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TREASURY AND GAO BUDGET OUTLOOK
TRILLIONS IN UNFUNDED LIABILITIES

5 March 2010

SUMMARY

Two recent reports provide further evidence of the Federal Government's worsening long-term fiscal condition. One report, by the Department of the Treasury, shows U.S. obligations approaching a staggering $62 trillion. The second, by the Government Accountability Office [GAO], reports the government's excess long-term spending obligations increased by 21.5 percent in just 9 months, to a stunning $76.4 trillion.

Both reports warn of the severe budgetary and economic consequences these trends will produce, unless actions to alter the government's fiscal path are taken soon. As GAO puts it: "[A]bsent policy changes the Federal Government faces an unsustainable growth in debt. Under our Alternative simulation, debt held by the public as a share of GDP [gross domestic product] could exceed the historical high reached in the aftermath of World War II by 2020 . . .10 years sooner than our simulation showed just 2 years ago."

The discussion below summarizes the findings of these two reports.

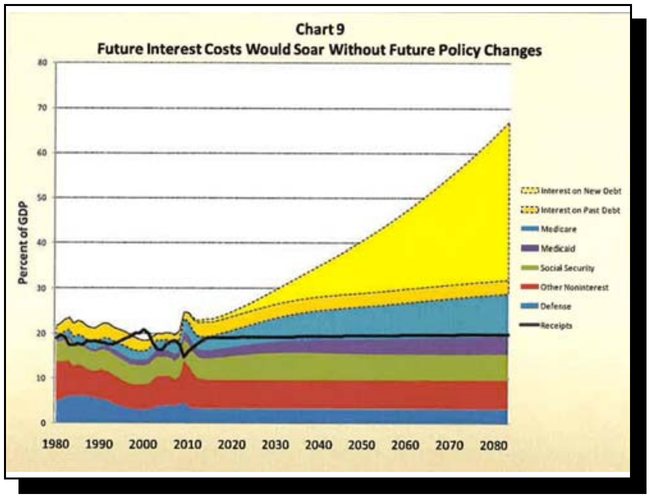
THE TREASURY REPORT

The Treasury's assessment, showing $62 trillion in U.S. obligations, appears in the Department's *Financial Report of the United States Government.* Representative Jim Cooper (D-Tennessee), speaking at the recent health care "summit," described Treasury's work as "the only report that uses real accounting to describe America's fiscal problems – and the news is not pretty."

The report outlines the Nation's fiscal situation on an accrual basis, rather than a cash basis. This means it recognizes obligations when they are incurred, not simply when they are due to be paid out. Consequently, accrual accounting offers a better assessment of the magnitude of government promises that cannot be met. By explicitly outlining the future obligations for Social Security and Medicare, the Treasury report provides a chilling portrait of future debt levels. Among its other findings, the report states:

- *Looking forward, in the absence of policy changes, large and growing primary deficits will increase debt held by the public and interest on that debt . . . net interest expressed as a share of GDP is estimated to rise from 1.3 percent in 2009 to 10 percent in 2040 and to 35 percent in 2080. Because interest expenses grow, the total deficit and debt held by the public grow much more rapidly than does the primary deficit . . . current policies are not sustainable.* (See Chart 9 from Treasury's report, reproduced on the next page.)

- *Beginning in 2016, Social Security . . . will need to raise taxes, reduce benefits, increase borrowing from the public, and/or cut spending for other programs to meet its obligations to the trust fund. By 2037, the trust fund reserves (and thus reserve spending authority) are projected to be exhausted.*
- *The gap between total . . . Medicare income (including general revenue contributions) and expenditures begins around 2009 and then steadily continues to widen, reaching 3.4 percent of GDP by 2083.*



The report also highlights that the net present value of the government's unfunded promises to Social Security and Medicare total about $45 trillion. This means the government would need to have $45 trillion in the bank *today* to fulfill the promises made in these two programs.

The Treasury's full report can be found here:
http://www.fms.treas.gov/fr/09frusg/09frusg.pdf

THE GOVERNMENT ACCOUNTABILITY OFFICE

The GAO report, released on 2 March 2010, updates figures the agency published a year ago, tracing the growth, though January this year, in what is called the "fiscal gap." In March 2009, the gap was $62.9 trillion. In 9 months, that figure had grown to $76.4 trillion – an stunning increase of 21.5 percent.

GAO describes this presentation as follows: "The fiscal gap represents the difference, or gap, between revenue and spending in present value terms over a certain period, such as 75 years, that would need to be closed in order to achieve a specified debt level (e.g., today's debt to GDP ratio) at the end of the period. From the fiscal gap, one can calculate the size of action needed – in terms of tax increases, spending reductions, or, more likely, some combination of the two – to close the gap; that is, for debt as a share of GDP to equal today's ratio at the end of the period."

