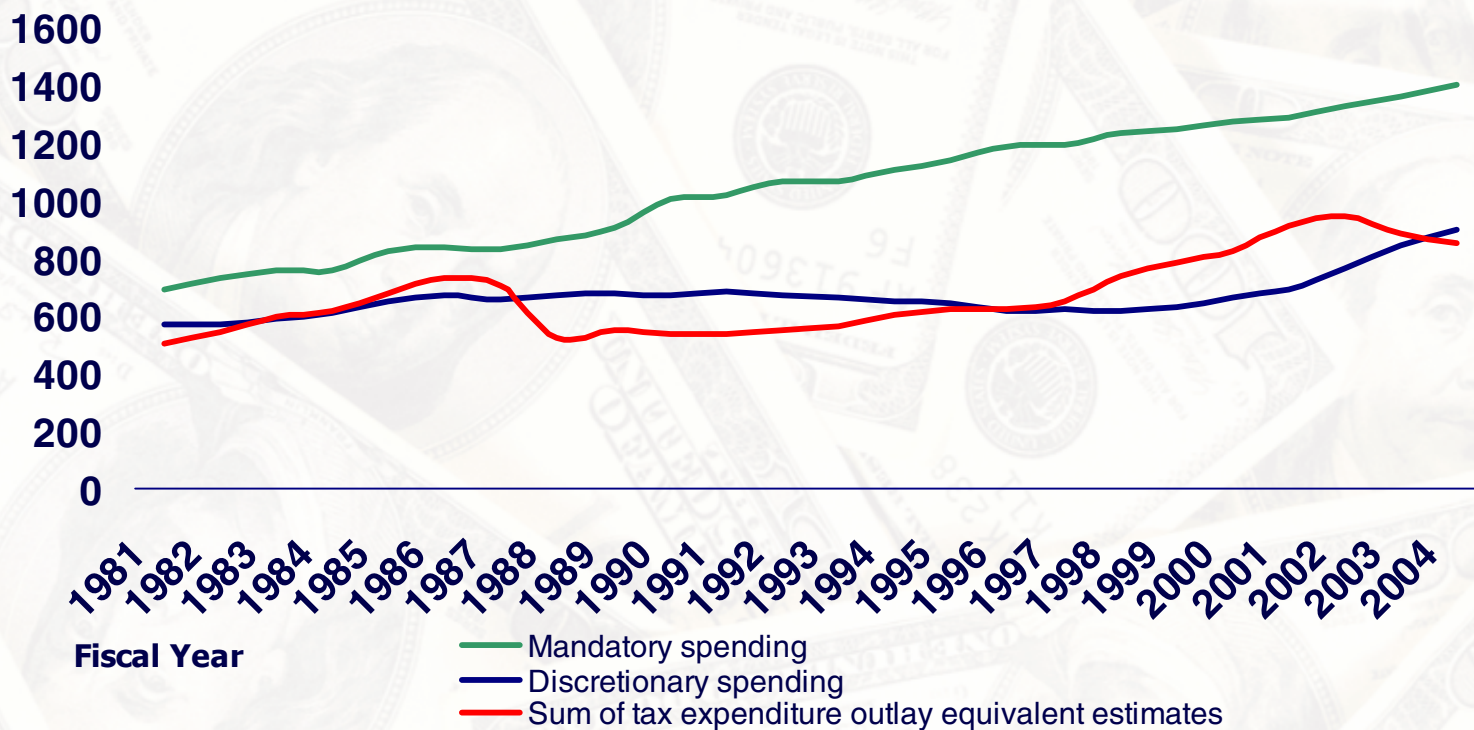
■ Debt per Capita

■ GDP per Capita

Source: GAO's January 2006 analysis.

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)

