

GAO

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Before the Committee on the Budget,
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**LONG-TERM BUDGET
OUTLOOK**

**Deficits Matter—Saving Our
Future Requires Tough
Choices Today**

Statement of David M. Walker
Comptroller General of the United States



Chairman Spratt, Mr. Ryan, Members of the Committee:

I appreciate this invitation to talk with you about why deficits matter—about our nation’s long-term fiscal outlook and the challenge it presents. Your decision to focus on this issue is an important statement about the seriousness with which you view this challenge and your commitment to begin to address it.

You all have entitled this hearing “Why Deficits Matter.” Let me start with a very simple reason: they matter for the world we leave our children and grandchildren. As all of you know—and as I will discuss in this statement—it is not the short-term deficit that threatens us; it is the long-term fiscal outlook. We are on an imprudent and unsustainable path. Continuing on our current fiscal path would gradually erode, if not suddenly damage, our economy, our standard of living, and ultimately even our domestic tranquility and our national security. This is a great nation with much to be proud of and much to be thankful for. But today we are failing in one of our most important stewardship responsibilities—our duty to pass on a country better positioned to deal with the challenges of the future than the one we were given.

The picture I will lay out for you today is not a pretty one and it’s getting worse with the passage of time. But this nation has met difficult challenges—including challenges to its very existence—in the past and I’m confident that we can do so again.

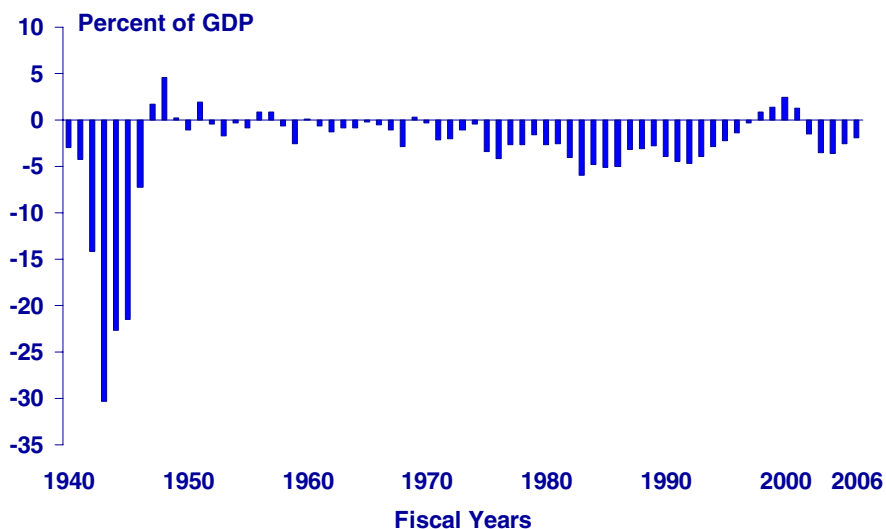
The essence of my message today is no surprise to Members of this Committee:

- Our current financial condition is worse than is widely understood.
- Our current fiscal path is both imprudent and unsustainable.
- Improvements in information and processes are needed and can help.
- Meeting our long-term fiscal challenge will require (1) significant entitlement reform to change the path of those programs; (2) reprioritizing, restructuring and constraining other spending programs; and (3) more revenues—hopefully through a reformed tax system. This will take bipartisan cooperation and compromise.
- The time to act to save our future is now!

When fiscal year 2006 ended a great deal of attention was paid to the fact that at \$248 billion “the deficit” came in lower than originally predicted and lower than in 2005. And just this week press reports have noted

that—as figure 1 shows—the (unified) deficit as a share of the economy is not terribly high.

Figure 1: Unified Surplus or Deficit as a Share of Gross Domestic Product (GDP), Fiscal Years 1940–2006



Source: Department of Commerce, Office of Management and Budget, and Congressional Budget Office.

This is all true—and it is also misleading. First, a single year’s unified budget deficit is not the critical issue here. Certainly this improvement in the 1-year fiscal picture is better than a worsening in that picture, but it did not fundamentally change our long-term fiscal outlook. In fact, the U.S. government’s total reported liabilities, net social insurance commitments, and other fiscal exposures continue to grow and now total approximately \$50 trillion, representing approximately four times the nation’s total output, or gross domestic product (GDP) in fiscal year 2006, up from about \$20 trillion, or two times GDP in fiscal year 2000.

Further, the long-term challenge is fast becoming a short-term one as the first of the baby boomers become eligible for early retirement under Social Security on January 1, 2008—less than one year—and for Medicare benefits in 2011—less than 4 years from now. The budget and economic implications of the baby boom generation’s retirement have already become a factor in the Congressional Budget Office’s (CBO) 10-year baseline projections and will only intensify as the baby boomers age. Simply put, our nation is on an imprudent and unsustainable fiscal path. Herbert Stein once said that something that is not sustainable will stop.

That, however, should not give us comfort. It is more prudent to change the path than to wait until a crisis occurs.

