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**“TRUTH AND TRANSPARENCY:
THE FEDERAL GOVERNMENT’S FINANCIAL CONDITION AND FISCAL OUTLOOK”
BY THE HONORABLE DAVID M. WALKER,
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Good afternoon and thank you for that kind introduction. I appreciate all of you who are here as well as those of you who are viewing this event via CSPAN or listening via NPR. In addition to those at the head table who have already been introduced, there are a number of other distinguished individuals here today, including members of Congress, high ranking government officials and one of my predecessors, Elmer Staats. I am also pleased that my wife, son, brother and a number of friends and fellow public servants are here today as well. A special thanks goes to each of you.

As was noted in my introduction, as Comptroller General of the United States I wear many professional hats, including serving as the head of the GAO, lead partner on the audit of the U.S. Government’s consolidated financial statements and the de-facto Chief Accountability Officer of the United States Government. On a more personal note, I am a citizen, taxpayer, father and grandfather.

While each of these roles provides me with a different perspective on the financial and fiscal challenges facing our nation, they all lead me to the same conclusion: We must begin to come to grips with the daunting fiscal realities that threaten our nation’s, children’s and grandchildren’s future.

I have entitled this talk “Truth and Transparency: The Federal Government’s Financial Condition and Fiscal Outlook.” Let me say at the outset, that my remarks are intended to represent a professional and non-partisan overview based on GAO’s work and my tenure as Comptroller General and not a political opinion. I have not come here to criticize the actions of any particular person, proposal or political party on either end of Pennsylvania Avenue. Rather, my remarks are intended to serve as a “wake up call” and an attempt to simply state the facts and speak truth to the American people, key policymakers and the press in a manner consistent with GAO’s core values of accountability, integrity and reliability. I hope that my remarks will serve to stimulate a broader discussion and much needed debate regarding where we are as a nation and what we need to do to address our large and growing fiscal challenge. It’s also important to note that I’m not the only person and GAO is not the only institution concerned about our fiscal challenge. Ultimately, it will take the combined efforts of many parties to successfully address the issues that I will raise. Now on to the main course!

Like many things in life, how you measure and keep score matters! When it comes to the U.S. Government's financial condition and fiscal outlook, the federal government's current measurement and scorekeeping approaches leave much to be desired. The result is an incomplete and misleading picture of the federal government's current financial condition and future fiscal outlook, as well as a delay in the timeliness in which we address important issues.

Let me start by reviewing the federal government's current financial condition. The federal government's fiscal 2002 annual financial report says a lot but not enough. The good news is that as of September 30, 2002, we had about \$1 trillion in reported assets. The bad news is that we had almost \$8 trillion in reported liabilities. According to my math, that left us with an approximate \$7 trillion accumulated deficit, or a little over \$24,000 for every man, woman and child in the United States. In fiscal 2002, the federal government reported a net operating deficit of \$365 billion. Many of you may be more familiar with the unified budget deficit number, which was \$158 billion in fiscal 2002. Irrespective of whether you focus on the accrual based accounting numbers or the cash based budget numbers, the picture is not good and it's getting worse. For example, the Congressional Budget Office (CBO) estimates that the unified budget deficits in fiscal years 2003 and 2004 will be \$401 billion and \$480 billion, respectively. These numbers are up significantly from fiscal 2002. Interestingly, CBO estimates that we will incur about \$157 billion in interest on publicly held federal debt in fiscal 2003 even though current interest rates are low on a relative basis. Furthermore, CBO estimates that, excluding Social Security surpluses, the total deficit for fiscal years 2003 and 2004 will be \$562 billion and \$644 billion, respectively. If all these numbers are making your head spin, don't worry; just remember that they are all big, and they are all bad!

Importantly, while we are starting off in a financial hole we don't really have a very good picture of how deep it is. Specifically, there are a number of very significant items that are not currently included as liabilities in the federal government's financial statements; for example, several trillion dollars in non-marketable government securities in so-called "Trust Funds." In the case of the Social Security and Medicare Trust Funds, the federal government took in taxpayer money, spent it on other items and replaced it with an IOU. Given this fact, why aren't the amounts attributed to such activities shown as a "liability" of the U.S. Government? At the present time, they are not! Does this make sense, especially when the government continues to tell Social Security and Medicare beneficiaries that they can count on the bonds in these "Trust Funds"? Is the federal government trying to have its cake and eat it too?

