



Testimony
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THE NATION'S FISCAL HEALTH

Actions Needed to Achieve Long-Term Fiscal Sustainability

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Highlights

Highlights of [GAO-19-611T](#)

The Federal Government Is on an Unsustainable Long-Term Fiscal Path

Congress and the administration face serious economic, security, and social challenges that require difficult policy choices in the near term in setting national priorities and helping promote economic growth. This will influence the level of federal spending and how the government obtains needed resources.

At the same time, the federal government is highly leveraged in debt by historical norms. For example, debt held by the public as a share of GDP at the end of fiscal year 2018 was 78 percent, compared to an average of 46 percent since 1946.

Over the long term, the imbalance between spending and revenue that is built into current law and policy is projected to lead to continued growth of the federal deficit and debt held by the public as a share of GDP.

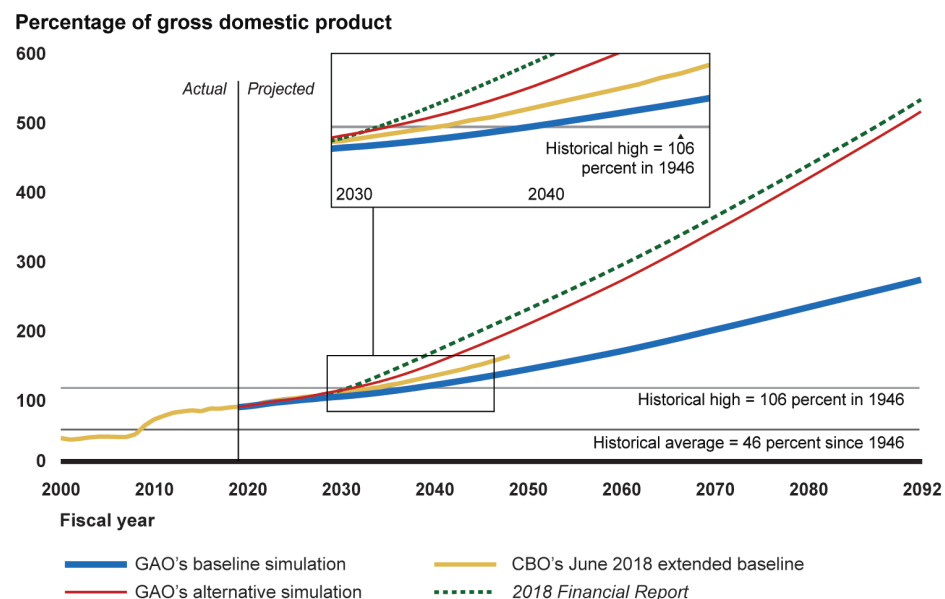
A testimony before the Committee on the Budget, U.S. Senate

The Nation's Fiscal Health

Actions Needed to Achieve Long-Term Fiscal Sustainability

Debt held by the public was \$15.8 trillion—or 78 percent of gross domestic product (GDP)—at the end of fiscal year 2018. It is projected to surpass its historical high of 106 percent within 13 to 20 years, and climb between about 250 to 500 percent by 2092, according to projections by GAO and others (see figure). Absent policy changes, the current federal fiscal path is unsustainable.

Debt Held by the Public under Projections from GAO, the Congressional Budget Office (CBO), and the *Fiscal Year 2018 Financial Report of the United States Government (2018 Financial Report)*



Source: GAO, Congressional Budget Office, and 2018 Financial Report. | GAO-19-611T

Note: GAO's simulations incorporate CBO's January 2019 baseline, which assumes lower emergency spending than CBO's June 2018 extended baseline, consistent with amounts appropriated at the time of that report.

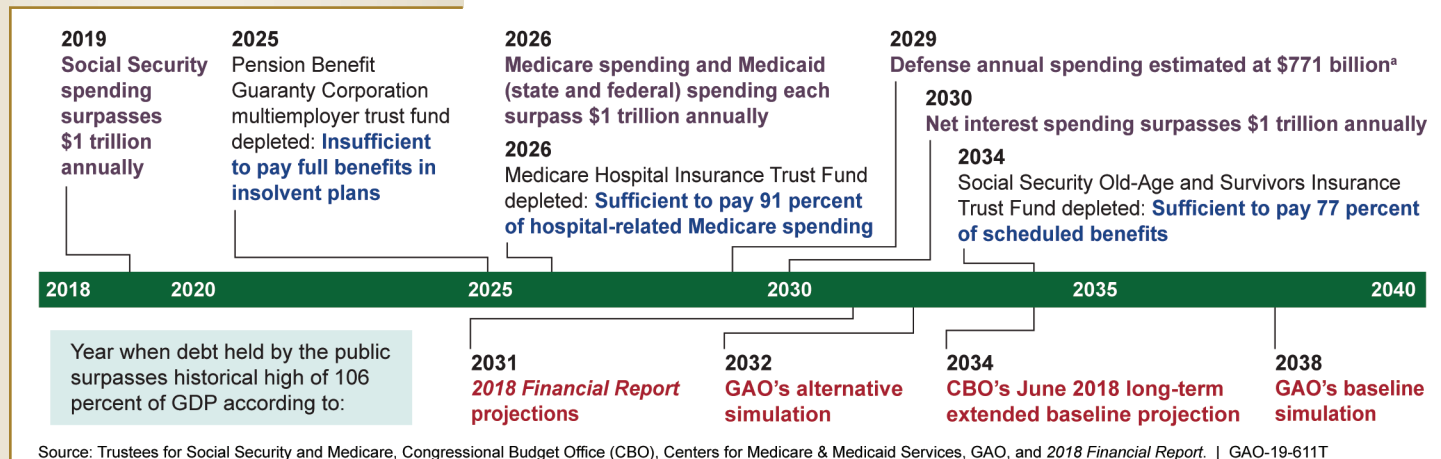
In the long-term, the key drivers of growing federal spending are health care programs (due to the aging population and per beneficiary spending) and net interest. Net interest is projected to eventually become the largest category of federal spending, surpassing:

- Nondefense discretionary spending in 2024,
- Defense discretionary spending in 2025,
- Medicare spending in 2042, and
- Social Security spending in 2046.

In 2092, according to GAO's alternative simulation, net interest is projected to account for about 40 percent of federal spending, compared to 8 percent in fiscal year 2018.

Impending Fiscal Pressures Add to Need for Timely Action

The federal budget is further strained by fiscal pressures, including known financial challenges for key programs (as shown below), and risks like natural disasters that could lead to unknown amounts of future spending. The longer action is delayed, the more drastic the changes will have to be.



^aCBO did not report defense spending projections separately from total discretionary spending in its long-term projections after 2029.

In addition, GAO has identified numerous opportunities for Congress and executive branch agencies to take steps in the near term that could improve the federal government's fiscal condition. These opportunities include addressing billions of dollars in improper payments and the over \$400 billion annual tax gap, evaluating the significant amount of revenue forgone through tax expenditures, as well as implementing GAO recommendations for defense operations. These actions would improve stewardship over federal resources in the near term. However, these actions alone cannot put the federal government on a sustainable fiscal path.

A Long-Term Plan Is Needed to Achieve Fiscal Sustainability

To address the growing federal debt and put the government on a more sustainable fiscal path, policymakers will need to consider a long-term plan that addresses the entire range of federal activities including both revenue and spending.

A long-term fiscal plan could include fiscal rules and targets that promote fiscal sustainability by imposing numerical guidelines on the budget (known as targets). Types of fiscal rules include:

- **Budget balance rules** that constrain deficit levels,
- **Debt rules** that limit public debt as a percentage of GDP,
- **Revenue rules** that set ceilings or floors on revenues, and
- **Expenditure rules** that limit spending.

Fiscal rules have been used by the United States and other countries to help promote fiscal sustainability. According to the International Monetary Fund, as of 2015 more than 70 countries had combined two or more fiscal rules. For example, the European Union's stability and growth pact combines an expenditure rule, budget balance rule, and a debt rule (e.g., debt-to-GDP), which are designed to ensure that countries in the European Union pursue sound public finances and coordinate their fiscal policies.

Rules can be designed to balance flexibility and enforceability. For example:

- Fiscal rules can include clauses allowing for flexibility to help respond to fiscal risks or unexpected events like recessions or natural disasters.
- Institutions like independent fiscal councils can help formulate and implement sound fiscal policy.
- Correction mechanisms can be designed to trigger automatically to respond to past deviations from the rule.

It will be important that any future U.S. fiscal rules target the right factors, enforce budget agreements, and limit exemptions. A fiscal target that sets a common goal to control the debt, and well-designed rules that form a path to achieve that target, could form part of a long-term plan for fiscal sustainability.

Unlike fiscal rules, the current approach used to set the U.S. government debt limit is not a control on debt but rather an after-the-fact measure that restricts authority to borrow. It does not restrict Congress and the President's ability to enact spending and revenue legislation that affects the level of debt. Failure to increase or suspend the debt limit in a timely manner disrupts the market for Treasury securities and can increase borrowing costs. Congress should consider alternative approaches to the debt limit as part of a long-term fiscal plan. GAO has recommended possible alternatives such as linking action on the debt limit to the budget resolution.

Chairman Enzi, Ranking Member Sanders, and Members of the Committee:

Thank you for the opportunity to be here today to discuss our nation's fiscal health and the actions needed to chart a more sustainable long-term fiscal path. Congress and the administration face serious economic, security, and social challenges that require difficult policy choices in the near term in setting national priorities and helping promote economic growth. These choices will influence the level and composition of federal spending and how the government obtains needed resources. Policymakers also face a federal government highly leveraged in debt by historical norms and on an unsustainable long-term fiscal path caused by an imbalance between revenue and spending that is built into current law and policy.

Decisions in the near term to support economic growth and address national priorities need to be accompanied by a broader fiscal plan to put the federal government on a sustainable long-term path. Such a plan 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 to address unforeseen events, such as natural disasters, economic downturns, wars, and cyberattacks.

Today, I will discuss the nation's fiscal health, specifically focusing on issues such as the federal government's unsustainable fiscal outlook, growing fiscal pressures that could further strain the federal budget, and the need for actions to address the growing debt. I will also discuss opportunities for Congress and the executive branch to take steps in the near term that would help improve the government's fiscal condition.

In April 2019, we issued our third annual report on the nation's fiscal health.¹ The report illuminated the need for a long-term fiscal plan by outlining the fiscal condition of the U.S. government and its future path based on current fiscal policy. My statement is based upon our 2019 annual report on the nation's fiscal health; our work on natural disasters and climate change; GAO's 2019 High-Risk List; the 2019 fragmentation,

¹GAO, *The Nation's Fiscal Health: Action Is Needed to Address the Federal Government's Fiscal Future*, [GAO-19-314SP](#) (Washington, D.C.: Apr. 10, 2019).

overlap, and duplication annual report; and other related work.² We also reviewed relevant fiscal laws and used our long-term fiscal outlook model to simulate potential fiscal changes to achieve certain debt targets.

These efforts are based upon work conducted 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. More details on the scope and methodology for our reports can be found in the full reports cited throughout this statement.

The Federal Government Is on an Unsustainable Long-Term Fiscal Path

Over the long term, 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 gross domestic product (GDP). This situation—in which debt grows faster than GDP—means the current federal fiscal path is unsustainable.

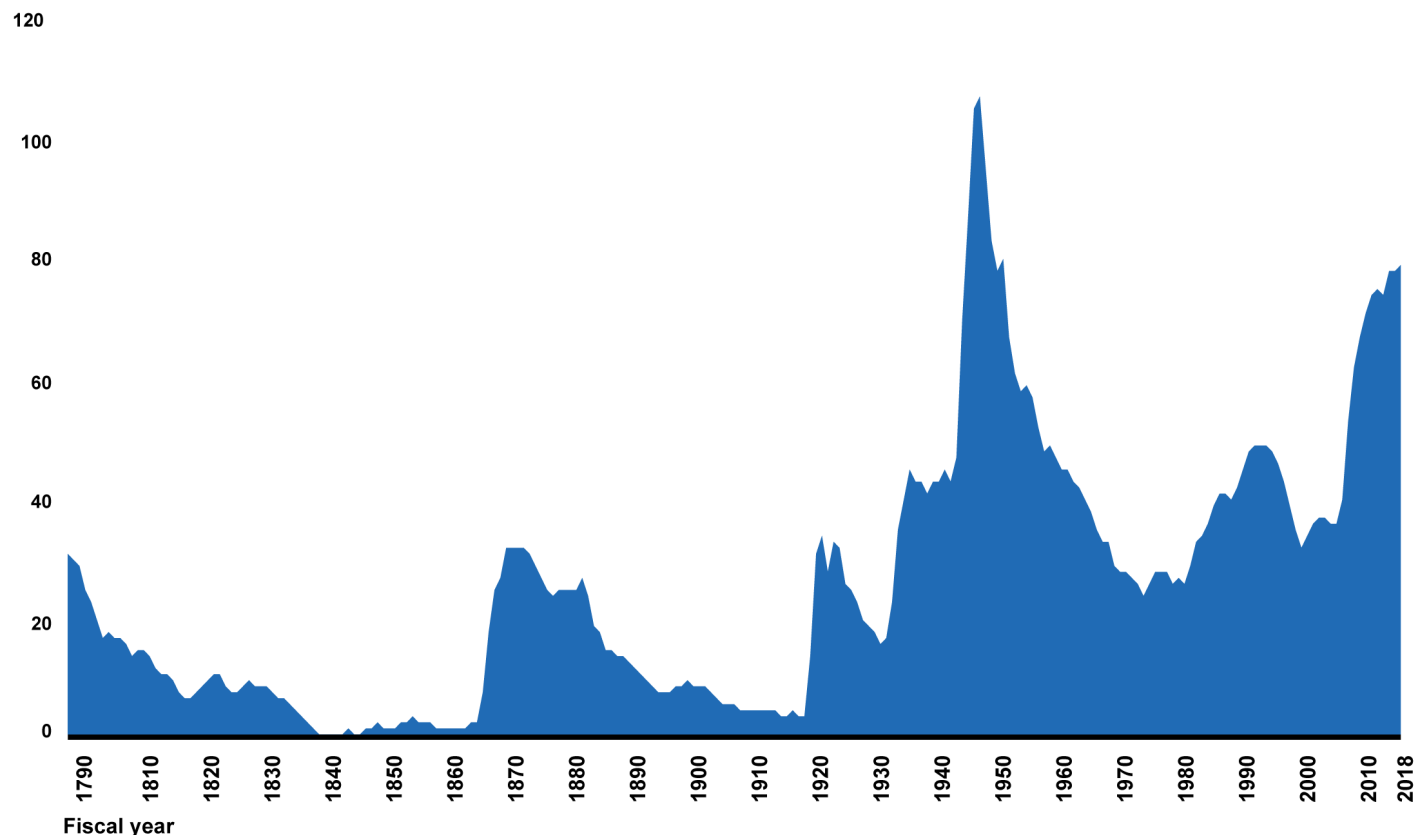
Growing Debt-to-GDP Ratio

For most of the nation's history, the debt-to-GDP ratio tended to increase during wartime and decline during peacetime. Historically, recessions have contributed to increases in this ratio, but the ratio has declined with economic recovery. This pattern is visible in figure 1. Publicly held debt as a share of GDP peaked at 106 percent just after World War II (in 1946) and has averaged 46 percent since then. However, debt has risen in more recent years, reaching 78 percent of GDP at the end of fiscal year 2018.

