



UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

Making Tough Budget Choices to Create a Better Future

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

**National Defense University
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Ft. McNair, Washington, D.C.
March 12, 2008**

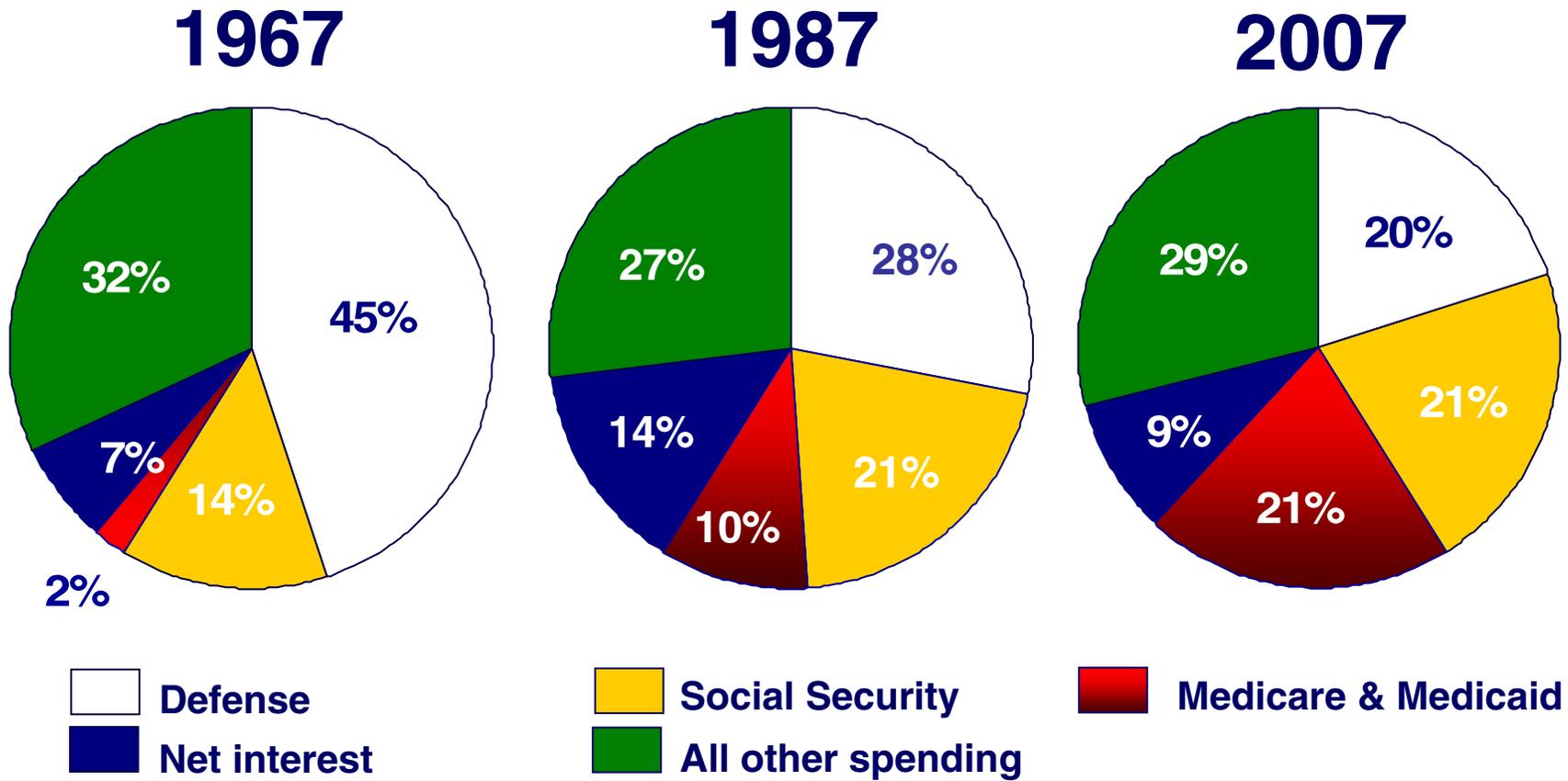


The Case for Change

The federal government is on a “burning platform,” and the status quo way of doing business is unacceptable for a variety of reasons, including:

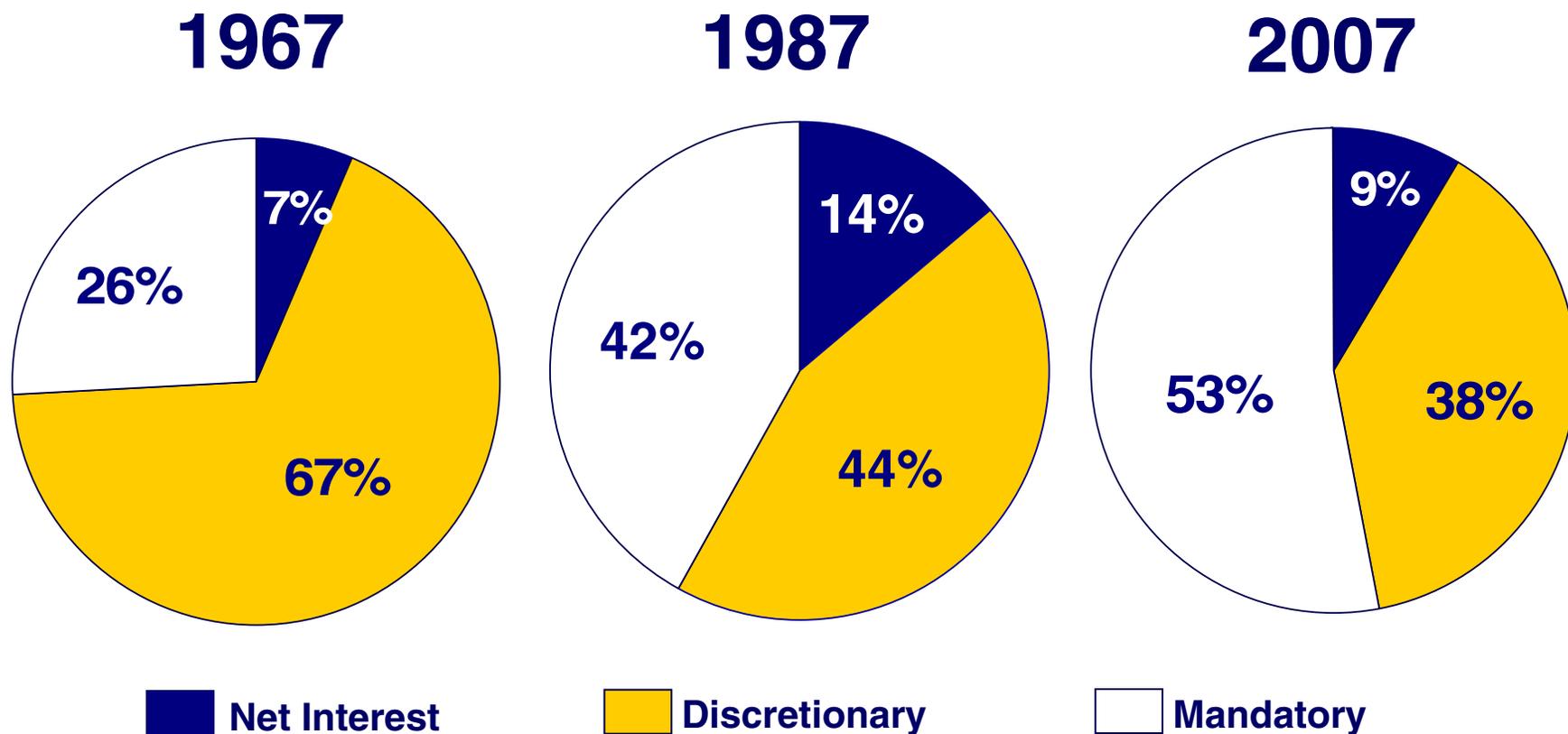
- Past fiscal trends and significant long-range challenges
- Selected trends and challenges having no boundaries
- Additional resource demands due to Iraq, Afghanistan, incremental homeland security needs, and recent natural disasters in the United States
- Numerous government performance/accountability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- Outdated federal organizational structures, policies, and practices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

