

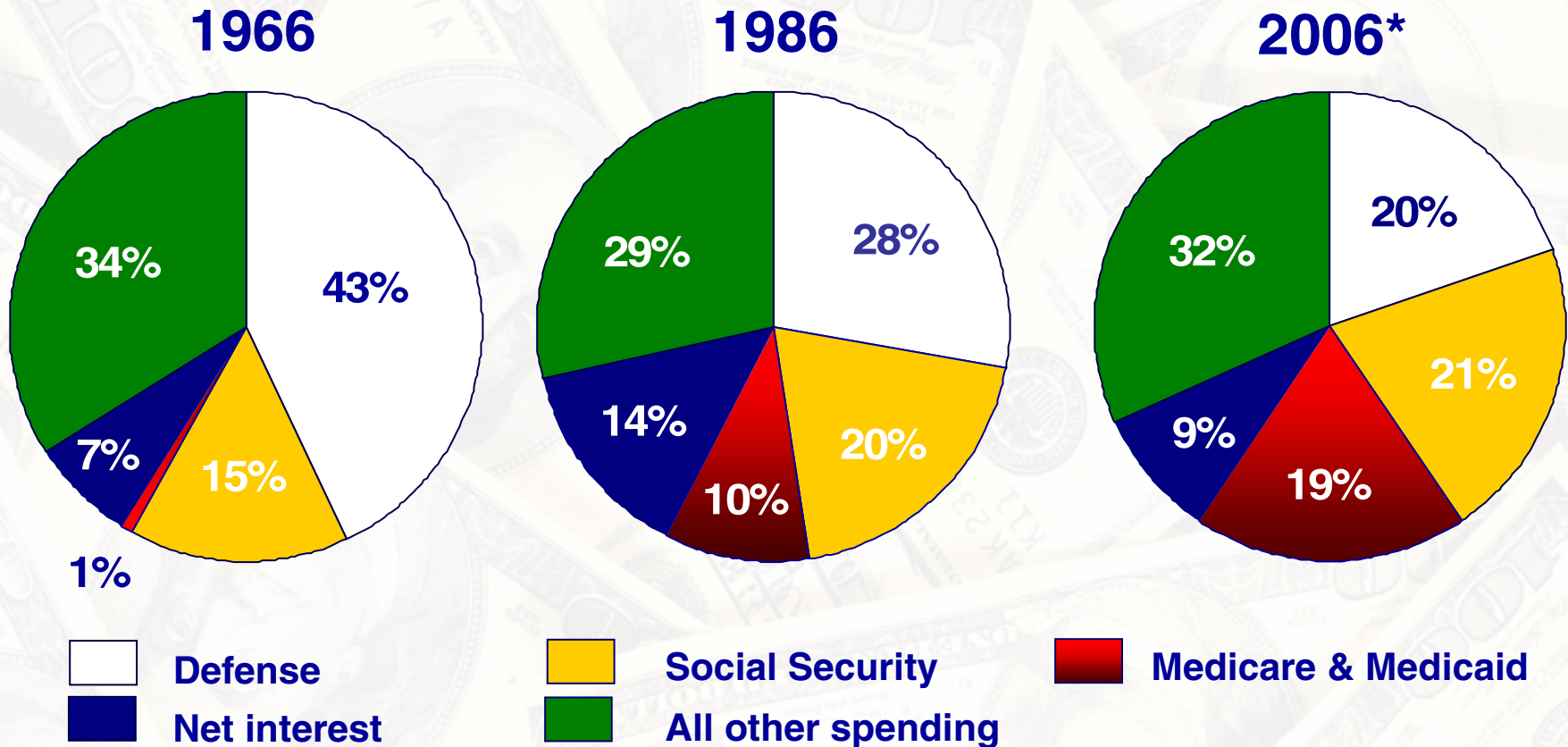
# **Long-Term Fiscal Challenge: Not just a Federal Concern**

Susan J. Irving  
Director, Federal Budget Analysis  
U.S. Government Accountability Office

OFFICIALS IN WASHINGTON  
CONTINUE TO IGNORE WARNINGS  
ABOUT THIS STORM, WHICH  
IS PROJECTED TO BE A  
CATEGORY 500 BILLION.....



