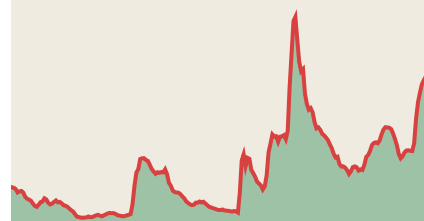


A Report to Congress

# The Nation's Fiscal Health



Action is Needed to Address the Federal Government's Fiscal Future



# GAO Highlights

Highlights of GAO-17-237SP

A Report to Congress

## The Nation's Fiscal Health

### Action is Needed to Address the Federal Government's Fiscal Future

The Congress and incoming Administration face serious economic, security, and social challenges that will require difficult policy choices in the short term about the level of federal spending and investments as well as ways to obtain needed resources. At the same time, the federal government is highly leveraged in debt by historical norms.

In addition to near term financing decisions, a broader plan is needed to put the government on a more sustainable long-term path. This report illuminates this need by outlining the fiscal condition of the U.S. government and its future path based on current fiscal policies. It draws on the recently issued *Fiscal Year 2016 Financial Report of the United States Government (2016 Financial Report)* and GAO's audit of the government's consolidated financial statements.

#### Significant Changes to the Government's Fiscal Condition in Fiscal Year 2016

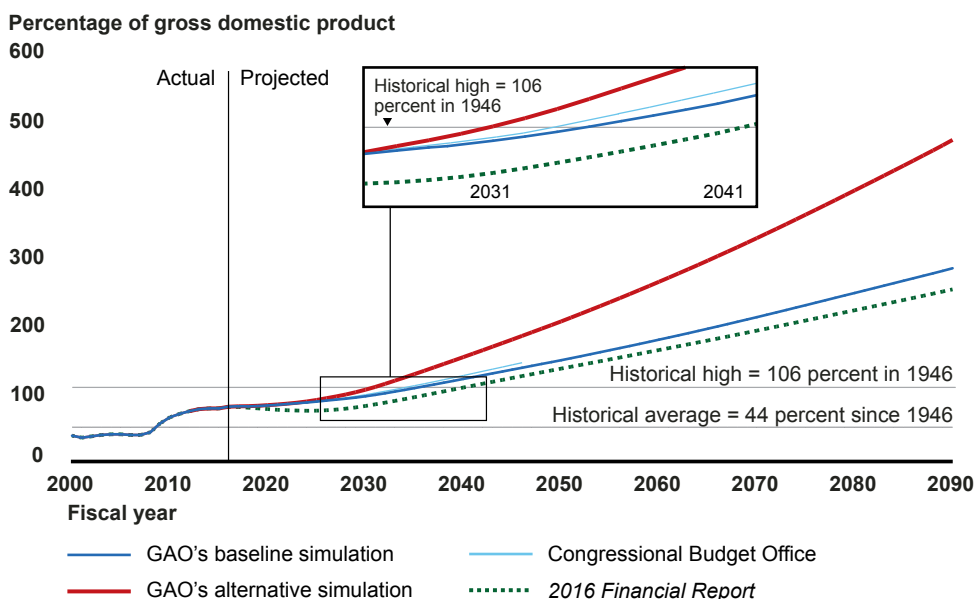
According to the *2016 Financial Report*, the federal deficit in fiscal year 2016 increased to \$587 billion—up from \$439 billion in fiscal year 2015. Federal receipts grew a modest \$18.0 billion due primarily to extensions of tax preferences, but that was outweighed by a \$166.5 billion increase in spending, driven by Social Security, Medicare, and Medicaid, and interest on debt held by the public (net interest). Debt held by the public rose as a share of gross domestic product (GDP), from 74 percent at the end of fiscal year 2015 to 77 percent at the end of fiscal year 2016. This compares to an average of 44 percent of GDP since 1946.

#### Long-Term Fiscal Projections Show the Federal Government is on an Unsustainable Fiscal Path

The *2016 Financial Report*, CBO, and GAO also all show that the key drivers of growing federal spending in the long term are federal spending on health care programs and net interest.

The *2016 Financial Report*, the Congressional Budget Office (CBO), and GAO projections all show that, absent policy changes, the federal government's fiscal path is unsustainable and that the debt-to-GDP ratio would surpass its historical high of 106 percent within 15 to 25 years (see figure below).

#### Debt Held by the Public Under Projections from the 2016 Financial Report, the Congressional Budget Office, and GAO

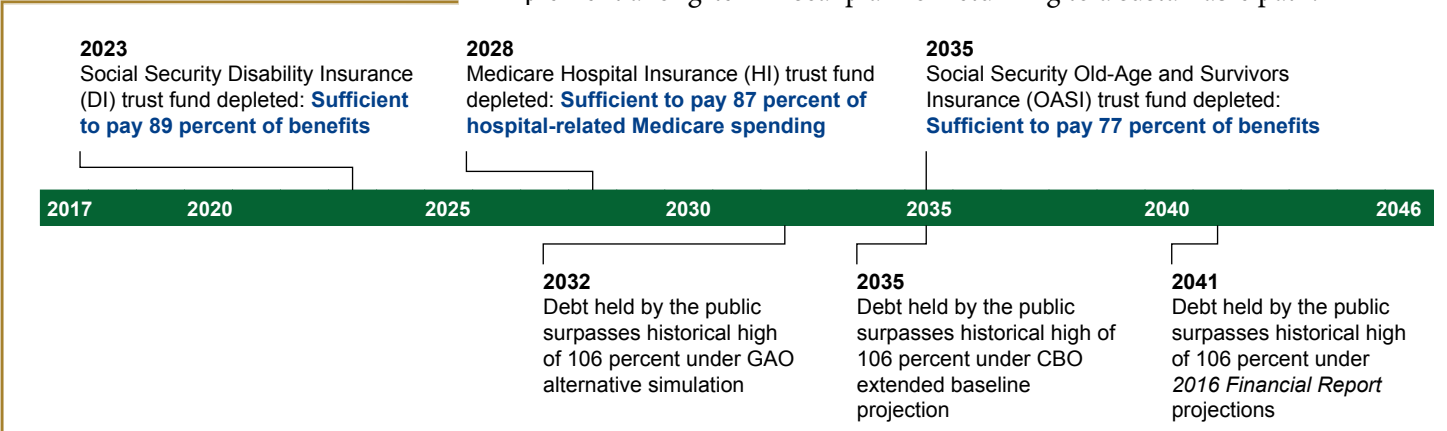


View [GAO-17-237SP](#). For more information, contact Robert F. Dacey at (202) 512-3406 or [daceyr@gao.gov](mailto:daceyr@gao.gov), Gary T. Engel, (202) 512-3406 or [engelg@gao.gov](mailto:engelg@gao.gov), or Susan J. Irving, (202) 512-6806, [irvings@gao.gov](mailto:irvings@gao.gov).

## Long-Term Fiscal Projections Show the Federal Government Is on an Unsustainable Fiscal Path

(continued)

**Importance of Early Action:** The 2016 *Financial Report*, CBO, and GAO all make the point that the longer action is delayed, the greater and more drastic the changes will have to be. As shown in the timeline below, Medicare’s Hospital Insurance trust fund, and Social Security’s Disability Insurance trust fund and Old-Age and Survivors Insurance trust fund face financial challenges that add to the importance of beginning action. It is important to develop and begin to implement a long-term fiscal plan for returning to a sustainable path.



Sources: Trustees for Social Security and Medicare, Congressional Budget Office, GAO, and 2016 *Financial Report*. | GAO-17-237SP

**Alternative Approach to Managing Debt Is Needed:** The current debt limit is not a control on debt, but rather an after-the-fact measure that restricts the Department of the Treasury’s authority to borrow to finance the decisions already enacted by Congress and the President. GAO has suggested Congress consider alternative approaches that would better link decisions about borrowing to finance the debt with decisions about spending and revenue at the time those decisions are made.

## Fiscal Risks Place Additional Pressure on the Federal Budget

Fiscal risks are responsibilities, programs, and activities that may legally commit or create expectations for future spending based on current policy, past practices, or other factors.

Of further concern is the fact that none of the long-term projections include certain other fiscal risks that could affect the federal government’s financial condition in the future. These include risks stemming from crises to which the public expects a federal fiscal response, such as wars, economic, financial or weather-related crises. A more complete understanding of fiscal risks can help policymakers anticipate changes in future spending and can enhance oversight of federal resources.

## Executive Agencies Have Opportunities to Contribute Toward Fiscal Sustainability

Executive actions alone cannot put the U.S. government on a sustainable fiscal path, but it is important for agencies to act as stewards of federal resources. In prior work, GAO has identified numerous actions for executive agencies to contribute toward a more sustainable fiscal future.

<b>Reduce improper payments</b>	Reducing payments that should not have been made or that were made in an incorrect amount could yield significant savings. The improper payments estimate in fiscal year 2016 was over \$144 billion. Since fiscal year 2003, cumulative estimates have totaled over \$1.2 trillion.
<b>Address the persistent tax gap</b>	Reducing the gap between taxes owed and those paid on time could increase tax collections by billions. The annual gross tax gap is estimated to be \$458 billion.
<b>Continue to address duplication, overlap, and fragmentation</b>	GAO has identified numerous areas to reduce, eliminate, or better manage fragmentation, overlap, or duplication; achieve cost savings; or enhance revenue. Actions taken so far by Congress and the executive branch have resulted in roughly \$56 billion in financial benefits from fiscal years 2010 through 2015, with at least an additional \$69 billion in estimated benefits projected to be accrued through 2025.
<b>Improve information on programs and fiscal operations</b>	Decision-making could be improved by strengthened internal controls over financial reporting, increased attention to tax expenditures, and effective implementation of the Digital Accountability and Transparency Act of 2014 (DATA Act).

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## Abbreviations

ACA	Patient Protection and Affordable Care Act
CBO	Congressional Budget Office
CHIP	Children's Health Insurance Program
CMS	Centers for Medicare & Medicaid Services
DATA Act	Digital Accountability and Transparency Act of 2014
DI	Disability Insurance
DOD	Department of Defense
EU	European Union
Fannie Mae <i>2016 Financial Report</i>	Federal National Mortgage Association <i>2016 Financial Report of the United States Government</i>
Freddie Mac	Federal Home Loan Mortgage Corporation
GDP	gross domestic product
GSE	government-sponsored enterprise
HHS	Department of Health and Human Services
IRS	Internal Revenue Service
MACRA	Medicare Access and CHIP Reauthorization Act of 2015
OASI	Old-Age and Survivors Insurance
OMB	Office of Management and Budget
PAYGO	Pay-As-You-Go
PBGC	Pension Benefit Guaranty Corporation
SSA	Social Security Administration
Treasury	Department of the Treasury
USPS	United States Postal Service
VA	Department of Veterans Affairs

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January 17, 2017

The President  
The President of the Senate  
The Speaker of the House of Representatives

The Congress and incoming Administration face serious economic, security, and social challenges that will require difficult policy choices in the short term about the level of federal spending and investments as well as ways to obtain needed resources. These policymakers also face a federal government highly leveraged in debt by historical norms and on an unsustainable long-term fiscal path caused by a structural imbalance between revenue and spending absent a change in fiscal policy. Thus, decisions over the near term to enhance economic growth and address national policies need to be accompanied by a fiscal plan to put the national government on a more sustainable long-term path. This is essential to ensure that the United States remains in a strong economic position to meet its security and social needs as well as to preserve flexibility in addressing unforeseen events.

This report is intended to illuminate the need for such a long-term fiscal plan by outlining the current fiscal condition of the U.S. government and its future fiscal path based on current fiscal policies. It draws on the recently issued *Fiscal Year 2016 Financial Report of the United States Government (2016 Financial Report)* and our audit of the government's consolidated financial statements for fiscal years 2016 and 2015.<sup>1</sup> Annually, the Department of the Treasury (Treasury), in consultation with the Office of Management and Budget (OMB), prepares the U.S. government's financial statements, which along with related information, are presented in the Financial Report of the United States Government.<sup>2</sup> GAO is responsible for auditing these statements. The *2016 Financial*

<sup>1</sup>GAO, *Financial Audit: Fiscal Years 2016 and 2015 Consolidated Financial Statements of the U.S. Government*, [GAO-17-283R](#) (Washington, D.C.: Jan. 12, 2017).

<sup>2</sup>As discussed in the *2016 Financial Report*, we were unable to provide an audit opinion on the federal government's fiscal year 2016 consolidated financial statements due to material weaknesses in internal control and uncertainties concerning the sustainability financial statements. However, almost all of the financial statements for the significant federal entities received unmodified or "clean" opinions. The significant entities which were unable to issue audited financial statements, were unable to receive unmodified opinions on a complete set of financial statements, or received disclaimers of opinion include the Departments of Defense, Housing and Urban Development, and Agriculture.

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*Report* contains information on the federal government's financial position and condition, including its operating results (costs and revenues), among other information.<sup>3</sup> In this report we discuss the federal government's current fiscal condition and how it changed in fiscal year 2016, the federal government's unsustainable long-term outlook and risks to the government's financial condition, as well as opportunities to improve its fiscal health.<sup>4</sup>

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## Significant Changes to the Government's Fiscal Condition in Fiscal Year 2016

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### Modest Federal Revenue Growth Outweighed by Growth in Mandatory Spending

According to the *2016 Financial Report*, the federal deficit in fiscal year 2016 increased to \$587 billion—up from \$439 billion in fiscal year 2015. This marked a change from 6 years of declining deficits. The federal government's receipts (taxes and other collections) increased by \$18.0 billion (0.6 percent), from \$3,248.7 billion to \$3,266.7 billion, but this was outweighed by a \$166.5 billion increase in spending from \$3,687.6 billion to \$3,854.1 billion. The *2016 Financial Report* attributes the modest increase in receipts to the January 2015 expiration of numerous individual and corporation income tax preferences followed by their retroactive extension in the Consolidated Appropriations Act, 2016. The expiration boosted fiscal year 2015 collections, and the retroactive extension reduced fiscal year 2016 collections;<sup>5</sup> absent these extensions, receipts would have grown more in fiscal year 2016. The Congressional Budget

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<sup>3</sup>The *2016 Financial Report* also includes a reconciliation of operating results to the primarily cash-based budget deficit and changes in cash, a balance sheet (assets and liabilities), and sustainability financial statements, including long-term fiscal projections for the government as a whole and for social insurance programs (e.g., Social Security and Medicare). It also contains related unaudited financial information, such as information on the tax gap and improper payments. Also, most federal agencies prepare audited financial statements that provide more detailed information at the agency and program level.

