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## 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
- Selected trends and challenges having no boundaries
- Additional resource demands due to Iraq, Afghanistan, incremental homeland security needs, and past natural disasters in the United States
- Numerous government performance/accountability and high risk challenges
- Outdated federal organizational structures, policies, and practices
- Rising public expectations for demonstrable results and enhanced responsiveness

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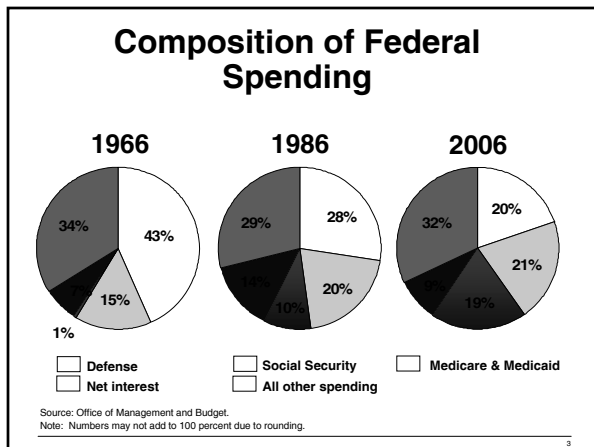
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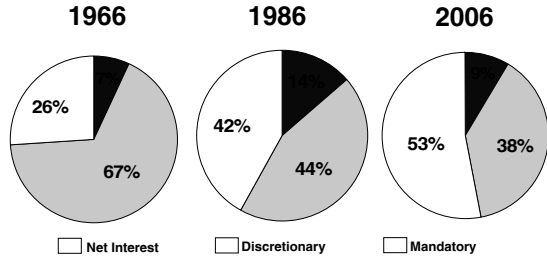
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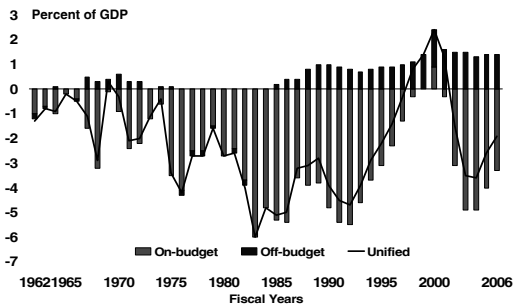
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## Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

## Surplus or Deficit as a Share of GDP Fiscal Years 1962-2006



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

## Fiscal Year 2005 and 2006 Deficits and Net Operating Costs

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

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

<sup>a</sup>Includes \$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.

<sup>b</sup>Fiscal 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.



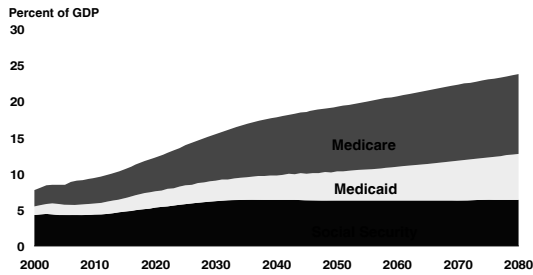


Slide 11

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**GAO11** JSS: SOURCE: st loc mod 2005 update200703 v 5 con re elast.wf1  
SHOW (OPBALNETCAP\_0/GDP)\*100 (NETLENDGSL\_0/GDP)\*100  
GAO, 7/9/2007

## Social Security, Medicare, and Medicaid Spending as a Percent of GDP



Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration, Office of the Actuary, Centers for Medicare and Medicaid Services, and Congressional Budget Office.

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

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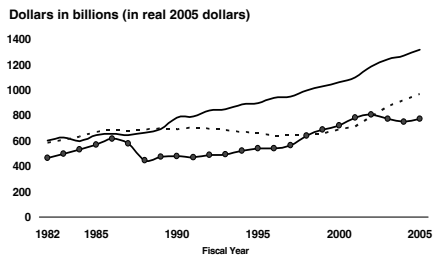
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## Federal Tax Expenditures Exceeded Discretionary Spending for Half of the Last Decade



Source: GAO analysis of OMB budget reports on tax expenditures, fiscal years 1976-2007.

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.

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## 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 two 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.

