



UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

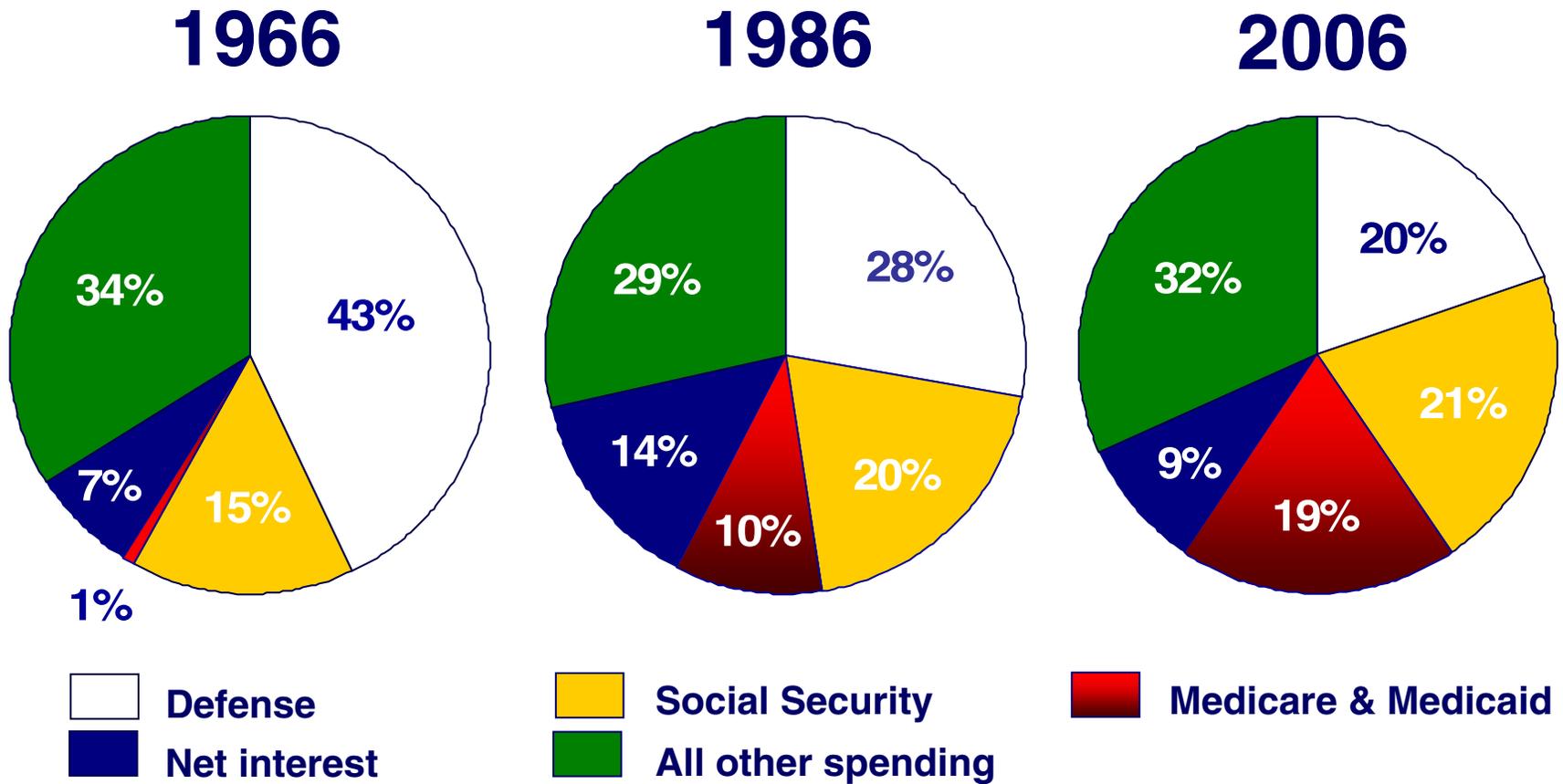
America's Fiscal Future

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

**Institutional Investor's
Public Funds Symposium
Washington, D.C.
October 16, 2007**



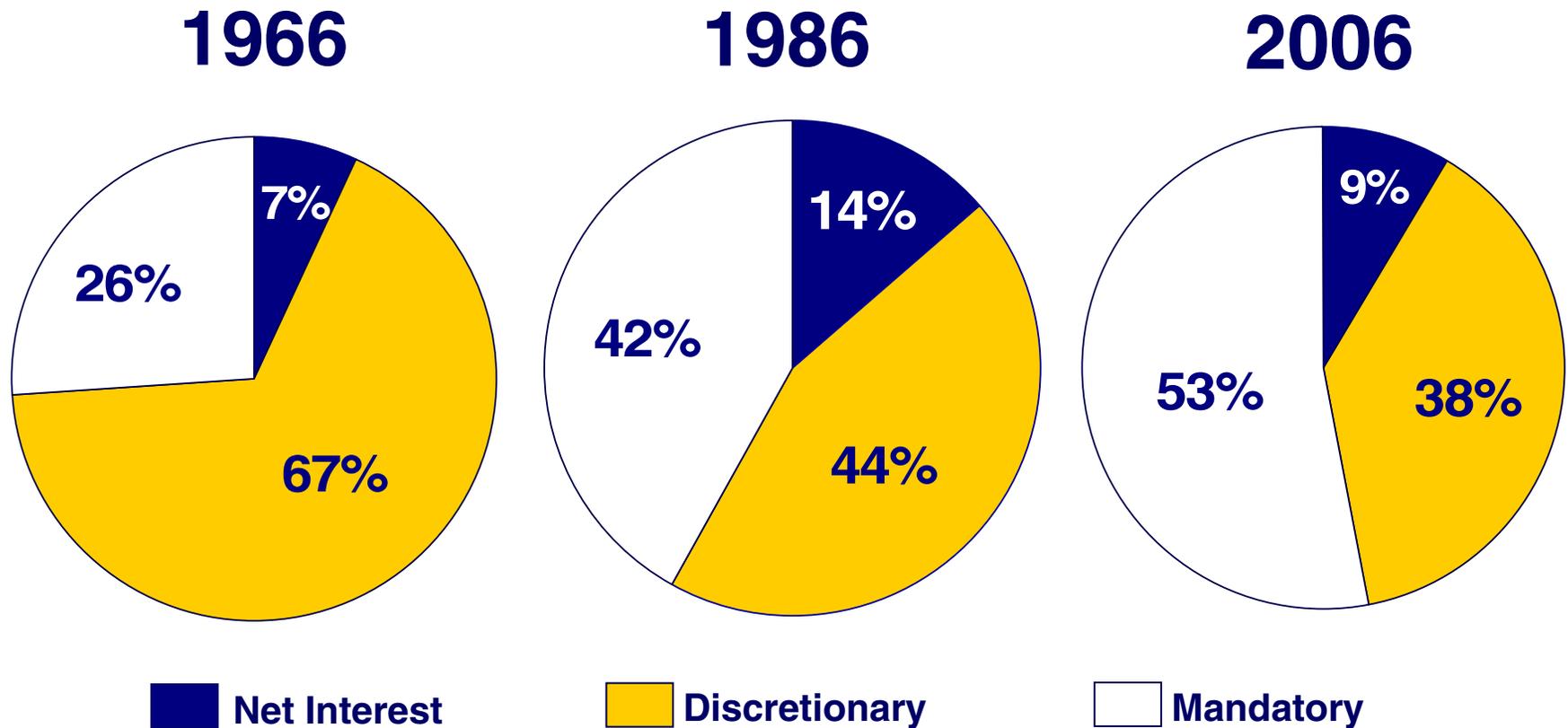
Composition of Federal Spending



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

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

Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

Fiscal Year 2005 and 2006 Deficits and Net Operating Costs

	Fiscal Year 2005	Fiscal Year 2006
	(\$ Billion)	
On-Budget Deficit	(494)	(434)
Unified Deficit^a	(318)	(248)
Net Operating Cost^b	(760)	(450)

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

^aIncludes \$173 billion in Social Security surpluses for fiscal year 2005 and \$185 billion for fiscal year 2006; \$2 billion in Postal Service surpluses for fiscal year 2005 and \$1 billion for fiscal year 2006.

^bFiscal year 2005 and 2006 net operating cost figures reflect significant but opposite changes in certain actuarial costs. For example, changes in interest rates and other assumptions used to estimate future veterans' compensation benefits increased net operating cost by \$228 billion in 2005 and reduced net operating cost by \$167 billion in 2006. Therefore, the net operating costs for fiscal years 2005 and 2006, exclusive of the effect of these actuarial cost fluctuations, were (\$532) billion and (\$617) billion, respectively.

Major Fiscal Exposures

(\$ trillions)

	2000	2006	% Increase
• Explicit liabilities	\$6.9	\$10.4	52
<ul style="list-style-type: none"> • Publicly held debt • Military & civilian pensions & retiree health • Other 			
• Commitments & contingencies	0.5	1.3	140
<ul style="list-style-type: none"> • E.g., PBGC, undelivered orders 			
• Implicit exposures	13.0	38.8	197
• Future Social Security benefits	3.8	6.4	
• Future Medicare Part A benefits	2.7	11.3	
• Future Medicare Part B benefits	6.5	13.1	
• Future Medicare Part D benefits	--	7.9	
Total	\$20.4	\$50.5	147

Source: 2000 and 2006 Financial Report of the United States Government.