²For example, GAO, *2019 Annual Report: Additional Opportunities to Reduce Fragmentation, Overlap, and Duplication and Achieve Billions in Financial Benefits*, [GAO-19-285SP](#) (Washington, D.C.: May 21, 2019) and *High-Risk Series: Substantial Efforts Needed to Achieve Greater Progress on High-Risk Areas*, [GAO-19-157SP](#) (Washington, D.C.: Mar. 6, 2019). A list of our related products is included at the end of this statement.

Figure 1: Federal Debt Held by the Public

Percentage of gross domestic product



Source: GAO analysis of Congressional Budget Office data. | GAO-19-611T

Total debt is comprised of debt held by the public (the value of all federal securities sold to investors outside of the federal government) and intragovernmental debt (debt held by government accounts). As of the end of May 2019, the total federal debt was about \$22 trillion, consisting of about \$16.2 trillion in debt held by the public and about \$5.8 trillion in intragovernmental debt.

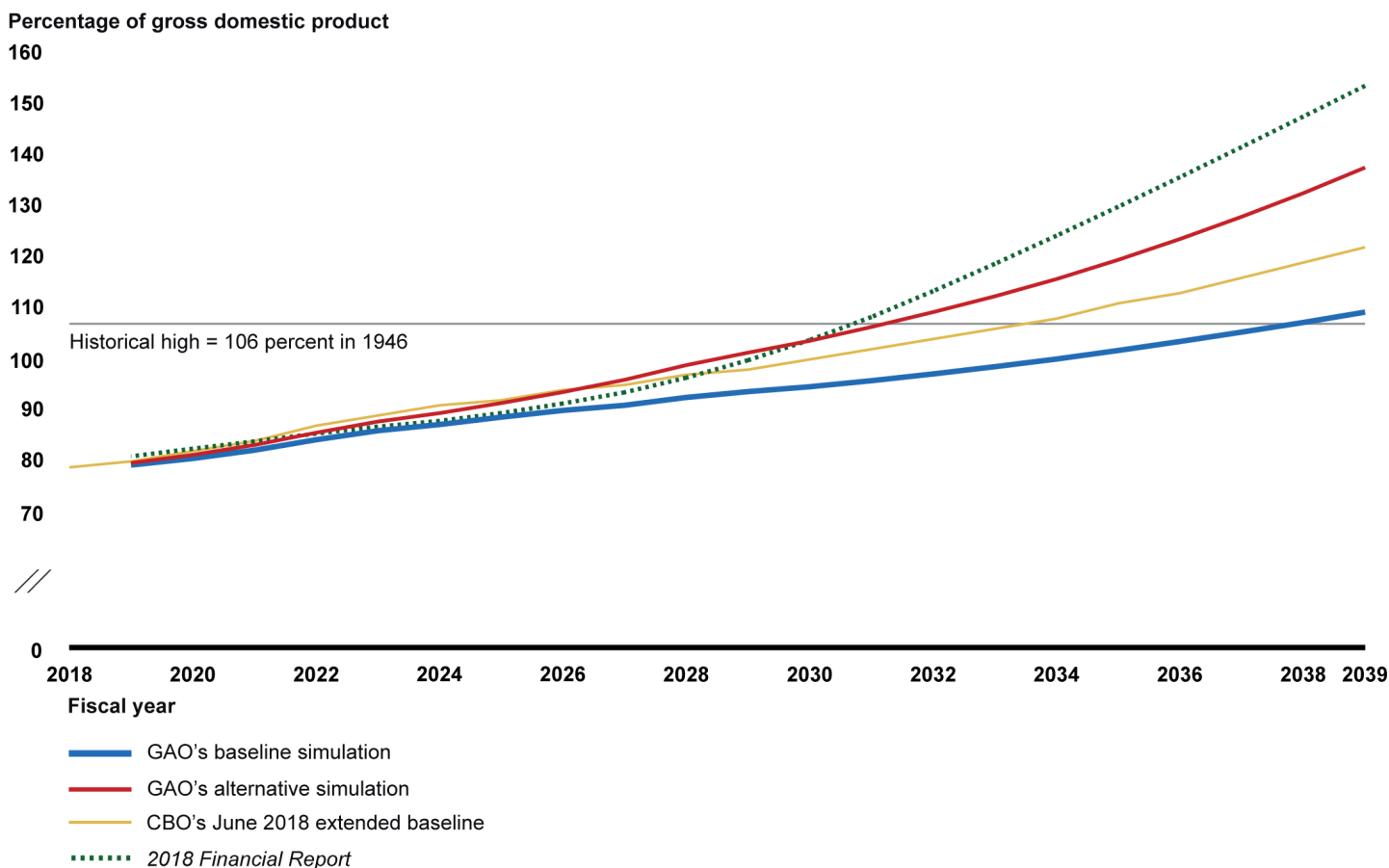
Long-term fiscal projections by GAO, the Congressional Budget Office (CBO), and the *Fiscal Year 2018 Financial Report of the United States*

*Government (2018 Financial Report)*³ all show that debt held by the public as a share of GDP will grow substantially in the coming years.⁴ All of these projections show that, absent a change in policy, debt held by the public would grow to be greater than the size of the U.S. economy and it would surpass its historical high of 106 percent of GDP within the next 13 to 20 years (see figure 2.)

³See GAO, *Financial Audit: Fiscal Years 2018 and 2017 Consolidated Financial Statements of the U.S. Government*, [GAO-19-294R](#) (Washington, D.C.: Mar. 28, 2019). The Financial Report of the United States Government is prepared by the Secretary of the Treasury in coordination with the Director of the Office of Management and Budget.

⁴The timing and pace of debt-to-GDP growth depend on the underlying data and assumptions made in the projections. All projections involve some degree of uncertainty. For more information on these long-term fiscal projections and their assumptions, see [GAO-19-314SP](#).

Figure 2: Debt Held by the Public as Share of Gross Domestic Product, 2018-2039



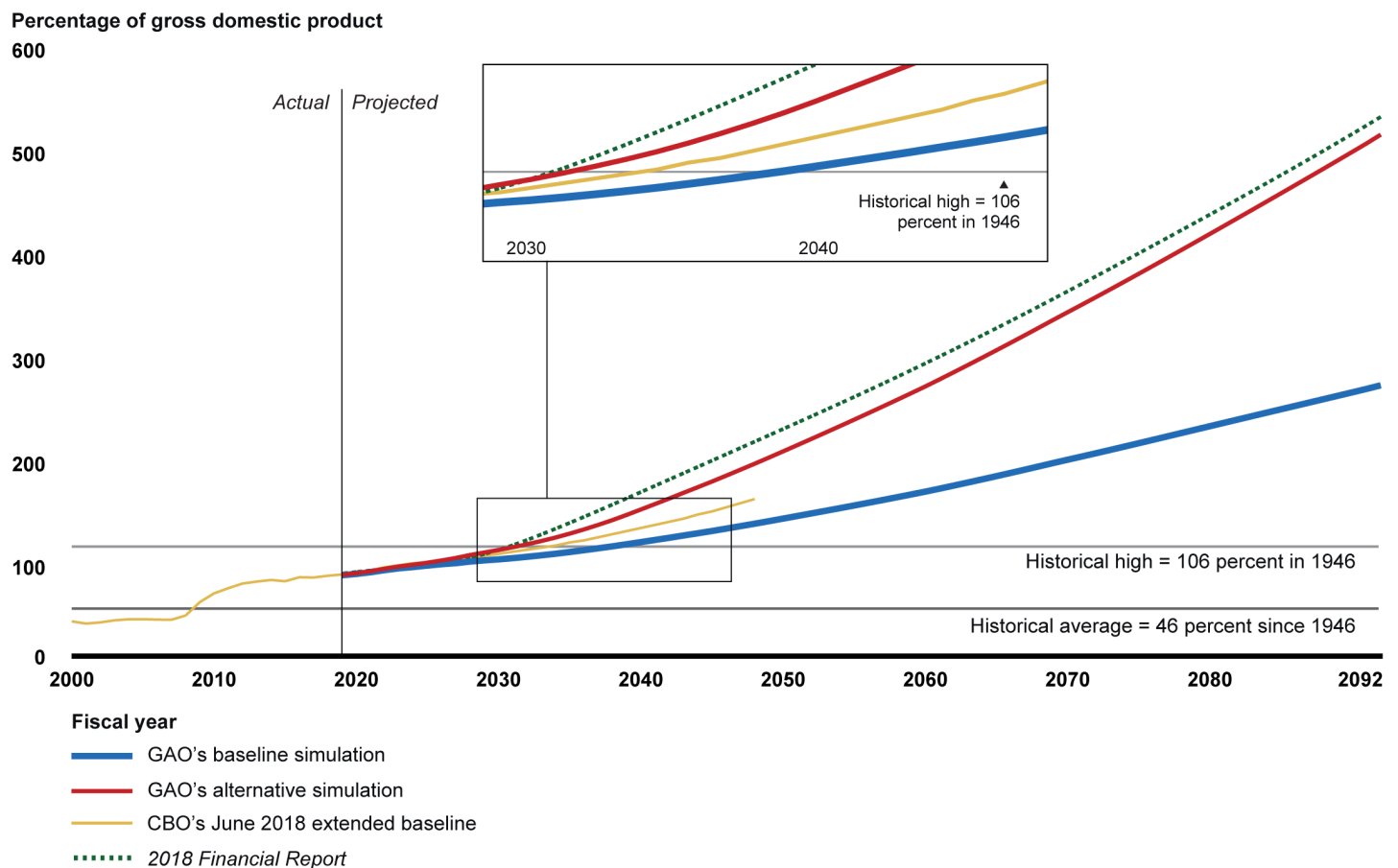
Source: GAO, Congressional Budget Office, and 2018 Financial Report. | GAO-19-611T

Note: GAO's baseline simulation generally assumes current laws continue into the future (e.g., that tax provisions expire as scheduled), while GAO's alternative simulation changes some of the assumptions to reflect historical trends, rather than current law (e.g., that tax provisions that are scheduled to expire are extended). GAO's simulations incorporate CBO's January 2019 baseline, which assumes lower emergency spending than CBO's June 2018 extended baseline, consistent with amounts appropriated at the time of that report. For more information on GAO's, CBO's, and the 2018 Financial Report's long-term fiscal projections and their assumptions, see [GAO-19-314SP](#).

Further, all the projections show that debt held by the public as a share of GDP will continue to grow to unsustainable levels over the long term. Figure 3 shows that debt held by the public as a share of GDP grows substantially in all the projections we discuss in this statement. In 2092, debt held by the public is expected to be more than 250 percent of GDP under GAO's baseline simulation, and more than 500 percent of GDP

under GAO's alternative simulation and the *2018 Financial Report* projections.⁵

Figure 3: Debt Held by the Public as Share of Gross Domestic Product, 2000-2092



Source: GAO, Congressional Budget Office, and *2018 Financial Report*. | GAO-19-611T

Note: GAO's baseline simulation generally assumes current laws continue into the future (e.g., that tax provisions expire as scheduled), while GAO's alternative simulation changes some of the assumptions to reflect historical trends, rather than current law (e.g., that tax provisions that are scheduled to expire are extended). GAO's simulations incorporate CBO's January 2019 baseline, which assumes lower emergency spending than CBO's June 2018 extended baseline, consistent with amounts appropriated at the time of that report. For more information on GAO's, CBO's, and the *2018 Financial Report's* long-term fiscal projections and their assumptions, see [GAO-19-314SP](#).

⁵CBO projects that debt held by the public will surpass 150 percent of GDP in 2048, the latest year included in its June 2018 extended baseline.

Both the current fiscal condition and the long-term projections of fiscal sustainability are driven by the economy and by laws enacted by Congress and the President. In fiscal year 2018, for example, the tax reform law, commonly known as the Tax Cuts and Jobs Act, the Bipartisan Budget Act of 2018, and the Consolidated Appropriations Act, 2018, increased the projected debt-to-GDP ratio in all of the projections discussed earlier. CBO estimated that legislation enacted from June 2017 to April 2018—primarily these three laws—would increase deficits by \$2.7 trillion between 2018 and 2027.⁶ According to CBO, annual federal deficits are projected to reach \$1 trillion in 2022, compared to \$779 billion in fiscal year 2018.