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## 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 21<sup>st</sup> Century (i.e., entitlement programs, other spending, and tax policy)**

*Solutions Require Active Involvement from both the Executive and Legislative Branches*

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## 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 and preparation of 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

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## 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)

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## 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

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## 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

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## 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	

Source: 2006 OECD Factbook

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## 21<sup>st</sup> Century Challenges Report

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



Source: GAO.

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## 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

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## Generic Reexamination Criteria and Sample Questions

### Relevance of purpose and the federal role

Why did the federal government initiate this program and what was the government trying to accomplish?

Have there been significant changes in the country or the world that relate to the reason for initiating it?

### Measuring success

Are there outcome-based measures? If not, why?

If there are outcome-based measures, how successful is it based on these measures?

### Targeting benefits

Is it well targeted to those with the greatest needs and the least capacity to meet those needs?

### Affordability and cost effectiveness

Is it using the most cost-effective or net beneficial approaches when compared to other tools and program designs?

### Best practices

Is the responsible entity employing prevailing best practices to discharge its responsibilities and achieve its mission?

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## Selected Sustainability Challenges

- Fiscal Deficits and Debt Burdens
- Health Care Quality, Access, and Costs
- Defense and Homeland Security Strategies
- Social Insurance Commitments
- Tax Gaps and Policies
- Energy, Environment, and Resource Protection
- Immigration Policies

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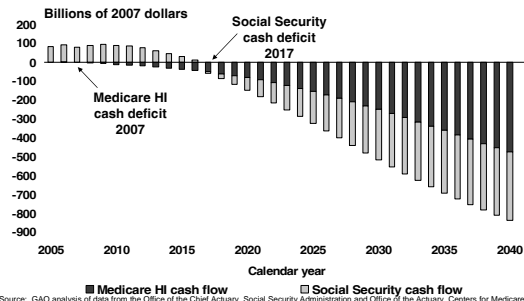
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## Social Security and Medicare's Hospital Insurance Trust Funds Face Cash Deficits



Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration and Office of the Actuary, Centers for Medicare and Medicaid Services.  
 Note: Projections based on the intermediate assumptions of the 2007 Trustees' Reports. The CPI is used to adjust from current to constant dollars.

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## Key Dates Highlight Long Term Challenges of the Social Security System

Date			Event
OASI	DI	OASDI	Cash surplus begins to decline
2009	--	2009	
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).

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### GAO Criteria for Evaluating Social Security Reform Proposals

Reform proposals should be evaluated as packages that strike a balance among individual reform elements and important interactive effects.

Comprehensive proposals can be evaluated against three basic criteria:

- Financing sustainable solvency
- Balancing adequacy and equity in the benefits structure
- Implementing and administering reforms

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### 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)

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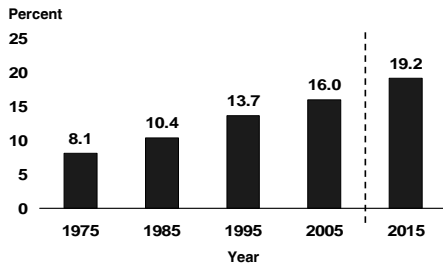
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### Growth in Health Care Spending: Health Care Spending as a Percentage of GDP



Source: The Centers for Medicare & Medicaid Services, Office of the Actuary.  
Note: The figure for 2015 is projected.

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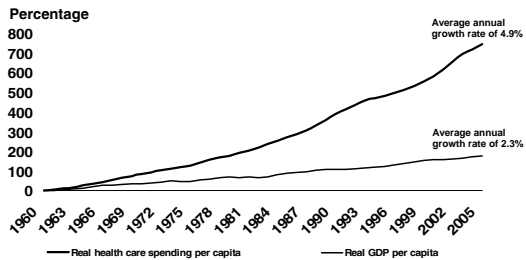
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## Growth in Health Care Spending: Cumulative Growth in Real Health Care Spending Per Capita and Real GDP Per Capita, 1960-2005



Source: GAO analysis of data from the Centers for Medicare & Medicaid Services, Office of the Actuary, and the Bureau of Economic Analysis.

Note: The most current data available on health care spending per capita are for 2005.

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## Key Dates Highlight Long Term Challenges of the Medicare Program

Date	Event
2007	Medicare Part A outlays exceed cash income
2007	"Medicare funding warning" triggered
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).