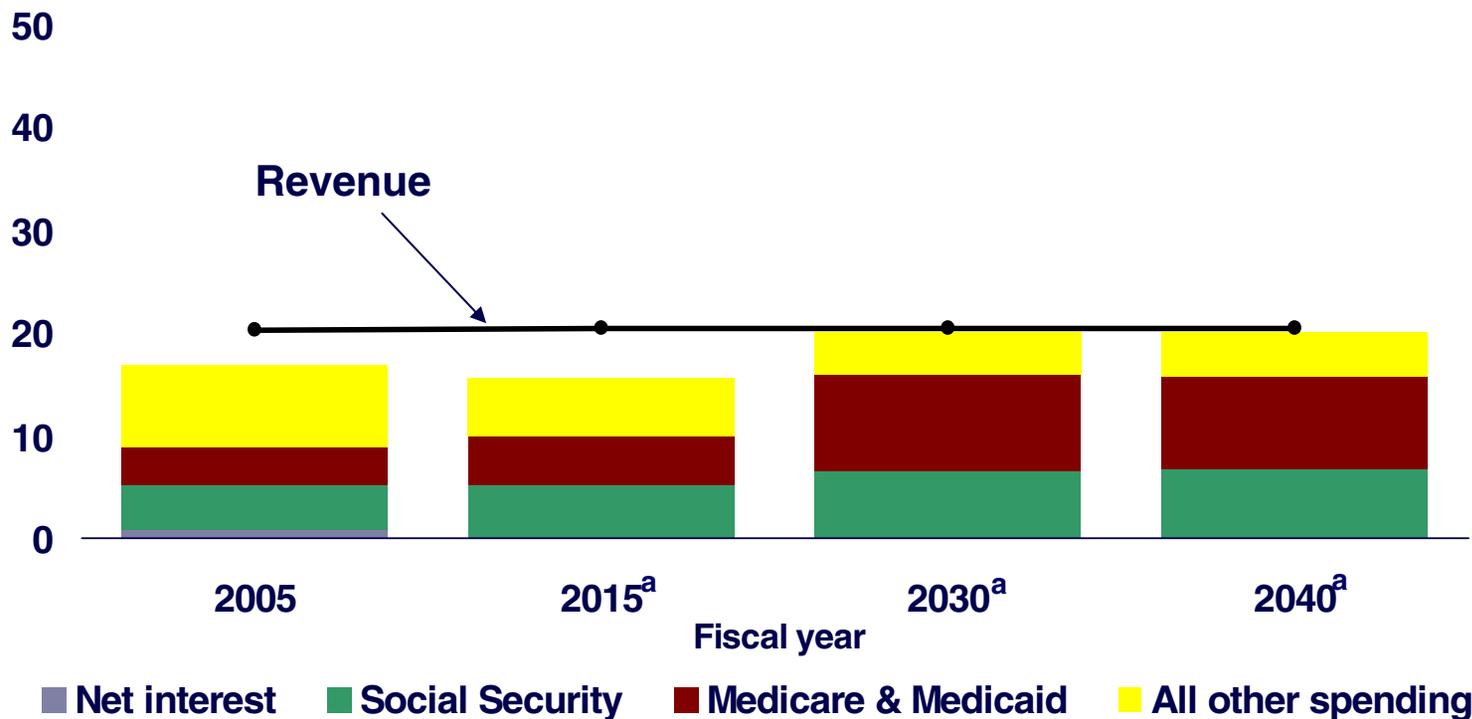
Note: Totals and percent increases may not add due to rounding. Estimates for Social Security and Medicare are at present value as of January 1 of each year and all other data are as of September 30.

Potential Fiscal Outcomes

Under Baseline Extended (January 2001)

Revenues and Composition of Spending as a Share of GDP

Percent of GDP



Source: GAO's January 2001 analysis.

^aAll other spending is net of offsetting interest receipts.