# Composition of Federal Spending

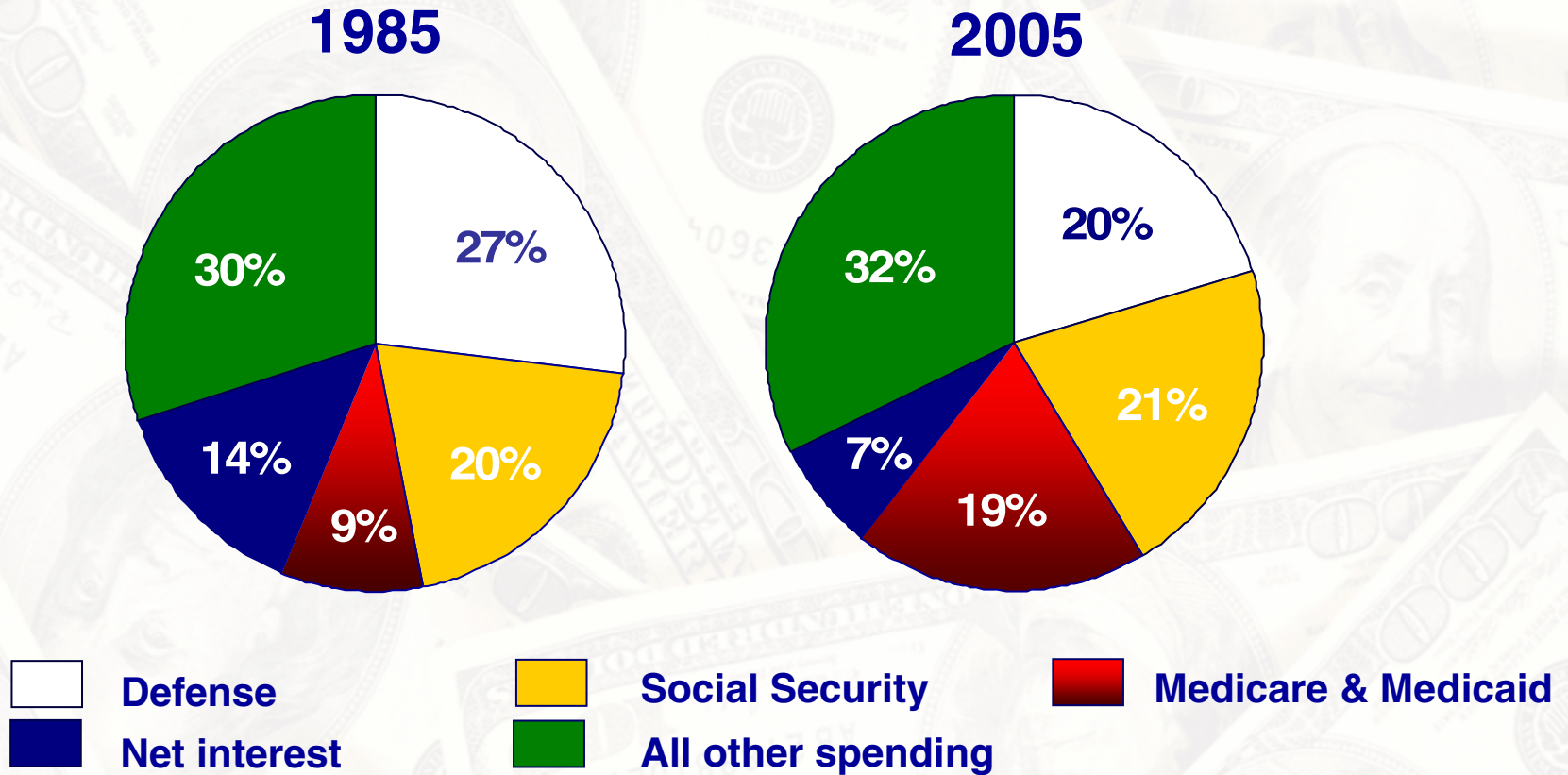


\*Preliminary.

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

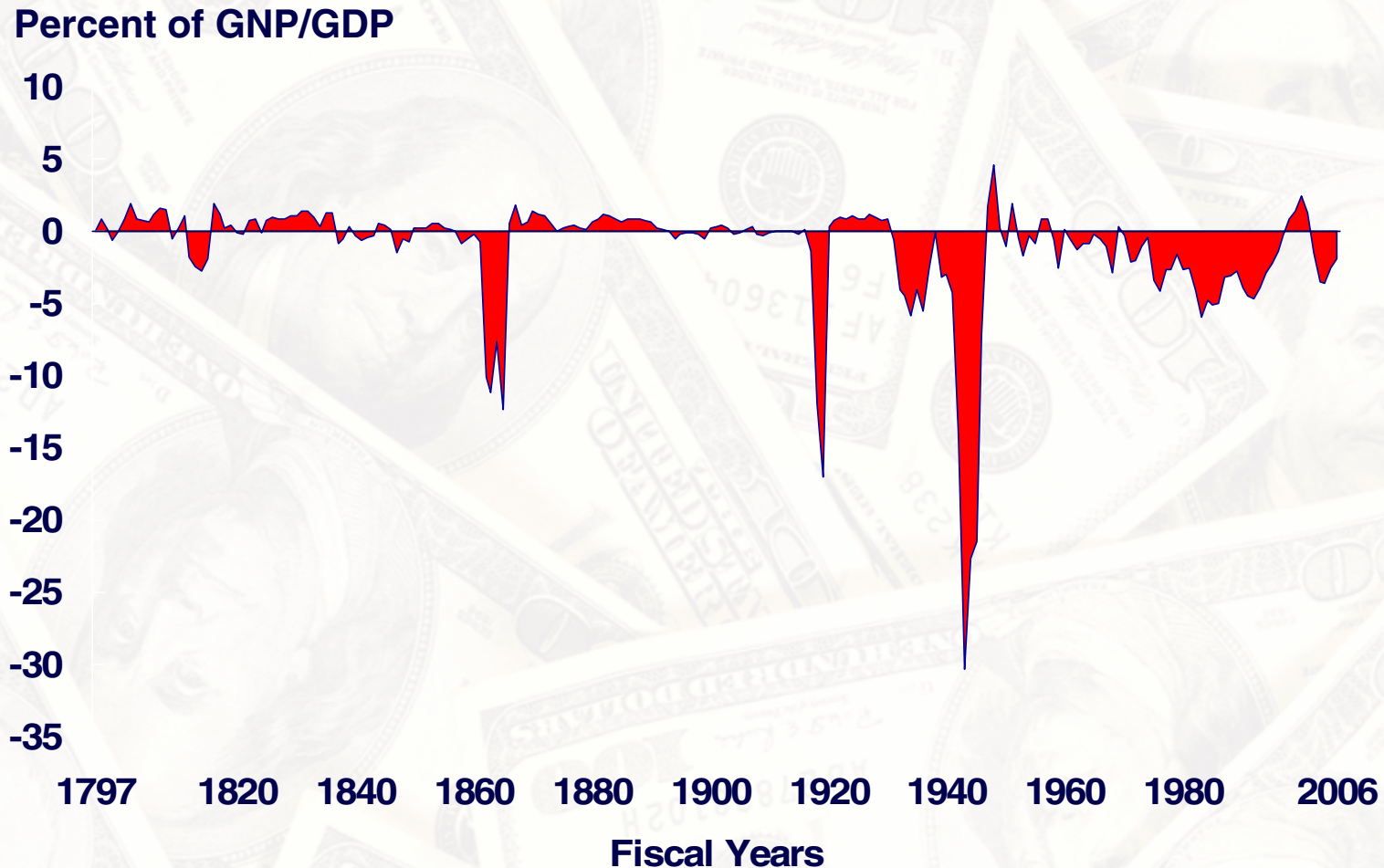
Note: Numbers may not add to 100 percent due to rounding.

# Composition of Federal Spending



Source: Office of Management and Budget.