Composition of Federal Spending



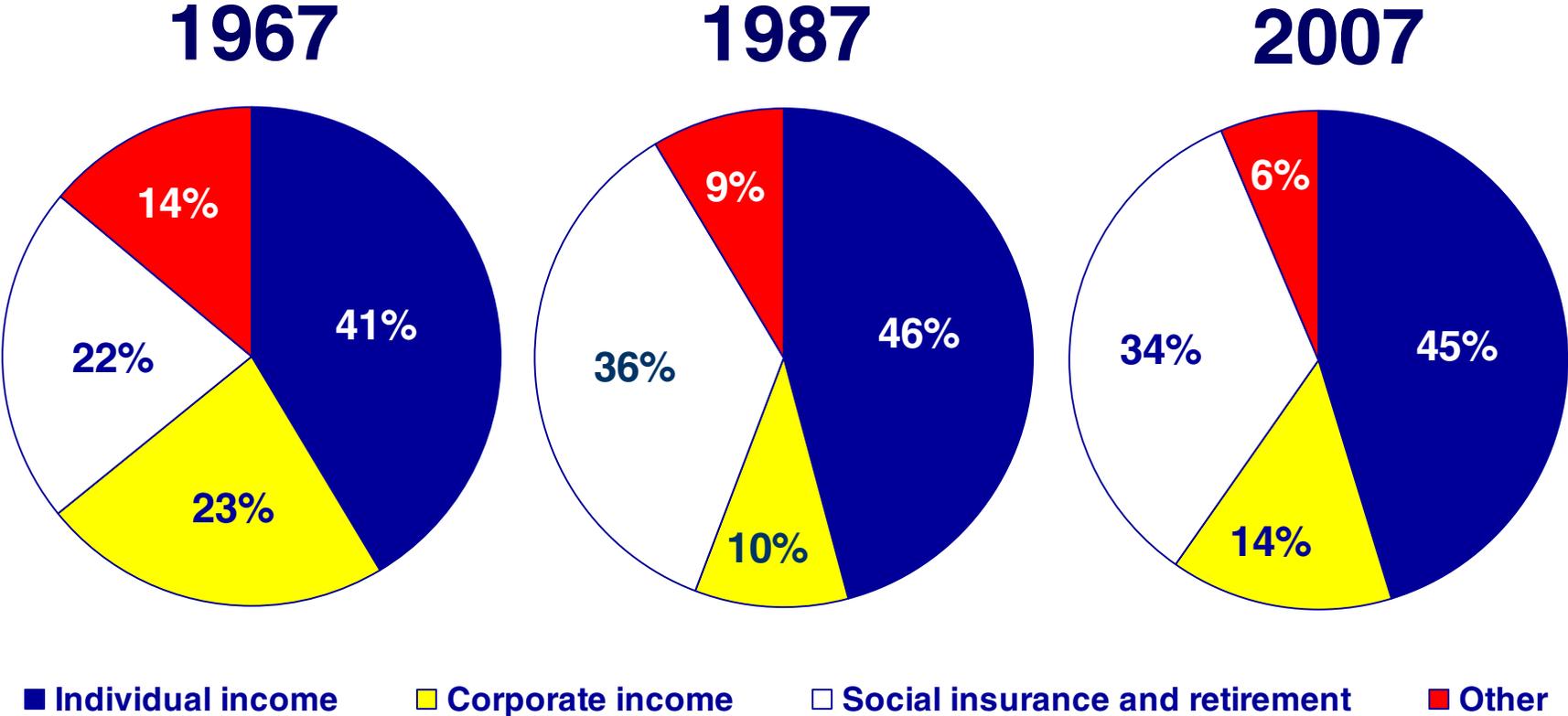
Source: GAO analysis of data from the Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

Composition of Federal Receipts by Source



Source: Office of Management and Budget.

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

Fiscal Year 2006 and 2007 Deficits and Net Operating Costs

| | Fiscal Year 2006 | Fiscal Year 2007 |
|------------------------------|---------------------|---------------------|
| | (\$ Billion) | |
| On-Budget Deficit | (434) | (344) |
| Unified Deficit ^a | (248) | (163) |
| Net Operating Cost | (450) | (276) |

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

^aIncludes \$185 billion in Social Security surpluses for fiscal year 2006 and \$186 billion for fiscal year 2007; \$1 billion in Postal Service surpluses for fiscal year 2006 and a \$5 billion deficit for fiscal year 2007.

Major Fiscal Exposures

(\$ trillions)

| | 2000 | 2007 | % Increase |
|--|---------------|---------------|------------|
| • Explicit liabilities | \$6.9 | \$10.8 | 57 |
| <ul style="list-style-type: none"> • Publicly held debt • Military & civilian pensions & retiree health • Other | | | |
| • Commitments & contingencies | 0.5 | 1.1 | 97 |
| <ul style="list-style-type: none"> • E.g., PBGC, undelivered orders | | | |
| • Implicit exposures | 13.0 | 40.8 | 213 |
| <ul style="list-style-type: none"> • Future Social Security benefits | 3.8 | 6.8 | |
| <ul style="list-style-type: none"> • Future Medicare Part A benefits | 2.7 | 12.3 | |
| <ul style="list-style-type: none"> • Future Medicare Part B benefits | 6.5 | 13.4 | |
| <ul style="list-style-type: none"> • Future Medicare Part D benefits | -- | 8.4 | |
| Total | \$20.4 | \$52.7 | 158 |

Source: 2000 and 2007 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.

How Big is Our Growing Fiscal Burden?

This fiscal burden can be translated and compared as follows:

| | |
|--|------------------------|
| Total –major fiscal exposures | \$52.7 trillion |
| Total household net worth¹ | \$58.6 trillion |
| Burden/Net worth ratio | 90 percent |
| Burden² | |
| Per person | \$175,000 |
| Per full-time worker | \$410,000 |
| Per household | \$455,000 |
| Income | |
| Median household income³ | \$48,201 |
| Disposable personal income per capita⁴ | \$33,253 |

Source: GAO analysis.