By every measure included in the study, the U.S. debt level is demonstrably worse (see Table 1 on the next page).

The fiscal gap is widening mainly due to the government's largest entitlement programs: Medicare, Medicaid, and Social Security. Without reform, the spending and debt accumulating in these programs will overwhelm the budget and smother the U.S. economy. Moreover, the longer Congress delays action to gain control of the problem, the worse it gets – as the GAO figures make clear. Like the Treasury report, GAO's account shows that without real reform, it will be impossible to fulfill the promises made to current and future retirees, and increasingly difficult to provide for the Federal Government's other top priorities, such as national defense.

Table 1: Changes in Fiscal Outlook March 2009 to January 2010 – GAO 'Alternative' Simulation

	March 2009 GAO Update	January 2010 GAO Update	Percent Increase
Year Debt Exceeds Historical High	2025	2020	–
Fiscal Gap (trillions)	$62.9	$76.4	21.5%
Percent Revenue Increase to Close Fiscal Gap Today	43.6%	50.5%	15.8%
Percent Spending Reduction to Close Fiscal Gap Today	30.9%	34.2%	10.7%

Source: GAO, *The Federal Government's Long-Term Fiscal Outlook – January 2010 Update.*

The figures cited here come from what GAO calls its "Alternative" simulation, which is essentially a projection based on historical trends and current policy. As GAO describes it: "Discretionary spending grows with GDP rather than inflation during the first 10 years, Medicare physician payment rates are not reduced as in CBO's baseline, all tax provisions are extended to 2020, and the alternative minimum tax [AMT] exemption amount is indexed to inflation through 2020; revenues are then brought back to their historical level." The administration, the Congressional Budget Office [CBO], and other nonpartisan budget analysts provide projections with similar assumptions.

Some key facts with respect to GAO's Alternative simulation:

- By 2020, roughly 93 cents of every dollar of Federal revenue will be spent on major entitlement programs and net interest costs.
- By 2030, net interest payments on the Federal Government's accumulating debt will exceed 8 percent of gross domestic product [GDP] – making them the largest single expenditure in the Federal budget.
- To close the fiscal gap today, the government would have to immediately raise taxes by 50.5 percent, or cut non-interest spending by 34.2 percent.
- If no action is taken in the next 10 years, in 2020 the government would have to raise taxes by 60.7 percent, or cut noninterest spending by 40.2 percent

More from the GAO report:

- *[T]he longer action to deal with the nation's long-term fiscal outlook is delayed, the greater the risk that the eventual changes will be disruptive and destabilizing. Under our Alternative simulation, waiting even 10 years would increase the fiscal gap to 11.0* *percent of GDP – meaning a revenue increase of about 61 percent or a noninterest spending cut of about 40 percent or some combination of the two would be required to bring debt back to today's level by 2084*. – page 8.

- *Our long-term simulations show that absent policy changes the Federal Government faces an unsustainable growth in debt. Under our Alternative simulation, debt held by the public as a share of GDP could exceed the historical high reached in the aftermath of World War II by 2020 . . .10 years sooner than our simulation showed just 2 years ago.* – page 1.

- *While the drivers of the long-term fiscal outlook have not changed, the sense of urgency has . . . many of the long-term challenges highlighted in past updates, including health care cost growth and the aging population, have already begun to affect the Federal budget – in some cases sooner than previously estimated – and the pressures only grow in the coming decade. For example, Social Security cash surpluses have served to reduce the unified budget deficit. However, CBO recently estimated that due to current economic conditions the program will run small temporary cash deficits for the next 4 years and then, similar to the Trustees estimates, run persistent cash deficits beginning in 2016. The fluctuation and eventual disappearance of the Social Security cash surplus will put additional pressure on the rest of the budget.* – page 2.

- *No one can say with certainty what the next 75-years will bring, but simulations by GAO, the Office of Management and Budget, CBO and others, which use some different assumptions, all show an unsustainable long-term fiscal path*. – page 3.

- *In our Alternative simulation, which assumes expiring tax provisions are extended through 2020 and then revenue is held constant at the 40-year historical average, roughly 93 cents of every dollar of Federal revenue will be spent on the major entitlement programs and net interest costs by 2020. By 2030, net interest payments on the Federal Government's accumulating Federal debt exceed 8 percent of GDP—making it the largest single expenditure in the Federal budget.* – page 6.

- *Under our Alternative simulation, the fiscal gap is 9.0 percent of GDP (or a little over $76 trillion in present value dollars). This means that revenue would have to increase by about 50 percent or noninterest spending would have to be reduced by 34 percent on average over the next 75 years (or some combination of the two) to keep debt at the end of the period from exceeding its level at the beginning of 2010 (53 percent of GDP).* – page 7.

GAO's full report can be found here:
http://www.gao.gov/new.items/d10468sp.pdf

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