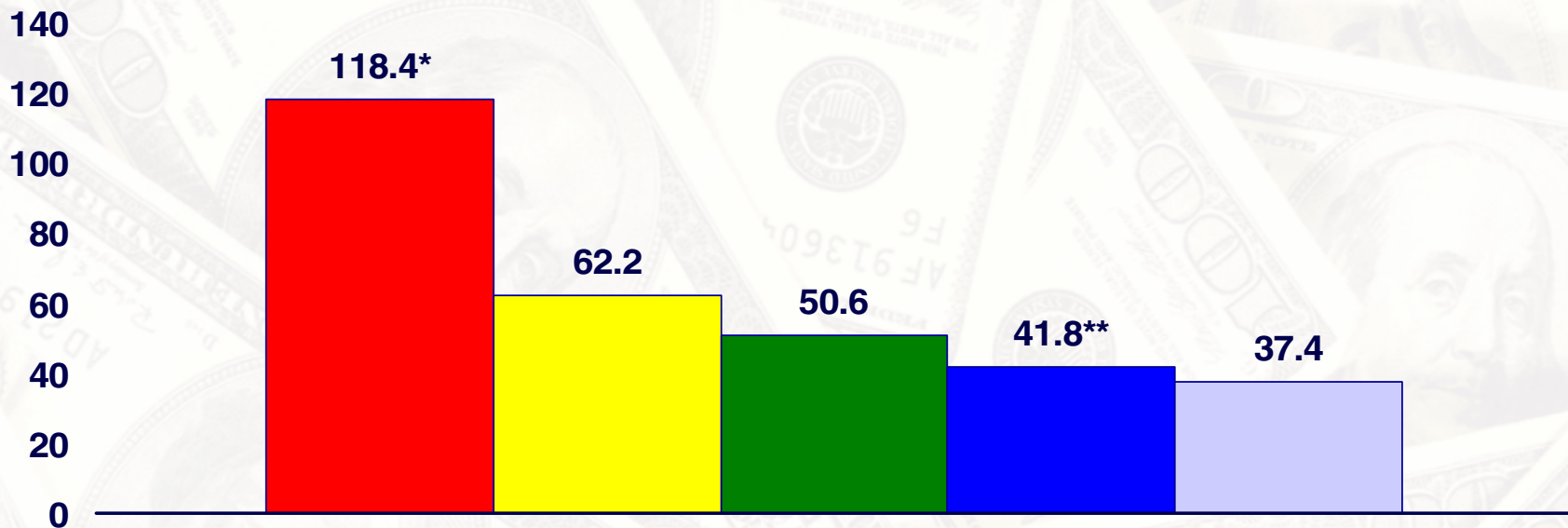


Note: Outlay-equivalent estimates represent the amount of budget outlays that would be required if the government were to provide taxpayers with the same after-tax income they receive through the tax expenditure. Outlay-equivalent estimates are useful to compare tax expenditures and other parts of the federal budget. Summing tax expenditure estimates does not take into account interactions between individual provisions.

Source: GAO Analysis of OMB's Budget Reports on Tax Expenditures, Fiscal Years 1976-2006.

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

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.

*If 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.

**This is the revenue loss and does not include associated outlays of \$14.6 billion.

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

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.

Is this Only the Federal Government's Problem?

NO...

...Bad News Flows **DOWNHILL!**

Selected State Fiscal Challenges

States have many of their own fiscal challenges, including:

- Unsustainable Medicaid cost increases
- Unfunded liabilities of state retirement systems (e.g. pensions and health)
- Education funding squeezed by competing demands
- Infrastructure maintenance and expansion needs given unparalleled sprawl and congestion
- Emergency preparedness response and recovery needs (e.g. natural disaster, terrorist incident, pandemic flu)

The Way Forward: Three Pronged Approach

Re-impose Budget Controls

- Discretionary spending caps
- PAYGO rules on both sides of the ledger
- Mandatory spending triggers

Improve Accounting and Reporting and Metrics:

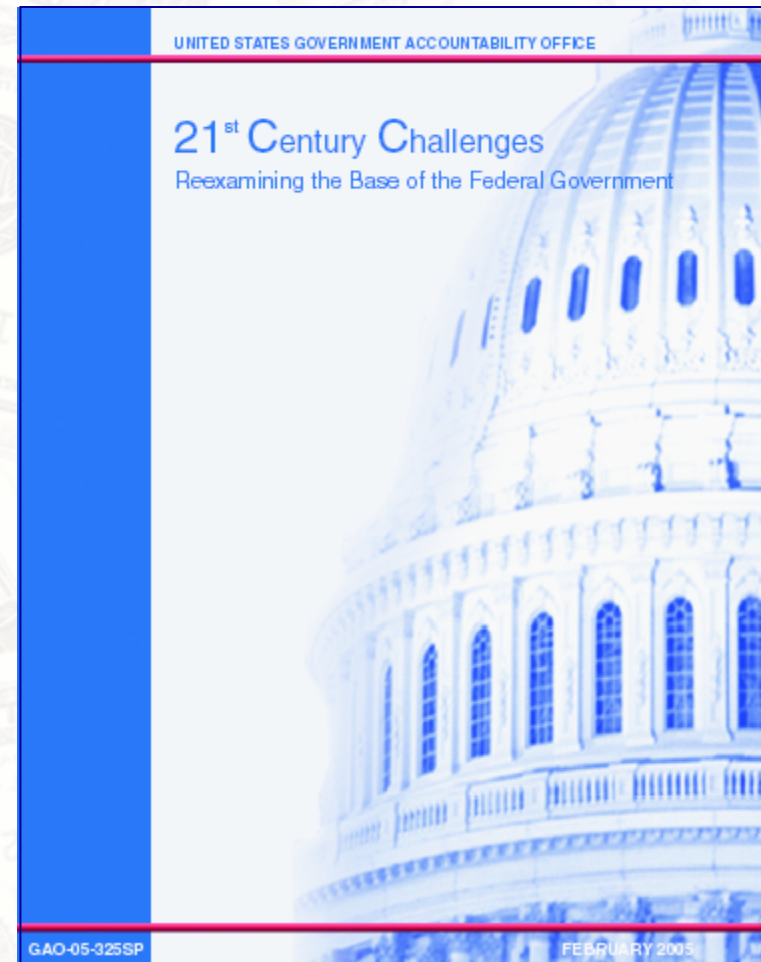
- Enhanced financial statement presentation
- Automatic present value disclosures for legislative debate on major tax and spending bills
- Develop key national (outcome-based) indicators

Re-examine Policies and Programs:

- Restructure existing entitlement programs
- Reexamine the base of all other spending programs
- Review and revise existing tax policy, including tax preferences and enforcement programs
- Expand scrutiny of proposed new programs, policies, or activities

21st Century Challenges Report

- Provides background, framework, and questions to assist in reexamining the base
- Covers entitlements & other mandatory spending, discretionary spending, and tax policies and programs
- Based on GAO's work for the Congress



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

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.

Key National Indicators: Where the World's Sole Superpower Ranks

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

16 OUT OF 28

OECD Categories for Key Indicators (2006 OECD Factbook)

• Population/Migration	• Energy	• Environment	• Quality of Life
• Macroeconomic Trends	• Labor Market	• Education	• Economic Globalization
• Prices	• Science & Tech.	• Public Finance	

Source:

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

VALUES

PEOPLE

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