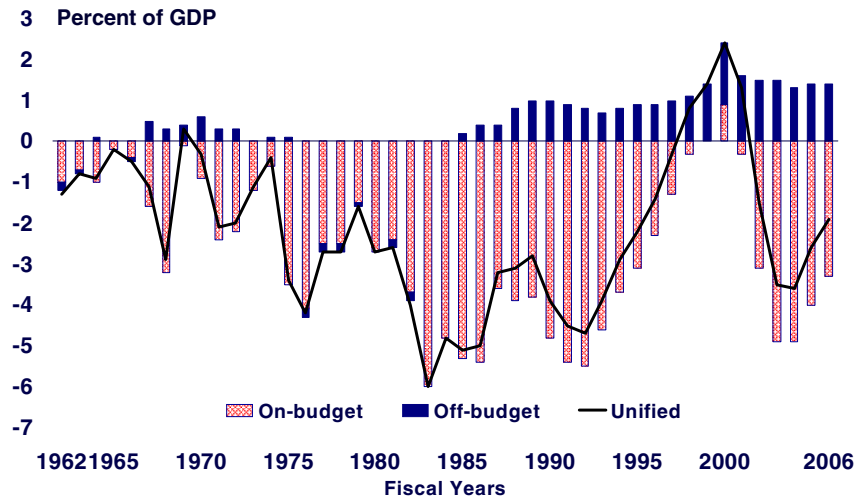
And that brings me to my next point. While restraint in the near term and efforts to balance the budget over the next 5 years can be positive, it is important that actions to achieve this also address the long-term fiscal outlook. The real problem is not the near-term deficit—it is the long-term fiscal outlook. It is important to look beyond year 5 or even year 10. Both the budget and the budget process need more transparency about and focus on the long-term implications of current and proposed spending and tax policies. In this testimony I will suggest a number of things that I believe will help in this area.

Our Fiscal and Financial Condition Is Worse Than Widely Understood

A great deal of budget reporting focuses on a single number—the unified budget deficit, which was \$248 billion in fiscal year 2006. This largely cash-based number represents the difference between revenues and outlays for the government as a whole. It is an important measure since it is indicative of the government’s draw on today’s credit markets—and its claim on today’s economy. But it also masks the difference between Social Security’s cash flows and those for the rest of the budget. Therefore we also need to look beneath the unified deficit at the on-budget deficit—what I like to call the “operating deficit.” And, finally, we should be looking at the financial statements’ report of net operating cost—the accrual-based deficit.

Social Security currently takes in more tax revenue than it needs to pay benefits. This cash surplus is invested in Treasury securities and earns interest in the form of additional securities. The difference between the on-budget deficit and the unified budget deficit is the total surplus in Social Security (cash and interest) and the U.S. Postal Service. Excluding consideration of the \$185 billion surplus in Social Security and a \$1 billion surplus in the Postal Service, the on-budget deficit was \$434 billion in 2006. Figure 2 shows graphically how the on-budget deficit and the off-budget surplus have related and combine to lead to the unified deficit. Since the Social Security trust fund invests any receipts not needed to pay benefits in Treasury securities, its cash surplus reduces the amount the Treasury must borrow from the public. As I will note later, this pattern of cash flows is important—and it is projected to come to an end just 10 years from now.

Figure 2: Surplus or Deficit as a Share of GDP, Fiscal Years 1962–2006



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

The third number, net operating cost, is the amount by which costs exceed revenue and it is reported in the federal government's financial statements, which are prepared using generally accepted accounting principles.¹ Costs are recorded on an accrual basis—namely, in the period when goods are used or services are performed as opposed to when the resulting cash payments are made. However, most revenues, on the other hand, are recorded on the modified cash basis—that is, they are recorded when collected. The net operating cost can be thought of as the accrual deficit. The accrual measure primarily provides more information on the longer-term implications of today's policy decisions and operations by showing certain costs incurred today but not payable for years to come, such as civilian and military pensions and retiree health care. In fiscal year 2006 net operating cost was \$450 billion.

All three of these numbers are informative. However, neither accrual nor cash measures alone provide a full picture of the government's fiscal condition or the cost of government. Used together, they present complementary information and provide a more comprehensive picture of

¹The *Financial Report of the United States Government, 2006* can be found at www.fms.treas.gov/fr/index.html.

the government's financial condition today and fiscal position over time. For example, the unified budget deficit provides information on borrowing needs and current cash flow. The accrual deficit provides information on the current cost of government, but it does not provide information on how much the government has to borrow in the current year to finance government activities. Also, while accrual deficits provide more information on the longer-term consequences of current government activities, they do not include the longer-term cost associated with social insurance programs like Social Security and Medicare. In addition, they are not designed to provide information about the timing of payments and receipts, which can be very important. Therefore, just as investors need income statements, statements of cash flow, and balance sheets to understand a business's financial condition, both cash and accrual measures are important for understanding the government's financial condition.²

Although looking at both the cash and accrual measures provides a more complete picture of the government's fiscal stance today and over time than looking at either alone, even these together do not tell us the full story. For example, as shown in table 1, all three of these deficits improved between fiscal year 2005 and fiscal year 2006.³ This improvement, however, did not result from a change in the fundamental drivers of our long-term challenge and did not signal an improvement in that outlook. To understand the long-term implications of our current path requires more than a single year's snapshot. In this regard, the long-term outlook has worsened significantly in the last several years. That is why for more than a decade GAO has been running simulations to tell this longer-term story.

² GAO is responsible for auditing the financial statements included in the *Financial Report*, but we have been unable to express an opinion on them for 10 years because the federal government could not demonstrate the reliability of significant portions of the financial statements, especially in connection with the Department of Defense. Accordingly, amounts taken from the *Financial Report* may not be reliable.