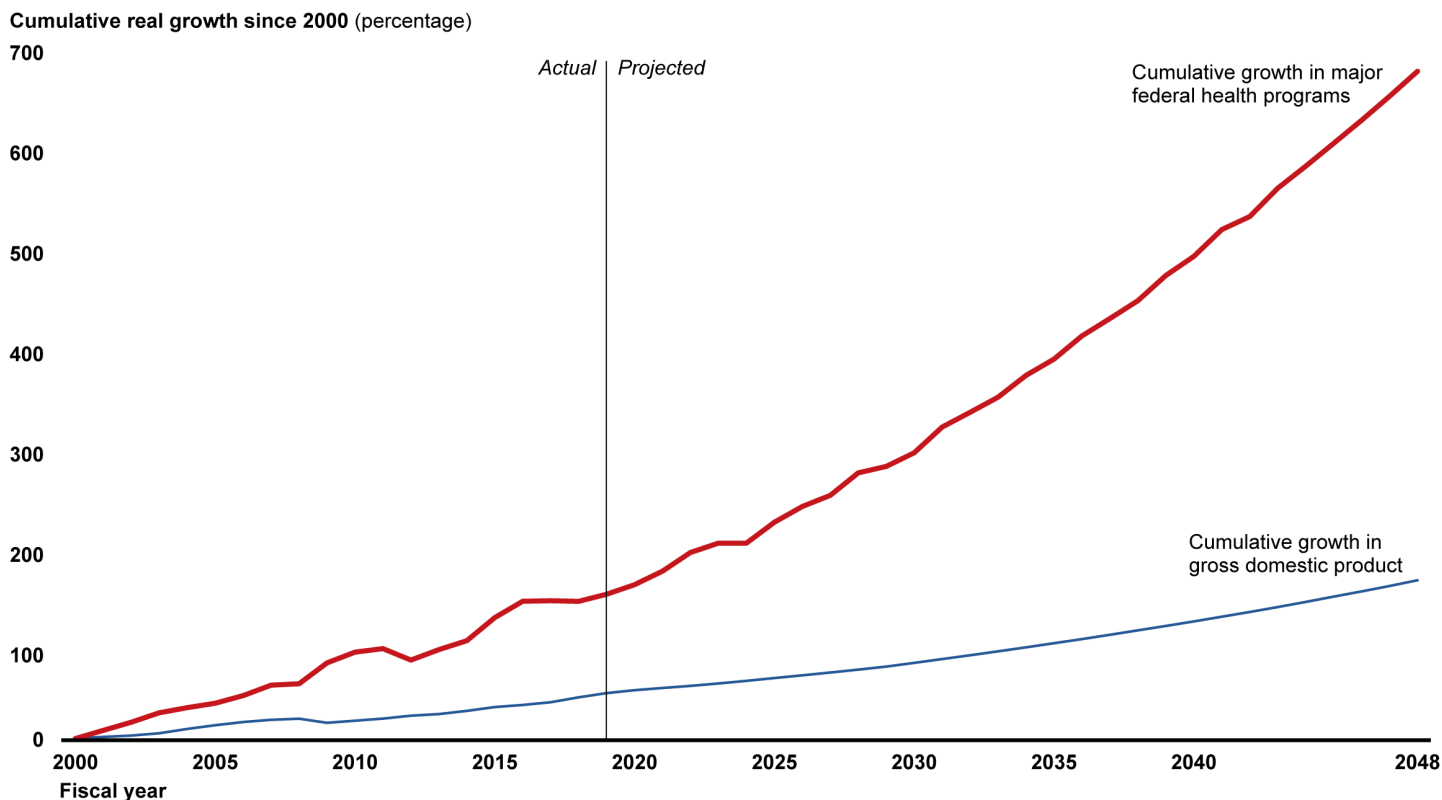
Future policy decisions about levels of federal spending, revenues, the federal role in the delivery of health care, and other areas could also change the projections. In addition, changes in projected health care costs, interest rates, spending levels, revenues, or economic growth would likely affect the debt-to-GDP ratio. For example, a recession or other economic crisis would likely increase the debt-to-GDP ratio beyond its projected levels because of a decline in GDP growth, and an increase in spending on federal social safety net programs.

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

Although growth in health care spending has slowed recently, total health care spending (public and private) in the United States continues to grow faster than the economy. Federal spending for major health care programs—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—makes up about a quarter of the federal budget. Federal health care spending also accounts for more than a quarter of total public and private health care spending. As figure 4 shows, this spending has historically exceeded the growth of GDP and is projected to continue to do so.

⁶CBO’s April 2018 projections also estimated an additional \$1 trillion in reductions to projected deficits because of changes to its economic forecast. This reduction is almost entirely because of increased projections of revenues, about half of which is attributable to the macroeconomic feedback related to the Tax Cuts and Jobs Act.

Figure 4: Federal Spending on Major Health Care Programs Grows Faster Than Gross Domestic Product



Source: GAO analysis of Congressional Budget Office and Bureau of Economic Analysis data. | GAO-19-611T

Note: Cumulative growth in both gross domestic product (GDP) and federal spending on major health care programs has been adjusted for inflation. GDP is the value of all goods and services produced in a country in a given year. Major federal health care programs consist of 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.

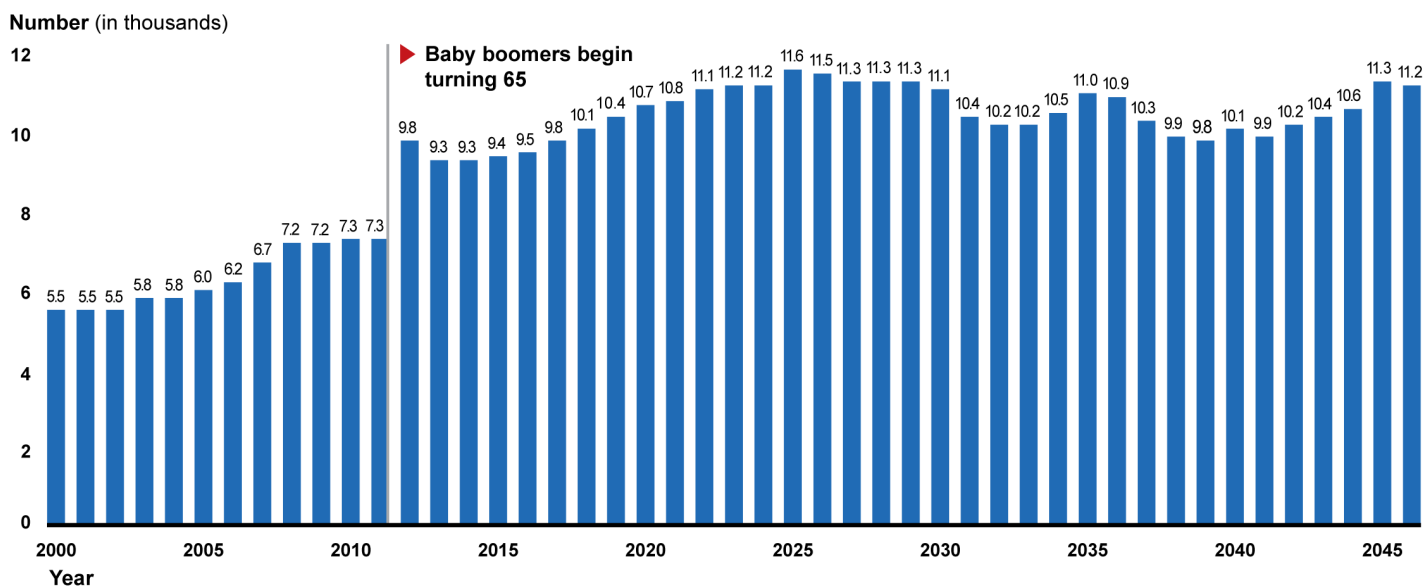
In the long term, growth in federal spending on health care is driven by increasing enrollment in health care programs—particularly in Medicare, stemming primarily from the aging population—and by the increase in health care spending per beneficiary.⁷

- **Aging population.** In its 2018 long-term budget outlook report, CBO projected that, by 2048, 22 percent of the population will be age 65 or

⁷See appendix II for our recommendations to help control the costs of Medicare and Medicaid.

older, compared to 16 percent in 2018. This demographic trend is largely driven by lower fertility rates and increases in life expectancy. The trend has been accelerated by the relatively large baby boom generation, which began turning 65 in 2011 (see figure 5). As the number of people older than 65 increases, Medicare and Medicaid enrollment is expected to increase.⁸

Figure 5: Daily Average Number of People Turning 65



Source: GAO analysis of U.S. Census Bureau information. | GAO-19-611T

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

- **Per beneficiary spending.** The amount of money spent on health care per person has historically risen faster than per capita economic output and is projected to do so in the future. In its 2018 long-term budget outlook report, CBO projected that the growth in health care spending per person will account for about two-thirds of the increase in spending for the major health care programs as a share of GDP between 2018 and 2048.

⁸For more information on Medicare and Medicaid, see GAO, Medicare and Medicaid – High Risk, accessed June 5, 2019, https://www.gao.gov/key_issues/medicare_payment_management_integrity/issue_summary and https://www.gao.gov/key_issues/medicaid_financing_access_integrity/issue_summary.

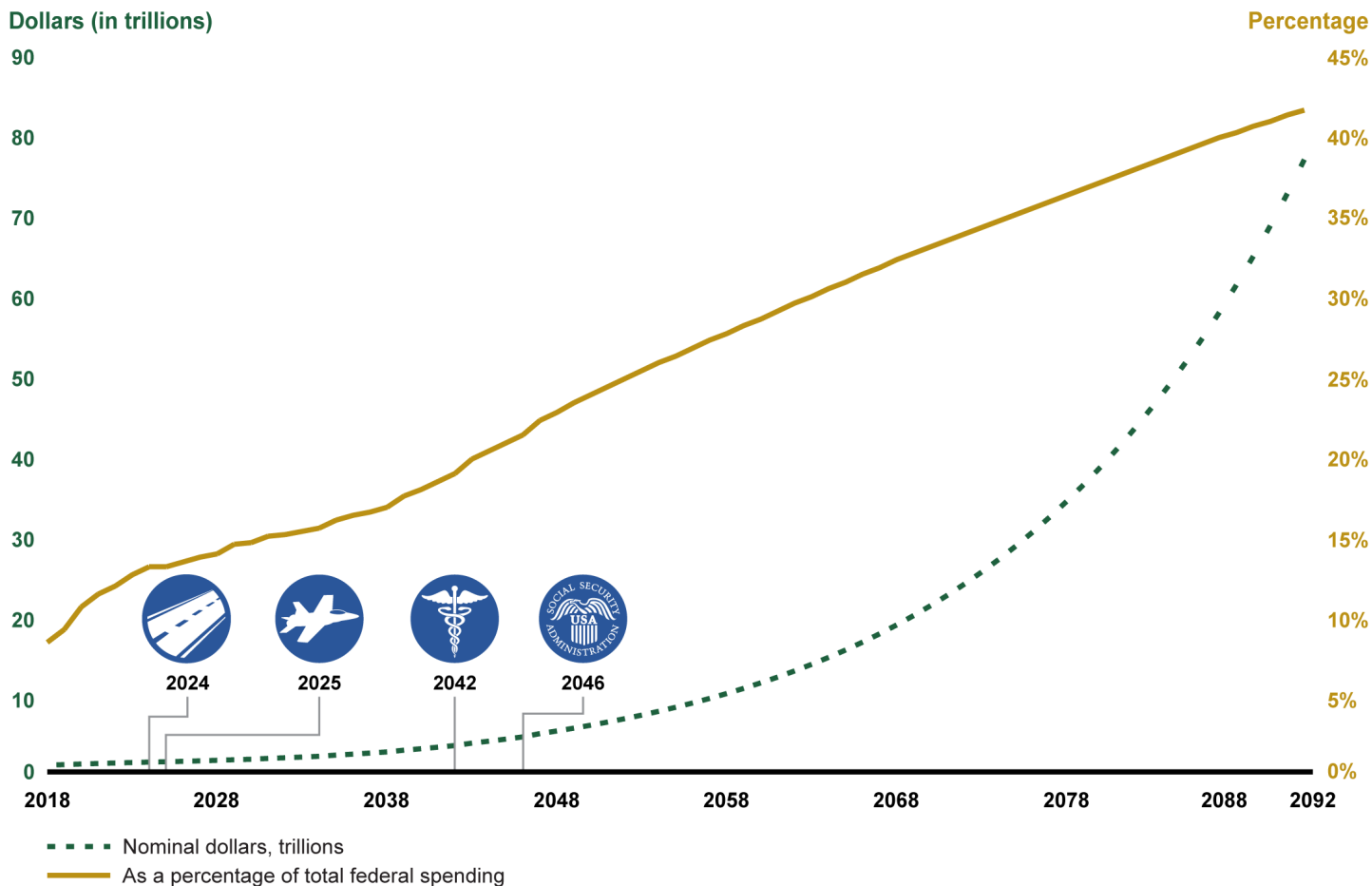
Both the *2018 Financial Report's* long-term fiscal projections and GAO's simulations show spending on net interest growing such that over the long term it becomes the largest category of spending.⁹ According to CBO, spending on net interest totaled \$325 billion in 2018 (8 percent of total federal spending), which is already larger than some other categories of spending, such as agriculture, transportation, veterans' benefits, and veterans' services combined. As shown in figure 6, spending on net interest is projected to continue to grow, surpassing:

- Nondefense discretionary spending in 2024,
- Defense discretionary spending in 2025,
- Medicare spending in 2042, and
- Social security spending in 2046.

In 2092, net interest is projected to account for about 40 percent of federal spending, according to GAO's alternative simulation.