<sup>4</sup>For more information on our objectives, scope, and methodology, see Appendix I.

<sup>5</sup>The Department of the Treasury and Office of Management and Budget, *Joint Statement of Jacob J. Lew, Secretary of the Treasury, and Shaun Donovan, Director of the Office of Management and Budget, on Budget Results for Fiscal Year 2016* (Washington, D.C.: Oct. 14, 2016).

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Office (CBO) notes a number of offsetting movements in the major sources of revenues, including weakness in nonwage income in 2015 (affecting payments in 2016) and the drop in corporate income taxes due at least in part to the retroactive extension of a number of tax preferences in the Consolidated Appropriations Act, 2016.<sup>6</sup>

Spending increases in 2016 were driven by Social Security (the Old-Age and Survivors Insurance and Disability Insurance programs), Medicare, Medicaid, and interest on debt held by the public. CBO projected in its 2016 budget and economic outlook reports that several recently enacted laws, including the Bipartisan Budget Act of 2015, would have a modest effect on Medicare spending, with a projected increase of \$5 billion on Medicare in 2016 but a cumulative effect of lowering Medicare spending by \$21 billion over the next 10 years. CBO did not project a significant effect on the other entitlement programs from legislation in its 2016 projections. Moving forward, spending on these programs will continue to increase due to long-standing demographic and economic trends—namely, the aging of the population and increasing health care costs. These trends will affect the federal government’s long-term fiscal path, as discussed in the following section of this report.<sup>7</sup>

A more complete picture of the government’s fiscal results requires looking at both the Budget of the United States Government (budget) and the Financial Report of the United States Government. The federal budget is the government’s primary financial planning and control tool and is largely cash based, with the deficit (or surplus) being the difference between receipts (cash received by the U.S. government) and outlays (payments made by the U.S. government). The Financial Report of the United States Government is a broad comprehensive overview of the government’s financial position and condition, including its revenues and costs, and assets and liabilities. Since it is generally prepared on an accrual basis, it includes some items that are not in the budget. The Financial Report of the United States Government focuses on costs (amounts incurred but not necessarily yet paid) and revenues (amounts

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<sup>6</sup>Congressional Budget Office, *Monthly Budget Review: Summary for Fiscal Year 2016* (Washington, D.C.: Nov. 7, 2016).

<sup>7</sup>In addition, a portion of spending increases stemmed from the fact that October 1, 2016 fell on a weekend, which accelerated the monthly benefit payments for certain programs into September, resulting in 13 monthly payments for these programs in fiscal year 2016.



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the government earned but not necessarily yet received). The difference between them is the “net operating cost.”<sup>8</sup>

In a trend similar to that of the budget deficit, net operating cost fell steadily from fiscal year 2012 to fiscal year 2015 but increased in fiscal year 2016. Fiscal year 2016 net operating cost was \$1.05 trillion—about double the \$514 billion in fiscal year 2015. This increase was largely due to actuarial losses, attributed primarily to changes in actuarial assumptions about projected costs at the Department of Veterans Affairs (VA). Every year, agencies that administer benefit plans perform complex actuarial computations that consider the effects of changes in assumptions and the effects of the current year actual experience. According to the *2016 Financial Report*, VA’s net costs increased by \$474 billion, with \$377 billion of that resulting from changes in the assumptions VA used to project future costs. According to VA’s Fiscal Year 2016 Agency Financial Report, \$277 billion of this increase was due to greater projected increases in the number of veterans and their families receiving compensation benefits, and \$45 billion was from new mortality rates and mortality improvement factors.<sup>9</sup> The Office of Personnel Management and the Department of Defense (DOD), which also administer large benefits plans, recorded actuarial gains, albeit significantly smaller than the actuarial losses recorded by VA.

Over four-fifths of the fiscal year 2016 net costs of operating the federal government came from four agencies—the Department of Health and Human Services (HHS), the Social Security Administration (SSA), VA, and DOD—and interest on debt held by the public. Although the largest increase in net costs was for VA (as described above), net costs also increased for each of the other three agencies. For example, consistent with the increase in spending discussed earlier, SSA (which administers the Social Security programs) and HHS (which administers Medicare and Medicaid) reported increases in net costs of about \$37 billion and \$45 billion, respectively. The *2016 Financial Report* reported interest on the debt was \$273 billion in fiscal year 2016, up from \$251 billion in fiscal year 2015.

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<sup>8</sup>For more discussion of the crosswalk between the cash and accrual deficits, see the *2016 Financial Report* and, GAO, *Fiscal Outlook: Measuring the Federal Deficit*, accessed January 7, 2017, [http://www.gao.gov/fiscal\\_outlook/measuring\\_the\\_federal\\_deficit/overview#t=1](http://www.gao.gov/fiscal_outlook/measuring_the_federal_deficit/overview#t=1).

<sup>9</sup>Compensation benefits are paid to eligible veterans who die or are disabled from military service-related causes, as well as their dependents.

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As discussed in the *2016 Financial Report*, as of September 30, 2016, the federal government held about \$3.5 trillion in assets (including \$1.3 trillion in net loans receivable—primarily student loans—and about \$1 trillion in net property, plant, and equipment) on its balance sheet. The federal government has resources beyond these assets, as noted in the *2016 Financial Report*, including:

- stewardship assets (such as national parks), which are discussed in the notes to the financial statements, are generally expected to be preserved indefinitely, and are measured in physical units with no financial value assigned to them;
- certain oil and gas reserves, which are reported in the unaudited required supplementary information section;
- the federal government's power to tax, which is not reflected in the financial statements as revenue until the federal government collects taxes or when it is agreed that taxes are owed; and
- the ability to set monetary policy, which includes actions undertaken by the Federal Reserve System that influence the availability and cost of money and credit as a means of helping to promote national economic goals.

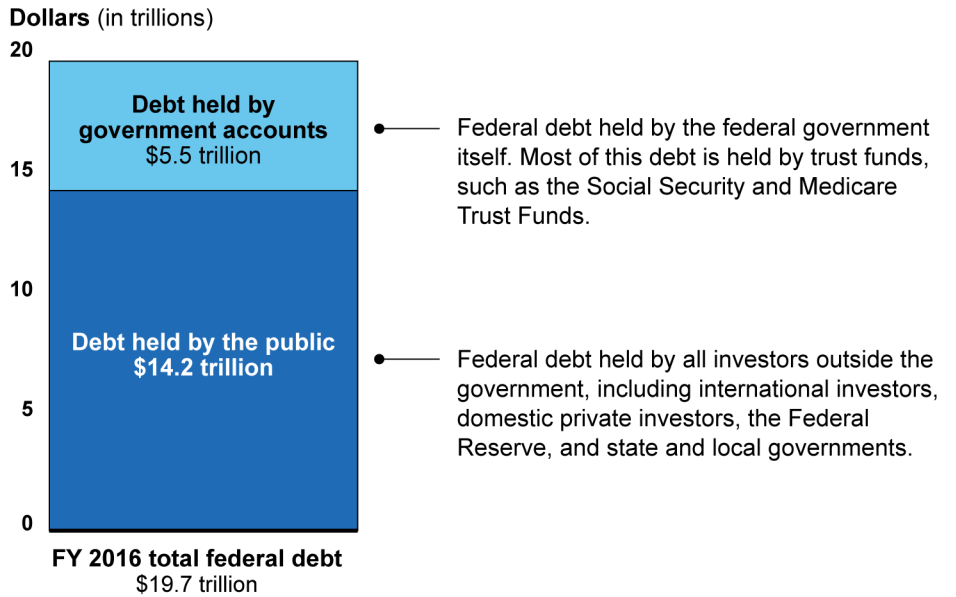
The *2016 Financial Report* also reported total liabilities of \$22.8 trillion as of September 30, 2016. These consisted mostly of \$14.2 trillion in federal debt securities held by the public and accrued interest, and \$7.2 trillion in federal employee and veteran benefits payable (\$2.3 trillion in civilian and \$4.9 trillion in military and veterans).

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## Federal Debt Increased in Fiscal Year 2016

Federal debt is made up of debt held by the public and debt held by government accounts (known as intragovernmental debt). (See figure 1.) According to the *2016 Financial Report*, total debt rose to \$19.7 trillion during fiscal year 2016, an increase of \$1.4 trillion from fiscal year 2015. This change reflected an increase of intragovernmental debt from \$5.1 trillion to \$5.5 trillion and an increase in debt held by the public of a little over \$1.0 trillion to \$14.2 trillion.

**Figure 1: Fiscal Year 2016 Debt Held by the Public and Intragovernmental Debt**



Source: 2016 Financial Report. | GAO-17-237SP

Federal debt held by the public is the value of all federal securities sold to investors outside of the federal government. Debt held by the public rose as a share of gross domestic product (GDP), from 74 percent at the end of fiscal year 2015 to 77 percent at the end of fiscal year 2016.<sup>10</sup> The fiscal year 2016 increase in debt held by the public of \$1.05 trillion was greater than the reported fiscal year 2016 federal deficit of \$587 billion, primarily because of the timing of the restoration of uninvested principal in the Government Securities Investment Fund (G Fund) of the federal employees' Thrift Savings Plan resulting from extraordinary actions taken

<sup>10</sup>GDP is the value of all goods and services produced in in a country in a given year. It is measured quarterly by the Bureau of Economic Analysis within the Department of Commerce. For more information on the concept and how it is measured, see Bureau of Economic Analysis, *Measuring the Economy: A Primer on GDP and the National Income and Product Accounts*, accessed January 11, 2017, [https://www.bea.gov/national/pdf/nipa\\_primer.pdf](https://www.bea.gov/national/pdf/nipa_primer.pdf).

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to remain below the debt limit (\$203 billion),<sup>11</sup> as well as increases in the government's cash balance (\$159 billion), and net non-cash loan and loan guarantee activity (\$103 billion).

Debt held by the public is reported as a liability on the consolidated financial statements of the U.S. government. Debt held by government accounts is debt owed by Treasury to another part of the government. It is an asset to those accounts, but a liability to Treasury; they offset each other in the consolidated financial statements. However, when securities from intragovernmental debt are redeemed the federal government will need to obtain the resources to reimburse the government accounts, which could lead to increased debt held by the public. This is also why debt held by the public as a share of GDP is used as a measure and not total or gross debt. Debt held by the public is a claim on today's economy; debt held by governmental accounts is a claim on the future economy.

Debt held by the public is owed to a wide variety of investors: international investors, domestic private investors, the Federal Reserve, and state and local governments.<sup>12</sup> Figure 2 shows changes in the distribution of ownership of debt held by the public by these investors since 2001.<sup>13</sup> Over that period the distribution has fluctuated annually. The largest overall change can be seen in the distribution between international investors and domestic private investors.

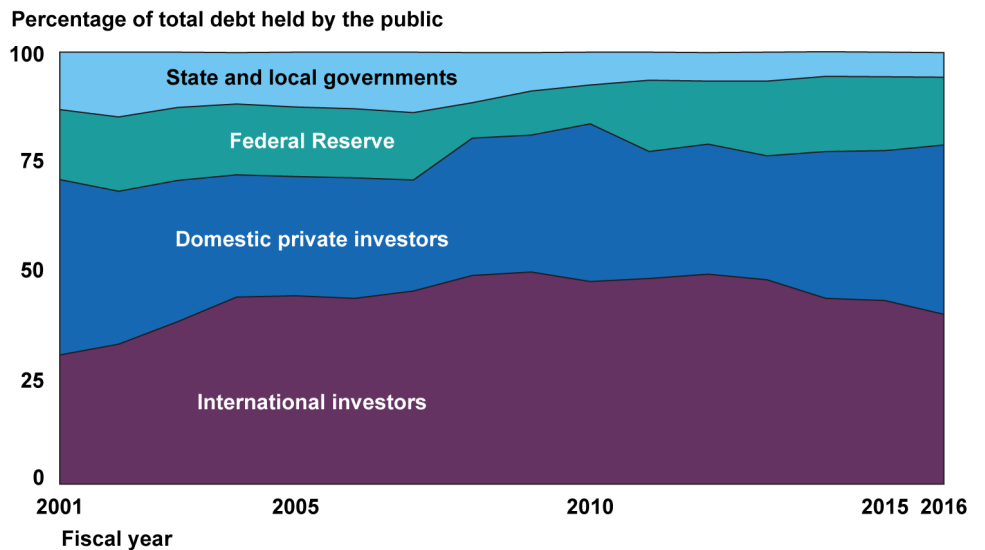
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<sup>11</sup>Because of delays in raising the debt limit, Treasury took a number of extraordinary actions—consistent with relevant laws—beginning in fiscal year 2015 and continuing into fiscal year 2016 (from March 16, 2015 through October 30, 2015) to avoid exceeding the debt limit. Many of the extraordinary actions resulted in federal debt securities not being issued to certain federal government accounts, such as for certain fiscal year 2015 receipts from the G Fund. As of the end of fiscal year 2015, uninvested principal for the G Fund was recorded as a miscellaneous liability on the consolidated financial statements, but would have been reported in fiscal year 2015 as federal debt securities held by the public had the securities been issued.

<sup>12</sup>12 USC 355.

<sup>13</sup>For our analysis of trends in ownership of debt held by the public, we analyzed data from the Federal Reserve's *Financial Accounts of the United States*. Data from the Federal Reserve flow of funds report is indirectly based on data in the Treasury International Capital reporting system. Due to adjustments made before being published by the Bureau of Economic Analysis and Federal Reserve, these data will vary from the data as presented in the Treasury International Capital reporting system.