³ The decline in both the cash and accrual deficits in 2006 was primarily driven by an increase in federal revenue by almost 12 percent. In addition, the decline in the accrual deficit relative to the cash deficit was primarily due to a decrease in accrual-based expenses resulting from changes in assumptions that are the basis for actuarial estimates for certain accrued long-term liabilities. For a discussion of how the accrual and cash deficits relate to each other see GAO, *Understanding Similarities and Differences between Accrual and Cash Deficits*, [GAO-07-117SP](#) (Washington, D.C.: December 2006) and *Understanding Similarities and Differences between Accrual and Cash Deficits, Update for Fiscal Year 2006*, [GAO-07-341SP](#) (Washington, D.C. January 2006).

Table 1: Fiscal Year 2005 and 2006 Deficits and Net Operating Cost

Dollars in billions	Fiscal year 2005	Fiscal year 2006
On-budget deficit	(\$494)	(\$434)
Unified deficit	(318)	(248)
Net operating cost ^a	(760)	(450)

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

^a 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.

The Current Long-term Fiscal Outlook is Unacceptable

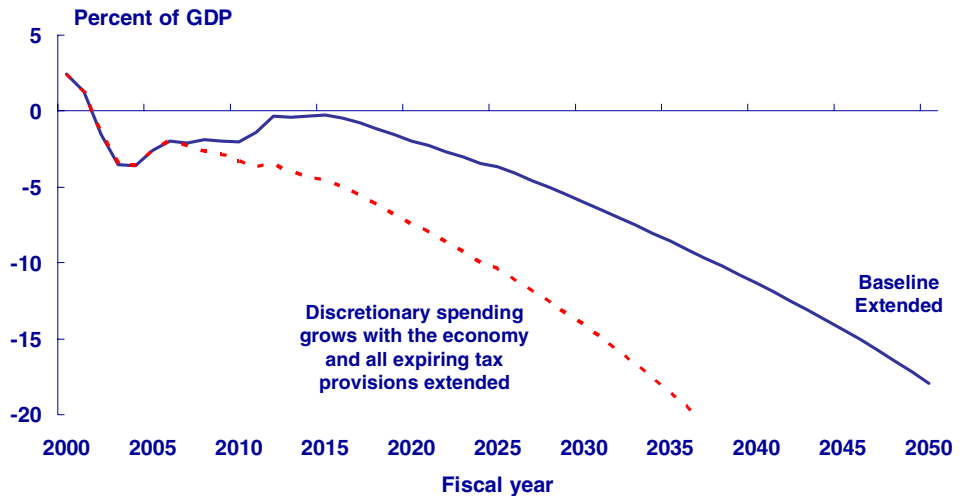
As I mentioned, it is not the recent past shown in figure 1—nor the outlook for this year—that should concern us. Rather it is the picture in figure 3 that should worry us.

Long-term fiscal simulations by GAO, CBO, and others all show that we face large and growing structural deficits driven primarily by rising health care costs and known demographic trends. GAO runs simulations under two sets of assumptions. One takes the legislatively-mandated baseline from CBO for the first 10 years and then keeps discretionary spending and revenues constant as a share of GDP while letting Social Security, Medicare, and Medicaid grow as projected by the Trustees and CBO under midrange assumptions.⁴ The other, perhaps more realistic, scenario based on the Administration's announced policy preferences changes only two things in the first 10 years: discretionary spending grows with the economy and all expiring tax provisions are extended.⁵ Like the "Baseline Extended" scenario, after 10 years both revenues and discretionary spending remain constant as a share of the economy. As figure 3 shows, deficits spiral out of control under either scenario. We will be updating these figures with the release of the new CBO baseline later this month, but even with the lower deficit in 2006, the long-term picture will remain daunting.

⁴ Social Security and Medicare spending is based on the May 2006 Trustees' intermediate projections. Medicaid spending is based on CBO's December 2005 long-term projections under midrange assumptions.

⁵ Additional information about the GAO model, its assumptions, data, and charts can be found at <http://www.gao.gov/special.pubs/longterm/>.

Figure 3: Unified Surpluses and Deficits as a Share of GDP under Alternative Fiscal Policy Simulations



Source: GAO's August 2006 analysis.

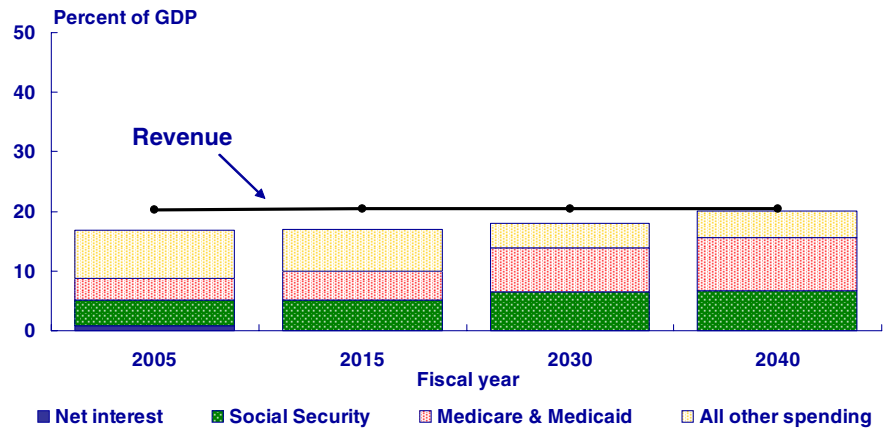
Note: Assumes currently scheduled Social Security benefits are paid in full throughout the simulation period.