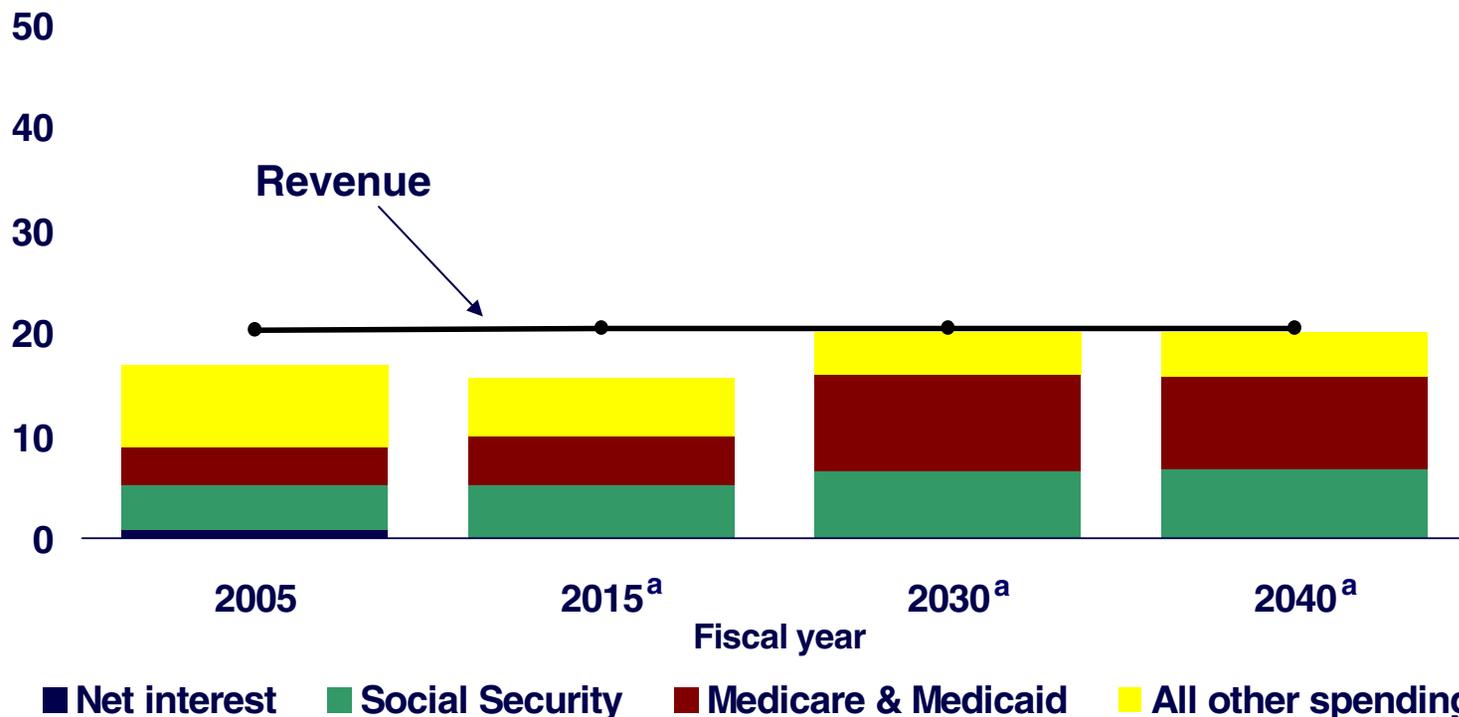
Notes: (1) Federal Reserve Board, Flow of Funds Accounts, Table B.100, 2007:Q3 (December 6, 2007); (2) Burdens are calculated using estimated total U.S. population as of 10/1/2007, from the U.S. Census Bureau; full-time workers reported by the Bureau of Economic Analysis, in NIPA table 6.5D (Aug. 1, 2007); and households reported by the U.S. Census Bureau, in Income, Poverty, and Health Insurance Coverage in the United States: 2006 (Aug. 2007); (3) U.S. Census Bureau, Income, Poverty, and Health Insurance Coverage in the United States: 2006 (Aug. 2007); and (4) Bureau of Economic Analysis, Personal Income and Outlays, table 2, (Nov. 29, 2007).

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.

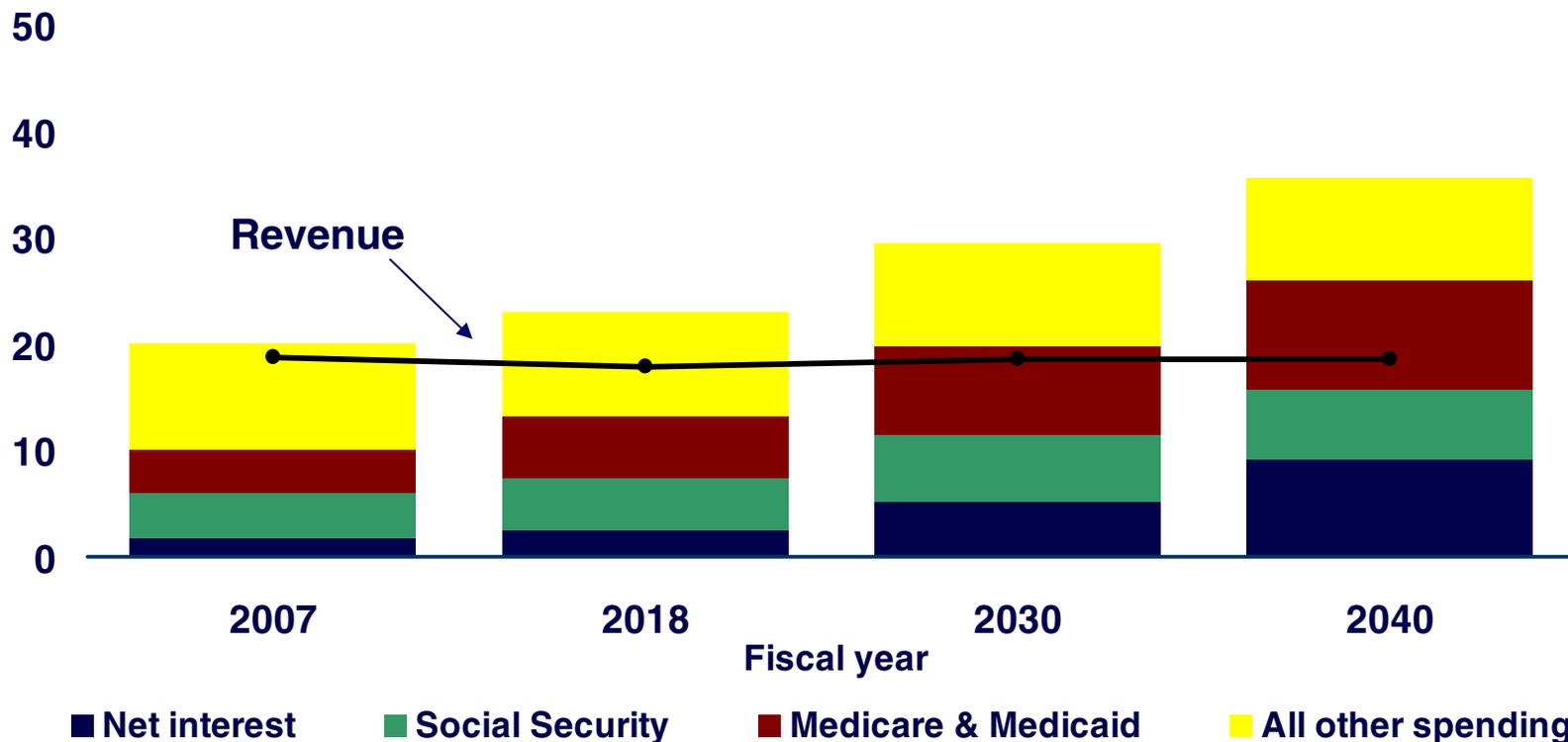
^aAll other spending is net of offsetting interest receipts.