**Figure 2: Distribution of Ownership of Debt Held by the Public, 2001 to 2016**



Source: GAO analysis of data from the Federal Reserve, Financial Accounts of the United States. | GAO-17-237SP

Note: In 2015, the Federal Reserve expanded the Treasury Securities category to include all marketable and nonmarketable Treasury securities held by the public. Specifically, the Federal Reserve added nonmarketable Treasury securities held by federal government employee defined benefit plans to this category because federal government defined benefit pension plans were considered part of the financial business sector as opposed to intragovernmental holdings as reported on the Monthly Statement of the Public Debt. Some of the recent increase in ownership by domestic private investors after 2014 is due to that adjustment.

The share of debt held by the public in foreign ownership was 39 percent at the end of fiscal year 2016, higher than the 30 percent held at the end of fiscal year 2001. The overall increase in international ownership of federal debt holdings since 2001 reflects a number of trends, including, among other things: persistent federal deficits, low domestic saving (which lowers domestic investment in Treasury securities), and the relative attractiveness of U.S. assets for investment. An economy open to international investment, such as the United States, essentially can “borrow” the surplus of savings of other countries to finance more investment than U.S. national saving would permit. The flow of foreign capital into the United States has gone into a variety of assets, including Treasury securities, corporate securities, and direct investment.

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## Long-Term Fiscal Projections Show the Federal Government Is on an Unsustainable Fiscal Path

The accrual-based financial statements in the Financial Report of the United States Government provide certain information not included in the cash-based budget, but neither the accrual-based financial statements nor the cash-based budget alone provides a full picture of the government's long-term financial condition or fiscal outlook. In both the United States and internationally there has been increasing recognition of the need for a more comprehensive statement illustrating the long-term fiscal sustainability of the government as a whole.<sup>14</sup> Sustainability reporting is recommended by international governmental accounting standards and by other international organizations and is commonly used by governments internationally to assess the sustainability of the government's fiscal policy.<sup>15</sup> Generally accepted U.S. accounting principles issued by the Federal Accounting Standards Advisory Board<sup>16</sup> require that the Financial Report of the United States Government include such a report on the long-term sustainability of the federal government's fiscal policies and its major social insurance programs (e.g., Social Security and Medicare).<sup>17</sup>

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<sup>14</sup>We suggested this in GAO, *Understanding the Similarities and Differences Between Accrual and Cash Deficits*, [GAO-07-117SP](#) (Washington, D.C.: Dec. 1, 2006); and *Budget Issues: Accrual Budgeting Useful in Certain Areas but Does Not Provide Sufficient Information for Reporting on Our Nation's Longer-Term Fiscal Challenge*, [GAO-08-206](#) (Washington, D.C.: Dec. 20, 2007). Further, for example, the International Monetary Fund (IMF) includes fiscal sustainability reporting as one of the principles in its "Fiscal Transparency Code," an international standard for disclosure of information about public finances, (<http://www.imf.org/external/np/fad/trans/>). Also, see Organisation for Economic Co-operation and Development (OECD) *Government at a Glance 2013* ([http://www.oecd-ilibrary.org/governance/government-at-a-glance-2013\\_gov\\_glance-2013-en](http://www.oecd-ilibrary.org/governance/government-at-a-glance-2013_gov_glance-2013-en)).

<sup>15</sup>See International Public Sector Accounting Standards Board Recommended Practice Guideline 1: *Reporting on the Long-Term Sustainability of an Entity's Finances* (July 2013).

<sup>16</sup>The Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards 36: "Comprehensive Long-Term Projections for the U.S. Government", as amended, required a new basic financial statement, the Statement of Long-Term Fiscal Projections, beginning in fiscal year 2015, along with the related notes, as part of the U.S. government's consolidated financial statements. It also required presentation of the information as unaudited information from fiscal years 2010 through 2014.

<sup>17</sup>The Statement of Long-Term Fiscal Projections presents, for all the activities of the federal government, the present value of projected receipts and non-interest spending under current policy without change, the relationship of these amounts to projected GDP, and changes in the present value of projected receipts and non-interest spending from the prior year.



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The Statements of Long-Term Fiscal Projections included in the *2016 Financial Report* show that, absent policy changes, the federal government continues to face an unsustainable long-term fiscal path.<sup>18</sup> Debt-to-GDP at the end of the 75-year projection period was generally higher in fiscal year 2016 than fiscal year 2015, but still lower than fiscal year 2014. The projections in the *2016 Financial Report* show a slight improvement in the near term with the unified budget deficit decreasing over the next 5 years before increasing in 2022. Over the long term, however, the imbalance between spending and revenue that is built into current law and policy is projected to lead to continued growth of the deficit and debt held by the public as a share of GDP. This situation—in which debt grows faster than GDP—means the current federal fiscal path is unsustainable.

The *2016 Financial Report* goes on to say that under these projections, spending for the major health and retirement programs will increase more rapidly than GDP in coming decades as more members of the baby-boom generation become eligible for benefits. These projections, with regard to Social Security and Medicare, are based on the same assumptions underlying the information presented in the Statement of Social Insurance within the *2016 Financial Report* and assume that the provisions enacted in the Patient Protection and Affordable Care Act (ACA) designed to slow the growth of Medicare costs are sustained and remain effective throughout the projection period.<sup>19</sup> They also reflect the effects of the Medicare Access and CHIP Reauthorization Act of 2015 (MACRA), which, among other things, revised the methodology for determining physician payment rates.<sup>20</sup> If, however, the Medicare cost containment measures and the physician payment rate methodology in current law are not sustained over the long term—concerns expressed by the Trustees of the Medicare trust funds, the Centers for Medicare & Medicaid Services' (CMS) Chief Actuary, CBO, and others—spending on federal health care programs will grow more rapidly than assumed in the projections.

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<sup>18</sup>The sustainability statements in the *2016 Financial Report* include the Statements of Long-Term Fiscal Projections and related information in Note 23 and in the unaudited Required Supplementary Information section of the report.

<sup>19</sup>ACA, Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

<sup>20</sup>MACRA, Pub. L. No. 114-10, title I, § 101, 129 Stat. 87, 89 (Apr. 16, 2015).

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As we discuss in our audit report, the *2016 Financial Report* notes that there are significant uncertainties concerning the achievement of anticipated reductions in the projections in the growth of Medicare payment rates.<sup>21</sup> These uncertainties are due to the likelihood of modifications to the scheduled reductions in annual Medicare payment rate growth for most categories of Medicare providers under the ACA's productivity adjustment provision and to the specified physician payment updates under MACRA. The extent to which actual future costs exceed the current law amounts due to changes to such scheduled reductions in Medicare payment rate growth depends on both the specific changes that might be legislated and whether such legislation would include further provisions to help offset such costs.<sup>22</sup>

In addition to sustainability information reported in the *2016 Financial Report*, CBO and GAO also prepare long-term federal fiscal simulations which continue to show debt held by the public rising as a share of GDP.<sup>23</sup> Similar to the *2016 Financial Report* projections, GAO's baseline extended simulation is based on achievement of the Medicare cost growth reductions expected under the ACA and MACRA provisions and is affected by the uncertainties discussed above. GAO's alternative simulation incorporates the CMS Actuary's illustrative alternative assumptions for Medicare along with other differing assumptions. Under GAO's alternative simulation debt held by the public as a share of GDP

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<sup>21</sup>See Note 22 to the financial statements in the *2016 Financial Report*.

<sup>22</sup>The *2016 Financial Report* also includes an illustrative Medicare Trust Fund projection using alternative assumptions intended to provide context regarding the long-term sustainability of the Medicare program and to illustrate the uncertainties in the *2016 Financial Report*. (See <https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/2016TRAlternativeScenario.pdf>.) As discussed in the *2016 Financial Report*, the bottom line of the illustrative Medicare Trust Fund projection exceeds the \$32.5 trillion estimate in the 2016 Statement of Social Insurance by \$11.0 trillion. The significant uncertainties about projected reductions in health care cost growth also affect the projected Medicare costs reported in the Statement of Long-Term Fiscal Projections. As a result of these significant uncertainties, we were unable to provide an opinion on the sustainability statements in the *2016 Financial Report*.

<sup>23</sup>GAO prepares both a baseline extended and an alternative simulation. CBO discusses the impact of different assumptions on its extended baseline projection and shows the impact of different deficits over the next 10 years. CBO's long-term outlook goes out 30 years, while the *2016 Financial Report's* projections and GAO's simulations go out 75 years. GAO, *Fiscal Outlook: Federal Fiscal Outlook*, accessed January 8, 2017, [http://www.gao.gov/fiscal\\_outlook/federal\\_fiscal\\_outlook/overview](http://www.gao.gov/fiscal_outlook/federal_fiscal_outlook/overview). CBO, *The 2016 Long-Term Budget Outlook* (Washington, D.C.: July 12, 2016)

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would surpass its historical high of 106 percent (in 1946) by 2032.<sup>24</sup> CBO's extended baseline shows debt held by the public surpassing that level by 2035 and the *2016 Financial Report* projections show debt held by the public surpassing 106 percent in 2041.

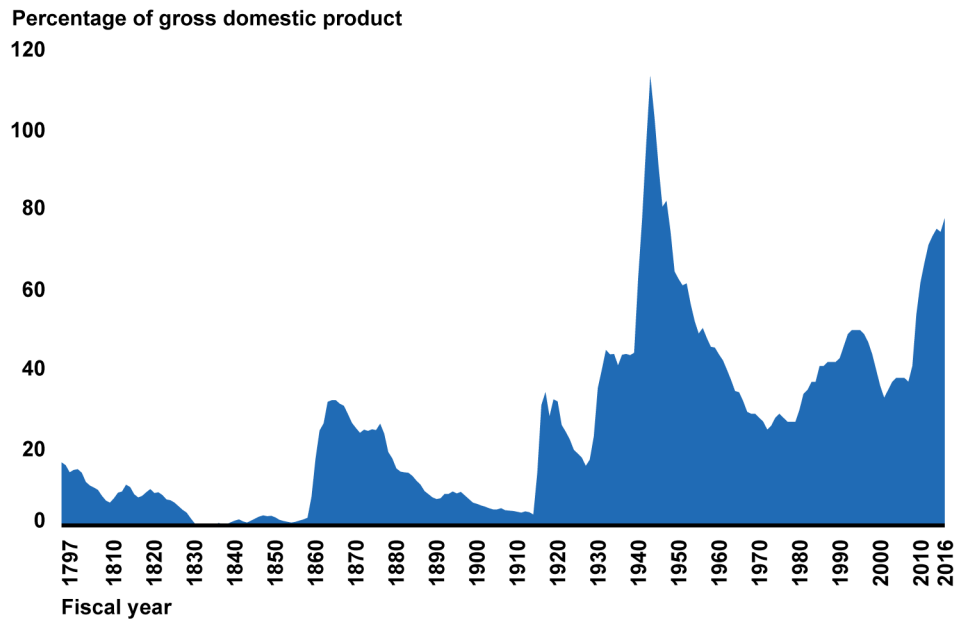
The long-term fiscal projections in the federal government's *2016 Financial Report* and those prepared annually by CBO and GAO each use somewhat different assumptions, but their results are the same: absent policy changes, the federal government's fiscal path is unsustainable.

While the federal government has carried debt throughout virtually all of U.S. history, the *2016 Financial Report* shows that the current fiscal position is unusual in the nation's history and that debt as a share of the economy is the highest it has been since 1950. The dollar value of debt is difficult to interpret absent some sense of the size of the economy supporting it. Therefore, the ratio of debt to GDP is used throughout the world to gauge a country's ability to pay its debt. The *2016 Financial Report* notes that for most of the nation's history the debt-to-GDP ratio tended to increase during wartime and decline during peacetime. Recessions can contribute to increases in this ratio, but it declines with economic recovery. Both are visible in figure 3. Debt as a share of GDP peaked at 106 percent just after World War II, but then fell rapidly. However, as the *2016 Financial Report* notes, it grew rapidly from the mid-1970s until the early 1990s. In the 1990s, strong economic growth and a number of fiscal decisions including implementation of "Pay-As-You-Go" (PAYGO) rules generated a significant decline in this ratio to 31 percent in 2001.

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<sup>24</sup>GAO's alternative simulation incorporates the CMS Actuary's alternative projections for health care cost growth, which assume certain cost controls under the ACA and MACRA are not maintained over the long term. GAO's alternative simulation also assumes that tax provisions that are scheduled to expire are extended. In the alternative simulation, discretionary spending follows the limits established in the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, but not the lower limits triggered by the automatic enforcement procedures.

**Figure 3: Federal Debt Held by the Public as a Share of Gross Domestic Product, 1797-2016**



Source: GAO analysis of 2016 *Financial Report* and Congressional Budget Office data. | GAO-17-237SP  
Note: For years 1797-1939, year refers to calendar year. For years 1940-2016, year refers to fiscal year. The Congressional Budget Office notes it estimated gross domestic product (GDP) from several sources. Data from 1929 onward reflect revisions to the estimates of GDP that the Bureau of Economic Analysis released in July 2013.

Since then, as the figure shows, U.S. debt held by the public has grown considerably as a percentage of GDP. The 2016 *Financial Report* states that during the last decade, much of the progress in reducing the debt-to-GDP ratio was undone as PAYGO rules were allowed to lapse, significant tax cuts were implemented, entitlements were expanded, and spending related to defense and homeland security increased. By September 2008, the debt-to-GDP ratio was 39 percent of GDP. The extraordinary demands of the last economic and fiscal crisis and the consequent actions taken by the federal government, combined with slower economic growth in the wake of the crisis, pushed the debt-to-GDP ratio up to 74.4 percent for fiscal year 2014, but the ratio declined slightly during fiscal year 2015 to 73.8 percent despite a slight increase in borrowing to finance the deficit. Since 1946 the debt-to-GDP ratio has averaged 44 percent. However, by the end of fiscal year 2016 it reached 77 percent.