The current U.S government liability figures also do not adequately consider veterans' health care benefit costs provided through the Department of Veteran's Affairs nor do they include the difference between future promised and funded benefits in connection with the Social Security and Medicare programs. These additional amounts total tens of trillions of dollars in discounted present value terms. Stated differently, they are likely to exceed \$100,000 in additional burden for every man, woman and child in America today, and these amounts are growing every day. These items may or may not ultimately be considered to be liabilities from an accounting perspective; however, they do represent significant commitments that ultimately have

to be addressed. The burden of paying for these is not a very nice present for a child born today! Personally, I'd prefer a savings bond rather than a bill!

In fairness, the federal government's financial statements also do not include certain assets and rights held by the government. For example, the financial statements do not include any recognition of the federal government's power to tax. The U.S. Government also owns and controls approximately 25% of all U.S. land mass. In addition, the financial statements do not include any asset value for so-called stewardship or heritage assets, items such as public lands and monuments, or national defense assets, which include items such as missiles, tanks, ships, and planes. While these items were acquired at a cost and have some value, do we really ever expect to sell them? For the most part, the answer is no.

Beyond financial information, the federal government as a whole and each federal department and agency needs to be able to demonstrate what results they are achieving with the resources and authorities they have been given. In this regard, I'm not talking about performance measurement in a narrow sense, but also whether agencies can show that they are making a difference towards meeting the needs of society. This type of performance information and related cost/benefit analyses needs to become a standard part of federal reporting and operations. Unfortunately, for the most part, this is not being done adequately at the present time.

The bottom line is that, in my view, the federal government's current financial statements and annual reports do not give policymakers and the American people an adequate picture of our government's overall performance and true financial condition. This is a serious issue. As Thomas Jefferson once noted, an informed electorate is the basis for a sound democracy. But how can the American people and their elected officials make sound decisions if they aren't given timely, accurate and useful information?

The recent accountability failures in the private sector serve to re-enforce the importance of proper accounting and reporting practices. It is critically important that such failures not be allowed to occur in the public sector. We at GAO are dedicated to assuring that they don't and to helping to assure that additional progress is made on these and other important transparency and accountability issues. In this regard, earlier this year GAO was unable to express an opinion as to whether the U.S. Government's consolidated financial statements were fairly stated for a sixth consecutive year. Our inability to express an opinion was based primarily on serious financial management problems at the Defense Department, the government's inability to adequately account for certain intra-governmental transactions, and the government's inability to properly prepare consolidated financial statements. Despite this track record, I believe that, like 21 of 24 major federal agencies, the federal government can and ultimately will receive an unqualified opinion on its financial statements, hopefully well before my term ends in 2013. At the same time, I can assure you that the U.S. Government will not receive an opinion on its financial statements from the GAO until it earns one!

While we may be in a financial hole today, what about our future fiscal outlook? After all, if it is positive then we don't need to be as concerned. Unfortunately, it is not positive under a "status quo" or "business as usual" scenario. It's true that

deficits are understandable and sometimes necessary in times of recession and/or war. However, while it may not seem like it to those who are out of work or underemployed, we have not been in a recession for almost two years. In addition, the current and projected deficits far exceed the costs associated with Iraq, the global war against terrorism and any incremental homeland security costs. The “bottom line” is, there is little question that deficits do matter, especially if they are large, structural and recurring in nature. In addition, our projected budget deficits are not “manageable” without significant changes in “status quo” programs, policies, processes and operations.

Specifically, GAO’s long-range budget simulations show that this nation faces a large and growing structural deficit due primarily to known demographic trends and rising health care costs. In less than 10 years, due primarily to the retirement of the baby boom generation, the United States will be hit by a huge demographic tidal wave that is not expected to ever recede! This is unprecedented in the history of our nation.

Candidly, we’ve had a long-range budget deficit problem for a number of years, even during recent years where we had significant annual budget surpluses. Unfortunately, the days of surpluses are gone and our current and projected budget situation has worsened significantly.