# Surplus or Deficit as a Share of GDP Fiscal Years 1797-2006

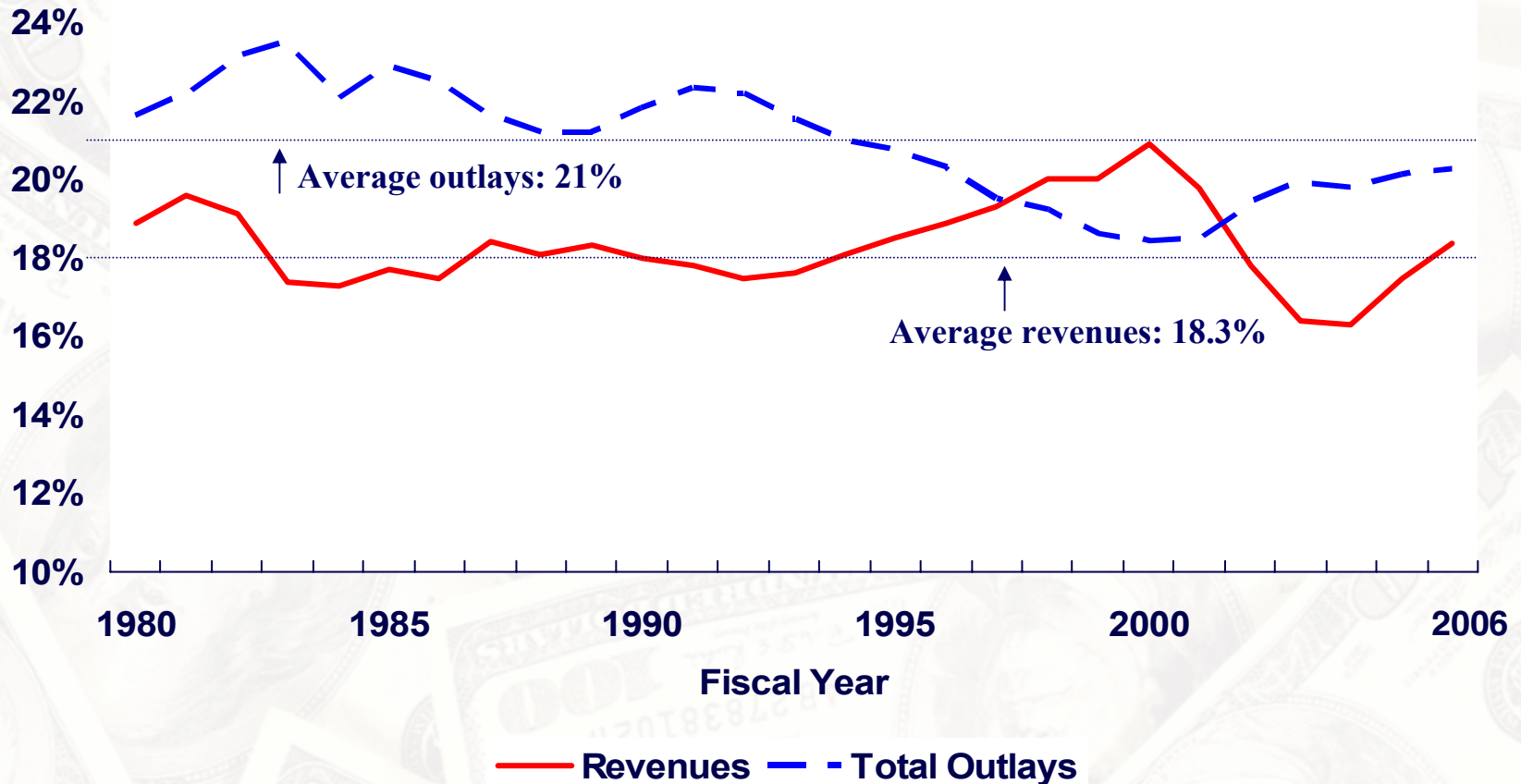


Note: Data until 1929 are shown as a percent of gross national product (GNP); data from 1930 to present are shown as a percent of GDP.  
Source: Department of Commerce, Office of Management and Budget, and Congressional Budget Office.