Looking more closely at each scenario gives a fuller understanding of what the impact of continuing these trends would have on what government does. And it shows us “Why Deficits Matter.”

First, it makes sense to look back to 2001—it is worth understanding how much worse the situation has become. As I noted, despite some recent improvements in short-term deficits, the long-term outlook is moving in the wrong direction.

Figures 4 and 5 show the composition of spending under our “Baseline Extended” scenario in 2001 and 2006. Even with short-term surpluses, we had a long-term problem in 2001, but it was more than 40 years out. Certainly an economic slowdown and various decisions driven by the attacks of 9/11 and the need to respond to natural disasters have contributed to the change in outlook. However, these items alone do not account for the dramatic worsening. Tax cuts played a major role, but the single largest contributor to the deterioration of our long-term outlook was the passage of the Medicare prescription drug benefit in 2003.

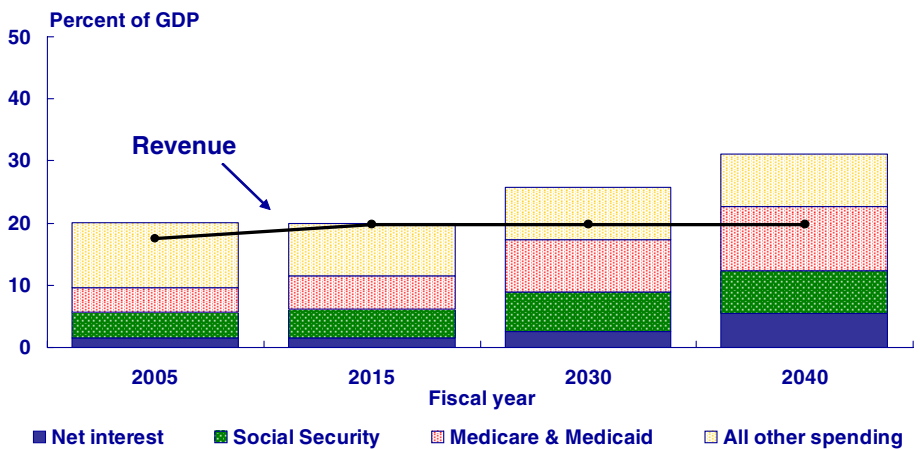
Figure 4: Composition of Spending as a Share of GDP under Baseline Extended, January 2001



Source: GAO's January 2001 analysis.

Note: All other spending is net of offsetting interest receipts in 2015–2040.

Figure 5: Composition of Spending as a Share of GDP under Baseline Extended, August 2006

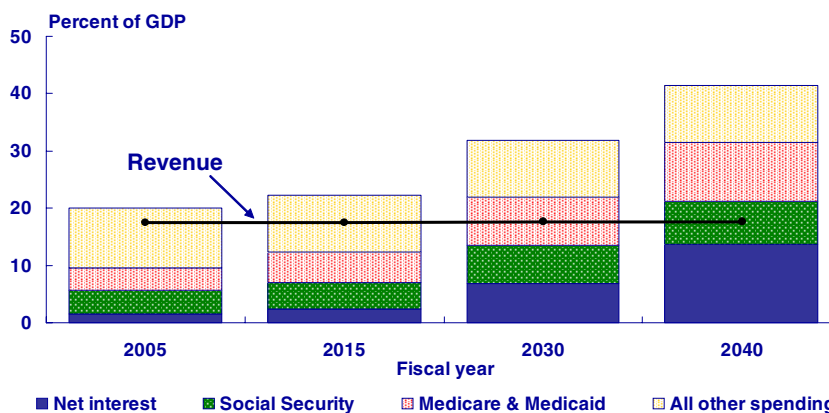


Source: GAO's August 2006 analysis.

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 alternative minimum tax, and (3) increased revenue from tax-deferred retirement accounts. After 2016, revenue as a share of GDP is held constant.

Figure 5 illustrates today’s cold hard truth, that neither slowing the growth in discretionary spending nor allowing the tax provisions to expire—nor both together—would eliminate the imbalance. This is even clearer under the more realistic scenario as shown in figure 6. Estimated growth in the major entitlement programs results in an unsustainable fiscal future regardless of whether one assumes future revenue will be somewhat above historical levels as a share of the economy as in the first simulation (fig. 5) or lower as shown in figure 6.

Figure 6: Composition of Spending as a Share of GDP Assuming Discretionary Spending Grows with GDP after 2006 and All Expiring Tax Provisions Are Extended



Source: GAO's August 2006 analysis.