Potential Fiscal Outcomes

Under Alternative Simulation

Revenues and Composition of Spending as a Share of GDP

Percent of GDP

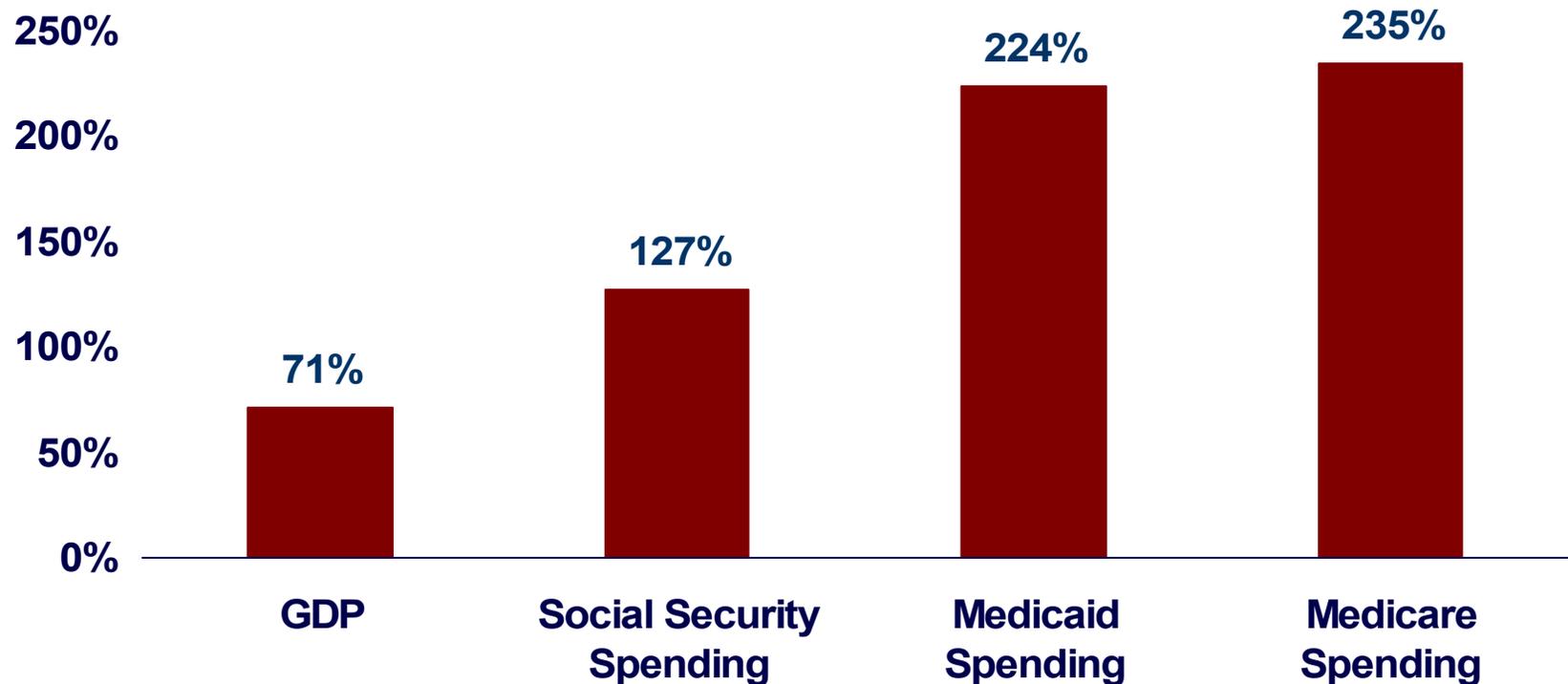


Source: GAO's January 2008 analysis.

Note: Discretionary spending grows with GDP after 2008. AMT exemption amount is retained at the 2007 level through 2018 and expiring tax provisions are extended. After 2018, 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.

Growth in Spending for Social Security, Medicare, and Medicaid Expected to Outpace Economic Growth

Growth in constant dollars 2007-2032

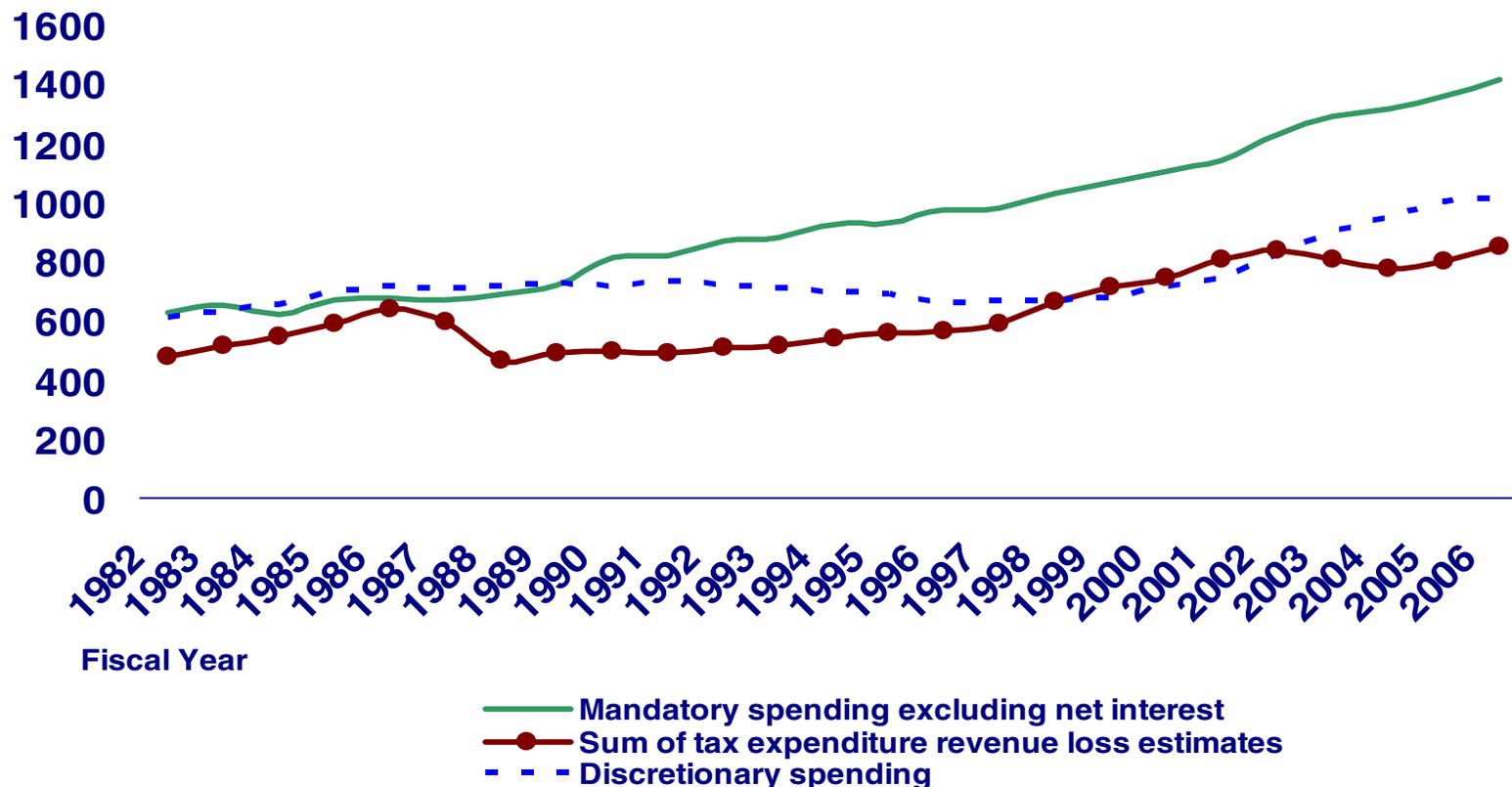


Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration; Office of the Actuary, Centers for Medicare and Medicaid Services; and the Congressional Budget Office.

Notes: Social Security and Medicare projections based on the intermediate assumptions of the 2007 Trustees' Reports. Medicaid projections based on CBO's August 2007 short-term Medicaid estimates and CBO's December 2005 long-term Medicaid projections under mid-range assumptions.