In recent years, Congress has taken actions that affected the growing debt and deficit. For example, according to the 2016 *Financial Report*, the

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long-term fiscal outlook was improved by the limits on discretionary spending called for in the Budget Control Act of 2011 and the revenue increases resulting from the expiration of some tax provisions contained in the American Tax Relief Act of 2012.<sup>25</sup> However, CBO estimates that the Consolidated Appropriations Act, 2016, which among other things permanently extended certain tax provisions,<sup>26</sup> will lower revenues by \$523 billion over next 10 years.<sup>27</sup> In addition, CBO estimates that the legislation's provisions on refundable tax credits would lower revenues by \$154 billion over the next 10 years.

Additional changes to legislation could have significant effects on long-term projections of fiscal sustainability of the federal government. For example, amendments to the ACA, tax laws, or other laws could affect the projected federal spending on major federal health care programs and federal revenues. The extent to which projections would change depends, in part, on policy decisions about levels of federal spending, revenues, the federal role in the delivery of health care, and other areas.

Figure 4 below shows that in the *2016 Financial Report* projections, CBO's extended baseline, and GAO's baseline extended and alternative simulations, debt held by the public as a share of GDP grows continuously. The timing and pace of this growth depend on underlying assumptions made in the projections and simulations, largely regarding health care costs, but all of them show that absent a change in policy,

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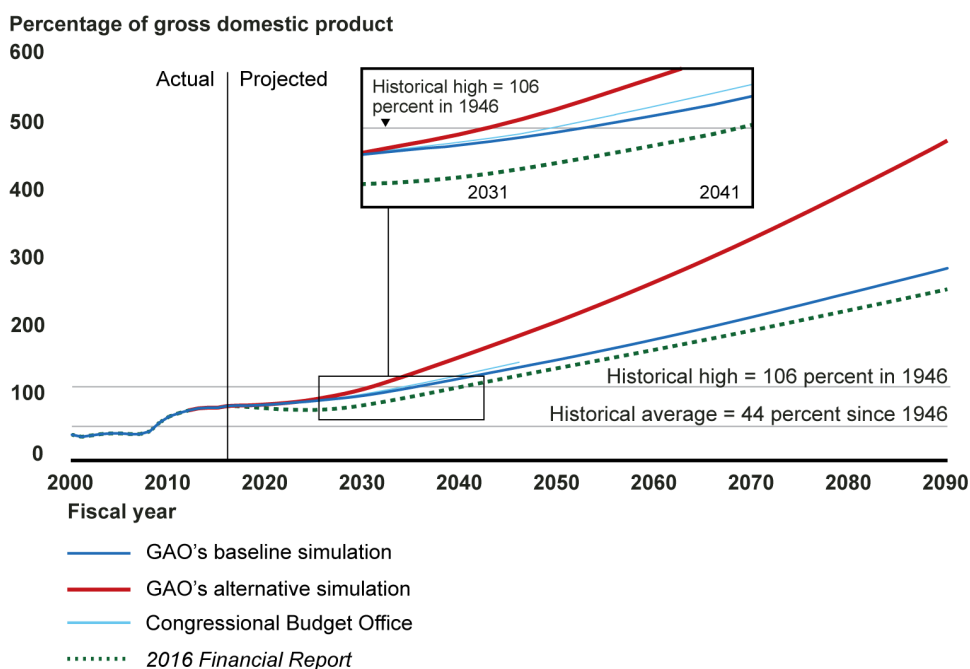
<sup>25</sup>Pub. L. No. 112-25, 125 Stat. 240 (Aug. 2, 2011); American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (Jan. 2, 2013).

<sup>26</sup>The Protecting Americans from Tax Hikes Act of 2015 (PATH Act), which was included in the Consolidated Appropriations Act, 2016, Public Law 114-113, extended or made permanent a number of expired or expiring tax provisions, including the Research Tax Credit, the Child Tax Credit, and the Earned Income Tax Credit. According to the *2016 Financial Report*, the extension of a number of tax expenditures resulted in slightly lower projections of effective tax rates for individual income taxes, which affected the long-term projections in the Statement of Long-Term Fiscal Projections for fiscal year 2016. Several factors contributed to the increase in excess of non-interest spending over receipts in the *2016 Financial Report* projections from 0.3 percent of GDP in the fiscal year 2015 projection to 0.8 percent of GDP in the fiscal year 2016 projection. These include (1) the actual budget results for fiscal year 2016 and other budget data used in formulating the projection (0.2 percent of GDP), nearly half of which relates to the effects of the PATH Act, and (2) changes in technical assumptions underlying the model, including revised assumptions about mandatory sequestration and refinements to the Medicaid projections (0.2 percent of GDP).

<sup>27</sup>Congressional Budget Office, *The Budget and Economic Outlook: 2016 to 2026* (Washington, D.C.: Jan. 25, 2016).

debt would be greater than the size of the U.S. economy. The debt-to-GDP ratio would surpass its historical high of 106 percent within 15 to 25 years and would continue to grow after that point.

**Figure 4: Debt Held by the Public Under Projections from the 2016 Financial Report, the Congressional Budget Office, and GAO**



Sources: GAO, Congressional Budget Office, and 2016 Financial Report. | GAO-17-237SP

Note: GAO's baseline extended simulation and the Congressional Budget Office's (CBO) long-term projection begin with a baseline using CBO estimates and generally assume current law continues into the future, such as the expiration of tax provisions as scheduled. One key difference between the results of the 2016 Financial Report projections and GAO's baseline extended simulation is that the 2016 Financial Report projections assume that individual income taxes increase gradually as real taxable incomes rise over time and an increasing share of total income is taxed at higher tax brackets, while GAO's baseline extended simulation assumes that revenue remains a constant share of gross domestic product. GAO's alternative simulation generally reflects historical trends, such as the extension of tax expenditures scheduled to expire, and incorporates the CMS Office of the Actuary's 2016 illustrative alternative assumptions for health care cost growth, which assume cost controls under the Patient Protection and Affordable Care Act and the Medicare Access and CHIP Reauthorization Act of 2015 are not maintained over the long term. As noted above, using the alternative assumptions, which are not included in the 2016 Financial Report projections and GAO's baseline extended simulation, projected health care costs substantially increase.

Many of the long-term fiscal pressures such as rising health care costs faced by the federal government are also faced by state and local governments in the United States. This can be seen in GAO's simulations of the state and local government sector. This could affect future federal



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funding of intergovernmental programs and the potential capacity of state and local governments to help fund and implement these programs.<sup>28</sup> GAO's simulations suggest that the state and local government sector could continue to face a gap between revenue and spending during the next 44 years. Since most state and local governments are required to balance their operating budgets, the fiscal conditions indicated by GAO's simulations continue to suggest that the sector would need to make policy changes to avoid fiscal imbalances in the future. That is, absent any intervention or policy changes, state and local governments are facing, and will continue to face, a gap between receipts and expenditures in the coming years. The simulations assume that the tax structure is unchanged in the future and that the provision of real government services per capita remains relatively constant.

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### Health Care Spending and Net Interest Are Key Drivers of Long-Term Federal Spending

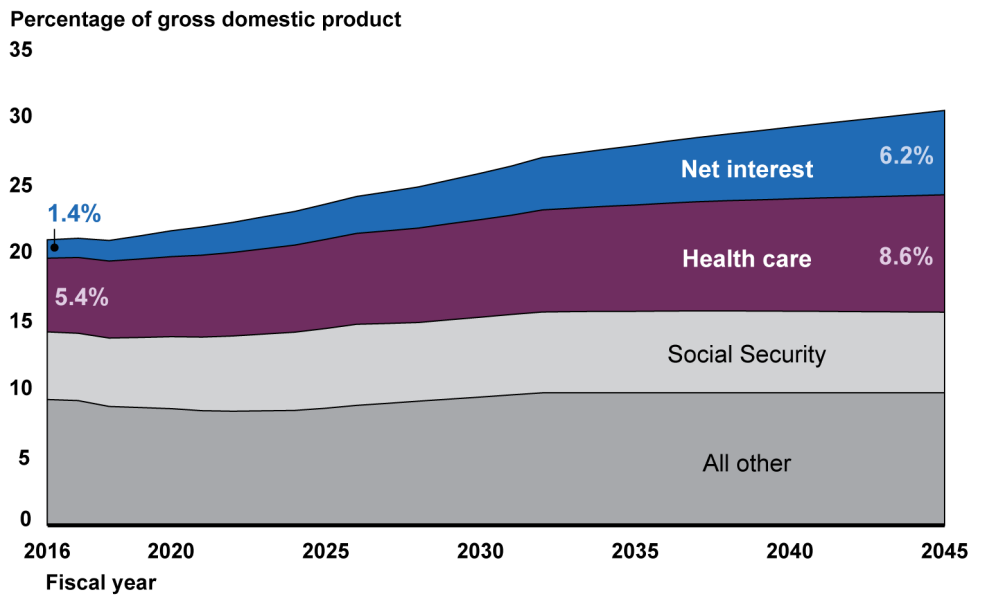
The *2016 Financial Report's* long-term fiscal projections, CBO's long-term projection, and GAO's long-term simulations all show that federal spending on health care programs and interest on debt held by the public (net interest) are the key drivers of growing spending in the long term (see figure 5).<sup>29</sup>

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<sup>28</sup>GAO, *State and Local Government's Fiscal Outlook: 2016 Update*, [GAO-17-213SP](#) (Washington, D.C.: Dec. 8, 2016).

<sup>29</sup>Net interest is primarily interest paid on debt held by the public. It is part of current outlays (spending) by the government (and appears as an outlay in the budget). It represents the cost of servicing the debt held by the public.

**Figure 5: Drivers of Long-Term Federal Spending**



Source: GAO. | GAO-17-237SP

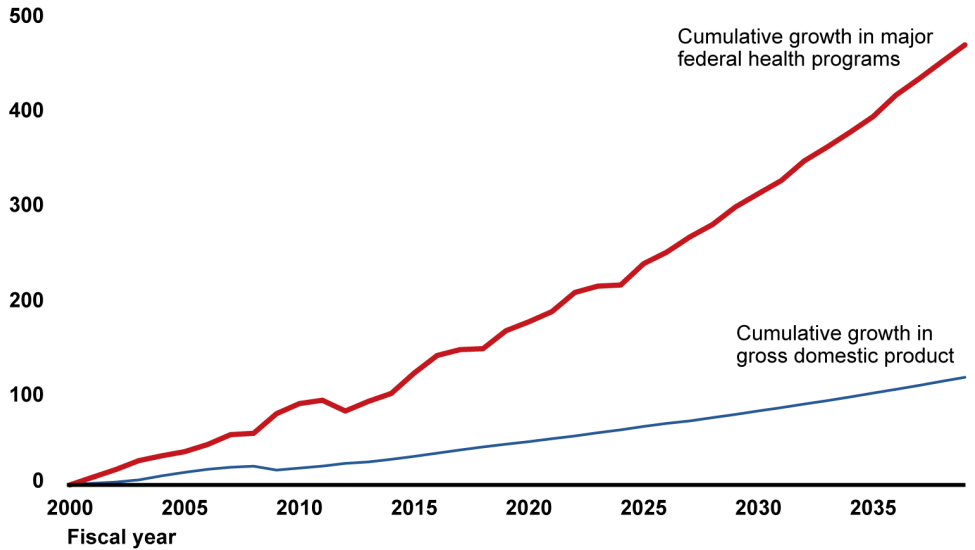
Note: Data based on GAO's 2017 alternative simulation. GAO's simulation holds discretionary spending and other mandatory spending constant as a share of gross domestic product in the long term. Health care spending on major health care programs consists of Medicare, Medicaid, exchange subsidies, and the Children's Health Insurance Program.

In addition, each of these drivers continues to increase in the coming years. Specifically, in GAO's alternative simulation, federal health care spending on major health care programs increases from \$993 billion in fiscal year 2016 to \$2 trillion in fiscal year 2045 in 2016 dollars and net interest increases from \$248 billion in fiscal year 2016 to \$1.4 trillion in fiscal year 2045 in 2016 dollars.

Total health care spending (public and private) in the United States continues to grow faster than the economy. As figure 6 shows, growth in federal spending for health care programs, more than a quarter of total health care spending, has exceeded the growth of GDP historically and is projected to grow faster than the economy. These health care programs include Medicare, Medicaid, and the Children's Health Insurance Program, along with federal subsidies for health insurance purchased through the marketplaces established by the ACA and related spending.

**Figure 6: Federal Spending on Major Health Care Programs Grows Faster than Gross Domestic Product**

Cumulative percentage change since 2000 (in 2015 dollars)



Source: GAO analysis of Congressional Budget Office data. | GAO-17-237SP

Note: Gross domestic product (GDP) is the value of all goods and services produced in a country in a given year. Major federal health programs include Medicare, Medicaid, the Children’s Health Insurance Program, and federal subsidies for health insurance purchased through the marketplaces established by the Patient Protection and Affordable Care Act and related spending.