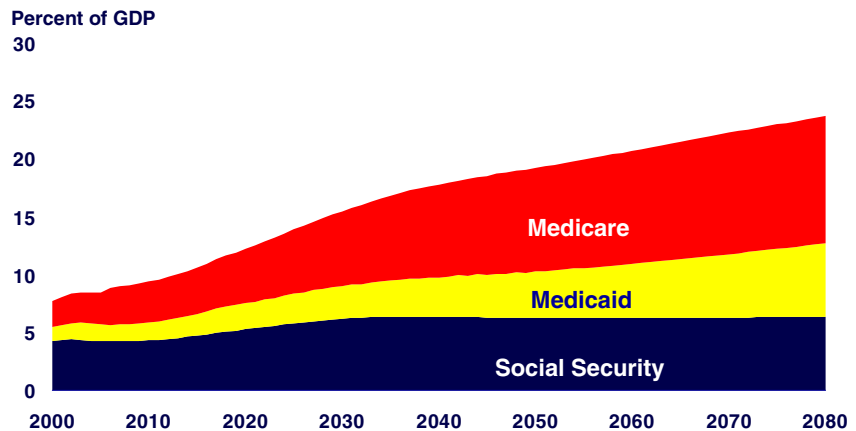
Both these simulations remind us “Why Deficits Matter.” They illustrate that without policy changes on the spending and revenue side of the budget, the growth in spending on federal retirement and health entitlements will encumber an escalating share of the government’s resources. A government that in our children’s lifetimes does nothing more than pay interest on its debt and mail checks to retirees and some of their health providers is unacceptable.

Although Social Security is a major part of the fiscal challenge, contrary to popular perception, it is far from our biggest challenge. While today Social Security spending exceeds federal spending for Medicare and Medicaid, that will change. Over the past several decades, health care spending on average has grown much faster than the economy, absorbing increasing shares of the nation’s resources, and this rapid growth is projected to continue. CBO estimates that Medicare and Medicaid spending will reach

6.3 percent of GDP in 2016, up from 4.6 percent this year (2007), while spending for Social Security will only reach 4.7 percent of GDP in 2016 up from 4.2 percent this year. For this reason and others, rising health care costs pose a fiscal challenge not just to the federal budget but also to states, American business, and our society as a whole.

While there is always some uncertainty in long-term projections, two things are certain: the population is aging and the baby boom generation is nearing retirement age. The aging population and rising health care spending will have significant implications not only for the budget but also for the economy as a whole. Figure 7 shows the total future draw on the economy represented by Social Security, Medicare, and Medicaid. Under the 2006 Trustees' intermediate estimates and CBO's long-term Medicaid estimates, federal spending for these entitlement programs combined will grow to 15.5 percent of GDP in 2030 from today's 9 percent. This graphic is another illustration of why we have to act. I do not believe we are prepared to have programs that provide income for us in retirement and pay our doctors absorb this much of our children's and grandchildren's economy. It is clear that taken together, Social Security, Medicare, and Medicaid under current law represent an unsustainable burden on future generations.

Figure 7: Social Security, Medicare, and Medicaid Spending



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.

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 midrange assumptions.

While Social Security, Medicare, and Medicaid dominate the long-term outlook, they are not the only federal programs or activities that bind the future. Part of what we owe the future is leaving enough flexibility to meet whatever challenges arise. So beyond dealing with the “big 3,” we need to look at other policies that limit that flexibility—not to eliminate all of them but to at least be aware of them and make a conscious decision about them. The federal government undertakes a wide range of programs, responsibilities, and activities that obligate it to future spending or create an expectation for spending and potentially limit long-term budget flexibility. GAO has described the range and measurement of such fiscal exposures—from explicit liabilities such as environmental cleanup requirements to the more implicit obligations presented by life-cycle costs of capital acquisition or disaster assistance.

Figure 8 shows that despite improvement in both the fiscal year 2006 reported net operating cost and the cash-based budget deficit, the U.S. government’s major reported liabilities, social insurance commitments, and other fiscal exposures continue to grow. They now total approximately \$50 trillion—about four times the nation’s total output (GDP) in fiscal year 2006—up from about \$20 trillion, or two times GDP in fiscal year 2000.

Clearly, despite recent progress on our short-term deficits, we have been moving in the wrong direction in connection with our long-range imbalance in recent years. Our long-range imbalance is growing daily due to continuing deficits, known demographic trends, rising health care costs, and compounding interest expense.

Figure 8: Major Reported Fiscal Exposures (Dollars in 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
<ul style="list-style-type: none"> • Future Social Security benefits • Future Medicare Part A benefits • Future Medicare Part B benefits • Future Medicare Part D benefits 	<ul style="list-style-type: none"> 3.8 2.7 6.5 -- 	<ul style="list-style-type: none"> 6.4 11.3 13.1 7.9 	
Total	\$20.4	\$50.5	147

Source: Department of Treasury.

Notes: Data from 2000 and 2006 Financial Report of the United States Government. 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. Percentage increases are based on actual data and may differ from increases calculated from rounded data shown in table.

We all know that it is hard to make sense of what “trillions” means. Figure 9 provides some ways to think about these numbers: if we wanted to put aside today enough to cover these promises, it would take \$170,000 for each and every American or approximately \$440,000 per American household. Considering that median household income is about \$46,000, the household burden is about 9.5 times median income.