# Federal Spending and Revenues as a Percent of GDP

Fiscal Years 1980-2006

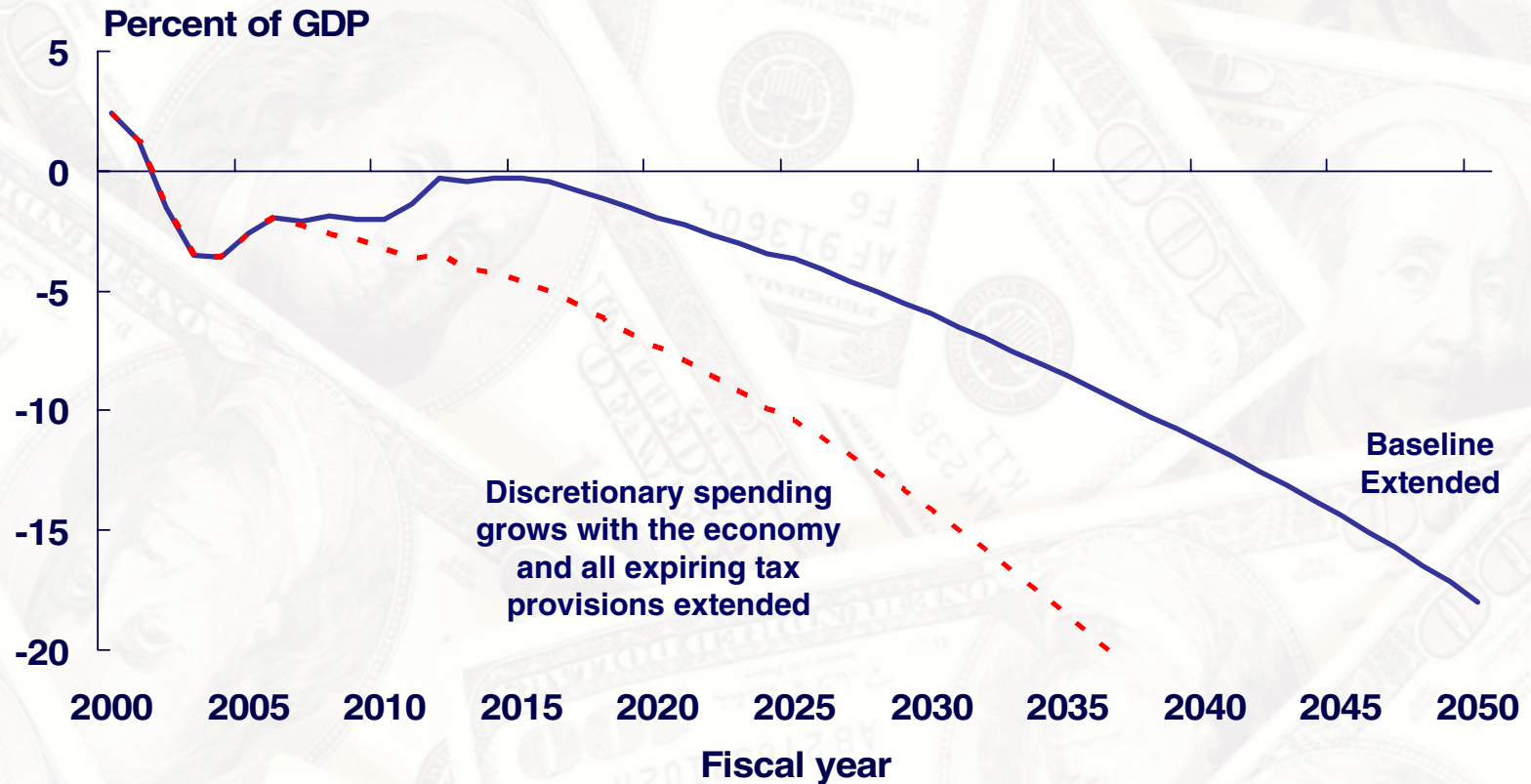
Percent of GDP



Source: Congressional Budget Office, January 2006

# Unified Surpluses and Deficits as a Share of GDP

## Under Alternative Fiscal Policy Simulations

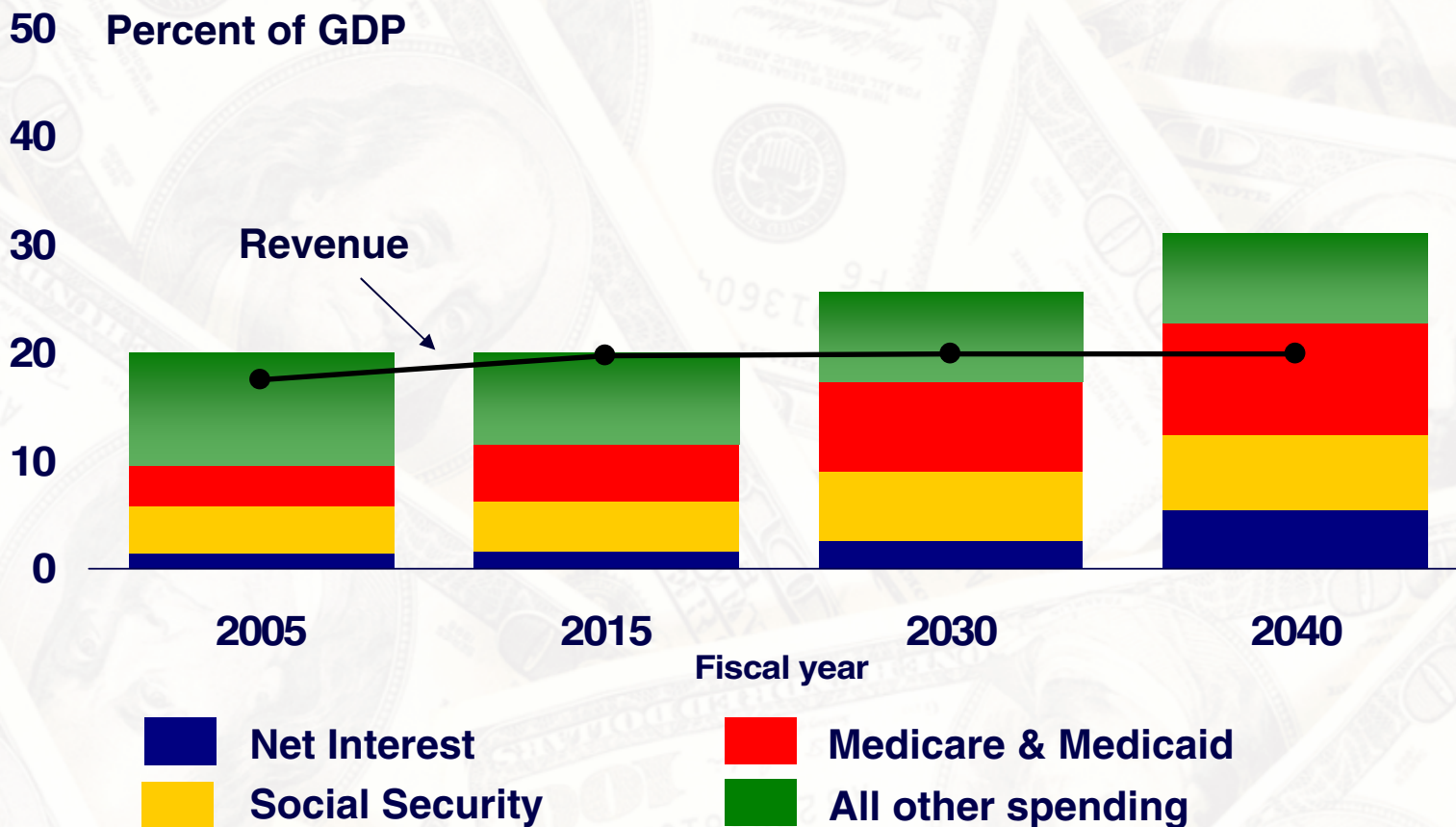


Note: Assume currently scheduled Social Security benefits are paid in full throughout the simulation period.

Source: GAO's August 2006 analysis.