It is true that additional economic growth can help us address our future fiscal gap. It is also true that some recent economic indicators have given us some hope that things may get better in the short-term. However, the consensus opinion at a recent meeting of prominent economists representing a wide variety of ideological viewpoints was that, as I stated in my speech during that meeting, “we cannot simply grow our way out of this problem!” In addition, we need to get started sooner rather than later so the miracle of compounding can start working for us rather than against us, as it is now.

As a result, the “status quo” scenario and “stay the course” approaches in connection with the deficit and fiscal matters are simply not viable options. Tough choices will have to be made by elected officials in order to address the nation’s large and growing fiscal gap. The ultimate alternatives to definitive and timely action are not only unattractive, they are arguably infeasible. Specifically, raising taxes to levels far in excess of what the American people have ever supported before, cutting total federal spending by unthinkable amounts, or further mortgaging the future of our children and grandchildren to an extent that our economy, our competitive posture and the quality of life for Americans would be seriously threatened.

While many members of Congress and other key policymakers and opinion leaders agree that we have a major fiscal challenge that must be dealt with, many do not want to talk about it publicly. Many believe that we will ultimately act to address this imbalance, but when will we start? Other nations have already started to address their long-range imbalances. When will we? Clearly, the sooner we start the better. Early action will reduce the significance of the changes that will be required and will allow individuals more time to adjust to any changes. Early action will also help to avoid a dangerous budgetary and economic spiral that would ultimately hurt every American.

Beyond the numbers, our current budget process needs to be reviewed and reconsidered. We're still making budget and appropriations decisions annually without giving adequate consideration to the longer-term cost and implications of legislative proposals before they are enacted into law. Ten-year cash flow projections just are not adequate when you face a huge and unprecedented demographic tidal wave. In addition, some of the current requirements and assumptions imposed on CBO for calculating their 10-year "base line" projections are simply unrealistic. Furthermore, back loading tax and spending proposals and including sunset provisions primarily as tactical budget scoring devices rather than as strategic and substantive fiscal control devices doesn't help either.

While reasonable people can and will disagree about the nature and extent of our long-range fiscal challenge and how to best address it, the time has come for all responsible parties to recognize reality. Our nation has a major long-term fiscal challenge that is not going away and requires serious and sustained attention.

Since I am a person of action, I do not believe in just stating the problem. As a result, I have a few suggestions for consideration by the Congress, the Administration, the press and the public:

- From an overall fiscal perspective, it is time to admit that we are in a fiscal hole and to "stop digging." The federal government must start exercising more fiscal discipline on both the spending side and the tax side. The simple fact of the matter is that, while many spending increases and tax cuts may be popular, they may not all be prudent. The time has come for a fiscal Hippocratic oath, "Do no harm!"
- With regard to our budget measurements and metrics, it is time to assure that the long-term cost of selected major spending and tax proposals are quantified and adequately considered before legislation is enacted into law. One possible approach would be to calculate the estimated discounted present value of major spending and tax proposals as a supplement to, not a substitute for the CBO's current 10-year cash flow projections. This is especially important in connection with proposals where the related costs significantly escalate after the current 10-year projection period. In addition, the rules for capital and various other public/private transactions need to be reviewed and reconsidered. In this regard, the government should base lease versus purchase decisions on a simple concept: What is in the best economic interest of the taxpayers?
- With regard to the Social Security and Medicare trust funds, in addition to the accounting and reporting issues that I noted previously, it is time to recognize that trust fund solvency alone is not an adequate gauge of the financial condition of these programs. In fact, focusing on solvency alone provides a false sense of security as to the true state and the budgetary and economic implications of these important social programs. We must take steps to assure that these programs are both solvent and sustainable over time.
- With regard to existing policies and programs, it is time to restructure existing entitlement programs to make them secure, sustainable and aligned with 21st Century economic, demographic and other realities. It is also time that we took steps to review and rationalize our promises in order to help ensure that

we can deliver on the promises that we make. At the same time, entitlement reform alone will not get the job done. As a result, policymakers need to begin to conduct base-line reviews of all major mandatory and discretionary government programs, policies and functions on both the spending and tax side. Contrary to the assertions of some, the base of government spending, policies, programs and operations is not OK. As a result, the federal government needs to look beyond incrementalism and start making some tough choices in setting priorities and linking resources to results.