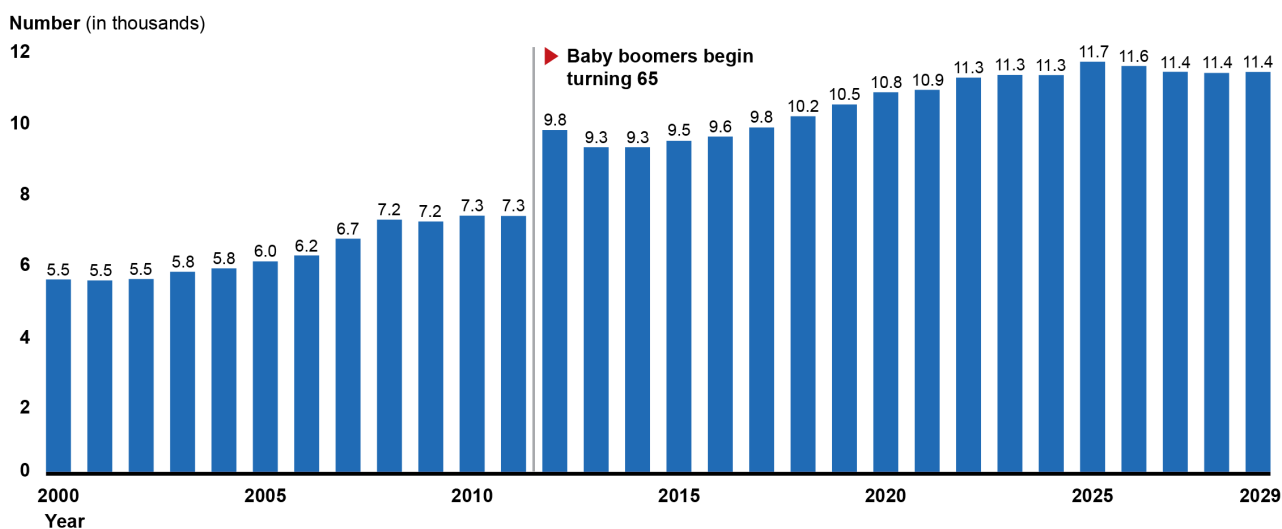
Both the *2016 Financial Report* and CBO note that growth in Medicare and Medicaid spending were key contributors to increased federal spending in 2016. According to CBO, in fiscal year 2016 total net outlays (net of offsetting receipts) were \$592 billion for Medicare and \$368 billion for Medicaid. After adjusting for payments that were shifted from one fiscal year to another, CBO reported that total net outlays increased by 4.9 percent for Medicare and 5.3 percent for Medicaid between fiscal year 2015 and fiscal year 2016.<sup>30</sup> Growth in federal spending on health care is driven, in part, by increasing enrollment, stemming from both the aging of the population and the expansion of federal programs.

- **Aging population.** Enrollment in the Medicare program has grown and is expected to continue to grow as the number of people age 65

<sup>30</sup>Because October 1, 2016 fell on a weekend, approximately \$22 billion in Medicare payments scheduled for that date were made in September (fiscal year 2016) instead of October (fiscal year 2017).

and older increases (see figure 7). Over the next decade, as many members of the baby-boom generation age and as life expectancy continues to generally increase, the number of people 65 or older is expected to rise by more than one-third, thereby increasing the number of Medicare beneficiaries. As of September 2016, CMS reported that Medicare had about 57 million beneficiaries; that number is projected to climb 32 percent to 75 million in 2026.<sup>31</sup>

**Figure 7: Daily Average Number of People Turning 65**



Source: GAO analysis of U.S. Census Bureau information. | GAO-17-237SP

Note: Census data estimates of population are as of July 1 in each year.

- Expansion of federal programs.** According to CBO, outlays for Medicaid in fiscal year 2016 rose by \$18 billion (or 5.3 percent) compared with outlays in fiscal year 2015. The decision of more than half the states to expand eligibility for their Medicaid programs as provided by the ACA was the primary reason for this growth. CBO also projected that there would be an increase in the number of people who receive federal subsidies for health insurance purchased through the exchanges under the provisions of the ACA, with a projected increase in outlays for exchange subsidies and related

<sup>31</sup>In addition to most individuals 65 years of age and older, Medicare beneficiaries also include individuals under age 65 who are receiving benefits from Social Security or the Railroad Retirement Board on the basis of a disability, and those having End Stage Renal Disease.

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spending under current law from \$56 billion in 2016 to \$109 billion by 2026.

The growth in federal spending on health care can also be attributed to increases in health care spending per enrollee. Per beneficiary health care spending has historically risen faster than per capita economic output and is projected to do so in the future. Although health care spending per person grew more slowly in the past several years than it has historically, CBO and the Medicare Trustees project that spending per enrollee in federal health care programs will grow more rapidly over the coming decade than it has in recent years. Various factors can affect per beneficiary spending such as the emergence of new medical procedures and treatments. According to CBO, even services that are relatively inexpensive could make per beneficiary spending rise quickly if growing numbers of patients use them.

Increased health care spending will continue to place a strain on the federal budget. For example, by 2023, the CMS Actuary projects that annual Medicaid expenditures will total \$835 billion, of which \$497.4 billion will be federal expenditures. For Medicare, CBO projects that in 2026 annual Medicare spending will reach almost \$1.1 trillion. The Medicare Trustees' 2016 report stated that, under current law expenditure projections, Medicare's share of GDP would rise from 3.6 percent today to 5.6 percent by 2040. In addition, as of 2028, Medicare's Hospital Insurance trust fund is expected to be depleted and payroll taxes are projected to cover only about 87 percent of all hospital-related Medicare spending.

Health care spending is a key programmatic and policy driver of the long-term outlook on the spending side of the budget. Eventually, however, spending on net interest becomes the largest category of spending in both the *2016 Financial Report's* long-term fiscal projections and GAO's simulations. Growth in interest payments occurs for two main reasons:

- **Growing debt:** As the debt held by the public grows it must be financed, resulting in greater interest payments than would otherwise exist with less debt.
- **Growth in interest rates:** In recent years interest rates on Treasury securities have remained low, lowering interest costs. However, CBO and others project those interest rates will rise in the long term, increasing the net interest costs on the debt. Marketable U.S. Treasury securities consist of bills, notes, and bonds. Treasury seeks

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to accomplish “lowest cost financing over time” in the way it manages debt issuance.<sup>32</sup>

Net interest costs will depend in part on the outstanding mix of Treasury securities. Treasury issues securities in a wide range of maturities to appeal to the broadest range of investors. Longer-term securities typically carry higher interest rates but offer the government the ability to “lock in” fixed interest payments over a longer period and reduce the amount of debt that Treasury needs to refinance in the short term. In contrast, shorter-term securities generally carry lower interest rates. They also play an important role in financial markets. For example, investors use Treasury bills to meet requirements to buy financial assets maturing in a year or less. However, shorter-term securities add uncertainty to the government’s interest costs and require Treasury to conduct more frequent auctions to refinance maturing debt. As of September 30, 2016, 58 percent of marketable Treasury securities held by the public were scheduled to mature and need to be refinanced in the next 4 years—potentially at higher interest rates.<sup>33</sup> As the *2016 Financial Report* notes, each year trillions of dollars of debt mature and new debt is issued in its place. In fiscal year 2016, new borrowings were \$8.4 trillion, and repayments of maturing debt held by the public were \$7.3 trillion.

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## Social Security Also Poses Significant Financial Challenges

Social Security has remained the bedrock of retirement security—insuring workers against the loss of income due to retirement, death, or disability—providing benefits to about 60 million older Americans, survivors, dependents, and individuals with disabilities and their families. It has helped reduce poverty among its beneficiaries, many of whom rely on Social Security for the majority of their income. According to Treasury’s September 2016 Monthly Treasury Statement, Social Security paid more than \$905 billion in Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) program benefits in fiscal year 2016. However, demographic factors, such as an aging population and slower labor force growth, are straining Social Security programs and contributing to a gap between program costs and revenues.

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<sup>32</sup>GAO, *Debt Management: Floating Rate Notes Can Help Treasury Meet Borrowing Goals, but Additional Actions Are Needed to Help Manage Risk*, [GAO-14-535](#) (Washington, D.C.: June 16, 2014).

<sup>33</sup>GAO, *Financial Audit: Bureau of the Fiscal Service’s Fiscal Years 2016 and 2015 Schedules of Federal Debt*, [GAO-17-104](#) (Washington, D.C.: Nov. 10, 2016).



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For many years Social Security's revenues exceeded program costs and the program built up reserves in the trust funds, one for the retirement program (OASI) and one for the disability insurance (DI) program. By law the Social Security trust funds must invest in interest-bearing federal government securities.<sup>34</sup> While the Social Security trust funds received more in revenue than they paid out in benefits, these excess revenues were invested in federal government securities, reducing the amount that must be borrowed from the public to finance other federal programs.

However, starting in 2005 for the DI trust fund and in 2010 for the OASI trust fund, this situation reversed as Social Security began paying out more in benefits than it receives in non-interest revenue. Absent any changes, the trust funds are projected to deplete their assets and incoming revenues will not be sufficient to pay benefits in full on a timely basis. Current projections indicate that the DI trust fund will deplete its assets by 2023 and then only be sufficient to pay 89 percent of scheduled benefits, while the OASI trust fund will deplete its assets by 2035 and only be sufficient to pay 77 percent of scheduled benefits.<sup>35</sup> While action will be needed in any case, acting soon would allow any adjustments to be smaller and spread across more generations of participants and be phased in so that affected individuals could have time to adjust their retirement planning.

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### Action Is Needed to Address an Unsustainable Fiscal Path

CBO has noted that large and growing amounts of federal debt held by the public over the coming decades would have negative long-term consequences for the economy and would constrain future budget policy. In particular, the projected amounts of debt would

- reduce national saving and income in the long term;

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<sup>34</sup>The Social Security Act requires that trust fund assets be invested in interest-bearing obligations of the United States, or in obligations guaranteed as to both principal and interest by the United States. We are using the term "federal government securities" to refer to these obligations.

<sup>35</sup>These projections are from *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* and reflect the intermediate assumptions. Because the future is uncertain, the Trustees use three sets of assumptions to show a range of possible outcomes. The intermediate assumptions represent the Trustees' best estimate of the trust funds' future financial outlook. The Trustees also present estimates using low cost and high cost sets of assumptions.

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- increase the government's interest costs, putting more pressure on the rest of the budget;
  - limit lawmakers' ability to respond to unforeseen events; and
  - make a fiscal crisis more likely.

The *2016 Financial Report* makes similar points that while national debt can at times play a role in facilitating a healthy economy, economic theory suggests that high levels of national debt may contribute to higher interest rates leading to lower investment and a smaller capital stock to assist economic growth. It also notes that one of the goals of fiscal policy is to manage the national debt so that it is not a burden to future generations. An important purpose of the Financial Report of the United States Government is to help citizens understand current fiscal policy and the importance and magnitude of policy reforms necessary to make it sustainable. A sustainable policy is one where the debt-to-GDP ratio is stable or declining over the long term.

To change the long-term fiscal path, policymakers will need to consider policy changes to the entire range of federal activities and spending—entitlement programs, other mandatory spending, discretionary spending, and revenue. One way to quantify the magnitude of the policy changes needed to address the increasing debt is by calculating the fiscal gap. The fiscal gap represents the difference—or gap—between revenue and program spending (i.e., spending other than interest payments) that would need to be closed immediately and permanently to hold debt constant as a share of GDP beginning in 2016. The size of the fiscal gap in 2016 was 6.1 percent of GDP under GAO's alternative simulation.

Closing the gap requires reductions in programmatic<sup>36</sup> (non-interest) spending, increases in revenue, or, more likely, a combination of the two. To illustrate this, one can calculate what it would take to have debt held by the public as a share of GDP in 75 years equal what it was at the beginning of the projection period:

- Under GAO's alternative simulation, the fiscal gap could be closed solely by cutting programmatic spending by about 25 percent over 75 years or solely by increasing revenue by about 33 percent over 75 years.

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<sup>36</sup>Programmatic spending (also referred to as non-interest spending) includes both discretionary spending and mandatory spending other than interest on the debt.

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- Under GAO’s baseline extended simulation, the fiscal gap could be closed solely by cutting programmatic spending by about 14.6 percent over 75 years or solely by increasing revenue by about 17.3 percent over 75 years.
  - Under the *2016 Financial Report* projections, the fiscal gap could be closed solely by cutting programmatic spending by about 7.6 percent over 75 years or solely by increasing revenue by about 7.9 percent over 75 years.

The *2016 Financial Report*, CBO, and GAO all make the point that the longer action is delayed, the greater and more drastic the changes will have to be, placing an additional burden on future generations.

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## Debt Limit Is Not a Control on Debt: Alternative Approach to Managing Debt Is Needed

In taking action to change the federal government’s long-term fiscal path, it will be important for Congress to consider alternative approaches for managing debt. As currently structured, the debt limit—a legal limit on the amount of federal debt that can be outstanding at one time—does not restrict Congress and the President’s ability to enact spending and revenue legislation that affects the level of debt; nor does it otherwise constrain fiscal policy.<sup>37</sup> Rather, the debt limit is an after-the-fact measure: the spending and tax laws that result in debt have already been enacted. In other words, the debt limit restricts Treasury’s authority to borrow to finance the decisions already enacted by Congress and the President.<sup>38</sup> We have recommended that decisions about providing Treasury the authority to borrow be made when decisions about spending and revenues are made.

U.S. Treasury securities play a vital role in the U.S. and global financial markets, in large part because of their large, liquid, and transparent market and because investors are confident that debt backed by the full faith and credit of the United States will be honored. This is seen in what is often called “the flight to quality”—the exceptionally strong demand for U.S. Treasury securities during times of economic uncertainty and stress around the world. Because Treasury securities are seen as one of the

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<sup>37</sup>GAO, *Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, [GAO-11-203](#) (Washington, D.C.: Feb. 22, 2011).

<sup>38</sup>For a description of what is included in the debt limit (most of total federal debt including intragovernmental debt) and more information on how it operates, see GAO, *Debt Limit: Analysis of 2011-2012 Actions Taken and Effect of Delayed Increase on Borrowing Costs*, [GAO-12-701](#) (Washington D.C.: July 23, 2012).