⁹CBO's projections in its June 2018 long-term outlook report also show net interest growing as a percentage of total spending. However, since CBO's June 2018 extended baseline projections only go out to 2048, spending on net interest does not quite overtake Social Security spending in the projection period.

Figure 6: Net Interest Spending in Dollars and as a Percentage of Total Federal Spending



Net interest spending is projected to exceed spending on:

-  Nondefense discretionary spending in 2024
-  Defense discretionary spending in 2025
-  Medicare spending in 2042
-  Social Security spending in 2046

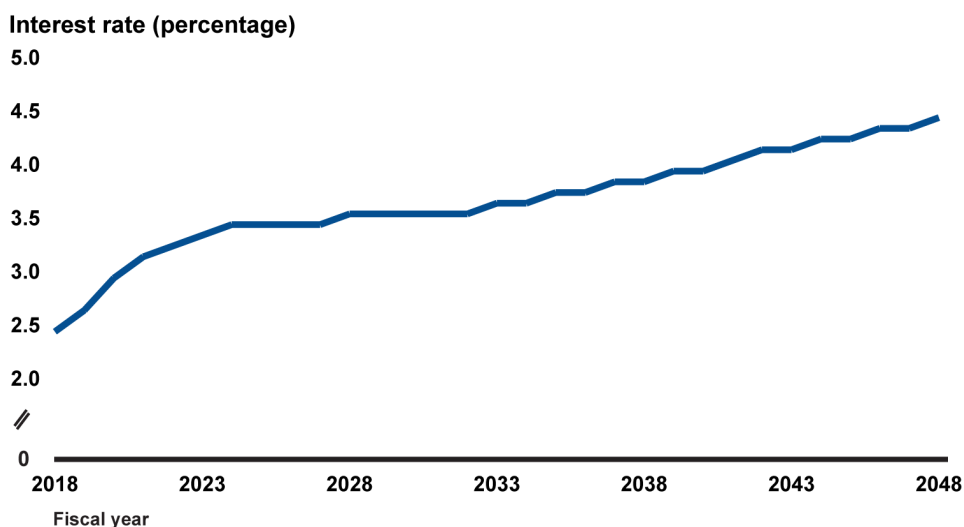
Source: GAO and GAO analysis of Congressional Budget Office data. | GAO-19-611T

Note: Projected spending on net interest, Medicare, and Social Security is based on GAO's 2019 alternative simulation. Projected nondefense discretionary and defense discretionary spending is based on the Congressional Budget Office's January 2019 baseline budget projections.

Interest spending grows for two main reasons:

- **Growing debt.** At any given interest rate (above zero percent), interest payments increase as the debt grows. Debt held by the public will continue to increase as the federal government borrows money to finance the annual deficit (including interest costs) and for other cash needs (including government lending for student loans). The federal government is paying the interest on the debt held by the public and not paying down the total principal outstanding.
- **Increases in interest rates.** Increases in interest rates have a compounding effect on debt. For any given level of debt, a change in interest rates changes interest costs. In recent years, interest rates on Department of the Treasury (Treasury) securities have remained low, so interest costs have been low. However, CBO projects that the average interest rate on all debt held by the public will rise to 4.4 percent in 2048, compared to 2.4 percent in 2018 (see figure 7). In its June 2018 long-term budget outlook report, CBO also noted that since the trend of increasing interest rates reflects long-term economic trends, it would be likely to continue even at the current debt level.¹⁰

Figure 7: Congressional Budget Office (CBO) Projections of the Average Interest Rate on All Federal Debt Held by the Public, Fiscal Years 2018-2048



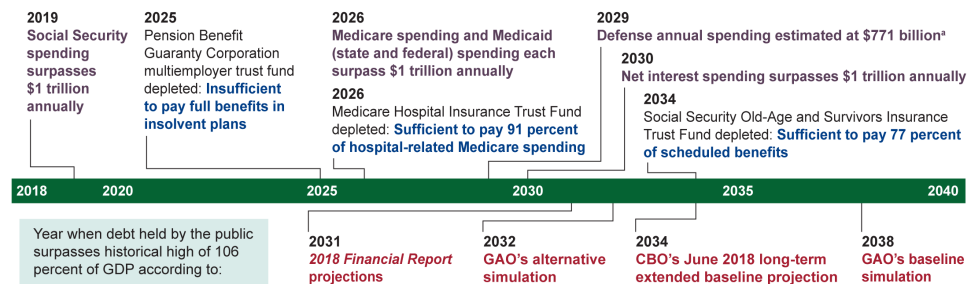
Source: GAO analysis of CBO data. | GAO-19-611T

¹⁰CBO regularly updates its economic projections, including its projections of interest rates, as part of its reports on the 10-year budget and economic outlook.

Impending Fiscal Pressures Add to Need for Timely Action

Growing pressures further strain the federal budget and are contributing to the growing debt. These pressures include known impending financial challenges for major programs, as well as fiscal risks (such as spending on natural disasters) that could lead to unknown amounts of future spending. As shown in figure 8, annual spending for some major programs, such as Social Security and Medicare, is expected to each surpass \$1 trillion. Several key program trust fund balances are projected to be depleted in coming years if no changes are made. The longer action to address these issues is delayed, the more drastic the changes will have to be.

Figure 8: Key Dates for Major Programs and Future Debt



Source: Trustees for Social Security and Medicare, Congressional Budget Office (CBO), Centers for Medicare & Medicaid Services, GAO, and 2018 Financial Report. | GAO-19-611T

*CBO did not report defense spending projections separately from total discretionary spending in its long-term projections after 2029.

Failure to act will lead to an increasingly constrained federal budget, limiting the federal government's flexibility to respond quickly and adequately to emerging issues and unforeseen events. Economic downturns, natural disasters, wars, cyberattacks, and health pandemics are among the events that pose fiscal risks.¹¹ Better understanding fiscal risks can help policymakers anticipate changes in future spending and can enhance oversight of federal resources. We have recommended ways for Congress and executive branch agencies to address several fiscal risks (see text box). For more information on these risks and our recommendations to address them, see appendix I. These risks are not

¹¹Fiscal risks or fiscal exposures are responsibilities, programs, and activities that may legally commit the federal government to future spending, or create expectations for future spending based on current policy, past practices, or other factors. See our infographic on federal fiscal risks at <https://www.gao.gov/assets/670/668649.pdf>.

fully budgeted for and could affect the government's future fiscal condition.

Examples of Federal Fiscal Risks

- **Housing finance.** The federal government continues to provide significant support to the housing finance market, even though the market has largely recovered since the 2007 to 2009 financial crisis. Congress should consider establishing objectives for the future federal role in housing finance, and housing and regulatory agencies should take actions to help manage mortgage-related risk, among other things.
- **Surface transportation.** Repairing and upgrading our nation's surface transportation system will cost hundreds of billions of dollars, according to estimates. Congress needs to pass a long-term, sustainable solution for funding surface transportation.
- **The Pension Benefit Guaranty Corporation (PBGC).** PBGC's liabilities exceeded its assets by about \$51 billion as of the end of fiscal year 2018. The financial stability of PBGC's single- and multiemployer programs faces many structural challenges that require congressional action.

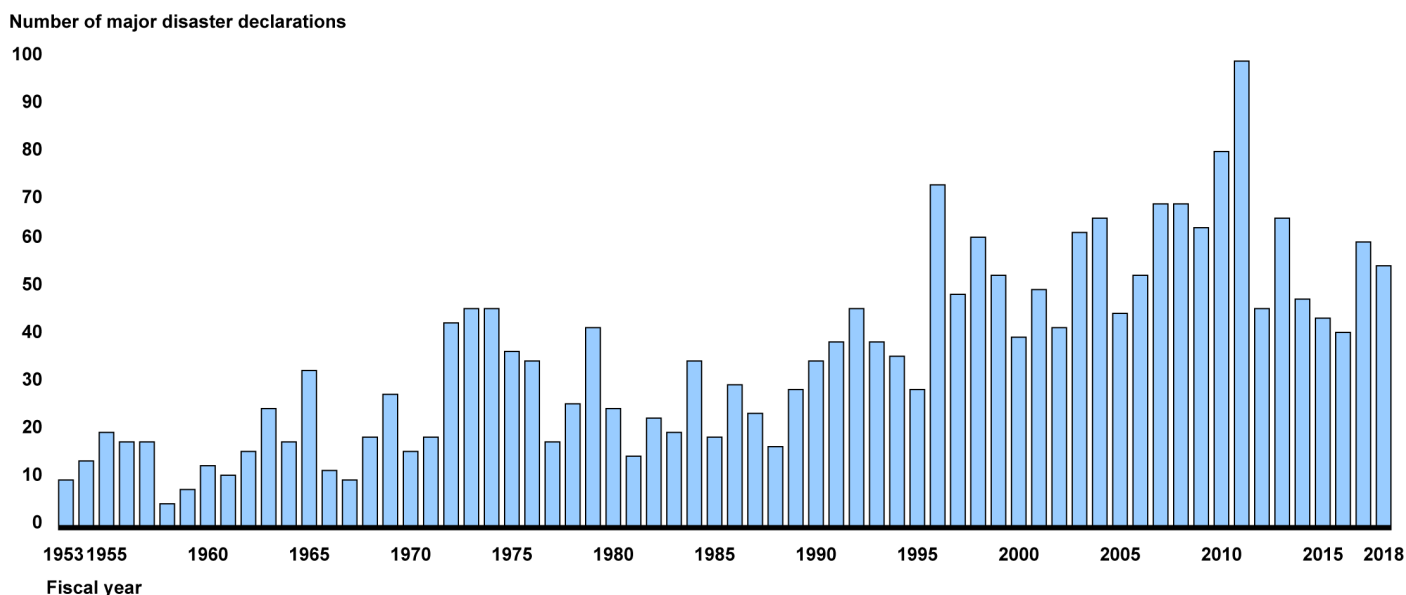
Source: GAO. | GAO-19-611T

Natural Disasters and Climate Change Create Fiscal Exposures

An example of a fiscal exposure facing the nation is the rising number of natural disasters and increasing state, local, and tribal reliance on federal disaster assistance. Such assistance can come from federal responsibilities, programs, and activities, such as national flood insurance, that may legally commit or create the expectation for future spending. Federal agencies can become involved in responding to a disaster when effective response and recovery are beyond the capabilities of the state and affected local governments. In such cases, the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act), permits the President to declare a major disaster in response to a request by the governor of a state or territory or by the chief executive of a tribal government.¹² Overall, the number of disaster declarations has fluctuated over the years, reaching a high of 98 disasters in fiscal year 2011 (see figure 9). There were 55 disasters declared in fiscal year 2018.

¹²42 U.S.C. § 5170.

Figure 9: Number of Major Disaster Declarations, Fiscal Years 1953–2018



Source: GAO analysis of Federal Emergency Management Agency data. | GAO-19-611T

In addition, associated requests for disaster assistance could increase the federal government's fiscal exposure. From 2008 through 2016, the Federal Emergency Management Agency (FEMA) received 294 Individual Assistance declaration requests from states, U.S. territories, and tribes to help individuals meet their immediate needs after a disaster.¹³ Of these requests, the President declared 168 and denied 126 requests.

¹³We have previously reported that requests to the federal government for Individual Assistance are often granted. See GAO, *Federal Disaster Assistance: Individual Assistance Requests Often Granted, but FEMA Could Better Document Factors Considered*, [GAO-18-366](#) (Washington, D.C.: May 31, 2018).

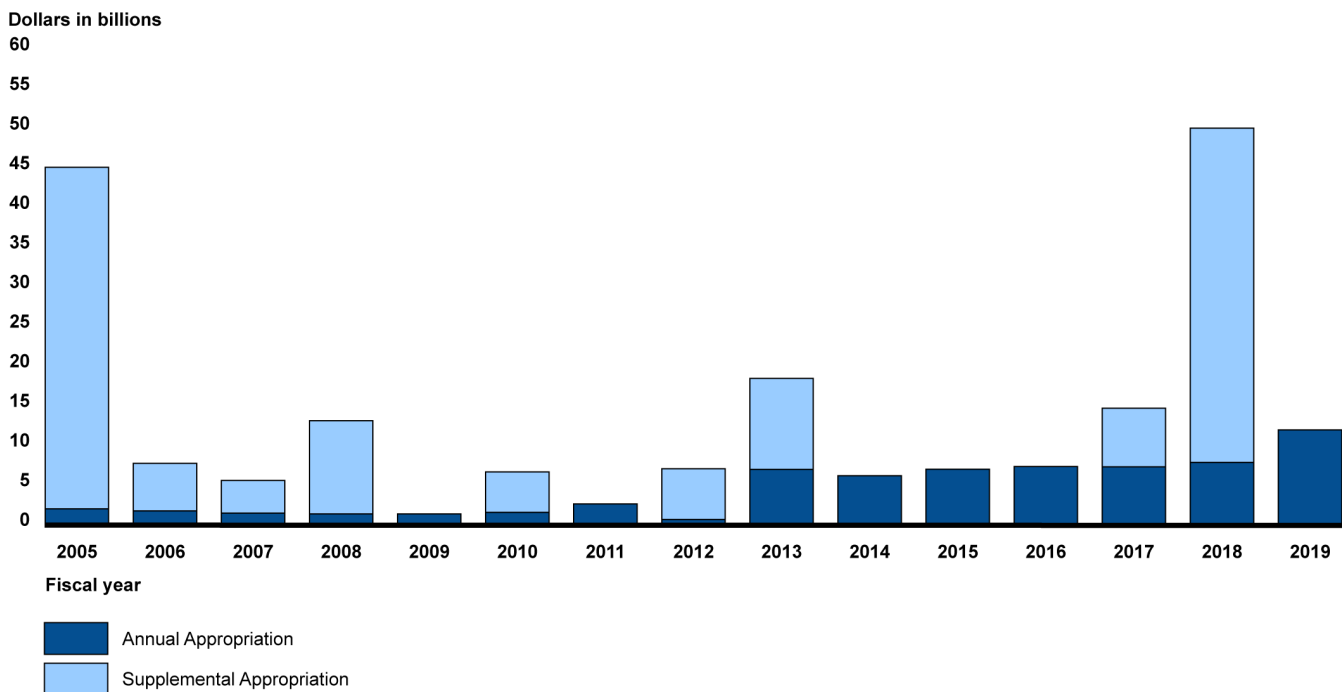
Since 2005, federal funding for disaster assistance has totaled at least \$450 billion,¹⁴ most recently for catastrophic hurricanes, flooding, wildfires, and other losses in 2017 and 2018. The Disaster Relief Fund is the primary source of federal disaster assistance for state, local, territorial, and tribal governments when a major disaster or emergency is declared. Although the Disaster Relief Fund receives funding through the annual appropriations process the federal government does not budget fully for the costs of disaster assistance (see figure 10). According to the Congressional Research Service, more than 85 percent of net appropriations for disaster relief are provided through supplemental appropriations on an ad hoc basis.¹⁵ These disaster relief supplemental appropriations generally do not count toward existing discretionary budget limits.¹⁶