- From a performance perspective, it is time to develop a set of key national indicators in order to assess America's position and progress over time and in relation to other major industrialized nations. After all, you manage what you measure, and the federal government needs an instrument panel to help guide our ship of state. At the present time, the federal government is either flying blind or with inadequate instruments in many areas. We also need a government-wide strategic plan and annual performance and accountability plans that are linked in some way to these key indicators and integrated into individual agency plans.
- From an operational perspective, it is time to streamline and simplify the federal government's organizational structure to make it more economical, efficient, effective, flexible, responsive and accountable. This includes addressing duplicative, overlapping, conflicting and outdated government programs, policies and operations. We also need to modernize existing human capital and other federal operating rules to reflect 21st century realities while protecting the integrity of the civil service and preventing abuse of federal employees.
- Finally, with regard to accounting and reporting issues, while the Federal Accounting Standards Advisory Board (FASAB) has accomplished a lot since it was established, it is time to review and consider the accounting and reporting issues that I mentioned earlier.

This is a big list, and it will take time to address all these issues. Fortunately, there are some glimmers of hope and light that we can point to. For example, the President's most recent budget submission and the latest Annual Report of the U.S. Government focused more attention on our long-range fiscal imbalance. The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB) and I have agreed that the accounting and financial reporting issues that I mentioned need to be considered by the FASAB. Under the leadership of Director Doug Holtz-Eakin, the CBO is placing additional emphasis on longer-term fiscal risks in its semi-annual reports. Clay Johnson, Deputy Director for Management at OMB, is leading two important Administration efforts. Specifically, the President's Management Agenda, which closely correlates with GAO's "High Risk List," is helping to focus much greater attention on important government operational issues. In addition, the Administration's Program Assessment and Review Tool (PART) initiative is helping to assess what results programs are generating with the resources they have been given. The House of Representatives has taken special steps this year to try and identify areas of fraud, waste, abuse and mismanagement for Congressional action. GAO has published a framework analyzing various Social Security reform proposals and will soon publish a framework for analyzing health care reform proposals. GAO has helped to form a consortium of "good government"

organizations to simulate the development of a set of key national indicators. Congresswoman Joanne Davis will chair a House Government Reform sub-committee hearing this afternoon on the organization of government and addressing duplicative and overlapping government programs. Senator George Voinovich and others are working together to modernize the federal government's human capital policies and practices. Finally, GAO is leading by example in connection with transforming how the government does business.

These are positive steps in the right direction; however, much more needs to be done, given the magnitude of our challenge and since our fiscal clock is ticking. As I mentioned earlier, many difficult choices will ultimately have to be made by elected officials. However, from a practical standpoint, elected officials are not likely to get too far out in front of the American people when addressing complex and controversial issues that are not only of interest to their constituents but also will likely affect their re-election chances. As a result, I believe that we also need to explore ways to engage in a major national education campaign and outreach effort to help the American people understand the nature and magnitude of our challenge. This effort, in which the press needs to play a big part, would serve to facilitate needed changes while helping all Americans plan for their future. We should not underestimate the intellect and ability of the American people. I am confident that a vast majority of them will "get the message" and understand the need for serious, early and sustained action if they are given the facts.

In closing, while I hope this serves as a "wake up call," it is also time for a "call to action." My fellow "baby boomers" and others need to recognize the leadership and stewardship obligations that we have to our children, grandchildren and future generations of Americans. In addition, members of Generations X and Y need to become actively engaged in this debate because they and their children will bear a disproportionate portion of the burden and adverse effects if policymakers fail to act in a reasoned and responsible manner.

We at GAO are dedicated to doing our part for the Congress and the country, but others need to help as well. In addressing these challenges, I am reminded of the words of my favorite 20th Century President, Theodore Roosevelt, who once said – "aggressive fighting for the right (cause) is the noblest sport the world affords." I hope that you will join me in this cause. Let's work together to speak the truth, enhance transparency and ensure accountability in these and other areas of importance to the American people. The time to start is now!

Thank you for your time and attention.