Potential Fiscal Outcomes

Under Alternative Simulation

Revenues and Composition of Spending as a Share of GDP

Percent of GDP

50

40

30

20

10

0

Revenue

2006

2015

2030

2040

Fiscal year

■ Net interest

■ Social Security

■ Medicare & Medicaid

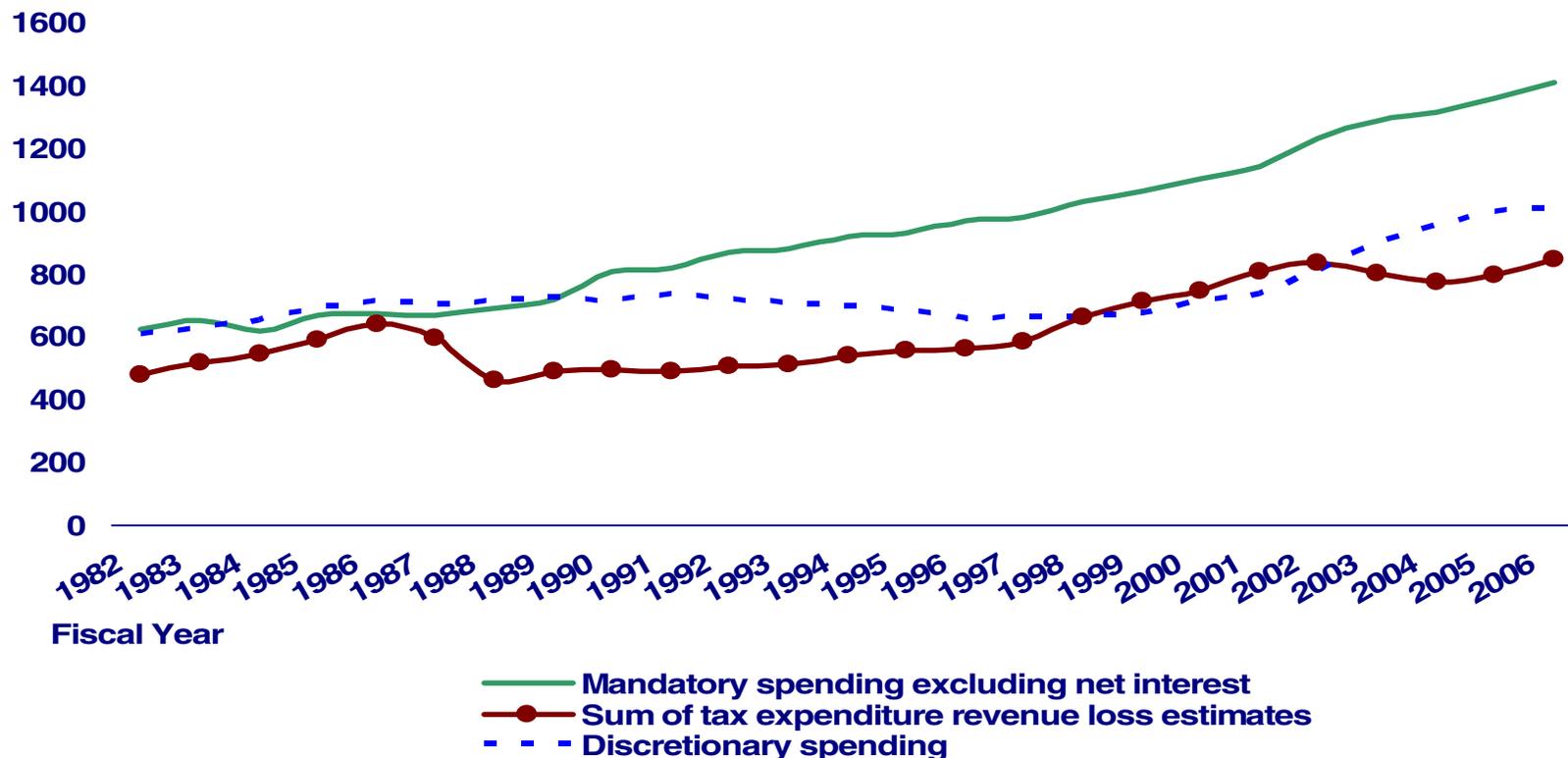
■ All other spending

Source: GAO's August 2007 analysis.

Notes: 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.

Federal Tax Expenditures Exceeded Discretionary Spending for Half of the Last Decade

Dollars in billions (in 2006 dollars)