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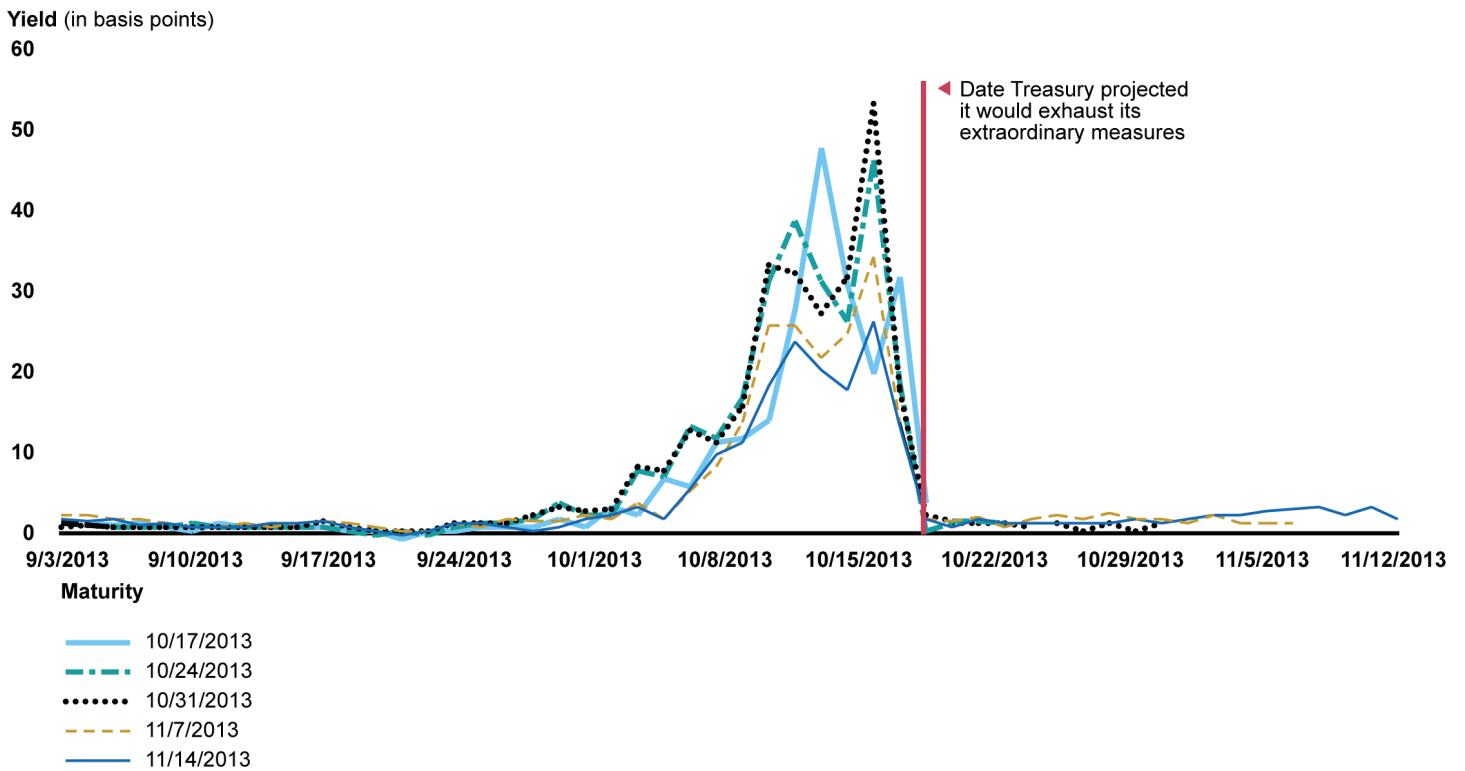
safest assets in the world, they are broadly held by individuals—including pension funds or mutual funds—and by institutions and central banks for use in everyday transactions. Treasury securities serve as a close substitute for cash for financial institutions and corporate treasurers, are one of the cheapest and most widely used forms of collateral for financial transactions, and are the basis for pricing many financial products such as corporate bonds, derivatives, and mortgages.

One cannot overstate the importance of preserving confidence in “the full faith and credit” of the United States. Failure to increase (or suspend) the debt limit in a timely manner could have serious negative consequences for the Treasury market and increase borrowing costs. The Treasury has low borrowing costs because investors are willing to pay more for the liquidity and safety Treasury securities offer. In contrast, disruptions in the market caused by uncertainty around whether the debt limit will be raised led to increases in borrowing costs in both 2011 and 2013. For those Treasury securities issued during the 2013 debt limit impasse, we estimated that the additional borrowing costs incurred through fiscal year 2014 were between \$38 and \$70 million depending on the specifications used. As figure 8 shows, in 2013, secondary market yields on Treasury bills maturing in late October through mid-November rose from about 1 basis point (or one-one hundredth of a percent) in mid-September to over 50 basis points prior to the resolution of the impasse on October 17.<sup>39</sup>

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<sup>39</sup>GAO, *Debt Limit: Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, [GAO-15-476](#) (Washington, D.C.: July 9, 2015).

**Figure 8: Secondary Market Yields on Treasury Bills Maturing in Late October through Mid-November 2013**



Source: GAO analysis of Bloomberg data. | GAO-17-237SP

Note: The Department of the Treasury refers to actions used to manage federal debt when it is at the debt limit as extraordinary measures.

During the 2013 impasse, investors also reported taking the unprecedented action of systematically avoiding certain Treasury securities—those that matured around the dates when Treasury projected it would exhaust the extraordinary actions used to manage debt when it is at the limit.<sup>40</sup> For these securities, the actions resulted in both a dramatic increase in interest rates and a decline in liquidity in the secondary market where securities are traded among investors. Demand at the relevant auctions was unusually low, and borrowing costs to Treasury increased. In addition, disruptions to the Treasury market from the 2013 debt limit impasse extended into other markets, such as short-term financing.

<sup>40</sup>GAO-15-476. For more information on extraordinary actions, see GAO-11-203.

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Market participants interviewed for our 2015 report told us that market reactions to future impasses could be more severe for several reasons. Investors told us that they are prepared to take steps—similar to those taken in 2013—to systematically avoid certain Treasury securities during future impasses. In addition, there have been changes in market practices since the financial crisis and investors have developed contingency plans.

The Bipartisan Budget Act of 2015 suspended the debt limit to March 15, 2017.<sup>41</sup> Timely action by Congress on the debt limit—on authorizing Treasury to borrow to finance the spending and revenue decisions already enacted into law—could avoid the negative impacts on the Treasury market and on interest costs.

The U.S. Constitution gives Congress the authority to borrow on behalf of the United States. Prior to 1917, Congress approved individual issuances of Treasury securities. The debt limit was enacted to make it easier for Treasury to finance the laws enacted by the Congress and the President. Treasury debt management is aimed at providing the least cost financing over time. The gap between spending and revenue is filled primarily by borrowing. Since current law leads to an ever-growing gap, debt held by the public also grows. If the level of debt or debt as a share of GDP is to be managed to change the long-term fiscal path, it needs to be considered as part of overall budget decisions. Such a step would provide a focus on the fiscal impacts of budget decisions and would avoid the negative impacts of debt limit impasses.

In 2015, we conducted a forum with experts in the field to help identify options for Congress to delegate its borrowing authority and better align decisions about the level of debt with decisions on spending and revenue.<sup>42</sup> Each of these options met the criteria of (1) minimizing disruptions to the market and (2) linking decisions about debt to decisions about spending and revenue at the time those decisions are made. All maintain Congressional control and oversight over federal borrowing. Our report described the benefits and challenges presented by each of the options described below:

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<sup>41</sup>Pub. L. No. 114-74, § 901, 129 Stat. 584, 620 (Nov. 2, 2015).

<sup>42</sup>[GAO-15-476](#).



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- **Option 1: Link Action on the Debt Limit to the Budget Resolution.** This is a variation of a previously used approach under which legislation raising the debt limit to the level envisioned in the Congressional Budget Resolution would be spun off and either be deemed to have passed or be voted on immediately thereafter.
  - **Option 2: Provide the Administration with the Authority to Increase the Debt Limit, Subject to a Congressional Motion of Disapproval.** This is a variation of an approach contained in the Budget Control Act of 2011. Congress would give the administration the authority to propose a change in the debt limit, which would take effect absent enactment of a joint resolution of disapproval within a specified time frame.
  - **Option 3: Delegating Broad Authority to the Administration to Borrow as Necessary to Fund Enacted Laws.** This is an approach used in some other countries: delegate to the administration the authority to borrow such sums as necessary to fund implementation of the laws duly enacted by Congress and the President. Since the laws that affect federal spending and revenue and so create the need for debt already require adoption by the Congress, Congress would still maintain control over the amount of federal borrowing.

We did not endorse a specific option but we did recommend that Congress consider alternative approaches that better link decisions about the debt limit with decisions about spending and revenue at the time those decisions are made, such as those identified by our expert forum.<sup>43</sup>

Some of the experts also supported replacing the debt limit with a fiscal rule imposed on spending and revenue decisions. The federal government has enacted such fiscal rules in the past. For example, the Budget Control Act of 2011 enacted limits on discretionary spending, which are enforced by additional spending cuts if those limits are breached (known as a sequester). Congress could consider additional fiscal rules to frame and control the overall results of spending and revenue decisions. Such rules could limit spending or affect other areas of the budget such as overall debt or annual deficits.

Other countries have also operated under such fiscal rules. For example, the European Union's (EU) stability and growth pact allows for sanctions against member states that exceed certain target levels of debt or deficits

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<sup>43</sup>For more discussion of the options identified by our expert forum, see [GAO-15-476](#).

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defined as “excessive” by the EU. The pact is a set of rules designed to ensure that countries in the EU pursue sound public finances and coordinate their fiscal policies. The EU defines an excessive budget deficit as one greater than 3 percent of GDP. Public debt is considered excessive if it exceeds 60 percent of GDP without diminishing at an adequate rate (defined as a decrease of the excess debt by 5 percent per year on average for more than 3 years).<sup>44</sup> That said, several nations have struggled to meet these targets in recent years. In general, budget experts and other observers have noted that the success of fiscal rules depends on effective enforcement and a sustained commitment by policymakers and the public.

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## Fiscal Risks Place Additional Pressure on the Federal Budget

None of the long-term projections include certain fiscal risks that could affect the federal government’s financial condition in the future.<sup>45</sup> Fiscal risks are responsibilities, programs, and activities that may legally commit or create expectations for future federal spending based on current policy, past practices, or other factors. A more complete understanding of fiscal risks can help policymakers anticipate changes in future spending and can enhance oversight of federal resources. Fiscal risks include the following examples.

- The Pension Benefit Guaranty Corporation’s (PBGC) financial future is uncertain because of long-term challenges related to PBGC’s governance and funding structure. PBGC’s liabilities exceeded its assets by over \$79 billion as of the end of fiscal year 2016—an increase of over \$3 billion from the end of fiscal year 2015 and of about \$44 billion since 2013 (see figure 9).<sup>46</sup> PBGC reported that it is subject to potential further losses of \$243 billion if plan terminations occur that are considered reasonably possible.

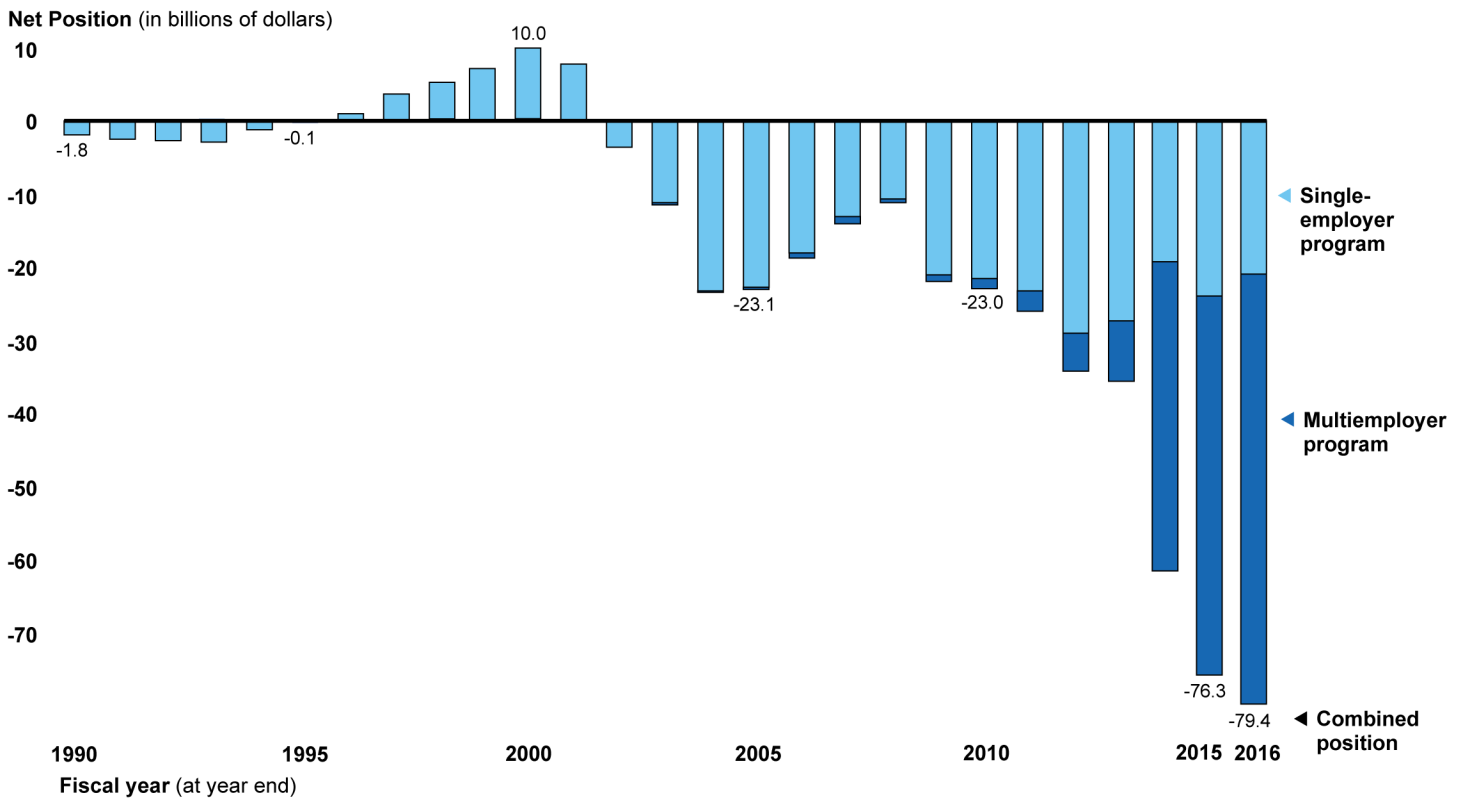
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<sup>44</sup>European Commission, *Stability and Growth Pact*, accessed on January 8, 2017, [http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/index\\_en.htm](http://ec.europa.eu/economy_finance/economic_governance/sgp/index_en.htm).