¹⁴This total includes, for fiscal years 2005 through 2014, \$278 billion that GAO found that the federal government had obligated for disaster assistance. See GAO, *Federal Disaster Assistance: Federal Departments and Agencies Obligated at Least \$277.6 Billion during Fiscal Years 2005 through 2014*, [GAO-16-797](#) (Washington, D.C.: Sept. 22, 2016). It also includes, for fiscal years 2015 through 2018, \$124 billion in select supplemental appropriations to federal agencies for disaster assistance and approximately \$7 billion in annual appropriations to the Disaster Relief Fund (a total of \$28 billion for the 4-year period). For fiscal years 2015 through 2018, it does not include other annual appropriations to federal agencies for disaster assistance. Lastly, on June 6, 2019, the Additional Supplemental Appropriations for Disaster Relief Act of 2019 was signed into law, which provides approximately \$19.1 billion for disaster assistance. Pub. L. No. 116-20, 133 Stat. 871 (2019).

¹⁵Congressional Research Service, *The Disaster Relief Fund: Overview and Issues*, R45484 (Washington, D.C.: Feb. 1, 2019).

¹⁶The Budget Control Act of 2011 allows spending limits to be adjusted upward to accommodate appropriations for emergencies when Congress and the president designate specified accounts as emergency funding or for Overseas Contingency Operations in statute. Pub. L. No. 112-25, tit. I, § 101, 125 Stat. 240, 243 (2011).

Figure 10: Appropriations to the Disaster Relief Fund, Fiscal Years 2005–2019



Source: GAO analysis of appropriation laws. | GAO-19-611T

Note: The 2005 supplemental appropriation includes a rescission of \$23.4 billion included in Pub. L. No. 109-148 on December 30, 2005. Without the rescission, the total supplemental appropriation to the Disaster Relief Fund in fiscal year 2005 was \$66.5 billion. No other rescissions are included in the figure.

Further, future federal disaster costs are projected to increase as certain extreme weather events become more frequent and intense because of climate change risks—as observed and projected by the U.S. Global Change Research Program and the National Academies of Sciences, Engineering, and Medicine.¹⁷ According to the Office of Management and Budget (OMB), since 1993 budget authority for activities related to climate change has totaled about \$154 billion—primarily for technologies to reduce emissions and for scientific research on climate change impacts.

¹⁷GAO, *Climate Change: Information on Potential Economic Effects Could Help Guide Federal Efforts to Reduce Fiscal Exposure*, [GAO-17-720](#) (Washington, D.C.: Sept. 28, 2017). See also U.S. Global Change Research Program, *Impacts, Risks, and Adaptation in the United States: Fourth National Climate Assessment, Volume II* (Washington, D.C.: 2018).

However, we found that this amount does not include information on relevant federal fiscal exposures including costs for disaster assistance programs.

Managing fiscal exposure due to climate change has been on GAO's High-Risk List since 2013, in part, because of concerns about the increasing costs of disaster response and recovery efforts.¹⁸ For instance, the National Flood Insurance Program has not collected sufficient premiums and does not have sufficient dedicated resources to cover expected costs without borrowing from Treasury.¹⁹ As of September 2018, FEMA, which administers the National Flood Insurance Program, owed \$20.5 billion to Treasury for money borrowed to pay claims and other expenses.²⁰ We have reported that FEMA is unlikely to collect enough in premiums in the future to repay this debt.²¹ Due to its financial challenges, the National Flood Insurance Program has been on GAO's High-Risk List since 2006.²²

In 2008, we recommended that FEMA take steps to ensure that its rate-setting methods, as a starting point for setting premium rates, accurately reflect the risk of losses from flooding. These steps should include, for example, verifying the accuracy of flood probabilities, damage estimates, and flood maps; ensuring that the effects of long-term planned and ongoing development, as well as climate change, are reflected in the flood probabilities used; and reevaluating the practice of aggregating risks across zones.²³

Further, we have an open matter for Congress to consider from our April 2017 report that examined actions Congress and FEMA could take to

¹⁸See [GAO-19-157SP](#), 110.

¹⁹For more information on federal insurance programs and the budget, see GAO, *Fiscal Exposures: Federal Insurance and Other Activities that Transfer Risk or Losses to the Government*, [GAO-19-353](#) (Washington, D.C.: Mar. 27, 2019).

²⁰The amount owed is net of \$16 billion of debt that was canceled in October 2017. Additional Supplemental Appropriations for Disaster Relief Requirements Act, 2017, Pub. L. No. 115-72, § 308, 131 Stat. 1224, 1228-29 (Oct. 26, 2017).

²¹GAO, *Flood Insurance: Comprehensive Reform Could Improve Solvency and Enhance Resilience*, [GAO-17-425](#) (Washington, D.C.: Apr. 27, 2017).

²²See [GAO-19-157SP](#), 272.

²³GAO, *Flood Insurance: FEMA's Rate-Setting Process Warrants Attention*, [GAO-09-12](#), (Washington, D.C.: Oct. 31, 2008).

reduce federal fiscal exposure and improve resilience to floods. We stated that Congress should consider comprehensive reform, which could include actions in six areas: (1) addressing the current debt, (2) removing existing legislative barriers to FEMA's ability to revise premium rates to reflect the full risk of loss, (3) addressing affordability, (4) increasing consumer participation, (5) removing barriers to private-sector involvement, and (6) protecting National Flood Insurance Program flood resilience efforts.²⁴

More complete information on programs for which costs are likely to increase due to climate change, such as disaster assistance, could help policymakers better understand the long-term effects of decisions and the trade-offs between spending with long-term benefits, such as resilience investments, and short-term benefits, such as post-disaster repairs. This information could also help the federal government develop a government-wide strategy for addressing climate change that focuses on reducing federal fiscal exposure.

We have identified a number of ways to reduce the federal fiscal risk related to natural disasters. For example:

- **Updating the methodology for major disaster declarations.** In 2012, we recommended that FEMA develop and implement an updated methodology that provides a more comprehensive assessment of a jurisdiction's capacity to respond to and recover from a disaster without federal assistance.²⁵ Our analysis showed that FEMA primarily relied on a single criterion, the per capita damage indicator, to determine whether to recommend to the President that a jurisdiction receive Public Assistance funding.²⁶ However, FEMA's per capita indicator, set at \$1 in 1986, has not been adjusted for the rise in (1) per capita personal income since it was created in 1986 or (2) inflation from 1986 to 1999 (though the indicator has been adjusted for inflation each year from 2000 through the present).

²⁴[GAO-17-425](#).

²⁵GAO, *Federal Disaster Assistance: Improved Criteria Needed to Assess a Jurisdiction's Capability to Respond and Recover on Its Own*, [GAO-12-838](#) (Washington, D.C.: Sept. 12, 2012).

²⁶The Public Assistance program provides for debris removal; emergency protective measures; and the repair, replacement, or restoration of disaster-damaged, publicly owned facilities and the facilities of certain private nonprofit organizations that provide services otherwise performed by a government agency.

The per capita indicator as of 2019 is \$1.50. However, based on our past analysis, the indicator would have been \$2.07 in 2012 had it been adjusted for inflation from 1986 to 1999, illustrating that the indicator is artificially low. Further, we found that, had FEMA updated its methodology based on per capita personal income, as many as 44 percent of federal disaster declarations from fiscal years 2004 through 2011 (totaling \$3.59 billion) would not have met the eligibility criteria that FEMA primarily used to determine whether federal assistance should be provided, which would have likely resulted in fewer disaster declarations.

FEMA has not implemented our recommendation, but the Disaster Recovery Reform Act of 2018 (DRRA) requires FEMA to initiate rulemaking to (1) update the factors considered when evaluating requests for major disaster declarations, including reviewing how FEMA estimates the cost of major disaster assistance, and (2) consider other impacts on the capacity of a jurisdiction to respond to disasters, by October 2020.²⁷ Until FEMA implements a new methodology, the agency will not have an accurate assessment of a jurisdiction's capabilities and runs the risk of recommending that the President award Public Assistance to jurisdictions that have the capacity to respond and recover on their own.

- **Strengthening resilience efforts.** In July 2015, we recommended that FEMA and its partners establish a comprehensive investment strategy to identify, prioritize, and implement federal disaster resilience investments.²⁸ FEMA and its partners have developed a draft National Mitigation Investment Strategy that may address this recommendation, but it is too early to assess its responsiveness because it has not been finalized. FEMA plans to issue the strategy publicly in July 2019. Further, as we have reported, enhancing resilience can reduce fiscal exposure by reducing or eliminating long-term risk to people and property from natural hazards. For example, a 2018 interim report by the National Institute of Building Sciences estimated approximate benefits to society in excess of costs for several types of resilience projects. While precise benefits are uncertain, the report estimated that for every dollar invested in

²⁷Pub. L. No. 115-254, § 1239, 132 Stat. 3186, 3466 (2018).

²⁸GAO, *Hurricane Sandy: An Investment Strategy Could Help the Federal Government Enhance National Resilience for Future Disasters*, [GAO-15-515](#) (Washington, D.C.: July 30, 2015).

designing new buildings to particular design standards, society could accrue benefits amounting to about \$11 on average.²⁹

- **Pre-disaster hazard mitigation.** We also found that the bulk of federal disaster resilience funding provided to states and localities comes after they have experienced a disaster, particularly a large or catastrophic disaster.³⁰ The DRRRA allows the President to set aside, with respect to each major disaster, a percentage of certain grants to use for pre-disaster hazard mitigation.³¹ In May 2019, FEMA announced that it is seeking public comments on the new program. FEMA anticipates issuing the first Notice of Funding Opportunity for this new program before the end of 2020. This new grant program will provide additional funding to make resilience investments before disaster strikes and could potentially help to reduce future risk.

Additional Opportunities to Contribute Toward Fiscal Health

In addition, we have identified numerous opportunities for Congress and executive branch agencies to take steps in the near term that could improve the federal government's fiscal condition. These opportunities include addressing billions of dollars in improper payments and the over \$400 billion annual tax gap, and evaluating the significant amount of revenue forgone through tax expenditures. There are also opportunities for the Department of Defense, which has the largest share of discretionary spending, to exercise careful stewardship over its resources in light of its high risk challenges. Collectively, these actions would improve stewardship over federal resources in the near term. However, these actions alone cannot put the federal government on a sustainable fiscal path and do not eliminate the need for a long-term fiscal plan. More information on the actions needed in these areas is included in appendix II.

A Long-Term Plan Is Needed to Achieve Fiscal Sustainability

A long-term fiscal plan is needed to address the growing federal debt and put the federal government on a more sustainable long-term fiscal path. To formulate such a plan, policymakers will need to consider policy changes to the entire range of federal activities and address both revenue and spending.

²⁹GAO, *Climate Change: Opportunities to Reduce Federal Fiscal Exposure*, [GAO-19-625T](#) (Washington, D.C.: June 11, 2019).

³⁰[GAO-15-515](#).

³¹Pub. L. No. 115-254, § 1234, 132 Stat. at 3461.

Fiscal Rules Can Guide Fiscal Policy Decisions to Control Debt

Other Countries Have Used Fiscal Rules to Control Debt

As part of a long-term plan, fiscal rules can support efforts to achieve fiscal sustainability by imposing numerical limits on the budget (known as targets) to guide fiscal policy. They have been used at both the national government level in the United States and other countries, as well as at the supranational level, such as the European Union (EU), to help promote fiscal responsibility and sustainability.

According to experts at the International Monetary Fund (IMF) and the Organization for Economic Co-operation and Development (OECD), several types or combinations of fiscal rules have the potential to contribute to fiscal sustainability:

- **Budget balance rules**, which constrain deficit levels and specify that the debt-to-GDP ratio converges to a defined finite level;
- **Debt rules**, which set an explicit limit or target for public debt as a percentage of GDP;
- **Revenue rules**, which set ceilings or floors on revenues and aim to increase revenue collection or prevent excessive tax burdens; and
- **Expenditure rules**, which limit spending, typically in absolute terms or growth rates and occasionally as a percent of GDP.

As part of our ongoing work on fiscal rules requested by the Chairman, we are examining in the design, implementation, and enforcement of these types of rules in other countries.

Governments can use a combination of different fiscal rules to address shortcomings of any one individual rule. According to the IMF, as of 2015, more than 70 countries had combined two or more fiscal rules, and most countries that use fiscal rules today have more than one in place. For example, at the supranational level, the EU's stability and growth pact combines an expenditure rule, budget balance rule, and a debt rule (e.g., debt-to-GDP), which are designed to ensure that countries in the EU pursue sound public finances and coordinate their fiscal policies. The pact permits sanctions against member states that fail to comply with these fiscal rules. In recent years, however, several EU nations have struggled to meet the targets set forth in the agreement.