Figure 9: Understanding the Size of Our Major Reported Fiscal Exposures

	2006
Major reported fiscal exposures	\$50.5 trillion
Total household net worth	\$53.3 trillion
Ratio of fiscal exposures to net worth	95 percent
Burden	
Per person	\$170,000
Per full-time worker	\$400,000
Per household	\$440,000
Income	
Median household income	\$46,326
Disposable personal income per capita	\$31,519
Ratio of household burden to median income	9.5

Sources: GAO analysis of data from the Department of the Treasury, Federal Reserve Board, U.S. Census Bureau and Bureau of Economic Analysis

Process and Presentational Changes to Increase Transparency and Focus on Long-Term Consequences Can Help

Since at its heart the budget challenge is a debate about the allocation of limited resources, the budget process can and should play a key role in helping to address our long-term fiscal challenge and the broader challenge of modernizing government for the 21st century. I have said that Washington suffers from myopia and tunnel vision. This can be especially true in the budget debate in which we focus on one program at a time and the deficit for a single year or possibly the costs over 5 years without asking about the bigger picture and whether the long term is getting better or worse. We at GAO are in the transparency and accountability business. Therefore it should come as no surprise that I believe we need to increase the understanding of and focus on the long term in our policy and budget debates. To that end—as I noted earlier—I have been talking with a number of Members of the Senate and the House as well as various groups concerned about this issue concerning a number of steps that might help. I've attached a summary of some of these ideas to this statement. Let me highlight several critical elements here.

- The President's budget proposal should again cover 10 years. This is especially important given that some policies—both spending and tax—cost significantly more (or lose significantly more revenue) in the second 5 years than in the first. In addition, the budget should disclose the impact of major tax or spending proposals on the short, medium, and long term.
- The executive branch should also provide information on fiscal exposures—both spending programs and tax expenditures—that is, the long-term budget costs represented by current individual programs, policies, or activities as well as the total.
- The budget process needs to pay more attention to the long-term implication of the choices being debated. For example, elected representatives should be provided with more explicit information on the long-term costs of any major tax or spending proposal before it is voted upon. It is sobering to recall that during the debate over adding prescription drug coverage to Medicare, a great deal of attention was paid to whether the 10-year cost was over or under \$400 billion. Not widely publicized—and certainly not surfaced in the debate—was that the present value of the long-term cost of this legislation was about \$8 trillion!

Of course, when you are in a hole, the first thing to do is stop digging. I have urged reinstatement of the statutory controls—both meaningful caps on discretionary spending and pay-as-you-go (PAYGO) on both the tax and spending sides of the ledger—that expired in 2002. However given the severity of our current challenge, Congress should look beyond the return to PAYGO and discretionary caps. Mandatory spending cannot remain on autopilot—it will not be enough simply to prevent actions to worsen the

outlook. We have suggested that Congress might wish to design “triggers” for mandatory programs—some measure that would prompt action when the spending path increased significantly. In addition, Congress may wish to look at rules to govern the use of “emergency supplementals.” However, as everyone in this committee knows, these steps alone will not solve the problem. That is why building in more consideration of the long-term impact of decisions is necessary.

Meeting the Long-Term Fiscal Challenge Requires Action on the Spending and Tax Sides of the Budget—Cooperation and Compromise Will Be Necessary

There is no easy way out of the challenge we face. Economic growth is essential, but we will not be able to simply grow our way out of the problem. The numbers speak loudly: our projected fiscal gap is simply too great. To “grow our way out” of the current long-term fiscal gap would require sustained economic growth far beyond that experienced in U.S. economic history since World War II.

Similarly, those who believe we can solve this problem solely by cutting spending or solely raising taxes are not being realistic. While the appropriate level of revenues will be part of the debate about our fiscal future, making no changes to Social Security, Medicare, Medicaid, and other drivers of the long-term fiscal gap would require ever-increasing tax levels—something that seems both inappropriate and implausible. That is why I have said that substantive reform of Social Security and our major health programs remains critical to recapturing our future fiscal flexibility. I believe we must start now to reform these programs.

Although the long-term outlook is driven by Social Security and health care costs, this does not mean the rest of the budget can be exempt from scrutiny. Restructuring and constraint will be necessary beyond the major entitlement programs. This effort offers us the chance to bring our government and its programs in line with 21st century realities.⁶ Many tax expenditures act like entitlement programs, but with even less scrutiny. Other programs and activities were designed for a very different time.

Taken together, entitlement reform and reexamination of other programs and activities could engender a national discussion about what Americans

⁶ GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, [GAO-05-325SP](#) (Washington, D.C.: February 2005) and *Suggested Areas for Oversight for the 110th Congress*, [GAO-07-235R](#) (Washington, D.C.: Nov. 17, 2006).

want from their government and how much they are willing to pay for those things.

Finally, given demographic and health care cost trends, the size of the spending cuts necessary to hold revenues at today's share of GDP seems implausible. It is not realistic to assume we can remain at 18.2 percent of GDP—we will need more revenues. Obviously we want to minimize the tax burden on the American people and we want to remain competitive with other industrial nations—but in the end the numbers have to add up.

As I noted, we need to start with real changes in existing entitlement programs to change the path of those programs. However, reform of the major entitlement programs alone will not be sufficient. Reprioritization and constraint will be necessary in other spending programs. Finally, we will need more revenues—hopefully through a reformed tax system.

The only way to get this done is through bipartisan cooperation and compromise—involving both the Congress and the White House.

Delay only makes matters worse. GAO's simulations show that if no action is taken, 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.