# Composition of Spending as a Share of GDP

## Under Baseline Extended

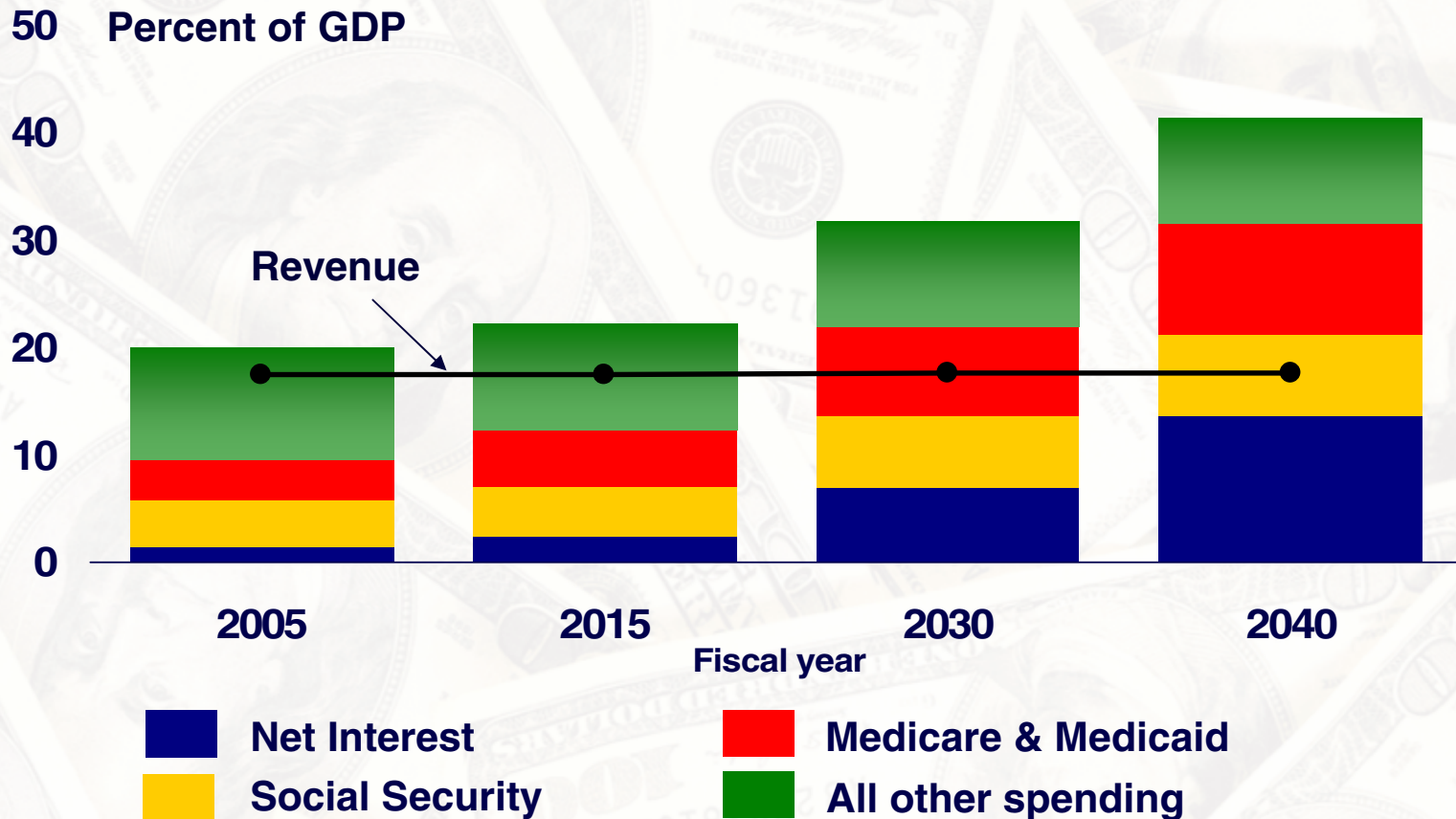


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2016 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2016, revenue as a share of GDP is held constant.

Source: GAO's August 2006 analysis.

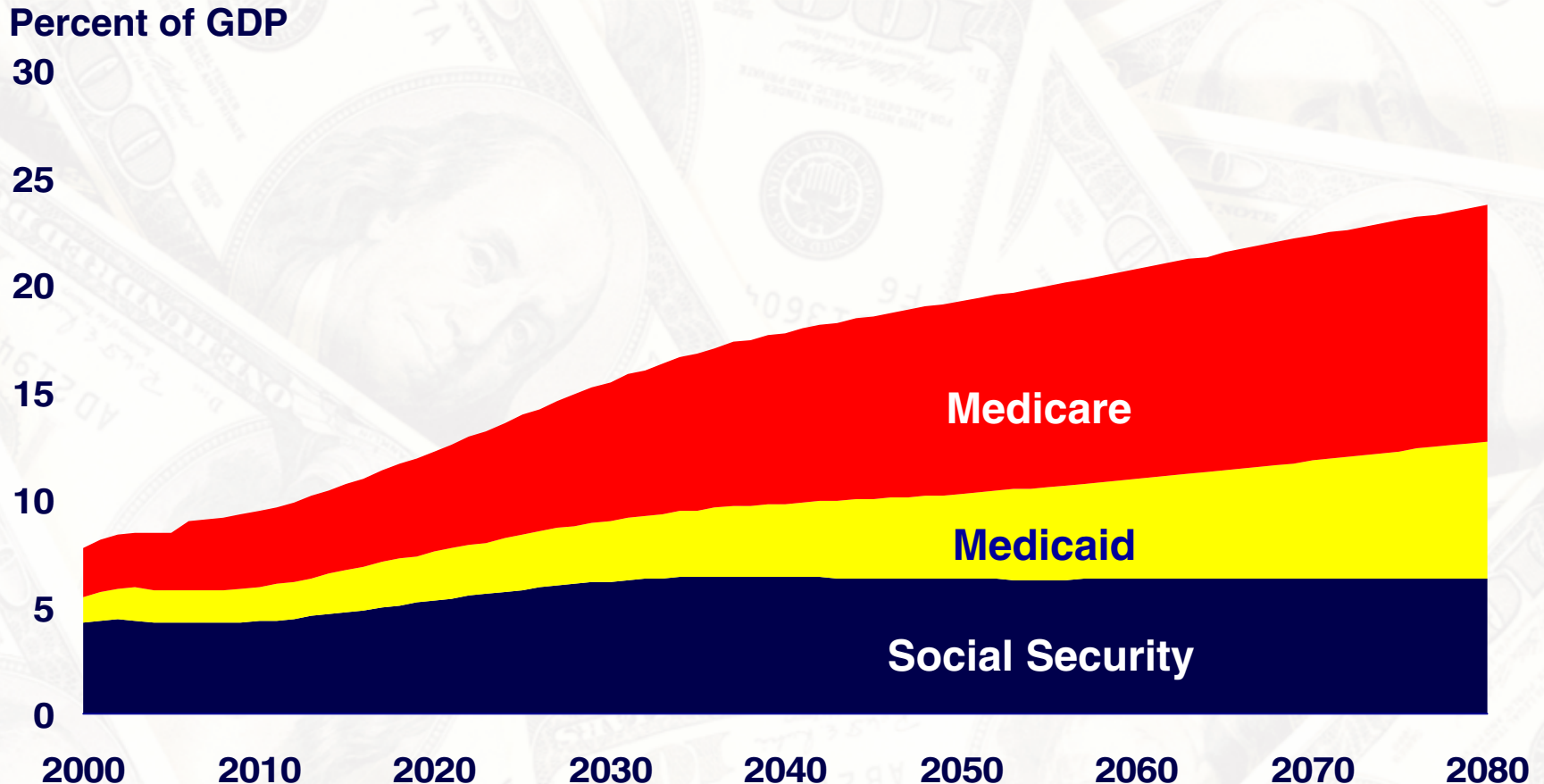
# Composition of Spending as a Share of GDP

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



Source: GAO's August 2006 analysis.