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

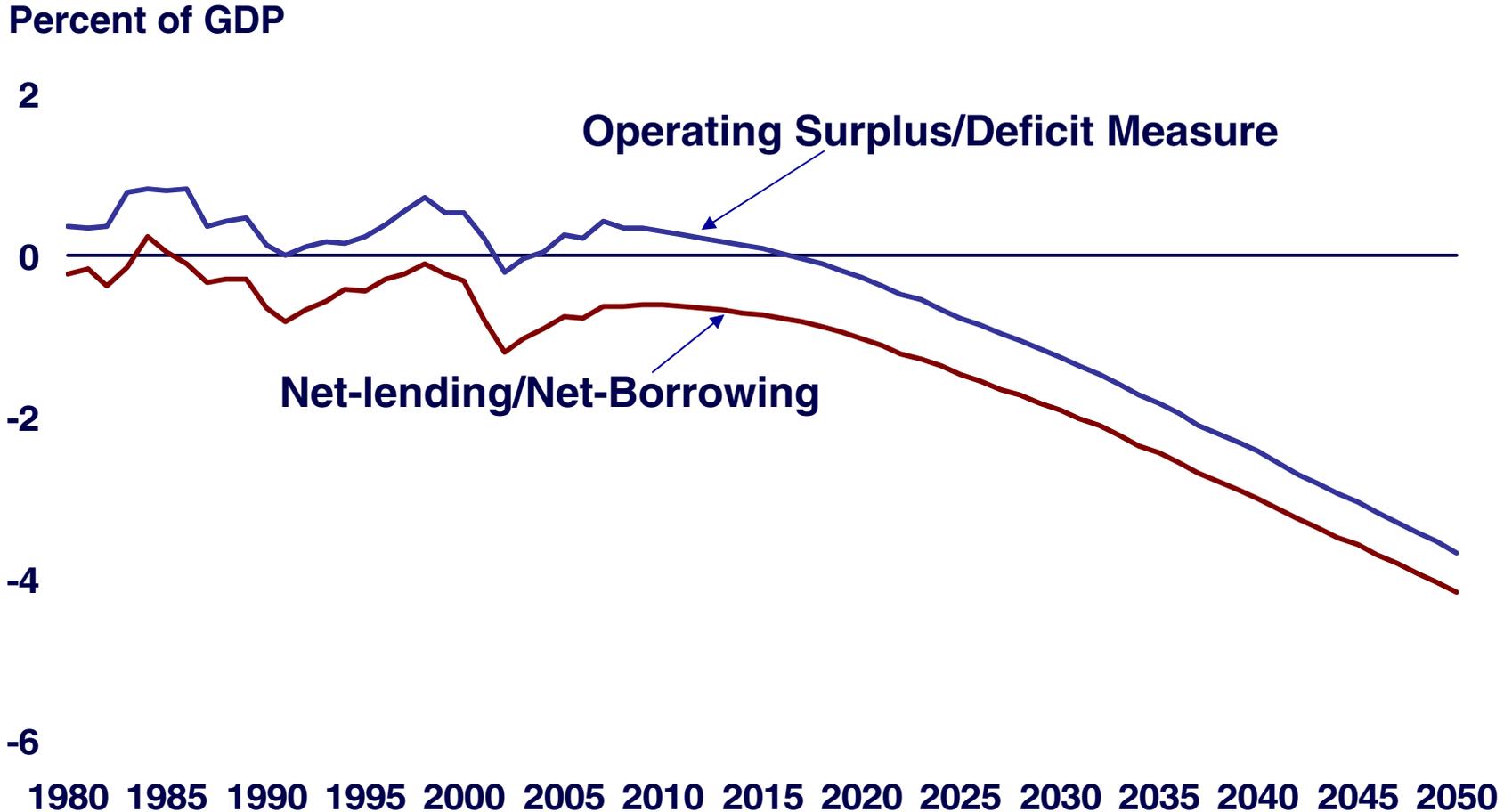
Dollars in billions (in 2006 dollars)



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.

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.

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

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)**

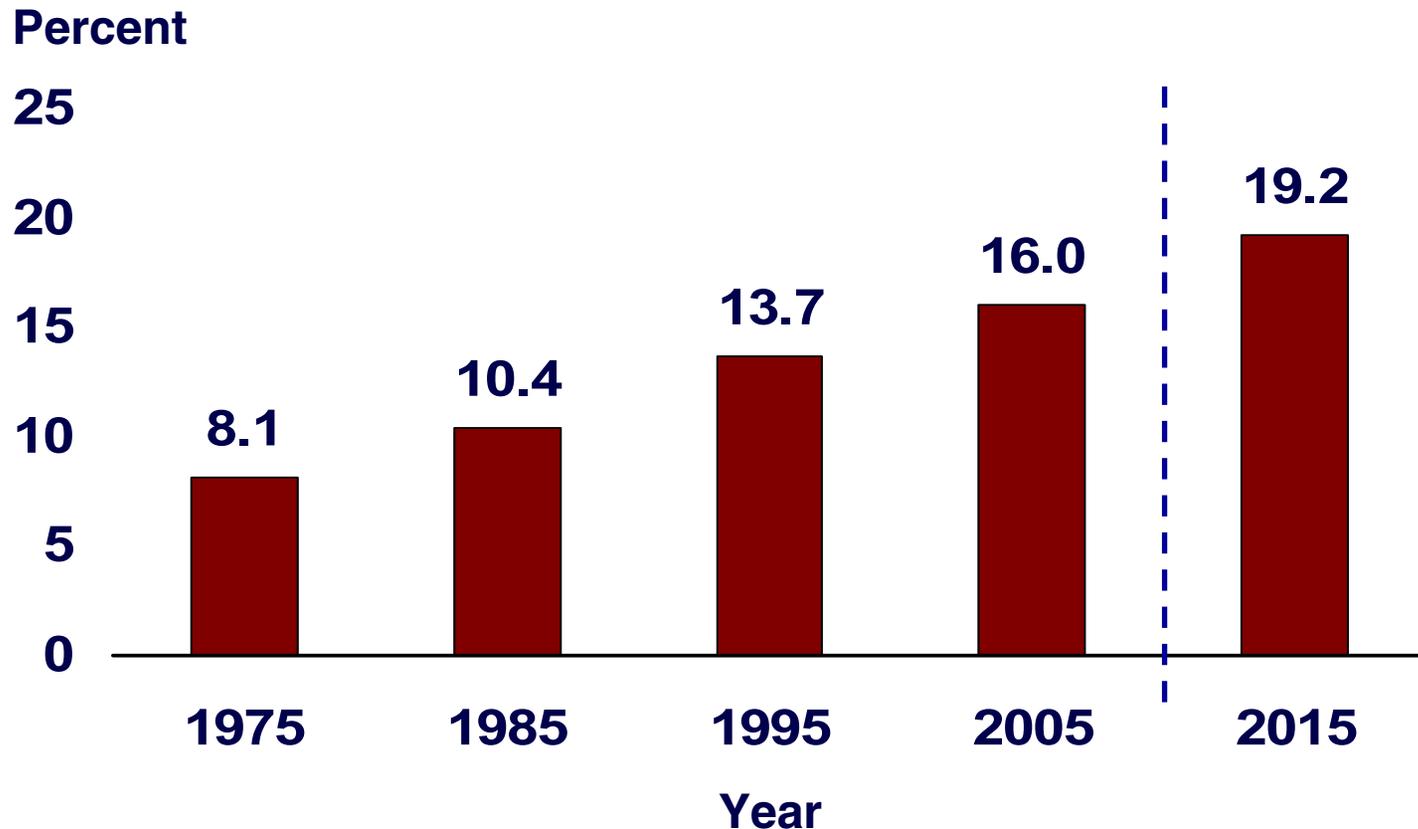
*Solutions Require Active Involvement from
both the Executive and Legislative Branches*

Key Sustainability Challenges

- Fiscal deficits and public debt burdens
- Social insurance commitments
- Health care quality, access, and costs
- K-12 education system
- Energy, environment, and resource protection
- Tax gaps and policies
- Immigration policies
- Infrastructure needs
- Governance, political reforms, and citizen engagement
- Security strategies, including defense and homeland issues, as well as Iraq
- Foreign policy strategies
- Federal workforce and related policies and practices

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.