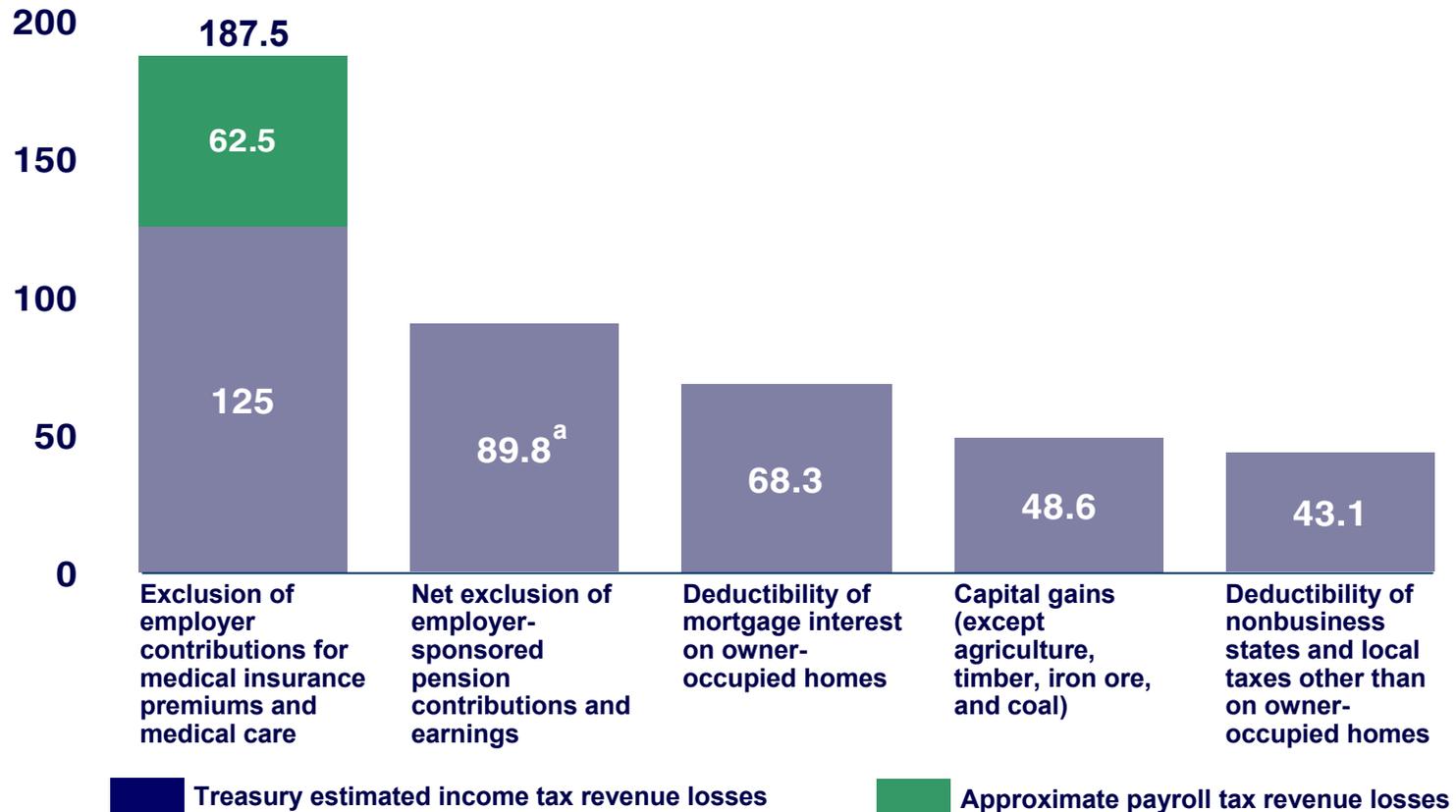


Source: GAO analysis of OMB budget reports on tax expenditures, fiscal years 1976-2008.

Note: Summing tax expenditure estimates does not take into account interactions between individual provisions. Outlays associated with refundable tax credits are included in mandatory spending.

Revenue Loss Estimates for the Largest Tax Expenditures Reported for Fiscal Year 2006

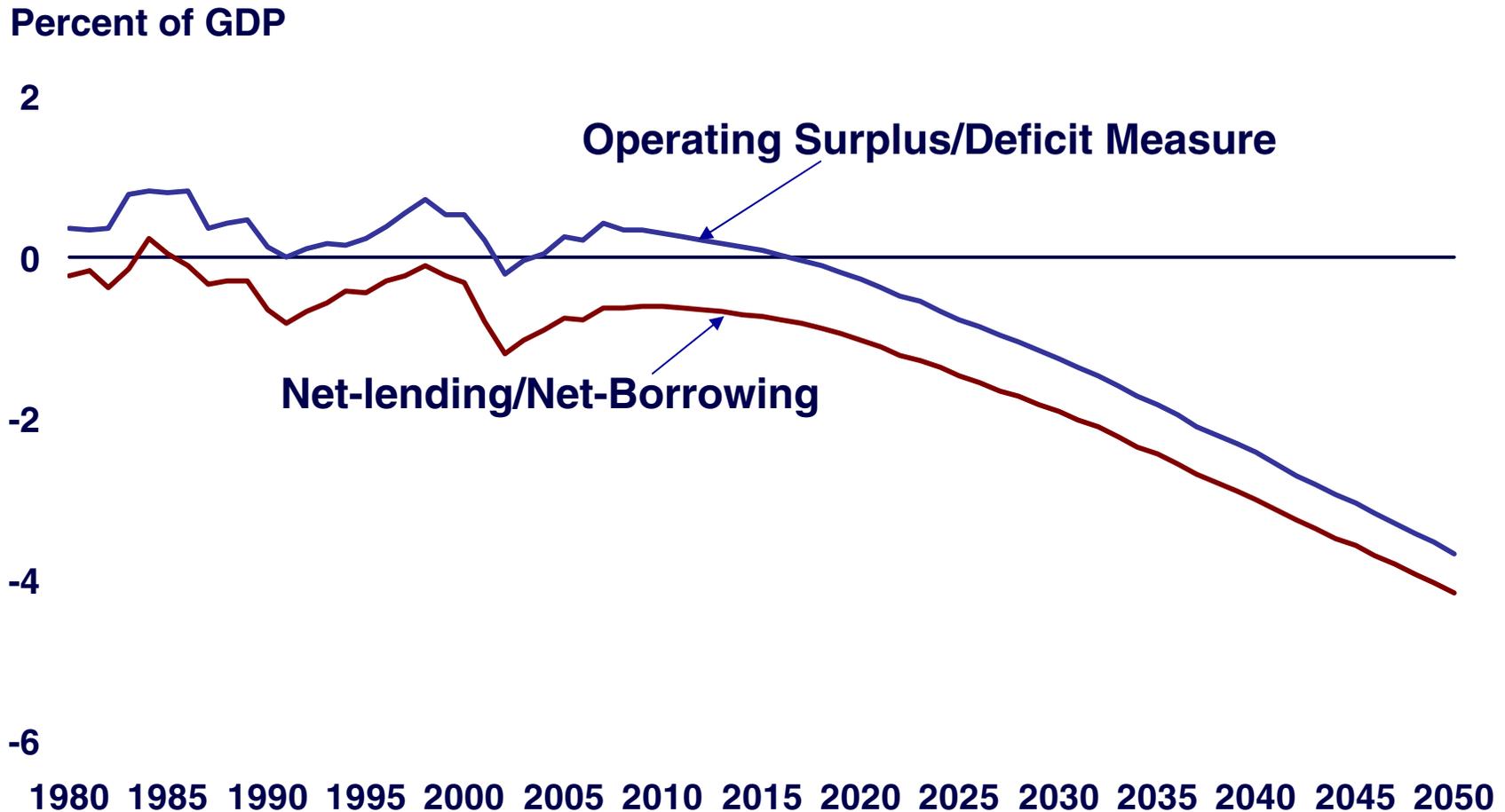
Revenue loss estimates (dollars in billions)