Economic literature notes that governments can design mechanisms to help fiscal rules strike a balance between flexibility and enforceability. For example:

- Many fiscal rules include clauses which allow for a level of flexibility in responding to fiscal risks or unexpected events like recessions or natural disasters.
- Other fiscal rules include features such as independent fiscal councils, which are institutions that can help formulate and implement sound fiscal policy, and constitutional mandates, which enshrine the rule in a country's constitution with the intent of making it more difficult to reverse or abandon.
- Some countries choose to use automatic correction mechanisms, which are designed to trigger automatically to respond to past deviations from a rule.

International economic organizations, such as the IMF and OECD, have found that fiscal rules are associated with successful efforts to stabilize debt. However, empirical evidence suggests that while fiscal rules may improve balance sheets, the correlation is weaker between fiscal rules and reductions in the debt-to-GDP ratio. In general, observers and budget experts have noted that success depends on effective enforcement of fiscal rules and sustained commitment by both policymakers and the public. Some experts believe that if governments try to subvert fiscal rules through creative accounting it could undermine credibility or transparency.

The Federal Government Has Previously Enacted Fiscal Rules

The U.S. federal government has previously enacted fiscal rules in the form of laws that constrain and enforce fiscal policy decisions (see table 1). These experiences illustrate the challenge in designing rules that are both achievable and effective in addressing the key drivers of the nation's growing debt.

Table 1: Previously-Enacted Federal Fiscal Rules

Law	Fiscal years in effect	Requirements	Limitations
Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA) Pub. L. No. 99-177, 99 Stat. 1037 (1985).	1986–1993 ^a	Created deficit limits to establish a balanced budget.	Some factors that affected the deficit were not within Congress’s control, such as economic or demographic changes.
Budget Enforcement Act of 1990 (BEA) Pub. L. No. 101-508, 104 Stat 1388-1 (1990).	1991–2002	- Limited annual discretionary spending. - Implemented a pay-as-you-go (PAYGO) rule for new direct spending and revenue legislation,^b under which the net effect of new laws could not increase the deficit in any given year.	Controls on discretionary spending and new legislation did not control the growth in spending that results from previously-enacted laws, such as Medicare.
Statutory Pay-As-You-Go Act of 2010 (Statutory PAYGO Act) Pub. L. No. 111-139, 124 Stat. 8 (2010).	2010–present (no expiration date)	Requires that the net effect of new direct spending and revenue laws cannot increase the deficit.	Like the BEA, the Statutory PAYGO Act does not control the growth in spending that results from previously enacted laws. The act also does not control discretionary spending.
Budget Control Act of 2011 (BCA) Pub. L. No. 112-25, 125 Stat. 240 (2011).	2012–2021 for discretionary spending 2012–2027 for direct (or mandatory) spending	- Limits annual discretionary spending. - Required Congress and the President to reach agreement on further deficit reduction. Absent such an agreement, discretionary spending was further reduced and reductions in direct spending took effect.^c	- Spending for emergencies and overseas contingency operations do not count towards discretionary spending limits.^d - Subsequent laws changed the discretionary spending limits or enforcement procedures, which increased annual deficits.^e - The law did not specify reductions to direct spending; rather, it provided for automatic, across-the-board reductions in direct spending if Congress and the President did not reach a deficit reduction agreement. - Congress and the President did not reach agreement on further deficit reduction as required.

Source: GAO analysis of applicable laws. | GAO-19-611T

^aAs enacted, BBEDCA contained a provision requiring the Comptroller General to report to the President whether revenues and outlays for the coming fiscal year would result in a deficit exceeding the maximum amount allowed under BBEDCA for that fiscal year and the budget reductions necessary to reach the prescribed deficit level. Pub. L. No. 99-177, § 251(b), 99 Stat. 1037, 1068-1069 (1985). The President was then required to order reductions in spending consistent with the Comptroller General’s report. Pub. L. No. 99-177, § 252(a)(3). In 1986 the Supreme Court held this provision unconstitutional because it assigned executive powers to the Comptroller General in violation of the doctrine of separation of powers. *Bowsher v. Synar*, 478 U.S. 714 (1986). Subsequently, BBEDCA was amended by the Balanced Budget Emergency Deficit Control

Reaffirmation Act of 1987. Pub. L. No. 100-119, 101 Stat. 754 (1987). Among other things, the 1987 law extended the time frame for balancing the budget to fiscal year 1993.

^bDirect spending, often referred to as mandatory spending, consists of budgetary resources provided by entitlement authority and laws other than appropriations acts.

^cThe BCA established the Joint Select Committee on Deficit Reduction (Joint Committee), which was tasked with proposing legislation to reduce the deficit by \$1.2 trillion or more through fiscal year 2021. The Joint Committee was to report its proposal by December 2, 2011, and Congress and the President were to enact legislation by January 15, 2012. The Joint Committee did not report a proposal and such legislation was not enacted. This failure triggered (1) sequestration of discretionary spending in fiscal year 2013, (2) reductions to annual discretionary spending limits through fiscal year 2021, and (3) automatic, across-the-board reductions to direct spending.

^dThe BCA allows its spending limits to be adjusted for certain categories such as emergency appropriations and appropriations for overseas contingency operations.

^eThese include the American Taxpayer Relief Act of 2012 (Pub. L. No. 112-240), the Bipartisan Budget Act of 2013 (Pub. L. No. 113-67), the Bipartisan Budget Act of 2015 (Pub. L. No. 114-74), and the Bipartisan Budget Act of 2018 (Pub. L. No. 115-123).

Generally, if spending exceeds a target specified by these laws, the President is required to issue an automatic, across-the-board cancellation of budgetary resources, known as sequestration. This order would reduce budget authority by a uniform percentage in the amount necessary to reach the target. Sequestration procedures were established under BBEDCA and continue under subsequent fiscal laws.³²

Certain programs are exempt from sequestration, while special rules apply to others. For example, Social Security, Medicaid, and veterans' compensation are exempt, while Medicare reductions are limited to 2 percent. As a result, programs without special status bear a greater reduction than they would if cuts were applied evenly to all programs. In addition, the sequestration process does not distinguish between programs that have already been reduced through legislation and those that have not.

The federal government's experience with these fiscal rules provides insights that can inform fiscal policy deliberations:

- **Targeting the right factors.** To effectively reduce the deficit and debt, policymakers will need to examine the factors that have the greatest impact on the government's fiscal condition and structure any fiscal rules and targets to reflect these factors. For example, in the

³²For more information on sequestration see GAO, *2014 Sequestration: Opportunities Exist to Improve Transparency of Progress Toward Deficit Reduction Goals*, [GAO-16-263](#) (Washington, D.C.: Apr. 14, 2016) and *2013 Sequestration: Agencies Reduced Some Services and Investments, While Taking Certain Actions to Mitigate Effects*, [GAO-14-244](#) (Washington, D.C.: Mar. 6, 2014).

Achieving a Debt-to-GDP
Target Would Require
Spending and Revenue
Changes

long-term, federal spending is being driven by federal health care programs and interest on debt held by the public, which results from previously-enacted laws. It is important for future fiscal rules to target all spending (entitlement programs, other mandatory spending, and discretionary spending) as well as revenues.

- **Enforcing budget agreements.** As we have previously reported, enforcing a budgetary agreement is more successful than forcing an agreement where none exists.³³ The experience of the BCA, for example, underscores this principle as the threat of sequestration did not lead to a deficit reduction agreement.
- **Limiting exemptions.** Since the BCA has been in effect, hundreds of billions of dollars in discretionary budget authority has been provided in areas that do not count towards its spending limits. Specifically, the BCA allows its spending limits to be adjusted for certain categories such as emergency appropriations and appropriations for overseas contingency operations.³⁴ While the government needs flexibility to address unforeseen events, it is important to design fiscal rules that can be adhered to absent a genuine crisis.

No process can force choices that the President and Congress are unwilling to make. However, having an agreed-upon goal can justify and frame the choices that must be made. With that in mind, a fiscal target that establishes a common goal for controlling the size of the federal debt relative to the economy, as well as well-designed rules that put the federal government on a path to achieve that target, could form part of a long-term plan to put the government on a sustainable fiscal path. In our ongoing work, we are examining key considerations for designing and implementing fiscal rules and targets for the U.S. government.

One way to quantify the magnitude of policy changes needed to achieve fiscal sustainability is by calculating the fiscal gap. The fiscal gap represents the difference between revenue and program spending (i.e., spending other than interest payments) that would need to be closed immediately and permanently to hold debt as a share of GDP at the end of a given period to the same level as the beginning of the period. To close the gap, policymakers would need to reduce program spending,

³³See GAO, *Budget Process: Enforcing Fiscal Choices*, [GAO-11-626T](#) (Washington, D.C.: May 4, 2011).

³⁴For more information on overseas contingency operations spending, see GAO, *Overseas Contingency Operations: Alternatives Identified to the Approach to Fund War-Related Activities*, [GAO-19-211](#) (Washington, D.C.: Jan. 28, 2019).

increase revenue, or, more likely, do both. The longer action is delayed, the greater and more drastic the changes will have to be, placing an additional burden on future generations.

To illustrate this point, table 2 shows the immediate changes that would be needed for the federal government to reach various debt targets at the end of a 75-year projection period. These targets represent a range of illustrative examples; we do not endorse any particular target. Adopting a fiscal target is a matter for policymakers to consider as they weigh the consequences of spending and revenue decisions and their effect on the federal debt.

Table 2: Illustrative Examples of Spending or Revenue Changes Needed to Achieve Debt Targets

The table shows the magnitude of actions needed to achieve certain levels of debt held by the public as a percentage of gross domestic product over a 75-year period by reducing spending alone or increasing revenue alone. More likely, both spending and revenue changes will be needed to achieve fiscal sustainability.

Debt target, percent of gross domestic product (end of 75 years)	Immediate and permanent reduction in the annual projected primary deficit required to achieve debt target (percent of gross domestic product) ^a	Immediate and permanent reduction in annual projected program spending alone to achieve debt target	Immediate and permanent increase in annual projected revenue alone to achieve debt target
Percent	Percent	Percent	Percent
100	6	25	35
78 (actual level as of fiscal year 2018)	6	27	37
60 (European Union target)	7	28	38
0 (pay off the debt)	8	31	43

Source: GAO’s 2019 alternative simulation. | GAO-19-611T

Note: This analysis was produced using GAO’s 2019 long-term fiscal outlook model, the alternative simulation. GAO most recently updated the data used in this model for its 2019 report on the nation’s fiscal health ([GAO-19-314SP](#)). The model does not account for potential macroeconomic effects of fiscal policy changes over time.

^aThese figures represent reductions in the primary deficit, which is the difference between revenues and program spending. Interest payments are excluded.

Debt Limit Is Not a Control on Debt: Alternative Approach Is Needed

Treasury is taking extraordinary actions to continue funding federal government activities. Treasury began taking these actions shortly after the debt limit suspension period ended on March 1, 2019.³⁵ Treasury will continue taking these actions until the debt limit is raised or suspended. With these extraordinary actions in place, CBO estimates that Treasury will have sufficient cash to make its usual payments until late into fiscal year 2019.

One cannot overstate the importance of preserving investors' confidence that debt backed by the full faith and credit of the U.S. government will be honored. Failure to increase (or suspend) the debt limit in a timely manner (before the extraordinary actions run out) could have serious negative consequences for the Treasury market and borrowing costs.

Our work has shown that uncertainty in the past around whether the debt limit would be raised or suspended has distorted the secondary market and led to increases in borrowing costs for Treasury.³⁶ During the 2013 debt limit impasse, investors reported that they took the unprecedented action of systematically avoiding certain Treasury securities—those that matured around the dates when Treasury projected it would exhaust the extraordinary actions. For these securities, interest rates increased dramatically and liquidity declined in the secondary market, where securities are traded among investors.

Rates in the secondary market ultimately affect Treasury's borrowing costs, as investors generally demand similar rates at auction to those in the secondary market. The significant increases in interest rates on these Treasury securities reflected a new level of investor uncertainty about Treasury's ability to pay its bills and avoid a delayed payment or a default. We estimated that total borrowing costs incurred through September 30, 2014, on Treasury securities issued during the 2013 debt limit impasse increased by roughly \$38 million to more than \$70 million, depending on the specifications used.

³⁵Extraordinary actions are actions that Treasury takes as it nears the debt limit to avoid exceeding the limit. The Bipartisan Budget Act of 2018 temporarily suspended the debt limit from February 9, 2018, through March 1, 2019. Bipartisan Budget Act of 2018, Pub. L. No. 115-123, div. C, tit. III, § 30301, 132 Stat. 64, 132 (2018).

³⁶GAO, *Debt Limit: Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, [GAO-15-476](#) (Washington, D.C.: July 9, 2015).

As part of a long-term fiscal plan, Congress should consider alternative approaches to the debt limit. As currently structured, the debt limit—a legal limit on the total amount of federal debt that can be outstanding at one time³⁷—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.³⁸ The debt limit is an after-the-fact measure; the spending and tax laws that result in debt have already been enacted. It restricts Treasury’s authority to borrow to finance decisions already made. If the level of publicly held debt or its share of GDP is to be used as a fiscal management tool to change the long-term fiscal path, it needs to be considered as part of overall budget decisions at the time those decisions are being made.

In 2015, we held a forum with experts and identified three options for Congress to delegate its borrowing authority, while maintaining control and oversight, and better align decisions about the level of debt with decisions on spending and revenue, and minimize disruption to the market.