Further Delay Will Only Worsen the Outlook

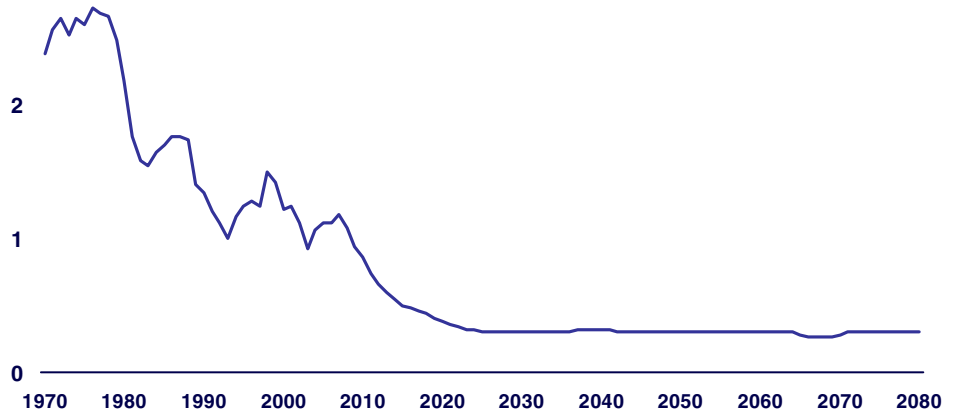
For many years those of us who talk about the need to put Social Security on a sustainable course and to reform Medicare have talked about the benefits of early action. Acting sooner rather than later can turn compound interest from an enemy to an ally. Acting sooner rather than later permits changes to be phased in more gradually and gives those affected time to adjust to the changes. Delay does not avoid action—it just makes the steps that have to be taken more dramatic and potentially harder.

Unfortunately, it is getting harder to talk about early action—the future is upon us.

Next year members of the baby boom generation start to leave the labor force. Figure 10 shows the impact of demographics on labor force growth.

Figure 10: Labor Force Growth Will Continue to Decline

3 Percentage change (5-yr moving average)



Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration.

Note: Percentage change is calculated as a centered 5-yr moving average of projections based on the intermediate assumptions of the 2006 Trustees' Reports.

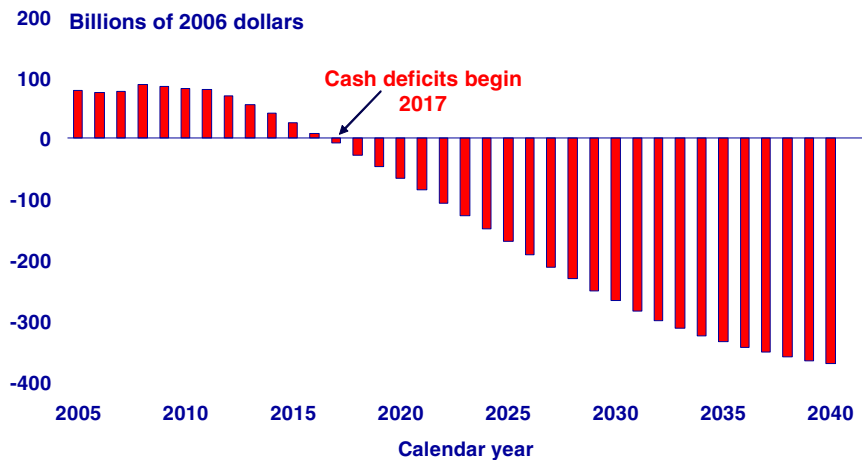
Reflecting this demographic shift, CBO projects the average annual growth rate of real GDP will decline from 3.1 percent in 2008 to 2.6 percent in the period 2012–2016. This slowing of economic growth will come just as spending on Social Security, Medicare and Medicaid will begin to accelerate—accounting for 56 percent of all federal spending by 2016 compared to 43 percent in 2006.

As I noted earlier, today Social Security's cash surplus helps offset the deficit in the rest of the budget, thus reducing the amount Treasury must borrow from the public and increasing budget flexibility—but this is about to change.

Growth in Social Security spending is expected to increase from an estimated 4.8 percent in 2008 to 6.5 percent in 2016. The result, as shown in figure 11, is that the Social Security surpluses begin a permanent decline in 2009. At that time the rest of the budget will begin to feel the squeeze since the ability of Social Security surpluses to offset deficits in the rest of the budget will begin to shrink. In 2017 Social Security will no longer run a cash surplus and will begin adding to the deficit. That year Social Security will need to redeem the special securities it holds in order to pay benefits. Treasury will honor those claims—the United States has never defaulted. But there is no free money. The funds to redeem those securities will have

to come from higher taxes, lower spending on other programs, higher borrowing from the public, or a combination of all three.

Figure 11: Projected Cash Surpluses and Deficits in the Combined Social Security Trust Fund



Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration.

Note: Projections based on the intermediate assumptions of the 2006 Trustees' Reports. The consumer price index is used to adjust from current to constant dollars.

I spoke before of how big the changes would have to be if we were to do nothing until 2040. Of course, we won't get to that point—something will force action before then. If we act now, we have more choices and will have more time to phase-in related changes.

Concluding Remarks

Chairman Spratt, Mr. Ryan, Members of the Committee—in holding this hearing even before the President's Budget is submitted you are signaling the importance of considering any proposal within the context of the long-term fiscal challenge. This kind of leadership will be necessary if progress is to be made.