<sup>45</sup>See GAO, *Fiscal Outlook: Federal Fiscal Outlook*, accessed on January 12, 2017, [http://www.gao.gov/fiscal\\_outlook/federal\\_fiscal\\_outlook/overview#t=3](http://www.gao.gov/fiscal_outlook/federal_fiscal_outlook/overview#t=3). The *2016 Financial Report* discusses various contingencies where the government may face the need for additional spending.

<sup>46</sup>GAO-17-283R.

**Figure 9: The Pension Benefit Guaranty Corporation's Net Position Is Declining**



Source: Pension Benefit Guaranty Corporation financial data. | GAO-17-237SP

- In 2008, during the financial crisis, the federal government placed the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) under conservatorship and entered into preferred stock purchase agreements with these government-sponsored enterprises (GSE) to help ensure their financial stability. The agreements with the GSEs could affect the federal government's financial position. At the end of fiscal year 2016, the federal government continued to report about \$109 billion of investments in the GSEs, which is net of about \$86 billion in valuation losses. The GSEs paid Treasury cash dividends of \$11.5 billion and \$20.4 billion during fiscal years 2016 and 2015, respectively. Although Treasury does not believe that any further draws by the GSEs are probable, the reported maximum remaining contractual commitment to the GSEs, if needed, is \$258.1 billion. Importantly, the ultimate role of the GSEs in the mortgage market could affect the financial condition of the Federal Housing

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Administration, which in the past expanded its lending role in distressed housing and mortgage markets.

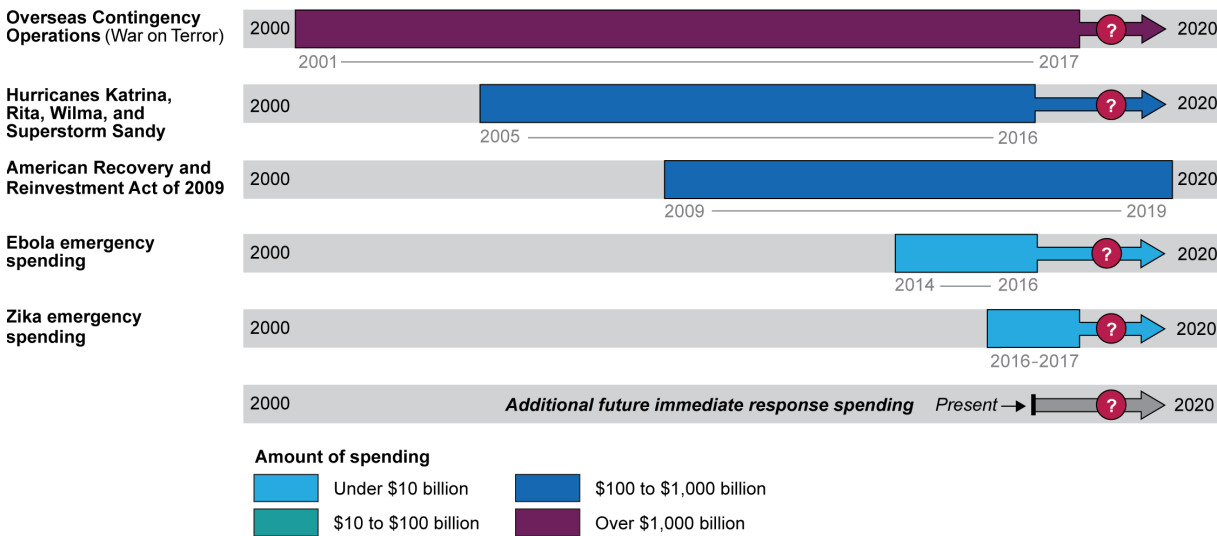
- The U.S. Postal Service (USPS) continues to be in a serious financial crisis as it has reached its borrowing limit of \$15 billion and finished fiscal year 2016 with a reported net loss of \$5.6 billion. USPS's business model is not viable and cannot fund its current level of services, operations, and obligations.<sup>47</sup> USPS's liabilities exceeded its assets by \$56 billion as of the end of fiscal year 2016 and USPS reported an additional \$39.5 billion in unfunded liabilities at that time for its retiree health and pension funds. USPS reported a total unfunded liability for its retiree health and pension funds of \$73.4 billion, \$33.9 billion of which relates to required prefunding payments for postal retirees' health benefits that have not been made and is included in the liabilities reported on its balance sheet.

Citizens also look to the federal government for assistance when crises happen and immediate federal action is expected. This can take the form of expectations for additional and large amounts of federal spending. These expectations have come in part from the way the government has responded to crises in the past. Recent examples of responses to events include federal funding provided after Superstorm Sandy and other hurricanes as well as funding for Ebola, Zika, and the health crisis in Flint, Michigan. The federal government is expected to respond quickly, often in an ad hoc manner, as events occur. Figure 10 provides some illustrative examples of resource allocation for such events as well as the length of time over which the resources were allocated.

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<sup>47</sup>GAO, U.S. Postal Service's Financial Viability – High Risk Issue, accessed on January 12, 2017, [http://www.gao.gov/key\\_issues/us\\_postal\\_service\\_financial\\_viability/issue\\_summary](http://www.gao.gov/key_issues/us_postal_service_financial_viability/issue_summary).

**Figure 10: Illustrative Examples of Immediate Response Spending**



Source: GAO analysis of legislation and Federal Emergency Management Agency, Congressional Research Service, Department of Homeland Security, Department of the Treasury, and Congressional Budget Office data. | GAO-17-237SP

Note: Spending ranges are approximate and based on budget estimates as well as reported agency obligations and appropriations.

These crises often cannot be predicted and are very difficult to budget for. According to the Congressional Research Service, the federal budget does contain some funds for disaster response through the Disaster Relief Fund; however, this fund often is insufficient to respond to the number and scope of natural disasters, and it is not typically used as a funding source for other types of unforeseen events such as wars, financial crises, cyberattacks, or health pandemics.

## Executive Agencies Have Opportunities to Contribute Toward Fiscal Sustainability

Changes in spending and revenue to ensure long-term fiscal sustainability require legislative actions to alter fiscal policies, but in our prior work we have identified numerous actions for executive agencies to contribute toward a more sustainable fiscal future. It is important for agencies to act as stewards of federal resources, but executive actions alone cannot put the U.S. government on a sustainable fiscal path.

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## Reduce Improper Payments: Agencies Need to Curtail Billions in Improper Payments

Improper payments—payments that should not have been made or that were made in an incorrect amount—have consistently been a government-wide issue.<sup>48</sup> Since fiscal year 2003—when certain agencies were required by statute to begin reporting improper payments—cumulative improper payment estimates have totaled over \$1.2 trillion.

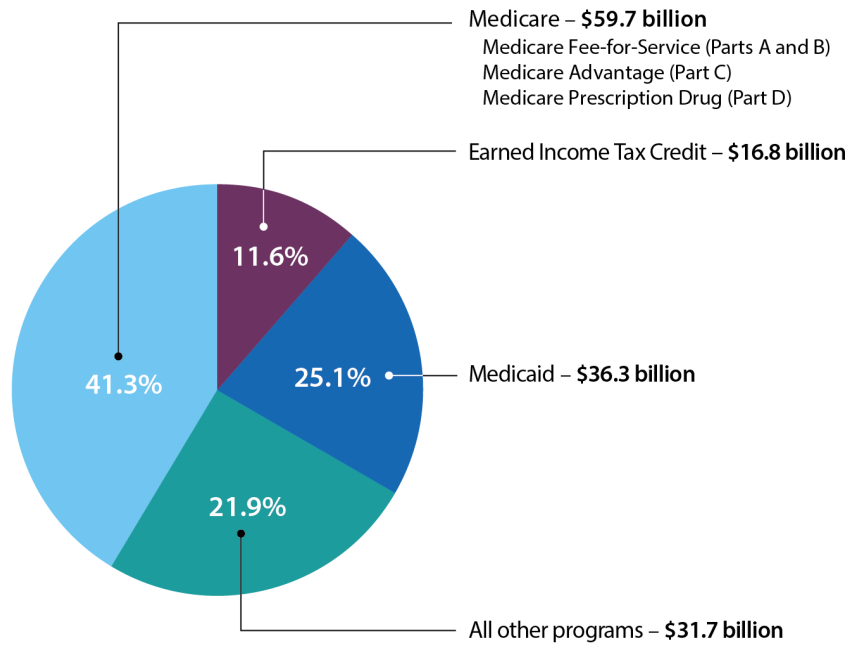
The improper payments annual estimate in fiscal year 2016, attributable to 112 programs across 22 agencies, was over \$144 billion, up from almost \$137 billion in fiscal year 2015 and almost \$125 billion in fiscal year 2014. As shown in figure 11, three large programs, Medicare, Medicaid, and the Earned Income Tax Credit, account for over 78 percent of the fiscal year 2016 government-wide improper payment estimate. Federal spending for Medicare and Medicaid is expected to significantly increase, so it is especially critical to take appropriate measures to reduce improper payments in these programs.<sup>49</sup>

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<sup>48</sup>We have reported improper payments as a material weakness in internal control in our audit reports on the U.S. government's consolidated financial statements. See [GAO-17-283R](#).

<sup>49</sup>For more information on our work on Medicare and Medicaid improper payments and our recommendations for how to address this issue, see GAO, *High-Risk Series: An Update*, [GAO-15-290](#) (Washington, D.C.: Feb. 11, 2015).

**Figure 11: Improper Payment Estimates Were Concentrated in Three Programs in Fiscal Year 2016**



Source: GAO analysis of agencies' fiscal year 2016 data. | GAO-17-2375P

Note: These estimates do not include the Department of Defense's Defense Finance and Accounting Service Commercial Pay program. Due to rounding, numbers may not add to 100 percent or match the government-wide improper payment estimate (\$144.3 billion).

In fiscal year 2016, 14 federal programs had improper payment estimates greater than \$1 billion.<sup>50</sup> Eleven programs had payment error rates that exceeded 10 percent. To address the issue of improper payments, agencies should first identify the root causes of improper payments and then implement internal controls aimed at both prevention and detection. The government's ability to understand the scope of the issue is hindered

<sup>50</sup>The 14 programs with improper payment estimates greater than \$1 billion in fiscal year 2016 were the (1) HHS's Fee-for-Service, (2) HHS's Medicaid, (3) Department of the Treasury's Earned Income Tax Credit, (4) HHS's Medicare Advantage, (5) SSA's Supplemental Security Income, (6) Department of Education's (Education) Direct Loan, (7) Department of Labor's Unemployment Insurance, (8) SSA's Old-Age, Survivors, and Disability Insurance program, (9) Department of Veterans Affairs' (VA) VA Community Care, (10) HHS's Medicare Prescription Drug, (11) Education's Pell Grant, (12) Department of Agriculture's School Lunch, (13) Department of Housing and Urban Development's Rental Housing Assistance, and (14) VA's Purchased Long-Term Services and Support programs.

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by incomplete, unreliable, or understated estimates; risk assessments that may not accurately assess the risk of improper payment; and noncompliance with criteria listed in federal law. For example, 18 federal programs determined to be at risk for improper payments did not report estimates of improper payments in fiscal year 2016, including Temporary Assistance to Needy Families, and the Supplemental Nutrition Assistance Program. In addition, DOD lacks quality assurance procedures to ensure the completeness and accuracy of the payment populations from which it develops estimates.<sup>51</sup> Further, various inspectors general reported deficiencies related to compliance with the criteria listed in the Improper Payments Elimination and Recovery Act of 2010 for fiscal year 2015 at their respective federal entities.<sup>52</sup> Our work has identified a number of strategies and specific actions agencies can take to reduce improper payments, which could yield significant savings, and help ensure that taxpayer funds are adequately safeguarded.<sup>53</sup>

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## Address the Persistent Tax Gap: Opportunities to Increase Revenues through Improved Collection Efforts

The tax gap is the difference between taxes owed to the government and total taxes paid on time. According to the *2016 Financial Report*, the estimated size of the annual gross tax gap is \$458 billion. The tax gap arises when taxpayers, whether intentionally or inadvertently, fail to (1) accurately report tax liabilities on tax returns (underreporting), (2) pay taxes due from filed returns (underpayment), or (3) file a required tax return altogether or on time (nonfiling). Underreporting accounted for 84 percent of the tax gap across tax years 2008 to 2010 (see figure 12).

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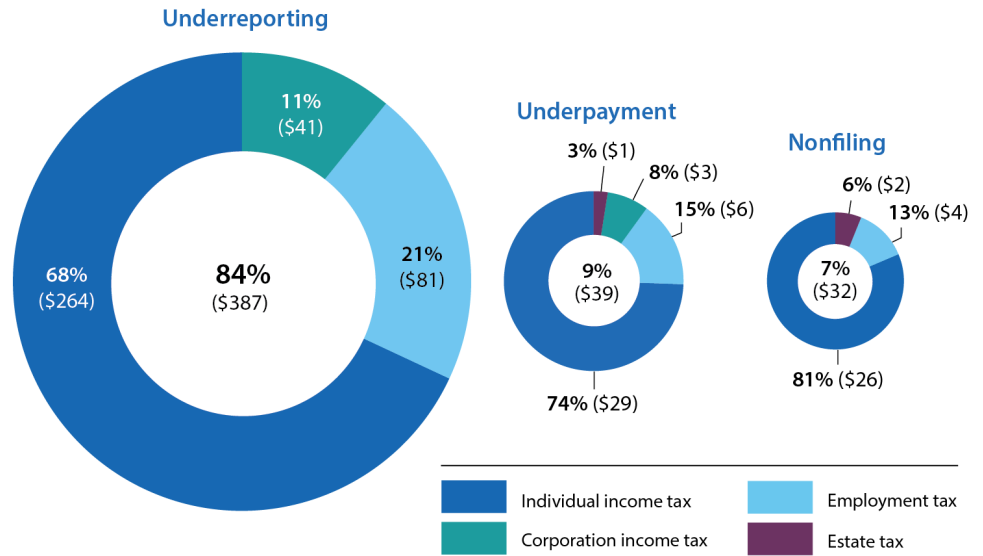
<sup>51</sup>In May 2013, we reported on major deficiencies in DOD's process for estimating fiscal year 2012 improper payments in the Defense Finance and Accounting Service Commercial Pay program, including deficiencies in identifying a complete and accurate population of payments; see GAO, *DOD Financial Management: Significant Improvements Needed in Effort to Address Improper Payment Requirements*, GAO-13-227 (Washington, D.C.: May 13, 2013). The foundation of reliable statistical sampling estimates is a complete, accurate and valid population from which to sample. As of October 2016, DOD's efforts to establish and implement key quality assurance procedures to ensure the completeness and accuracy of sampled populations were still under development.