Source: GAO analysis of OMB, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2008*.

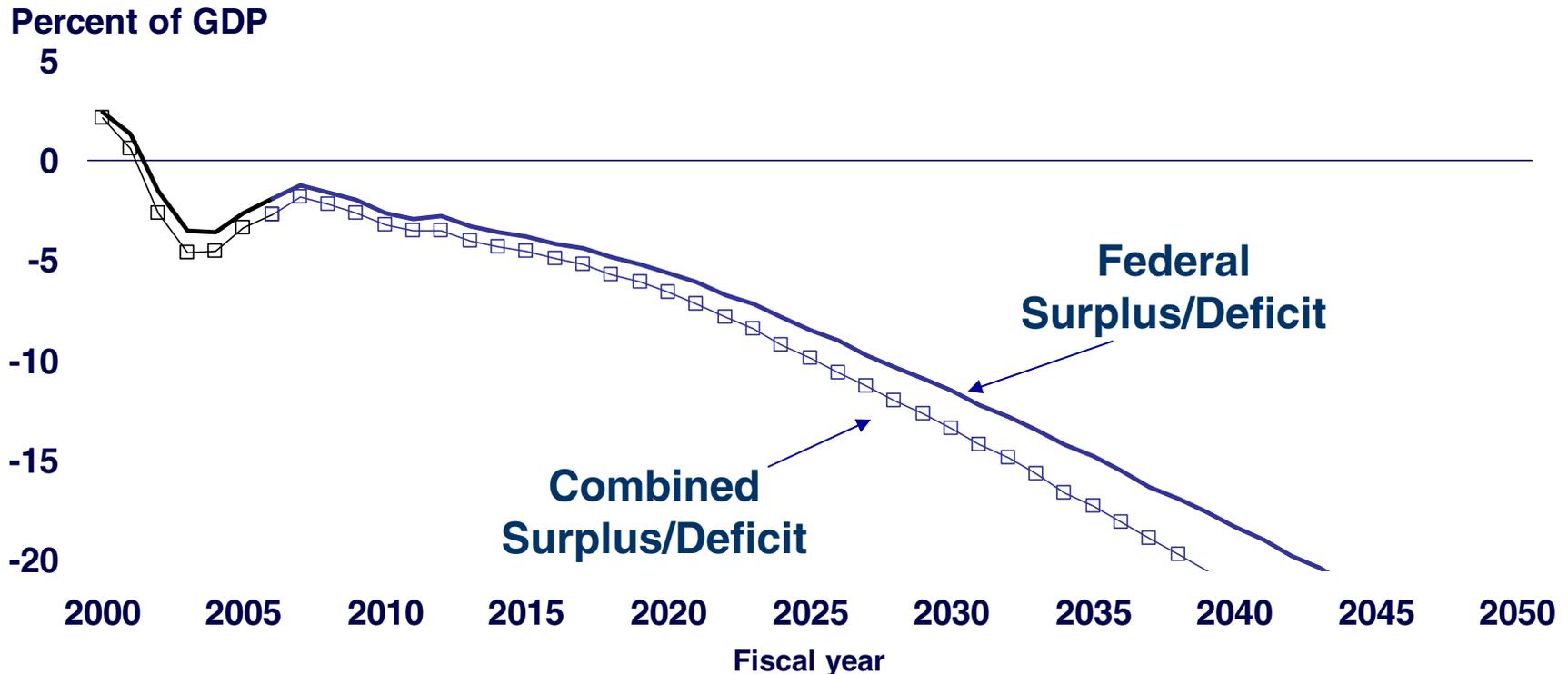
^aThe value of employer-provided health insurance is excluded from Medicare and Social Security payroll taxes. Some researchers have estimated that payroll tax revenue losses amounted to more than half of the income tax revenue losses in 2004, and we use this estimate for 2006. The research we are aware of dealt only with health care, therefore the 50 percent figure may not apply to other items that are excluded from otherwise applicable income and payroll taxes.