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

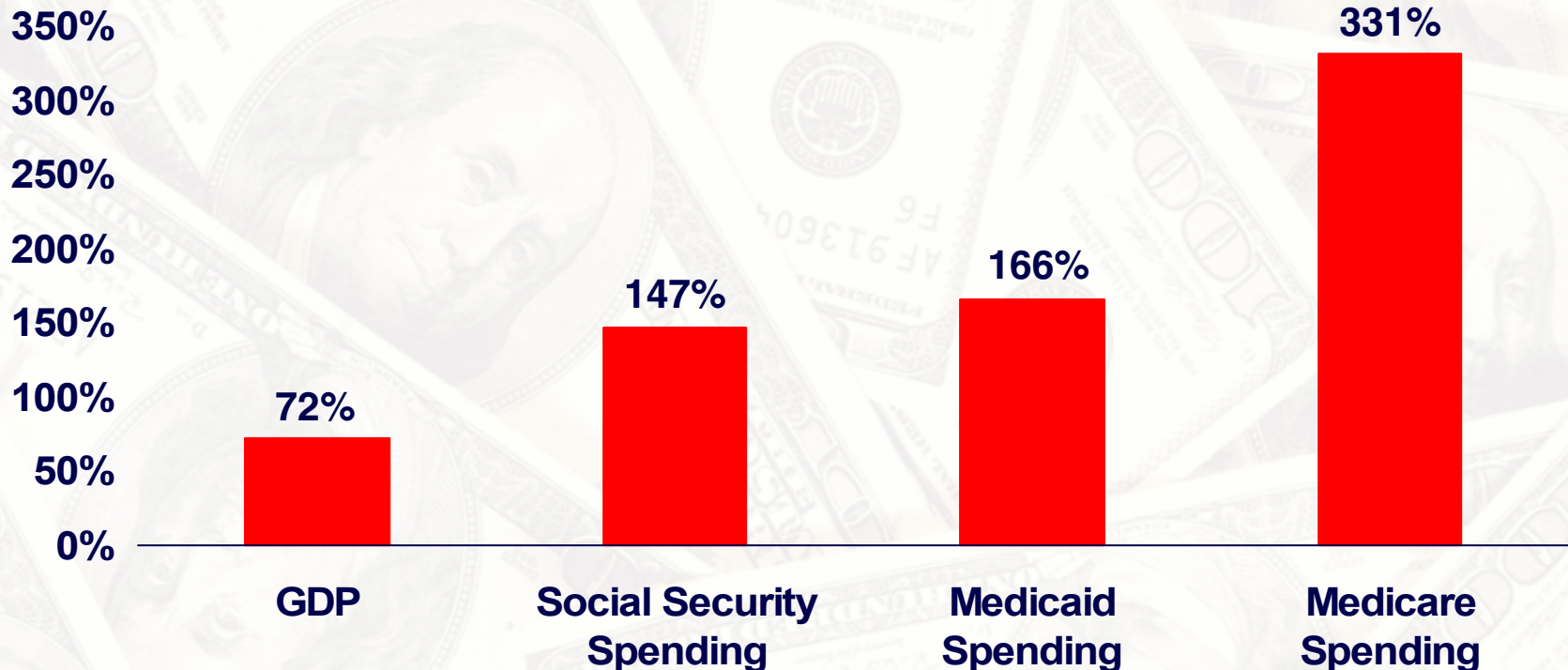


Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration, Office of the Actuary, Centers for Medicare and Medicaid Services, and the Congressional Budget Office.

Note: Social Security and Medicare projections based on the intermediate assumptions of the 2006 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.

# 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.

# Estimated Fiscal Exposures

(\$ trillions)

	2000	2006
<b>• Explicit liabilities</b>	<b>\$6.9</b>	<b>\$10.2</b>
<ul style="list-style-type: none"> <li>• Publicly held debt</li> <li>• Military &amp; civilian pensions &amp; retiree health</li> <li>• Other</li> </ul>		
<b>• Commitments &amp; contingencies</b>	<b>0.5</b>	<b>0.9</b>
<ul style="list-style-type: none"> <li>• E.g., PBGC, undelivered orders</li> </ul>		
<b>• Implicit exposures</b>	<b>13.0</b>	<b>38.8</b>
<ul style="list-style-type: none"> <li>• Future Social Security benefits</li> </ul>	3.8	6.4
<ul style="list-style-type: none"> <li>• Future Medicare Part A benefits</li> </ul>	2.7	11.3
<ul style="list-style-type: none"> <li>• Future Medicare Part B benefits</li> </ul>	6.5	13.1
<ul style="list-style-type: none"> <li>• Future Medicare Part D benefits</li> </ul>	--	8.0
<b>Total</b>	<b>\$20.4</b>	<b>\$49.9</b>

Source: U.S. government's consolidated financial statement, Social Security and Medicare Trustees reports and Monthly Treasury Statement, September 30, 2006.

Note: 2006 estimates are preliminary. 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.

# 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

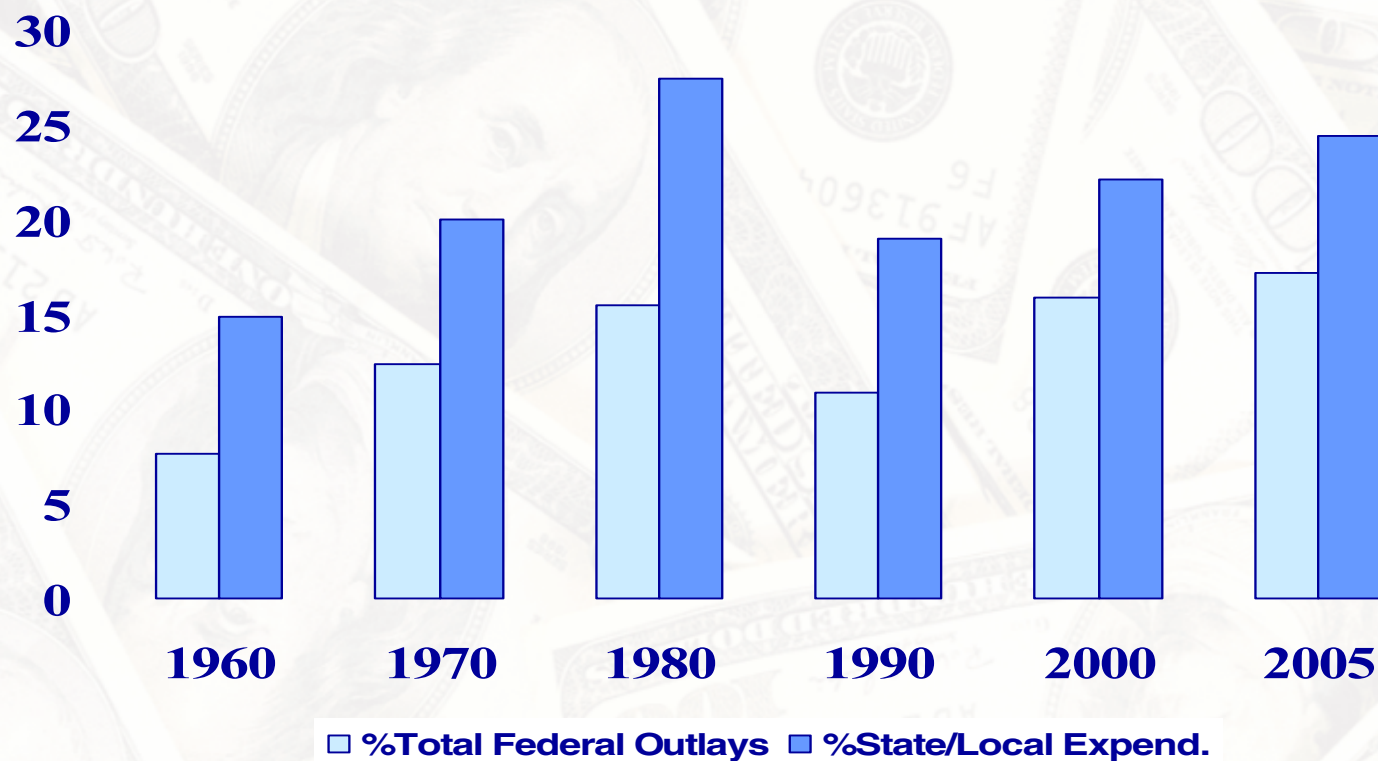
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**

- 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.