Where the United States Ranks on Selected Health Outcome Indicators

| Outcome | Rank |
|--|-----------------------------|
| Life expectancy at birth <i>U.S. = 77.8 years in 2004</i> | 23 out of 30 in 2004 |
| Infant Mortality <i>U.S. = 6.8 deaths in 2004</i> | 26 out of 30 in 2004 |
| Potential Years of Life Lost <i>U.S. = 5,066 in 2002</i> | 23 out of 26 in 2002 |

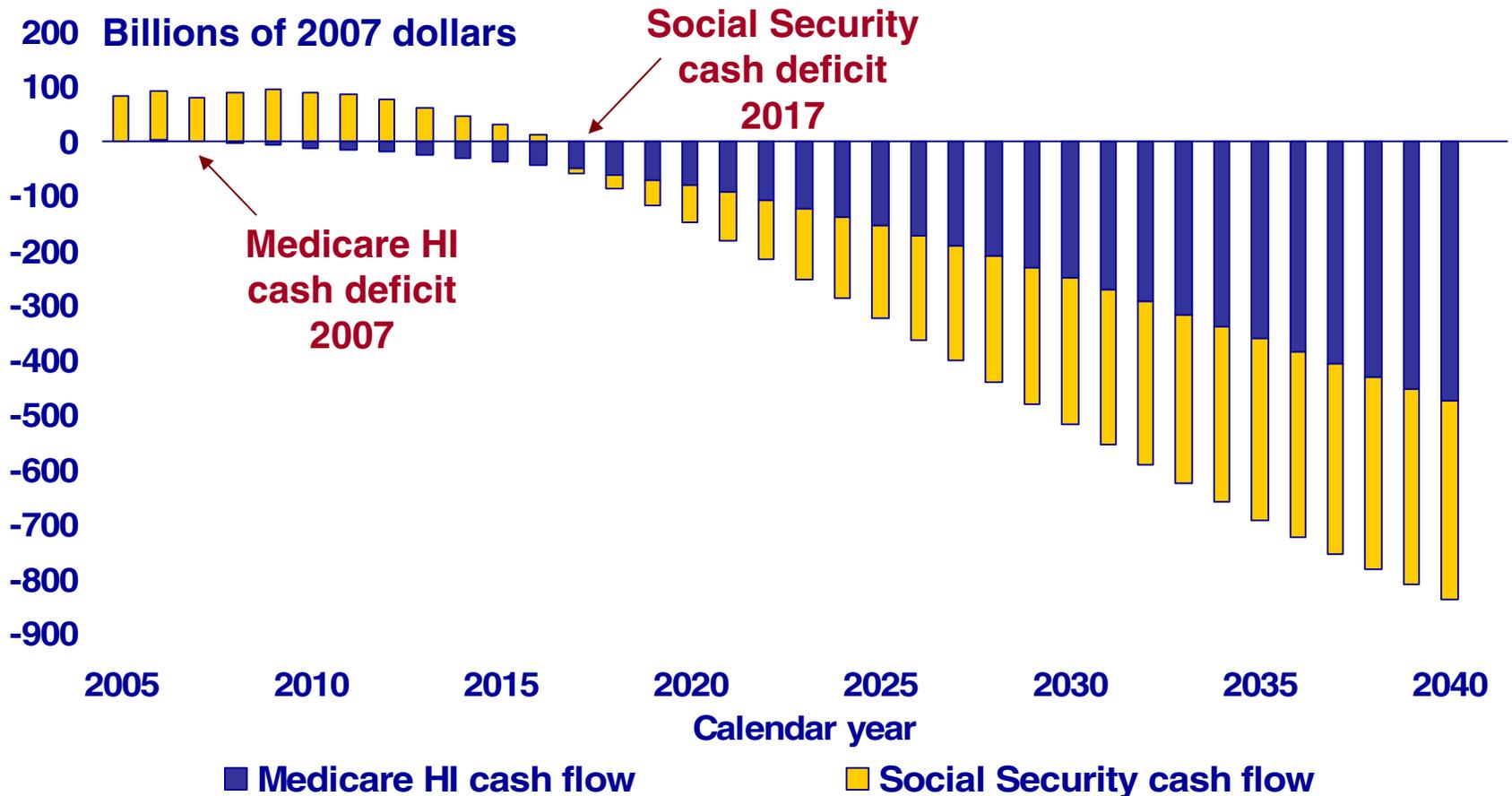
Source: *OECD Health Data 2006 and 2007.*

Notes: Data are the most recent available for all countries. Life expectancy at birth for the total population is estimated by the OECD Secretariat for all countries, as the unweighted average of the life expectancy of men and women. Infant mortality is measured as the number of deaths per 1,000 live births. Potential years of life lost (PYLL) is the sum of the years of life lost prior to age 70, given current age-specific death rates (e.g., a death at 5 years of age is counted as 65 years of PYLL).

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**

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.

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)

Trans *FORMATION*

Webster's definition

**An act, process, or instance
of change in structure
appearance, or character**

**A conversion, revolution,
makeover, alteration, or
renovation**

The Objective of Transformation for DOD

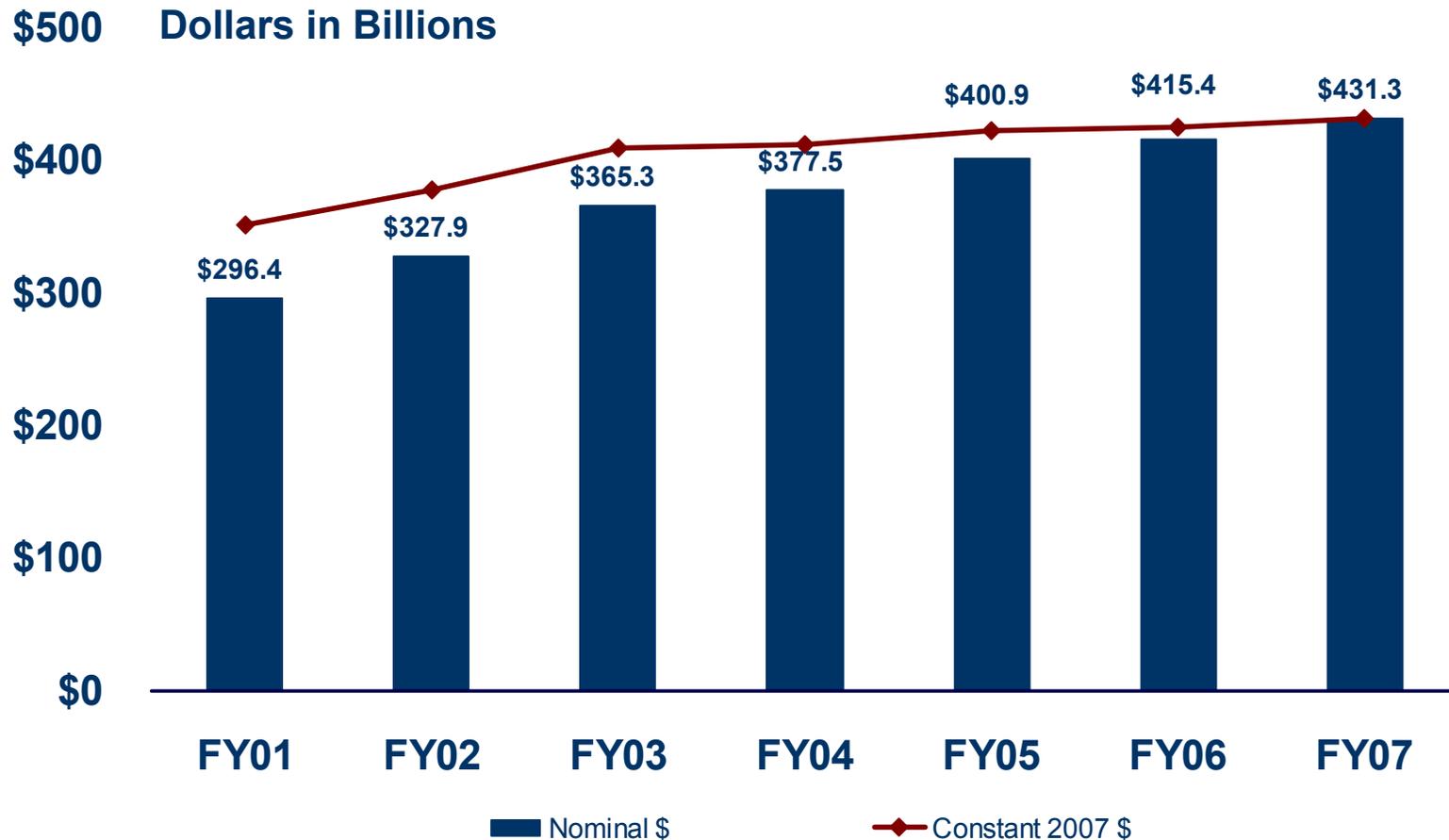
Creating the future of warfare and protecting our national security while improving how the department, including all of its various component parts, does business in order to support and sustain our position as the world's preeminent military power within current and expected resource limits