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



Source: 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.

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.

The Way Forward: A Three-Pronged Approach

- 1. Improve Financial Reporting, Public Education, and Performance Metrics**
- 2. Strengthen Budget and Legislative Processes and Controls**
- 3. Fundamentally Reexamine & Transform for the 21st Century (i.e., entitlement programs, other spending, and tax policy)**

Solutions Require Active Involvement from both the Executive and Legislative Branches

The Way Forward: *Improve Financial Reporting, Public Education, and Performance Metrics*

- Improve transparency & completeness of President's budget proposal:
 - Return to 10-year estimates in budget both for current policies and programs and for policy proposals
 - Include in the budget estimates of long-term cost of policy proposals & impact on total fiscal exposures.
 - Improve transparency of tax expenditures
- Consider requiring President's budget to specify & explain a fiscal goal and a path to that goal within 10-year window—or justify an alternative deadline
- Require annual OMB report on existing fiscal exposures [liabilities, obligations, explicit & implied commitments]
- Require enhanced financial statement presentation to address fiscal sustainability and intergenerational equity issues
- Prepare and distribute a summary annual report that is both useful and used
- Increase information on long-range fiscal sustainability issues in Congressional Budget Resolution & Budget Process.
- Develop key national (outcome-based) indicators (e.g. economic, security, social, environmental) to chart the nation's posture, progress, and position relative to the other major industrial countries

The Way Forward: *Strengthen Budget and Legislative Processes and Controls*

- Restore discretionary spending caps & PAYGO rules on both spending and tax sides of the ledger
- Develop mandatory spending triggers [with specific defaults], and other action-forcing provisions (e.g., sunsets) for both direct spending programs and tax preferences
- Develop, impose & enforce modified rules for selected items (e.g., earmarks, emergency designations, and use of supplementals)
- Require long-term cost estimates (e.g. present value) for any legislative debate on all major tax and spending bills, including entitlement programs. Cost estimates should usually assume no sunset
- Extend accrual budgeting to insurance & federal employee pensions; develop techniques for extending to retiree health & environmental liabilities
- Consider biennial budgeting
- Consider expedited line item rescissions from the President that would only require a majority vote to override the proposed rescission(s)

The Way Forward: *Fundamentally Reexamine & Transform*

- Restructure existing entitlement programs
- Reexamine and restructure the base of all other spending
- Review & revise existing tax policy, including tax preferences and enforcement programs
- Expand scrutiny of all proposed new programs, policies, or activities
- Reengineer internal agency structures and processes, including more emphasis on long-term planning, integrating federal activities, and partnering with others both domestically and internationally
- Strengthen and systematize Congressional oversight processes
- Increase transparency associated with government contracts and other selected items
- Consider a capable, credible, bi-partisan budget, entitlement, and tax reform commission

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); Jacksonville (Florida); Boston (Massachusetts))
- **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:** Key players working through a consortium within a nonprofit organization receiving technical assistance from the National Academies domestically and OECD and others providing assistance internationally on related efforts

Key National Indicators: Where the United States 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	

Key Elements for Economic Security in Retirement

- **Adequate retirement income**
 - Savings
 - Social Security
 - Pensions
 - Earnings from continued employment (e.g., part-time)
- **Affordable health care**
 - Medicare
 - Retiree health care
- **Long-term care (a hybrid)**
- **Major Players**
 - Employers
 - Government
 - Individuals
 - Family
 - Community

Working Longer May Help Address the Challenges of an Aging Population

- **Impact on the Economy**
 - Larger labor force
 - Additional economic growth
- **Impact on the Federal Budget**
 - Additional tax revenue
 - Reduced expenditures: Social Security & Medicare
- **Impact on Individuals**
 - Enhanced retirement security and quality of life

Why Older Americans Don't Work Longer

- **Cultural Expectation to Retire in Mid-60s**
 - Social Security early retirement age is 62
 - Many private pensions have similar or lower eligibility ages
- **Older Americans Perceive Few Opportunities**
 - Few older workers felt they had opportunities for partial retirement
 - Most older workers and retirees saw low wage, low skilled jobs as their primary employment opportunities
- **Most Employers Do Not Make a Special Effort to Hire and Retain Older Workers**
 - Many employers say they are willing to implement policies to recruit and retain older workers, but few have actually done so
 - Employers cite barriers, such as federal pension regulations, to flexible employment options for older workers

Key Dates Highlight Long Term Challenges of the Social Security System

Date			Event
OASI	DI	OASDI	
2009	--	2009	Cash surplus begins to decline
2018	2005	2017	Annual benefit costs exceed cash revenue from taxes
2028	2013	2027	Trust fund ceases to grow because even taxes plus interest fall short of benefits
2042	2026	2041	Trust fund exhausted

Source: Social Security Administration, *The 2007 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (Washington, DC: April 2007).