I have long believed that the American people can accept difficult decisions as long as they understand why such steps are necessary. They need to be given the facts about the fiscal outlook: what it is, what drives it, and what it will take to address it. As most of you know, I have been investing a good deal of time in the Fiscal Wake-Up Tour (FWUT) led by

the Concord Coalition. Scholars from both the Brookings Institution and the Heritage Foundation join with me and Concord in laying out the facts and discussing the possible ways forward. In our experience, having these people, with quite different policy views on how to address our long-range imbalance, agree on the nature, scale, and importance of the issue—and on the need to sit down and work together—resonates with the audiences. Although the major participants have been Concord, GAO, Brookings, and Heritage, others include such organizations as the Committee for Economic Development (CED); the American Institute of Certified Public Accountants (AICPA); the Association of Government Accountants (AGA); the National Association of State Auditors, Comptrollers and Treasurers (NASACT); and AARP. The FWUT also has received the active support and involvement of community leaders, local colleges and universities, the media, the business community, and both former and current elected officials. We have been to 17 cities to-date. The discussion has been broadcast on public television stations in Atlanta and Philadelphia. Earlier this month OMB Director Portman and former Senator Glenn joined us at an event at the John Glenn School of Public Affairs at Ohio State University in Columbus, Ohio.

The specific policy choices made to address this fiscal challenge are the purview of elected officials. The policy debate will reflect differing views of the role of government and differing priorities for our country. What the FWUT can do—and what I will continue to do—is lay out the facts, debunk various myths, and prepare the way for tough choices by elected officials. The American people know—or sense—that there is something wrong; that these deficits are a problem. If they understand that there truly is no magic bullet—if they understand that

- we cannot grow our way out of this problem;
- eliminating earmarks will not solve the problem;
- wiping out fraud, waste, and abuse will not solve the problem;
- ending the war or cutting way back on defense will not solve the problem;
- restraining discretionary spending will not solve the problem; and
- letting the recent tax cuts expire will not solve this problem;

then the American people can engage with you in a discussion about what government should do and how.

People ask me how I think this can happen. I know that some Members believe a carefully structured commission will be necessary to prepare a package while others feel strongly that elected officials should take up the task of developing that package. Whatever the vehicle, success will

require the active and open-minded involvement of both parties in and both houses of the Congress and of the President. With that it should be possible to develop a package which accomplishes at least three things: (1) a comprehensive solution to the Social Security imbalance—one that is not preprogrammed to require us to have to come back again, (2) Round I of comprehensive tax reform, and (3) Round I of Health Care Reform.

This is a great nation. We have faced many challenges in the past and we have met them. It is a mistake to underestimate the commitment of the American people to their children and grandchildren; to underestimate their willingness and ability to hear the truth and support the decisions necessary to deal with this challenge. We owe it to our country, to our children and to our grandchildren to address this fiscal imbalance. The world will present them with new challenges—we need not bequeath them this burden too. The time for action is now.

Mr. Chairman, Mr. Ryan, Members of the Committee, let me repeat my appreciation for your commitment and concern in this matter. We at GAO stand ready to assist you in this important endeavor.

Contact and Acknowledgments

For further information on this testimony, please contact Susan J. Irving at (202) 512-9142 or irvings@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. Individuals making key contributions to this testimony include Jay McTigue, Assistant Director; Linda Baker and Melissa Wolf.

Appendix I: Ideas for Improving the Transparency of Long-term Costs and the Attention Paid to These Costs before Decisions Are Made

Supplemental Reporting in the President's Annual Budget Submission

- Produce an annual Statement of Fiscal Exposures, including a concise list and description of exposures, cost estimates where possible, and an assessment of methodologies and data used to produce such cost estimates.
- Increase the transparency of tax expenditures by including them in the annual Fiscal Exposures Statement and, where possible, also showing them along with spending and credit programs in the same policy area.
- Provide information on the impact of major tax or spending proposals on short-term, mid-term, and long-term fiscal exposures and on the path of surplus/deficit and debt as percent of gross domestic product (GDP) over 10-year and longer-term horizons (and assuming no sunset if sunset is part of the proposal).
- Cover 10 years in the budget.
- Consider requiring the President to include in his annual budget submission a long-term fiscal goal (e.g., balance, surplus, or deficit as percent of GDP).

Additional Executive Branch Reports

- Prepare and publish a Summary Annual Report or Citizen's Summary that summarizes, in a clear, concise, plain English, and transparent manner, key financial and performance information included in the Consolidated Financial Report.
- Prepare and publish a report on long-range fiscal sustainability every 2 to 4 years.

Additional Cost Information on Proposals before Adoption

- Require improved disclosure—at the time proposals are debated but before they are adopted—of the long-term costs of individual mandatory spending and tax proposals over a certain size and for which costs will ramp up over time.

GAO Reports

- An annual report or reports by GAO including comments on the Consolidated Financial Statement (CFS), results of the latest long-term fiscal simulations, comments on the adequacy of information regarding long-term cost implications of existing and proposed policies in the previous year as well as any other significant financial and fiscal issues.

**Other Areas in Which
GAO Has Suggested That
Congress Might Consider
Changing the Budget
Treatment**

- Use accrual budgeting for the following areas where cash basis obligations do not adequately represent the government’s commitment:
 - employee pension programs (pre-Federal Employee Retirement System employees);
 - retiree health programs; and
 - federal insurance programs, such as the Pension Benefit Guaranty Corporation and crop insurance.
- Explore techniques for expanding accrual budgeting to
 - environmental cleanup and
 - social insurance—could consider deferring recognition of social insurance receipts until they are used to make payments in the future (this was suggested in GAO’s accrual budgeting report as an idea to explore, possibly with a commission designed to explore budget concepts).

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