<sup>52</sup>The most recent inspectors general reports on compliance with the criteria listed in the Improper Payments Elimination and Recovery Act were issued in 2016 for fiscal year 2015.

<sup>53</sup>For more information on our work improper payments and related recommendations, see GAO, *Reducing Government-wide Improper Payments*, accessed January 15, 2017, [http://www.gao.gov/key\\_issues/reducing\\_government-wide\\_improper\\_payments/issue\\_summary](http://www.gao.gov/key_issues/reducing_government-wide_improper_payments/issue_summary).



**Figure 12: Underreporting of Individual Income Tax Accounts for the Largest Share of the Average Annual Gross Tax Gap, Tax Years 2008-2010**  
Dollars (in billions)



Source: GAO analysis of Internal Revenue Service information. | GAO-17-2375P

Note: Individual income tax includes individual business income tax. Estate tax underreporting noncompliance is not shown in this graphic because it represents less than one-half percent of total underreporting noncompliance. Excise tax is not shown in this graphic because the Internal Revenue Service (IRS) does not have excise tax underreporting noncompliance or nonfiling noncompliance estimates, and its estimate for excise tax underpayment noncompliance represents less than one-half percent of total underpayment noncompliance. In addition, IRS does not have a corporation income tax estimate for nonfiling noncompliance.

For tax years 2008 through 2010, the Internal Revenue Service (IRS) estimated it would recover \$52 billion through enforcement actions and late payments. This resulted in an annual net tax gap of \$406 billion. Given the size of the tax gap, even modest reductions would yield significant financial benefits and help improve the government’s fiscal position.

This issue has been on our High Risk List since the list’s inception in 1990. Addressing the tax gap will require strategies on multiple fronts. Key factors that contribute to the tax gap include limited third-party reporting, resource trade-offs, and tax code complexity. For example, the extent to which individual taxpayers accurately report their income is correlated with the extent to which the income is reported to them and the IRS by third parties. Where there is little or no information reporting, such as with business income, taxpayers tend to significantly misreport their

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income. Our work has identified a number of strategies and specific actions Congress and agencies can take to reduce the tax gap, including simplifying the tax code.<sup>54</sup>

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### Continue to Address Duplication, Overlap, and Fragmentation: Agencies Have the Potential to Achieve Billions in Financial Benefits for the Government

Since 2011, we have reported on federal programs, agencies, offices, and initiatives that have duplicative goals or activities as well as opportunities to achieve greater efficiency and effectiveness that result in cost savings or enhanced revenue collection.<sup>55</sup> In our six annual reports from 2011 through 2016, we presented over 200 areas and 642 actions for Congress or executive branch agencies to reduce, eliminate, or better manage fragmentation, overlap, or duplication; achieve cost savings; or enhance revenue. Actions taken by Congress and the executive branch on these issues have resulted in roughly \$56 billion in financial benefits from fiscal years 2010 through 2015, with at least an additional \$69 billion in estimated benefits projected to be accrued through 2025. As of November 2016, about 40 percent of the actions were fully addressed, about 35 percent were partially addressed, and about 21 percent were not addressed.<sup>56</sup> We estimate that tens of billions of dollars in additional financial benefits are possible by fully implementing our recommended actions.

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### Improve Information: Agencies Could Aid Fiscal Decision Making by Providing Improved Information on Programs and Fiscal Operations

In many cases, agencies also need to take action to provide decision makers with additional or improved information on the performance and costs of policies or programs. In particular, decision-making could be improved by:

- strengthened internal controls over financial reporting,
- increased attention to tax expenditures, and

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<sup>54</sup>For more information on our work on the tax gap and our recommendations, see GAO, *Enforcement of Tax Laws – High Risk Issue*, accessed on January 8, 2017, [http://www.gao.gov/key\\_issues/tax\\_laws/issue\\_summary](http://www.gao.gov/key_issues/tax_laws/issue_summary).

<sup>55</sup>For more information on our work on duplication, overlap, and fragmentation including cost-savings and revenue enhancements, see GAO, *2016 Annual Report: Additional Opportunities to Reduce Fragmentation, Overlap, and Duplication and Achieve Other Financial Benefits*, GAO-16-375SP (Washington, D.C.: Apr. 13, 2016) and GAO, *Duplication & Cost Savings: Improving Efficiency and Effectiveness*, accessed on January 8, 2017, <http://www.gao.gov/duplication/overview>.

<sup>56</sup>Four percent of the actions have been consolidated or other—replaced or subsumed by new actions based on additional audit work or other relevant information.

- 
- effective implementation of the Digital Accountability and Transparency Act of 2014 (DATA Act).

**Eliminating material weaknesses in internal control over financial reporting.** Eliminating these weaknesses would improve the reliability of financial information and improve financial decision making. The U.S. government's consolidated financial statements are intended to present the results of operations and the financial position of the federal government as if the government were a single enterprise. Since the federal government began preparing consolidated financial statements 20 years ago, three major impediments have continued to prevent us from rendering an opinion on the federal government's accrual-based consolidated financial statements over this period: (1) serious financial management problems at DOD that have prevented its financial statements from being auditable, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements. Over the years, we have made a number of recommendations to OMB, Treasury, and DOD to address these issues.<sup>57</sup> Generally, these entities have taken or plan to take actions to address these recommendations.

The material weaknesses in internal control underlying these three major impediments continued to (1) hamper the federal government's ability to reliably report a significant portion of its assets, liabilities, costs, and other related information; (2) affect the federal government's ability to reliably measure the full cost, as well as the financial and nonfinancial performance of certain programs and activities; (3) impair the federal government's ability to adequately safeguard significant assets and properly record various transactions; and (4) hinder the federal government from having reliable financial information to operate in an efficient and effective manner.

**Increased attention to tax expenditures.** Tax expenditures are sometimes used to provide economic relief to selected groups of

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<sup>57</sup> See, GAO, *Management Report: Improvements Needed in Controls over the Processes Used to Prepare the U.S. Consolidated Financial Statements*, GAO-16-621 (Washington, D.C.: July 13, 2016). In addition, see GAO, *DOD Financial Management – High Risk Issue*, accessed on January 12, 2017, [http://www.gao.gov/key\\_issues/dod\\_financial\\_management/issue\\_summary#t=1](http://www.gao.gov/key_issues/dod_financial_management/issue_summary#t=1). Further, other auditors have made recommendations to DOD to improve DOD's financial management

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taxpayers or to encourage certain behavior or to accomplish other goals. The goals they seek to advance may be similar to the goals of mandatory or discretionary spending programs. According to Treasury, in fiscal year 2015, tax expenditures were estimated to reduce tax revenues by approximately \$1.23 trillion. However, despite their use as a policy tool, tax expenditures are not regularly reviewed, and their outcomes are not measured as closely as those from spending programs. In September 2005, we recommended that OMB take actions to develop a framework for evaluating tax expenditure performance and to regularly review tax expenditures in executive branch budget and performance review processes.<sup>58</sup> However, OMB has not developed a systematic approach for conducting such reviews and has not reported progress on addressing data availability and analytical challenges in evaluating tax expenditures since the President's fiscal year 2012 budget. In July 2016 we recommended that OMB work with agencies to identify which tax expenditures contribute to agency goals, and OMB generally agreed with the recommendation.<sup>59</sup> Absent such analysis, policymakers have little way of knowing whether these tax provisions support achieving the intended federal outcomes and lack information to compare their cost and efficacy with other policy tools.

**DATA Act.** Additionally, we have reported that the DATA Act holds great promise for improving the transparency and accountability of federal spending data by providing consistent, reliable, and complete data on federal spending and for helping decision makers in addressing the federal government's fiscal challenges. OMB and Treasury have taken significant steps toward implementing the DATA Act's various requirements, but agencies have reported that they continue to face challenges implementing the DATA Act, including systems integration issues, lack of resources, evolving and complex reporting requirements, and inadequate guidance. Agencies are taking actions to mitigate these challenges; nevertheless, as we reported in December 2016, the information reported by agencies and their inspectors general indicates that some agencies are at increased risk of not fully meeting the May

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<sup>58</sup>GAO, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, [GAO-05-690](#) (Washington, D.C.: Sept. 23, 2005).

<sup>59</sup>GAO, *Tax Expenditures: Opportunities Exist to Use Budgeting and Agency Performance Processes to Increase Oversight*, [GAO-16-622](#) (Washington, D.C.: July 7, 2016).

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2017 reporting deadline because of these challenges.<sup>60</sup> In order to fully and effectively implement the DATA Act, the federal government will need to continue addressing complex governance, policy, and technical issues. OMB and Treasury implemented several of our recommendations related to the DATA Act implementation. However, as of December 2016, additional effort is needed to address GAO recommendations that remain open.<sup>61</sup>

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This publication was prepared under the direction of Robert F. Dacey, Chief Accountant, who may be reached at (202) 512-3406 or [daceyr@gao.gov](mailto:daceyr@gao.gov), Gary T. Engel, Managing Director, Financial Management and Assurance, who may be reached at (202) 512-3406 or [engelg@gao.gov](mailto:engelg@gao.gov), and Susan J. Irving, Director, Strategic Issues, who may be reached at (202) 512-6806 or [irvings@gao.gov](mailto:irvings@gao.gov) if there are any questions. GAO staff who made key contributions to this publication are listed in appendix II. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this publication. In addition, this publication will be available at no charge on GAO's website at <http://www.gao.gov>.



Gene L. Dodaro  
Comptroller General  
of the United States

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<sup>60</sup>GAO, *DATA Act: OMB and Treasury Have issued Additional Guidance and Have Improved Pilot Design but Implementation Challenges Remain*, [GAO-17-156](#) (Washington D.C.: Dec. 8, 2016).

<sup>61</sup>See [GAO-17-156](#), appendix II for a list of our previous recommendations relating to the DATA Act and their implementation status.

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# Appendix I: Objectives, Scope, and Methodology

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This report summarizing the fiscal health of the federal government was conducted under the authority of the Comptroller General. In this report we discuss the federal government's current fiscal condition and how it changed in fiscal year 2016, the federal government's unsustainable long-term outlook, the risks to the government's financial condition, and opportunities to improve its fiscal health.

To summarize the current fiscal condition and how it changed in fiscal year 2016, we reviewed the *Fiscal Year 2016 Financial Report of the United States Government (2016 Financial Report)* prepared by the Department of the Treasury (Treasury) in coordination with the Office of Management and Budget; International Monetary Fund reports on global finance and government debt; Congressional Budget Office (CBO) data on the effects of legislation on its projections of federal debt; and our past work on federal debt.

For the federal government's long-term outlook, we reviewed the projections from the Statements of Long-Term Fiscal Projections in the *2016 Financial Report*, *CBO's 2016 Long-Term Budget Outlook*, and our long-term simulations of federal revenues and spending. To conduct our simulations, we used data from CBO for most projections through 2026. In the long term, we used data from the Medicare and Social Security Trustees and the Office of the Actuary at the Centers for Medicare & Medicaid Services. Our two simulations are the baseline extended and the alternative. The baseline extended begins with a baseline using CBO estimates and generally assumes current law continues into the future; for example, tax provisions expire as scheduled. The alternative generally reflects historical trends; for example, tax expenditures scheduled to expire are extended. For a description of the methodologies of these simulations, see [http://www.gao.gov/fiscal\\_outlook/federal\\_fiscal\\_outlook/overview#t=2](http://www.gao.gov/fiscal_outlook/federal_fiscal_outlook/overview#t=2).

To describe the risks to the federal government's financial condition, we drew from our audit report on the consolidated financial statements included in the *2016 Financial Report*, our work on fiscal exposures, and CBO and Congressional Research Service reports on the budgetary costs of fiscal exposures.

To identify opportunities to improve the fiscal health, we reviewed our reports on improper payments, the tax gap, our audit report on the consolidated financial statements included in the *2016 Financial Report*, and our work on duplication, overlap, and fragmentation.

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We conducted our work from July 2016 to January 2017 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this product.

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# Appendix II: GAO Contacts and Staff Acknowledgments

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## GAO Contacts

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## Staff Acknowledgments

In addition to the contacts named above, Janice Latimer (Assistant Director), Timothy Shaw (Analyst-in-Charge), Robert Gebhart, Kerstin Hudon, J. Lawrence Malenich, Donna Miller, Meredith Trauner Moles, Ernest Powell, Jr., Oliver Richard, Dawn Simpson, Jessica Cobert Smith and Ardith Spence made key contributions to this report. Additional assistance in their areas of expertise was provided by Barbara Bovbjerg, Shari Brewster, Nikki Clowers, Michael Collins, James Cosgrove, Gregory Giusto, Carol M. Henn, Charles Jeszeck, Emei Li, Julie Matta, Thomas J. McCabe, James McTigue, Rebecca Rust Williamson, Marylynn Sergent, Joseph Silvestri, Stewart W. Small, Frank Todisco, Carolyn Yocom, and Charles Young.



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