Possible Way Forward on Social Security Reform

Make little or no changes to those who are near retirement or already retired and make a number of adjustments that would affect younger workers:

- Phase-in an increase in the **normal** retirement age and index it to life expectancy
- Consider phasing-in an increase in the **early** retirement age and index it to life expectancy with a modified disability access provision
- Modify income replacement and/or indexing formulas for middle and upper income earners
- Strengthen the minimum benefit
- Consider a modest adjustment to the COLA formula
- Increase the taxable wage base, if necessary
- Consider supplemental individual accounts and mandatory individual savings on a payroll deduction basis (e.g., a minimum 2 percent payroll contribution and a program designed much like the Federal Thrift Savings Plan with a real trust fund and real investments)

Pension System Faces Variety of Challenges

- Significant coverage gaps and pre-retirement leakage
- Long term decline in the number of DB plans and active participants and change in the nature of DB plans
- Recent DB freezes and retiree health plan limitations are likely to accelerate due to prospective changes in current accounting for pension and post-employment benefits
- Recent and prospective large plan terminations by bankrupt sponsors have placed Pension Benefit Guaranty Corporation (PBGC), the federal agency insuring benefits, in financial jeopardy
 - Stock market, interest rate declines earlier this decade worsened overall plan funding
 - Demographics, global competition (steel, auto), industry deregulation restructuring (airlines) have contributed to both plan and corporate weakness
- Plan funding rules and PBGC premiums have proven to be inadequate

Pension Protection Act of 2006: An Important Reform with Unfinished Business

- PPA shrinks, but does not close, many loopholes regarding DB plan funding
- Ultimately does not address fundamental mismatch between DB plan assets and liabilities
- Will likely not reverse long-term decline in DB system
- Long phase-in period and uncertain effects suggest that careful ongoing monitoring of DB plans and PBGC deficit is needed.
- Financing of adequate retirement for all Americans continues to pose a major national challenge
 - Issues of coverage remain largely unanswered
 - Appropriate balance of responsibility for retirement among employers, government and workers remains unclear

Key Dates Highlight Long Term Challenges of the Medicare Program

Date	Event
2007	Medicare Part A outlays exceed cash income
2007	Estimated trigger date for “Medicare funding warning”
2013	Projected date that annual “general revenue funding” for Part B will exceed 45 percent of total Medicare outlays
2019	Part A trust fund exhausted, annual income sufficient to pay about 80% of promised Part A benefits

Source: 2007 Annual Report of The Boards of Trustees of The Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds (Washington, DC, April 2007).

Issues to Consider in Examining Our Health Care System

- The public needs to be educated about the differences between **wants, needs, affordability, and sustainability** at both the individual and aggregate level
- Ideally, health care reform proposals will:
 - **Align Incentives** for providers and consumers to make prudent decisions about the use of medical services,
 - **Foster Transparency** with respect to the value and costs of care, and
 - **Ensure Accountability** from insurers and providers to meet standards for appropriate use and quality.
- Ultimately, we need to address four key dimensions: **access, cost, quality, and personal responsibility**

Selected Potential Health Care Reform Approaches

Reform Approach	Short-term action	Long-term action
Revise the government's payment systems and leverage its purchasing authority to foster value-based purchasing for health care products and services	✓	
Consider additional flexibility for states to serve as models for possible health care reforms	✓	
Consider limiting direct advertising and allowing limited importation of prescription drugs	✓	
Foster more transparency in connection with health care costs and outcomes	✓	
Create incentives that encourage physicians to utilize prescription drugs and other health care products and services economically and efficiently	✓	
Foster the use of information technology to increase consistency, transparency, and accountability in health care	✓	
Encourage case management approaches for people with chronic and expensive conditions to improve the quality and efficiency of care delivered and avoid inappropriate care	✓	
Reexamine the design and operational structure of the nation's health care entitlement programs—Medicare and Medicaid, including exploring more income-related approaches	✓	✓

Selected Potential Health Care Reform Approaches

Reform Approach	Short-term action	Long-term action
Revise certain federal tax preferences for health care to encourage more efficient use of health care products and services	✓	✓
Foster more preventative care and wellness services and capabilities, including fighting obesity and encouraging better nutrition	✓	✓
Promote more personal responsibility in connection with health care	✓	✓
Limit spending growth for government-sponsored health care programs (e.g., percentage of the budget and/or economy)		✓
Develop a core set of basic and essential services. Create insurance pools for alternative levels of coverage, as necessary		✓
Develop a set of evidence-based national practice standards to help avoid unnecessary care, improve outcomes, and reduce litigation		✓
Pursue multinational approaches to investing in health care R&D		✓

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



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