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## 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**

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## The Need for Good Governance, Transparency, and Accountability

Good governance, transparency, and accountability are critical in:

- The private sector, to promote efficiency and effectiveness in the capital and credit markets, and overall economic growth, both domestically and internationally
- The public sector, for the effective and credible functioning of a healthy democracy, and in fulfilling the government's responsibility to citizens and taxpayers
- The independent (not-for-profit) sector, to promote the proper use of resources consistent with the organization's mission and applicable laws and to maintain the trust and confidence of contributors
- All sectors, to support a healthy economy that provides economic opportunities and benefits to citizens

Sorting out the needs—as well as the effective and appropriate governance and accountability mechanisms for different sectors and types of organizations—will be essential, both on a domestic and international scale

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## Financial Reporting: Improving Transparency of Long-term Costs Before Decisions Are Made

- **Require supplemental reporting in the President's annual budget submission** (e.g., require the President to annually present a Fiscal Exposures Statement covering at least 40 years)
- **Require additional executive branch reports** (e.g., require the annual publication of key financial and performance information and a periodic report on long-range fiscal sustainability)
- **Require CBO and JCT to provide additional cost information** on major spending and tax proposals before adoption
- **Require GAO to publish an annual report** that would include, among things: comments on whether the President and CBO/JCT met the new reporting requirements specified above

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## Social Insurance Reporting

Social Insurance programs include:

- Social Security
- Medicare
- Railroad Retirement
- Black Lung
- Unemployment Insurance

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## Proposed Changes in Social Insurance Reporting

- FASAB recently issued a preliminary views (PV) document requesting public comment on proposals to change social insurance reporting
- The PV contains two views for improving social insurance reporting:
  - Primary View
  - Alternative View
- Two years away from a resolution
- This is a very important matter

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## Objectives of Social Insurance Reporting

All current FASAB members agree that:

- It is important to provide useful financial information about the sustainability of social insurance programs
- Social insurance program information should be audited and transparent
- The Consolidated Financial Report of the United States Government should present this information and highlight any long-range fiscal imbalances anticipated in these programs

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## Both Views Share Certain Features

- Recognize a liability for social insurance benefits (but the two views differ significantly on how it should be calculated)
- Present three key pieces of information:
  - A statement of social insurance (SOSI) showing the present values of projected future program revenues and scheduled benefits (SOSI is currently required),
  - Changes in the present values during the reporting period, and
  - Other sustainability disclosures (currently required)

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## Guiding Principles in Selecting a Proposal

Guiding Principle	Alternative View	Primary View
Recognize the difference between exchange and non-exchange transactions	Yes	No
Avoid recognizing a liability for scheduled benefits that are uncertain, unsustainable, and not legally binding	Yes	No
Recognize only costs for services provided in the current year. Future program costs (e.g., social insurance, defense) are not recognized	Yes	No
Recognize a liability for earmarked revenue (payroll taxes) not yet used to pay benefits	Yes	No
Report on affordability of social insurance and other federal programs and annual changes therein (match long-term costs and revenues)	Yes	No
Present information on intergenerational equity for social insurance and other federal programs	Yes	No

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## What Needs To Happen?

- The public needs to be informed about the fiscal imbalance faced by our federal government
  - Improved financial reporting
  - Summary annual report
  - Discussion forums
  - Improved financial literacy
- What you can do
  - Get informed and involved
  - Communicate with key opinion leaders and your elected officials
  - Comment on your preferred accounting and reporting option to FASAB
  - Revisit your personal financial planning
- We're already ahead on social insurance accountability reporting – and we want to stay there – but how we go about this matters

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## 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 21<sup>st</sup> Century
  - Which programs and policies should be changed and how
  - How government should be financed

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## Four National Deficits

- ***Budget***
- ***Balance of Payments***
- ***Savings***
- ***Leadership***

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## Key Leadership Attributes Needed for These Challenging and Changing Times

- ***Courage***
- ***Integrity***
- ***Creativity***
- ***Partnership***
- ***Stewardship***

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### On the Web

Web site: [www.gao.gov/cghome.htm](http://www.gao.gov/cghome.htm)

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