- Option 1: Link action on the debt limit to the budget resolution.
- Option 2: Provide the administration with the authority to propose a change in the debt limit that would take effect absent enactment of a joint resolution of disapproval within a specified time frame.
- Option 3: Delegate broad authority to the administration to borrow as necessary to fund enacted laws.³⁹

The government must act soon to change the long-term fiscal path or risk significant disruption to individuals and the economy. Congress will need to discuss the entire range of federal activities and spending—entitlement programs, other mandatory spending, discretionary spending, and

³⁷The debt limit is codified at 31 U.S.C. § 3101(b), as amended, and applies to federal debt issued pursuant to the authority of 31 U.S.C. chapter 31. A very small amount of total federal debt is not subject to the debt limit. This amount primarily comprises unamortized discounts on Treasury bills and Zero Coupon Treasury bonds; debt securities issued by agencies other than Treasury, such as the Tennessee Valley Authority; and debt securities issued by the Federal Financing Bank.

³⁸GAO, *Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, [GAO-11-203](#) (Washington, D.C.: Feb. 22, 2011).

³⁹More detail about these options and a discussion of the advantages and challenges to each can be found in [GAO-15-476](#).

revenue. Moving forward, the federal government will need to make tough choices in setting priorities and ensuring that spending leads to positive results. Having a long-term fiscal plan that includes fiscal rules and targets, and decisions about how to better manage borrowing authority, would help with these tough decisions.

Thank you, Chairman Enzi, Ranking Member Sanders, and Members of the Committee, this concludes my prepared statement. I would be pleased to answer any questions.

GAO Contacts

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Appendix I: Opportunities to Address Federal Fiscal Risks

In addition to the fiscal risks related to natural disasters and climate change as discussed in the body of this statement, better understanding fiscal risks like housing finance, surface transportation, and the Pension Benefit Guaranty Corporation, can help policymakers anticipate changes in future spending and can enhance oversight of federal resources. We have recommended ways for Congress and executive branch agencies to address these fiscal risks.

Housing Finance Reform

The federal government continues to provide significant support to the housing finance market, even though the market has largely recovered since the 2007 to 2009 financial crisis. In 2008, 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. At the end of fiscal year 2018, the federal government reported about \$113 billion of investments in the GSEs, which is net of about \$91 billion in valuation losses.

The ultimate role of the GSEs could affect the financial condition of other federal entities, including the Federal Housing Administration (FHA), which in the past expanded its lending role in distressed housing and mortgage markets. At the end of fiscal year 2018, FHA's portfolio of federally-insured mortgages exceeded \$1.2 trillion. The Government National Mortgage Association (Ginnie Mae) guarantees the performance of almost \$2 trillion in securities backed by federally insured mortgages—the majority insured by FHA. We have reported on the need for Congress to consider legislation for making changes to the future federal role in housing finance that addresses the structure of the GSEs; establishes clear, specific, and prioritized goals; and considers all relevant federal entities, such as FHA and Ginnie Mae.¹

In addition, the share of nonbank mortgage originators and servicers grew since the 2007-2009 financial crisis. According to data from Inside Mortgage Finance, nonbanks originated roughly half of all mortgages sold to the GSEs in 2017 and the first three quarters of 2018. Nonbank servicers of loans backing mortgage-backed securities issued by the

¹GAO, *Housing Finance: Prolonged Conservatorships of Fannie Mae and Freddie Mac Prompt Need for Reform*, [GAO-19-239](#) (Washington, D.C.: Jan. 18, 2019). For more information on resolving the federal role in housing finance, see [GAO-19-157SP](#), 95.

GSEs have grown from 25 percent in 2014 to 38 percent as of the third quarter of 2018. For FHA-insured mortgages, nonbank originations represented 74 percent in 2003, declined to 56 percent in 2010, and then increased to 86 percent in fiscal year 2017. While Federal Housing Finance Agency (FHFA) and Department of Housing and Urban Development officials told us nonbanks have helped provide access to mortgage credit, several stakeholders and experts identified the increased presence of nonbank lenders can present additional liquidity risk in the housing finance system. We recommended that Congress consider granting FHFA the authority to examine third parties like nonbank lenders that do business with Fannie Mae and Freddie Mac, in order to identify and address deficiencies that could affect them.²

The Nation's Surface Transportation System

The nation's surface transportation system—including highways, transit, maritime ports, and rail systems—is critical to the economy and affects the daily lives of most Americans. However, according to estimates, it will cost hundreds of billions of dollars to repair and upgrade it to meet current and future demands. Meanwhile, traditional funding sources are eroding and the federal government lacks a long-term sustainable strategy for funding it. The major source of federal funding, the Highway Trust Fund, is increasingly unable to maintain current spending levels for highway and transit programs.³ Spending is projected to exceed revenues after 2021. In its January 2019 budget outlook, CBO estimated that \$159 billion in additional funding would be required to maintain current spending levels plus inflation from 2022 through 2029.⁴ Congress needs to pass a long-term, sustainable solution for funding surface transportation. Such a solution would balance revenues to and spending from the Highway Trust Fund.

²GAO, *Nonbank Mortgage Servicers: Existing Regulatory Oversight Could Be Strengthened* [Reissued on April 14, 2016], [GAO-16-278](#) (Washington, D.C.: Mar. 10, 2016).

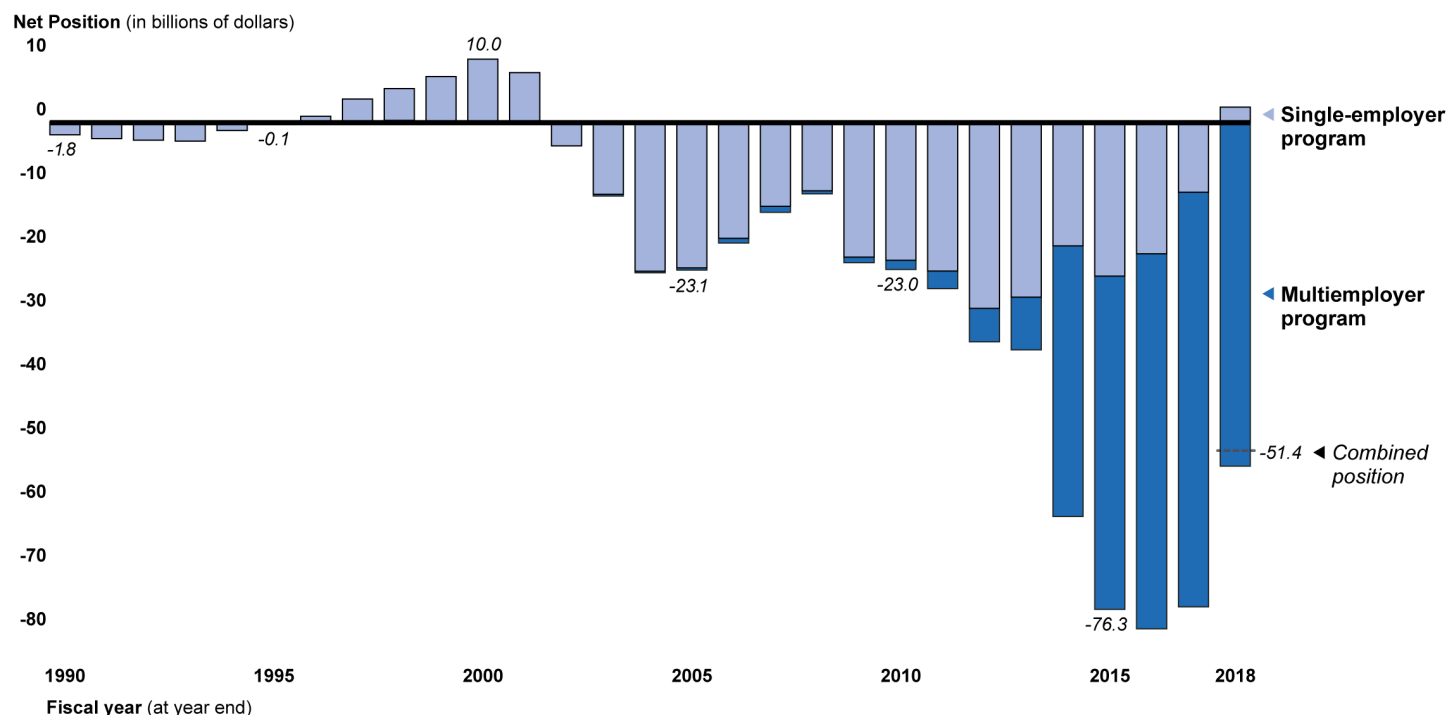
³For more information on funding the nation's surface transportation system, see [GAO-19-157SP](#), 86.

⁴As part of its baseline projection, CBO assumes that this payment will be made after the Highway Trust Fund is exhausted in 2021.

The Pension Benefit Guaranty Corporation

The Pension Benefit Guaranty Corporation's (PBGC) financial future is uncertain because of long-term challenges related to its funding and governance structure. PBGC's liabilities exceeded its assets by about \$51 billion as of the end of fiscal year 2018—an increase of about \$16 billion from the end of fiscal year 2013 (see figure 11).⁵

Figure 11: Pension Benefit Guaranty Corporation's Net Financial Position of the Single-Employer and Multiemployer Programs Combined, Fiscal Years 1990-2018



Source: Pension Benefit Guaranty Corporation (PBGC). | GAO-19-611T

PBGC estimated that its exposure to potential additional future losses for underfunded plans in both the single and multiemployer programs was nearly \$185 billion; the single-employer program accounts for \$175 billion of this amount. PBGC projected that there is more than a 90 percent likelihood that the multiemployer program will be insolvent by the year 2025 and a 99 percent likelihood by 2026. Although the single-employer program is currently in surplus, past experience shows that large claims can cause its condition to change quickly.

⁵For more information on PBGC insurance programs, see [GAO-19-157SP](#), 267.

We have suggested a number of matters for congressional consideration to strengthen PBGC, including (1) authorizing a redesign of PBGC's single employer program premium structure to better align premium rates with risk, (2) adopting additional changes to PBGC's governance structure, (3) strengthening funding requirements for plan sponsors as appropriate given national economic conditions, (4) working with PBGC to develop a strategy for funding PBGC claims over the long term as the defined benefit pension system continues to decline, and (5) enacting additional structural reforms to reinforce and stabilize the multiemployer system, and balance the needs and potential sacrifices of contributing employers, participants, and the federal government.

Appendix II: Near-Term Opportunities to Contribute Toward Fiscal Health

Changes in spending and revenue to ensure long-term fiscal sustainability will require legislative actions to alter fiscal policies. Meanwhile, Congress and executive branch agencies have opportunities in the near term to improve the government's fiscal condition and act as stewards of federal resources. Although these opportunities alone cannot put the federal government on a sustainable fiscal path, they would improve both the fiscal situation and the federal government's operations.

Continue to Address Fragmentation, Overlap, and Duplication

Since 2011, we have reported annually 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. Congress and executive branch agencies have partially or fully addressed 621 of the 805 actions (77 percent) we identified from 2011 to 2018, resulting in about \$262 billion in financial benefits. In our May 2019 report, we presented 98 new actions for Congress or executive branch agencies.¹ We estimate tens of billions more dollars could be saved by fully implementing our open actions.² See table 3 for examples of areas with open actions with potential financial benefits of \$1 billion or more.

¹[GAO-19-285SP](#). See GAO's Duplication and Cost Savings webpage for links to the 2011 to 2019 annual reports: <http://www.gao.gov/duplication/overview>.

²In calculating our total estimated realized and potential financial benefits, we relied on individual estimates from a variety of sources, which considered different time periods and utilized different data sources, assumptions, and methodologies. These totals represent a rough estimate of financial benefits. Realized benefits have been rounded down to the nearest \$1 billion. Estimated potential benefits are subject to increased uncertainty, depending on whether, how, and when they are addressed, and are presented using a notional statement of magnitude.

Table 3: Examples of Areas with Open Actions with Potential Financial Benefits of \$1 Billion or More

Area name and description	Mission	Potential financial benefits ^a (source)
*DOE’s Treatment of Hanford’s Low-Activity Waste: The Department of Energy (DOE) may be able to reduce certain risks by adopting alternative approaches to treating a portion of its low-activity radioactive waste. (GAO-17-306)	Energy	Tens of billions (GAO)
Defense Headquarters: The Department of Defense could review and identify further opportunities for consolidating or reducing the size of headquarters organizations. (GAO-12-345 , GAO-13-293 , GAO-14-439 , GAO-15-10)	Defense	\$9.4 billion (National Defense Authorization Act)
*Advanced Technology Vehicles Manufacturing Loan Program: Unless DOE can demonstrate demand for new Advanced Technology Vehicles Manufacturing loans and viable applications, Congress may wish to consider rescinding all or part of the remaining credit subsidy appropriations. (GAO-14-343SP)	Energy	Up to \$4.3 billion (DOE)
*Disability and Unemployment Benefits: Congress should consider passing legislation to prevent individuals from collecting both full Disability Insurance benefits and Unemployment Insurance benefits that cover the same period. (GAO-12-764)	Income security	\$2.5 billion over 10 years (Office of Management and Budget)
*Social Security Offsets: The Social Security Administration (SSA) needs data on pensions from noncovered earnings to better enforce offsets and ensure benefit fairness, which could result in cost savings if enforced both retrospectively and prospectively, according to the Congressional Budget Office (CBO) and SSA. Congress could consider giving the Internal Revenue Service the authority to collect the necessary information. Estimated savings would be less if SSA only enforced the offsets prospectively as it would not reduce benefits already received. (GAO-05-786T)	Income security	\$2.4 to \$7.9 billion over 10 years (CBO and SSA)
*Crop Insurance: Congress could consider limiting the subsidy for premiums that an individual farmer can receive each year from the Federal Crop Insurance program, reducing the subsidy, or some combination of limiting and reducing these subsidies and making changes to the program to reduce its delivery costs. (GAO-17-501 , GAO-12-256)	Agriculture	Up to \$1.4 billion annually (GAO)
Medicare Clinical Laboratory Payments: The Centers for Medicare & Medicaid Services should take steps to avoid paying more than necessary for clinical laboratory tests. (GAO-19-67)	Health	Over \$1 billion, or billions (GAO)
Department of Energy Environmental Liability: DOE could develop a program-wide strategy to improve decision-making on cleaning up radioactive and hazardous waste. (GAO-19-28)	Energy	Billions (GAO)

Area name and description	Mission	Potential financial benefits ^a (source)
*Identity Theft Refund Fraud: The Internal Revenue Service and Congress could improve the agency's efforts to prevent refund fraud associated with identity theft. (GAO-18-418, GAO-16-508)	General government	Billions (GAO)

Legend: * = Legislation is likely to be necessary to fully address all actions in this area.