# Federal Assistance to State and Local Governments

- Categorical (700+) and Block Grants
- Tax expenditures
  - Deductibility for state and local taxes
  - Tax exemption for state and local bonds
- Loans and loan guarantees
- Insurance
- Technical assistance

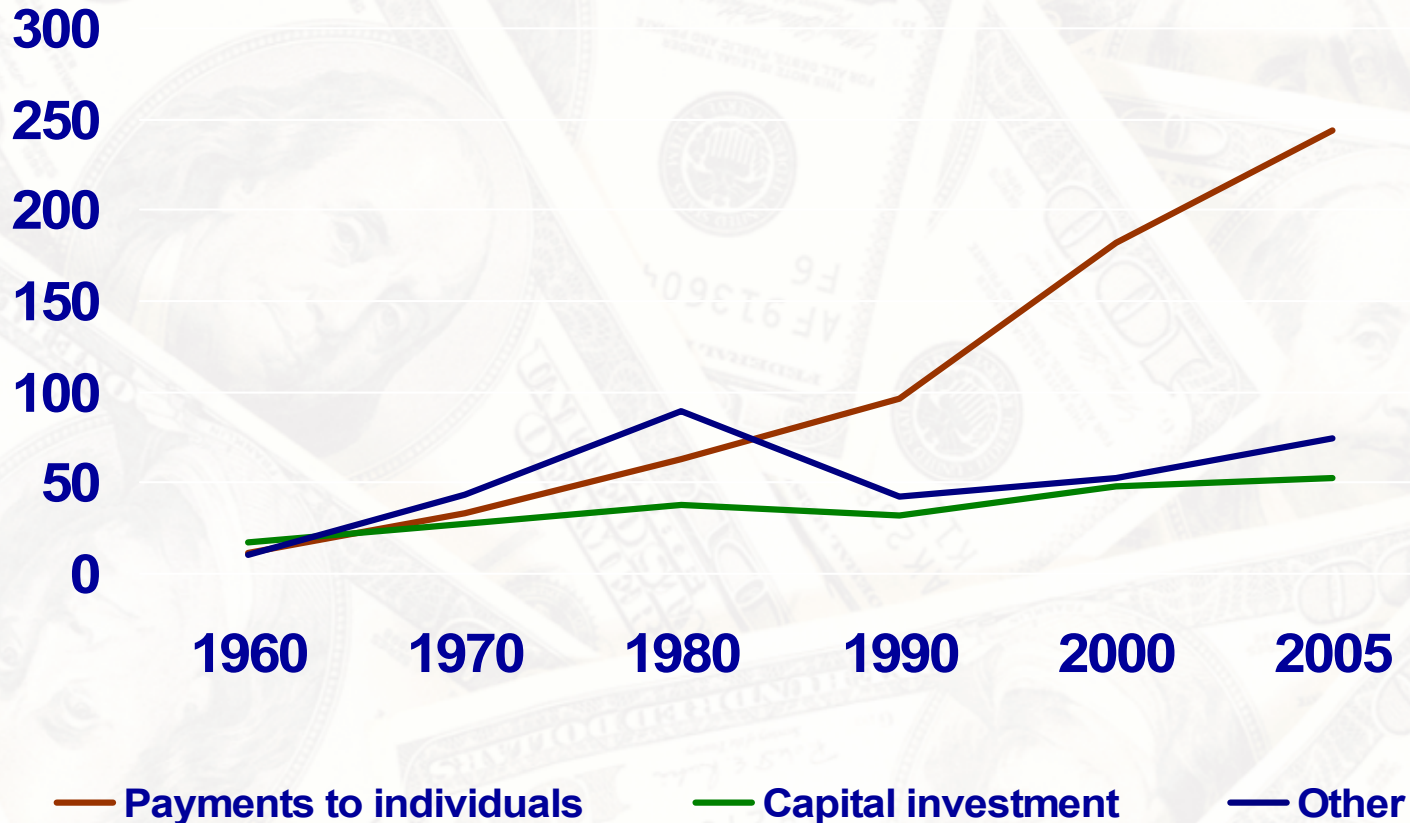
# Federal Grants: Percent of Federal and State/Local Spending



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

# Trends in Federal Grants to State and Local Governments

Billions of  
constant dollars



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

# 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)

# Natural Tension in A Federal System

- Nationalization
  - Pressures from a kind of domestic “globalization”—the lowering of boundaries; commercial interests.
  - Laws--No Child Left Behind; Help America Vote Act; Real ID Act
  - Regulation—pre-emption
  - “Conditions for Federal Funds”
    - Performance
    - other
- State Activism
  - Medicaid Waivers
  - Privatization of highways
  - Tax and expenditure limits defeated in 2006

# Attitude Toward Government?

There ought to be a law.

AND

Get the Government off my Back.

...NOW WE COVER IT WITH STICKS AND LEAVES SO THEY WON'T NOTICE IT UNTIL IT'S TOO LATE.

SOMEHOW, YOU DON'T EXPECT PARENTS TO BEHAVE LIKE THAT.



The Deficit

TOLES

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CHECK THE CLIMATE FORECAST.