Increased Budget Transparency Needed

- It is currently difficult to distinguish between incremental costs to support specific contingency operations and regular budget costs
 - GWOT requests include funding for items generally requested in the regular budget, such as future weapons systems, transformation, and increases in end strength
- DOD needs to take stronger actions to control GWOT costs by setting general parameters to guide commanders' and services' cost control efforts
- GAO has found significant reliability problems with the GWOT cost data, which impedes the ability of Congress and others to make informed decisions about GWOT costs and related funding needs

DOD's Regular Budget

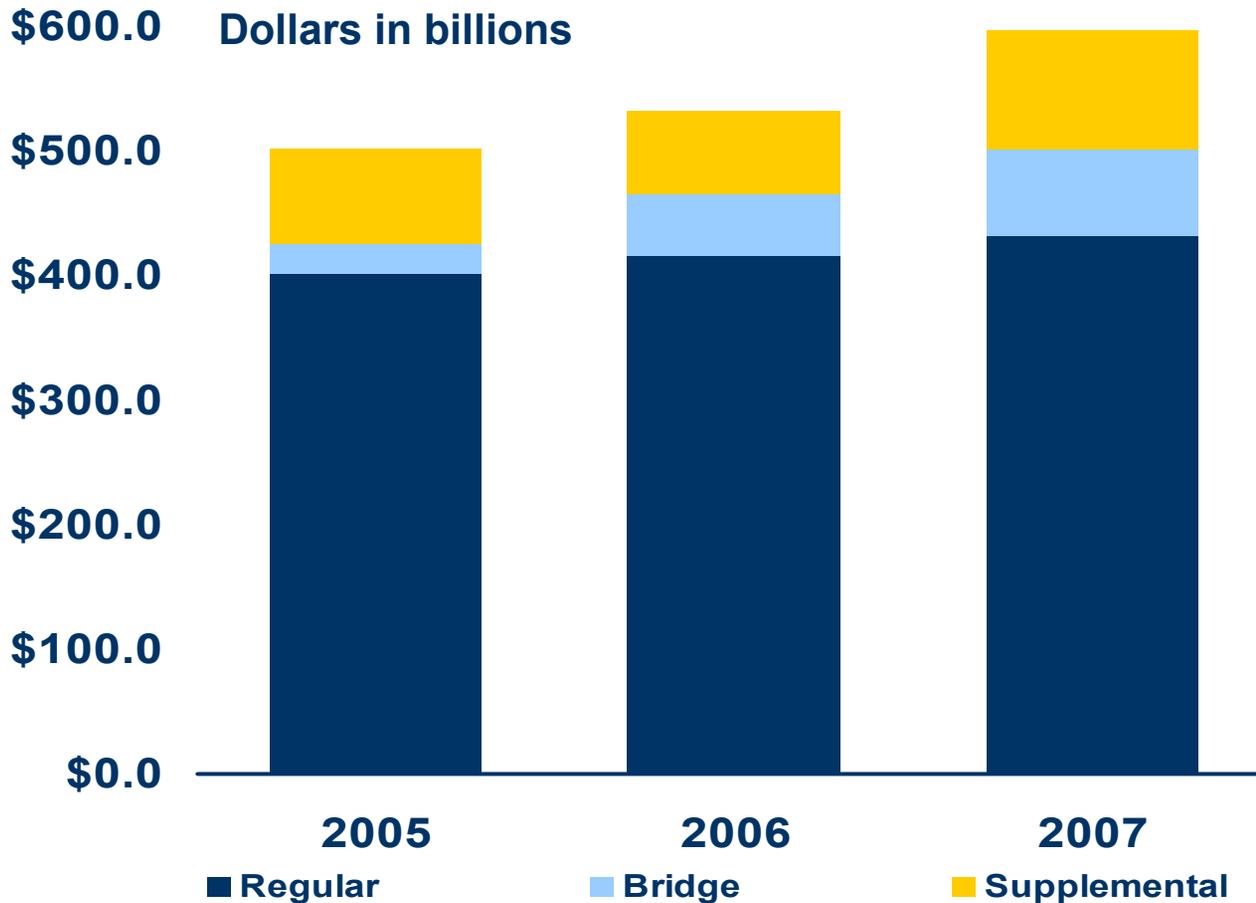
DOD Regular Appropriation FY 2001-2007 (Excluding GWOT)



Source: GAO analysis of Congressional Research Service and appropriations data.