4-16-06

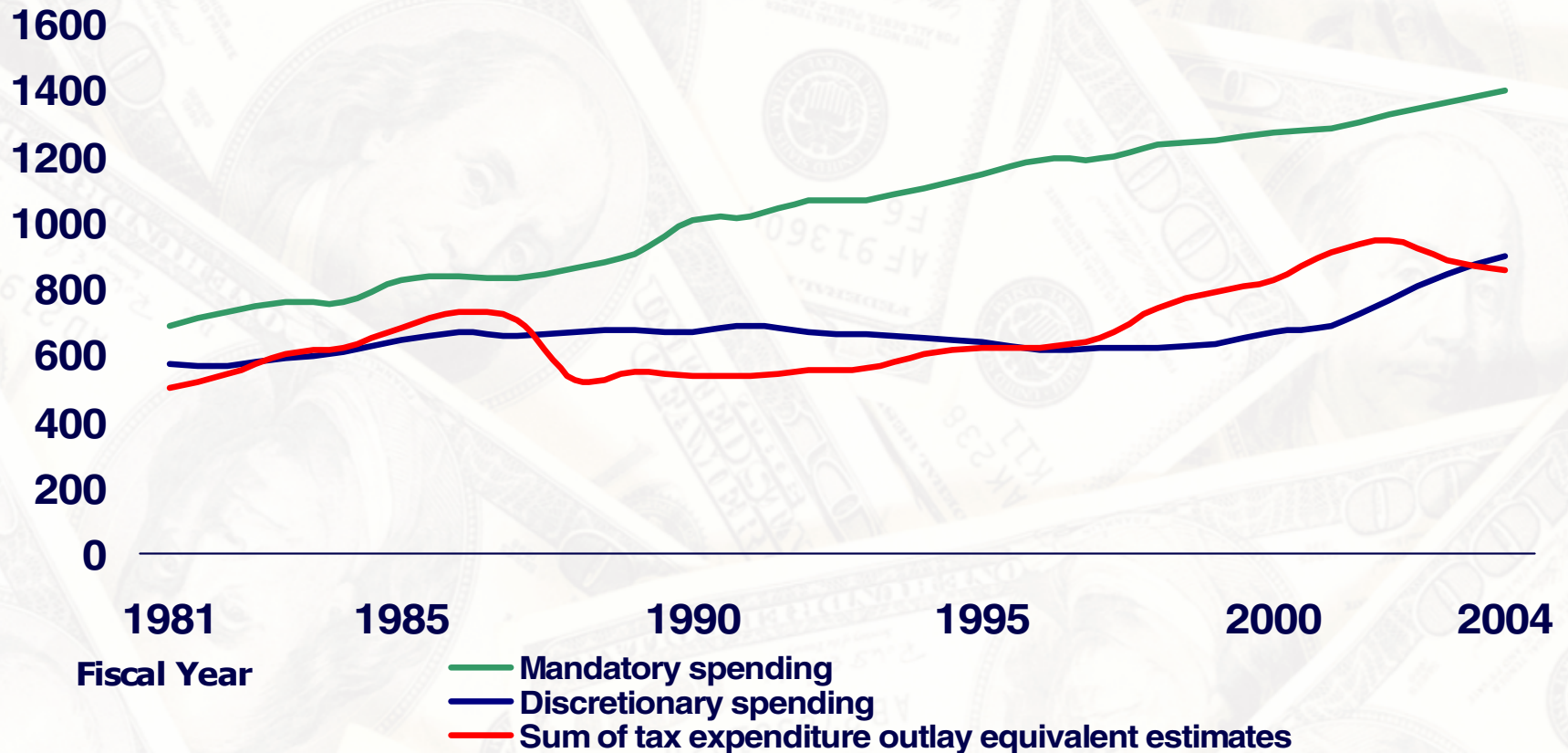
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# Another looming area

- Tax expenditures
  - Sometimes programs run thru the tax side
  - Get even less scrutiny than entitlements

# 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)

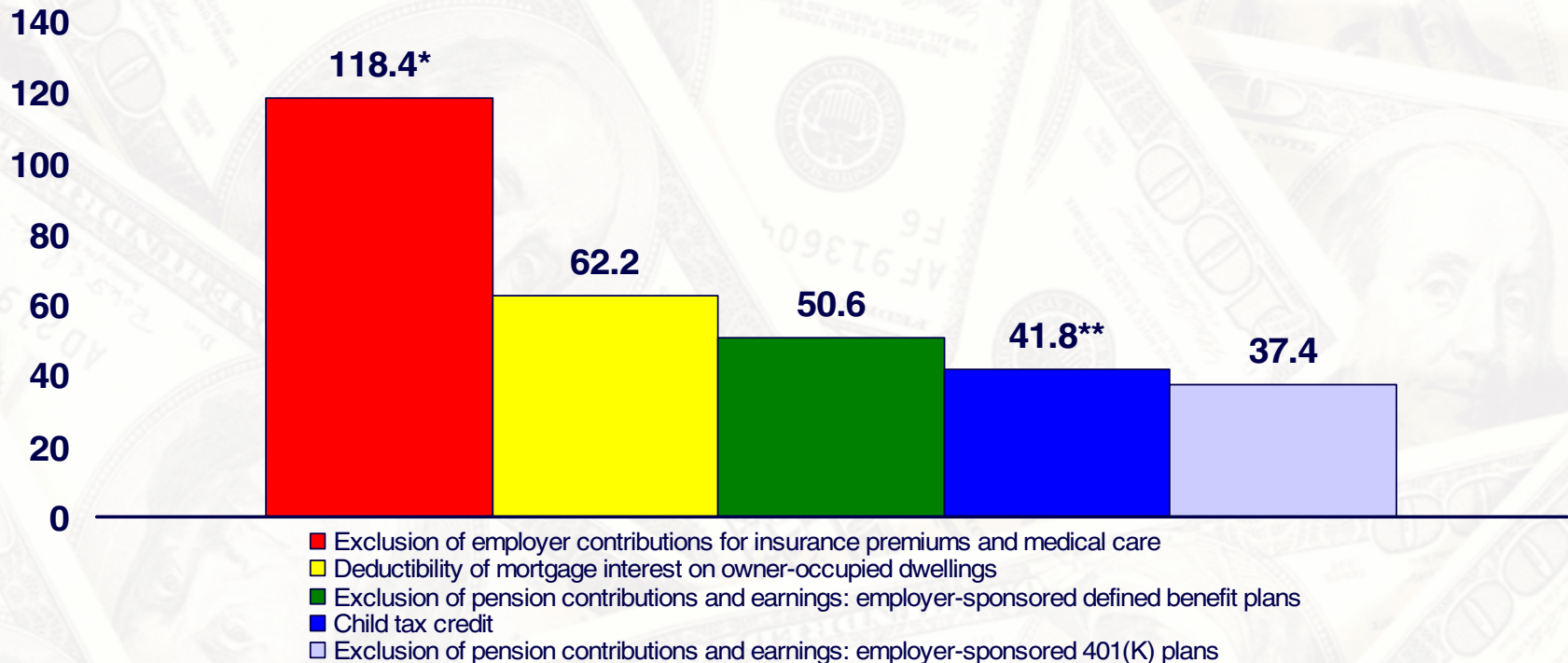


Note: Outlay-equivalent estimates represent the amount of budget outlays that would be required if the government were to provide taxpayers with the same after-tax income they receive through the tax expenditure. Outlay-equivalent estimates are useful to compare tax expenditures and other parts of the 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



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*.