Total Budgetary Resources Provided to DOD

Total Defense Resources FY 2005 - FY 2007

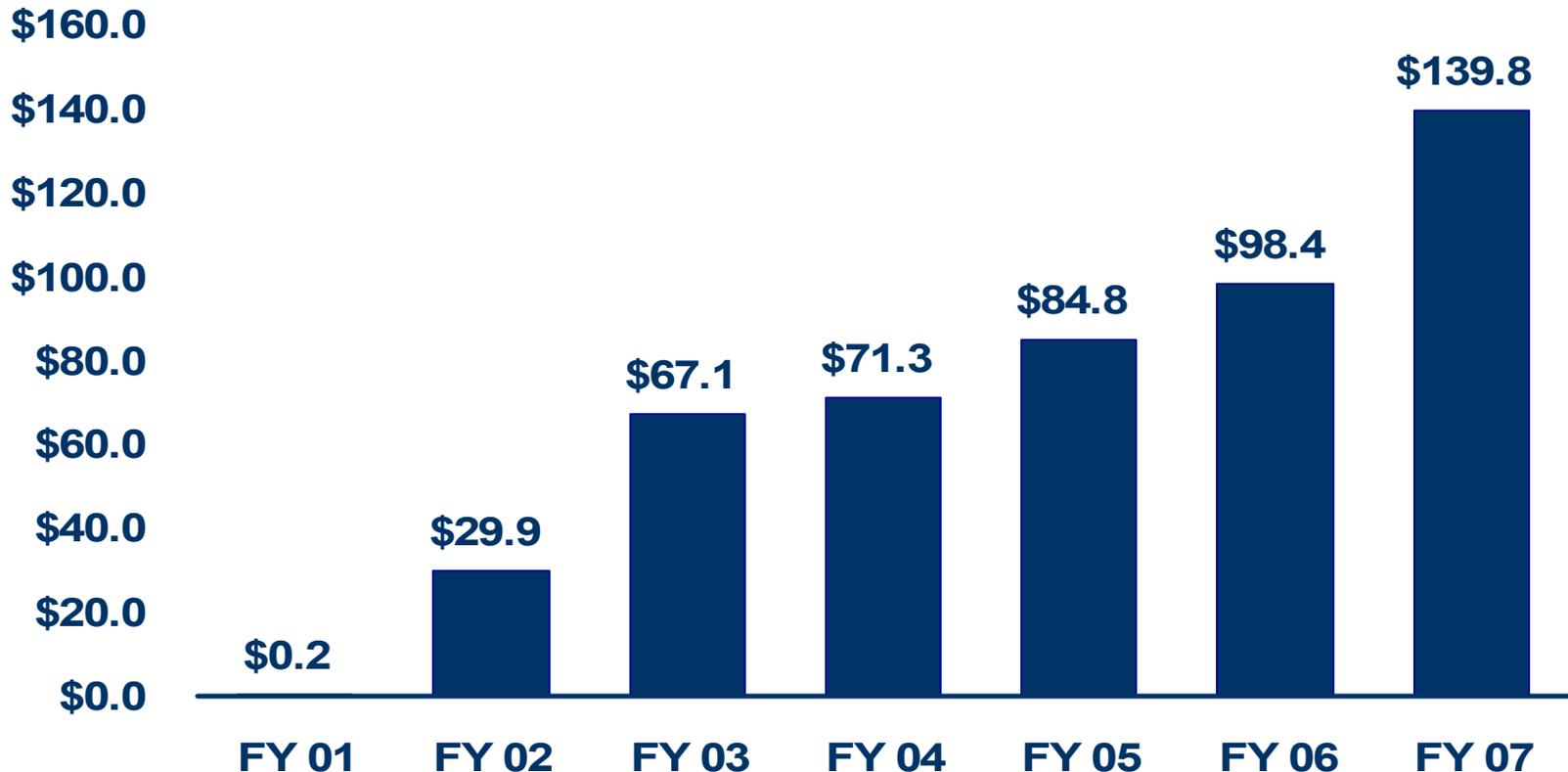


Source: GAO analysis of Congressional Research Service and appropriations data.

Notes: Bridge, or Title IX, is the section of DOD's regular defense appropriation that outlines emergency spending provisions for operations in support of GWOT.

DOD's Reported GWOT Obligations for FY 2001 thru FY 2007

Dollars in billions



Source: GAO analysis of DOD data.

Note: Reported GWOT obligations include Operation Noble Eagle, Operation Enduring Freedom, and Operation Iraqi Freedom. Figures include about \$19.4 billion obligated in FY 2002 – FY 2003 that DOD did not include in its cost reports. Figures do not include any obligations for classified activities. GAO has assessed the reliability of DOD's obligation data and found significant problems, such that they may not accurately reflect the true dollar value of GWOT obligations.

Systemic Defense Acquisition Challenges: Overview

- GAO has identified 15 systemic challenges relating to DOD's acquisition and contracting activities. Main areas address:
 - Identifying budgetary needs v. wants
 - Specifying realistic contract requirements
 - Ensuring accountability through effective contract oversight and management stability
- The following pages provide more detail

Systemic Defense Acquisition Challenges

1. Service budgets are allocated largely according to top line historical percentages rather than Defense-wide strategic assessments and current and likely resource limitations;
2. Capabilities and requirements are based primarily on individual service wants versus collective Defense needs (i.e. based on current and expected future threats) that are both affordable and sustainable over time;
3. Defense consistently over-promises and under-delivers in connection with major weapons, information, and other systems (i.e. capabilities, costs, quantities, schedule);
4. Defense often employs a “plug and pray approach” when costs escalate (i.e. divide total funding dollars by cost per copy, plug the number that can be purchased, then pray that Congress will provide more funding to buy more quantities);
5. Congress sometimes forces the department to buy items (e.g. weapons systems) and provide services (e.g. additional health care for non-actives) that the department does not want and we cannot afford;

Systemic Defense Acquisition Challenges (cont'd)

6. DOD tries to develop high risk technologies after programs start instead of setting up funding, organizations, and processes to conduct high risk technology development activities in low cost environments (i.e. technology development is not separated from product development). Program decisions to move into design and production are made without adequate standards or knowledge;
7. Program requirements are often set at unrealistic levels, then changed frequently as recognition sets in that they cannot be achieved. As a result, too much time passes, threats may change, and/or members of the user and acquisition communities may simply change their mind. The resulting program instability causes cost escalation, schedule delays, fewer quantities and reduced contractor accountability;
8. Contracts, especially service contracts, often do not have definitive or realistic requirements at the outset in order to control costs and facilitate accountability;
9. Contracts typically do not accurately reflect the complexity of projects nor appropriately allocate risk between the contractors and the taxpayers (e.g. cost plus, cancellation charges);

Systemic Defense Acquisition Challenges (cont'd)

10. Key program staff rotate too frequently thus promoting myopia and reducing accountability (i.e. tours based on time versus key milestones). Additionally, the revolving door between industry and the Department presents potential conflicts of interest;
11. The acquisition workforce faces serious challenges (e.g. size, skills, knowledge, succession planning);
12. Incentive and award fees are often paid based on contractor attitudes and efforts versus positive results (i.e. cost, quality, schedule);
13. Inadequate oversight is being conducted by both the Defense Department and the Congress which results in little to no accountability for recurring and systemic problems;
14. Some individual program and funding decisions made within the Department and by the Congress serve to undercut sound policies;
15. Lack of a professional, term-based CMO at DOD serves to slow progress on defense transformation and reduce the chance of success in the acquisitions/contracting and other key business areas.

Selected Potential DOD Transformation Related Actions

- Revise the current approach to developing national military strategy (e.g., order, integration)
- Take a longer range, and more enterprise-wide approach to program planning and budget integration (e.g., life cycles, opportunity costs)
- Employ a more strategic and integrated approach to business information system efforts and financial audit initiatives
- Differentiate between war fighting and business systems development, implementation, and maintenance (e.g., resource control, project approval)
- Focus on achieving real success in connection with financial management efforts (e.g., systems, controls, information, compliance and opinions)
- Employ a total force management approach to planning and execution (e.g., military, civilian, contractors)

Selected Potential DOD Transformation Related Actions

- Get the design and implementation of the NSPS right, including modernizing and integrating the DOD, Service, domain, unit, and individual performance measurement and reward systems
- Revise the process for developing and communicating key changes (e.g., DOD transformation, NSPS)
- Reduce the number of layers, silos, and footprints
- Recognize the difference between approving and informing
- Review and revise current military compensation policies and practices (e.g., more targeted and market-based)
- Strengthen emphasis on horizontal and external activities (e.g., partnerships)
- Create a Chief Management Officer (CMO) to drive the business transformation process

Transformation is a Long-Term Process

- DOD is perhaps the largest and most complex organization in the world
- Many of the department's weaknesses are decades in the making and solutions will take time and will not be easy
- Hundreds of dedicated and hardworking DOD employees are focusing on these issues
- The establishment of the Defense Business Systems Management Committee and the Business Transformation Agency are good first steps

GAO's Recommendation for a CMO at DOD

- **GAO has recommended that DOD establish a CMO to provide strong and sustained leadership over all major business transformation efforts. The CMO should be:**
 - Experienced with a proven track record as a business process change agent in a large, complex, and diverse organization
 - Codified in statute as a separate and full-time position
 - Designated an Executive Level II appointment that reports directly to the Secretary of Defense
 - Subject to an extended term (e.g., 5 to 7 years) that spans administrations
 - A single point within the department with the perspective and responsibility, as well as authority, to develop an overall and integrated business transformation plan and help to ensure the effective implementation of related functional management and business transformation efforts

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

Four National Deficits

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

Key Leadership Attributes Needed for These Challenging and Changing Times

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



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