Source: GAO. | GAO-19-611T

Note: All estimates of potential financial benefits are dependent on various factors, such as whether action is taken and how it is taken. Actual benefits may be less, depending on costs associated with implementing the action, unintended consequences, and the impact of other factors that could and should be controlled for. The individual estimates in this table should be compared with caution, as they come from a variety of sources, which consider different time periods and utilize different data sources, assumptions, and methodologies.

^aWe developed the notional estimates, which are intended to provide a sense of potential magnitude of financial benefits. Notional estimates have been developed using broad assumptions about potential benefits which are rooted in previously identified losses, the overall size of the program, previous experience with similar reforms, and similar rough indicators of potential benefits. We generally determine the notional label ("millions" vs. "tens of millions" vs. "hundreds of millions") using a risk-based approach that takes into account such factors as the possible minimum and maximum values of the financial benefits estimate (where available), the quality of the data underlying those values, the certainty of those values, and/or the rigor of the estimation method used.

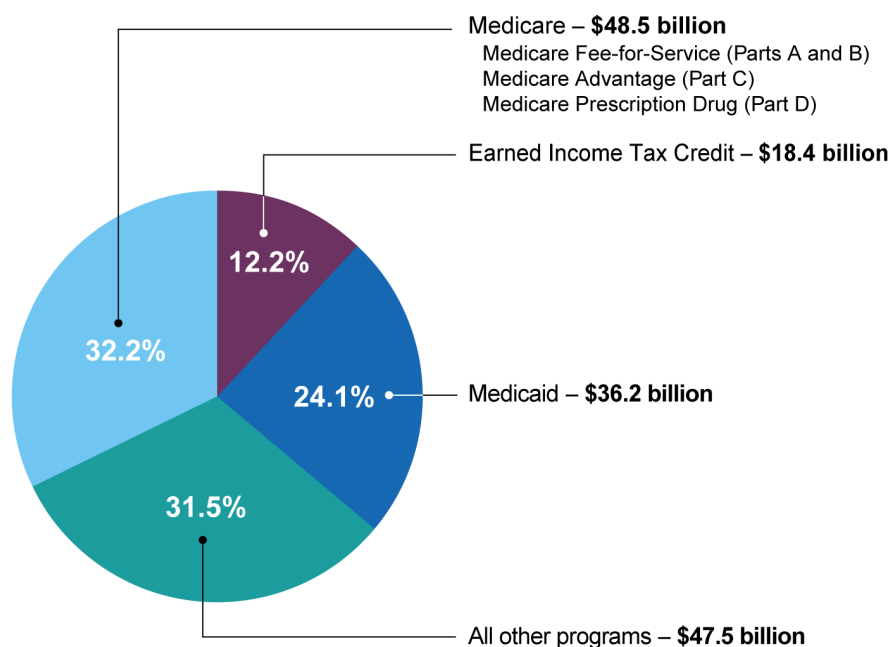
Actions Needed to Address Improper and Other Payments	Improper payments—payments that should not have been made or that were made in an incorrect amount—have consistently been a government-wide issue and if addressed could yield significant savings.³ For fiscal year 2018, agencies reported total improper payment estimates of about \$151 billion. Since fiscal year 2003, cumulative improper payment estimates government-wide have totaled about \$1.5 trillion.⁴ Medicare programs, Medicaid, and the Earned Income Tax Credit account for about 69 percent of the total improper payment estimates
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³Improper Payments Information Act of 2002, Pub. L. No. 107-300, 116 Stat. 2350 (2002), *codified as amended at* 31 U.S.C. § 3321 note. An improper payment is statutorily defined as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes any payment to an ineligible recipient, any payment for an ineligible good or service, any duplicate payment, any payment for a good or service not received (except for such payments where authorized by law), and any payment that does not account for credit for applicable discounts. OMB guidance also provides that when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment.

⁴Prior-year improper payment estimates have not been adjusted for inflation.

reported by agencies for fiscal year 2018 (see figure 12).⁵ Because health care is one of the major drivers of the long-term fiscal outlook, it is especially critical to take appropriate measures to reduce improper payments in Medicare and Medicaid.⁶

Figure 12: Improper Payment Estimates Were Concentrated in Three Areas in Fiscal Year 2018



Source: GAO analysis of agencies' fiscal year 2018 data. | GAO-19-611T

It is important for agencies to identify the root causes of improper payments and then implement internal controls aimed at both prevention and detection. However, the government's ability to understand the full extent to which improper payments occur is hindered by (1) incomplete, unreliable, or understated estimates; (2) risk assessments that may not accurately assess the risk of improper payment; and (3) noncompliance with criteria listed in federal law.

⁵Certain federal programs and activities determined to be at risk for improper payments did not report estimates of improper payments for fiscal year 2018, including the Premium Tax Credit and Temporary Assistance for Needy Families, among others.

⁶For more information on our work on Medicare and Medicaid including improper payments for these programs, see [GAO-19-157SP](#), 241 and 250.

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. For example,

- **Improvements to agency estimates.** In May 2018 we recommended OMB develop guidance to help ensure agencies' estimating processes for identifying improper payments reflect key risks, for example whether a payee is ineligible for a payment.⁷ As of April 2019, OMB has not implemented this recommendation.
- **Amendments to the Social Security Act.** We have suggested that Congress consider amending the Social Security Act to explicitly allow the Social Security Administration to share its full death data with Treasury's Do Not Pay working system for data matching.⁸ As of June 2019, no relevant legislation has been enacted.

**Actions Needed to
Address Medicare and
Medicaid Payments and
Control Health Care
Spending**

Spending for the Medicare and Medicaid programs—both projected to exceed \$1 trillion annually in fiscal year 2026—is a key driver of long-term federal spending. We have identified a number of actions for Congress and agencies to implement related to Medicare and Medicaid payments that could result in billions of dollars in savings, including the following:

- **Medicare—Payments by place of service.** In 2015, we recommended that Congress consider directing the Department of Health and Human Services (HHS) to equalize Medicare payment rates between settings for evaluation and management office visits and other services, and return associated savings to the Medicare

⁷GAO, *Improper Payments: Actions and Guidance Could Help Address Issues and Inconsistencies in Estimation Processes*, [GAO-18-377](#) (Washington, D.C.: May 31, 2018).

⁸GAO, *Improper Payments: Strategy and Additional Actions Needed to Help Ensure Agencies Use the Do Not Pay Working System as Intended*, [GAO-17-15](#) (Washington, D.C.: Oct. 14, 2016).

program.⁹ Several organizations have estimated that equalizing payment rates would save Medicare billions of dollars, with some estimates predicting savings of nearly \$1 billion to \$2 billion a year. Both Congress and the Centers for Medicare and Medicaid Services (CMS) have taken some actions to address this issue; however, these actions do not fully address the issue.

- **Medicare—Prior authorization.** CMS has used prior authorization, which generally requires health care providers and suppliers to demonstrate compliance with Medicare coverage and payment rules before certain items or services are provided to patients. In April 2018, we found that estimated savings from CMS's prior authorization demonstrations could be about \$1.1 to \$1.9 billion, but, at the time of our review, the demonstrations were paused, ended, or scheduled to end.¹⁰ We recommended that CMS take steps to continue prior authorization, which could save an additional tens of millions of dollars.

CMS has taken steps to resume a paused demonstration, extend the end date of a demonstration, and add items to the permanent program. We will continue to monitor agency guidance on the resumed and extended demonstrations and the results of independent evaluations of ended demonstrations. We also will evaluate additional steps CMS takes to continue prior authorization in Medicare, such as identifying new opportunities for prior authorization.

- **Medicare—Payments to cancer hospitals.** In 2015 we estimated that certain cancer hospitals received, on average, about 42 percent more in Medicare inpatient payments per discharge than what Medicare would have paid a local teaching hospital under the prospective payment system (PPS) to treat cancer beneficiaries with

⁹GAO, *Medicare: Increasing Hospital-Physician Consolidation Highlights Need for Payment Reform*, [GAO-16-189](#) (Washington, D.C.: Dec. 18, 2015). Medicare often pays providers at a higher rate when the same service is performed in a hospital outpatient department rather than in a physician office. On November 21, 2018, CMS issued a final rule that reduced payment rates for certain services furnished by the off-campus hospital outpatient departments—those that are not located on a hospital campus—that existed or were under construction in 2015. On December 4, 2018, the American Hospital Association and 4 other plaintiffs filed suit in the U.S. District Court for the District of Columbia arguing that CMS lacks the authority to change the payment rate for these hospital outpatient departments. *American Hospital Association v. Azar*, No. 18-cv-02841 (D.D.C. filed Dec. 4, 2018).

¹⁰GAO, *Medicare: CMS Should Take Actions to Continue Prior Authorization Efforts to Reduce Spending*, [GAO-18-341](#) (Washington, D.C.: Apr. 20, 2018).

the same level of complexity.¹¹ We recommended that Congress consider requiring Medicare to pay these cancer hospitals as it pays these teaching hospitals, or provide HHS with the authority to otherwise modify how Medicare pays cancer hospitals. These actions could save hundreds of millions of dollars each year.

- **Medicare—Medicare Advantage.** CMS pays plans in Medicare Advantage—private health plans that offer health care coverage to Medicare beneficiaries—a predetermined amount per beneficiary adjusted for health status based on a risk score. In 2013 we found that CMS’s adjustment to risk scores for 2010 through 2012 to account for diagnostic coding differences was too low, resulting in estimated excess payments of at least \$3.2 billion to Medicare Advantage plans.¹²

Congress has taken steps to increase the minimum adjustment made for differences in diagnostic coding patterns between these two groups, which are expected to result in savings of approximately \$2.5 billion from fiscal years 2013 through 2022. CMS could still take steps to better account for beneficiary characteristics such as sex and residential location, and use more current and refined data in determining Medicare Advantage payments. CMS could achieve billions of dollars in additional savings by better adjusting for differences between Medicare Advantage plans and traditional Medicare providers in the reporting of beneficiary diagnoses.

- **Medicaid—Supplemental payments.** Supplemental payments—those made to providers in addition to regular claims-based payments—totaled more than \$48 billion in fiscal year 2016. Based on problems we identified with the supplemental payments in multiple reports, we recommended that Congress consider requiring CMS to (1) improve state reporting of certain supplemental payments, including requiring annual reporting of payments made to individual facilities and other information that the agency determines is

¹¹GAO, *Medicare: Payment Methods for Certain Cancer Hospitals Should Be Revised to Promote Efficiency*, [GAO-15-199](#) (Washington, D.C.: Feb. 20, 2015). To control costs and reward efficiency, Medicare pays the majority of hospitals under the prospective payment system which is based on the clinical classification of each service; however, certain cancer hospitals are largely paid on the basis of reported costs.

¹²GAO, *Medicare Advantage: Substantial Excess Payments Underscore Need for CMS to Improve Accuracy of Risk Score Adjustments*, [GAO-13-206](#) (Washington, D.C.: Jan. 31, 2013).

necessary, and (2) clarify permissible methods of calculating these payments.¹³

We have also made several recommendations to CMS to improve the agency's oversight of these payments. In November 2018, CMS announced that it was planning a proposed rule that may improve oversight of Medicaid supplemental payments, which, if effectively implemented, could save hundreds of millions or billions of dollars.

- **Medicaid—Demonstration waivers.** In 2013 we found that HHS did not adequately ensure that four states' Medicaid demonstration projects would be budget neutral to the federal government before approving them, as required by HHS policy.¹⁴ We recommended that Congress could consider requiring HHS to improve the Medicaid demonstration review process. In recent years HHS issued guidance changing the methods it uses to determine whether demonstrations are budget neutral. As of July 2018, CMS estimated that the federal share for the 10 demonstrations that have been renewed under one new method has been reduced by more than \$121 billion over a 7-year period. Continuing to apply this guidance to other demonstrations, along with taking additional actions to ensure budget neutrality, could further reduce demonstration spending limits by billions of dollars.
- **Medicaid—Spending oversight.** In multiple reports in 2018, we found that CMS was not sufficiently identifying and targeting risk in its Medicaid spending oversight activities, which can result in potential overpayments and unallowable expenditures.¹⁵ For example, we found that CMS devotes similar levels of staff resources to review expenditures despite differing levels of risk across states. Specifically, the number of staff reviewing California's expenditures—which represent 15 percent of federal Medicaid spending—was similar to the

¹³GAO, *Medicaid: CMS Oversight of Provider Payments Is Hampered by Limited Data and Unclear Policy*, [GAO-15-322](#) (Washington, D.C.: April 10, 2015) and *Medicaid: More Transparency of and Accountability for Supplemental Payments Are Needed*, [GAO-13-48](#) (Washington, D.C.: Nov. 26, 2012).

¹⁴GAO, *Medicaid Demonstration Waivers: Approval Process Raises Cost Concerns and Lacks Transparency*, [GAO-13-384](#) (Washington, D.C.: Jun. 25, 2013).

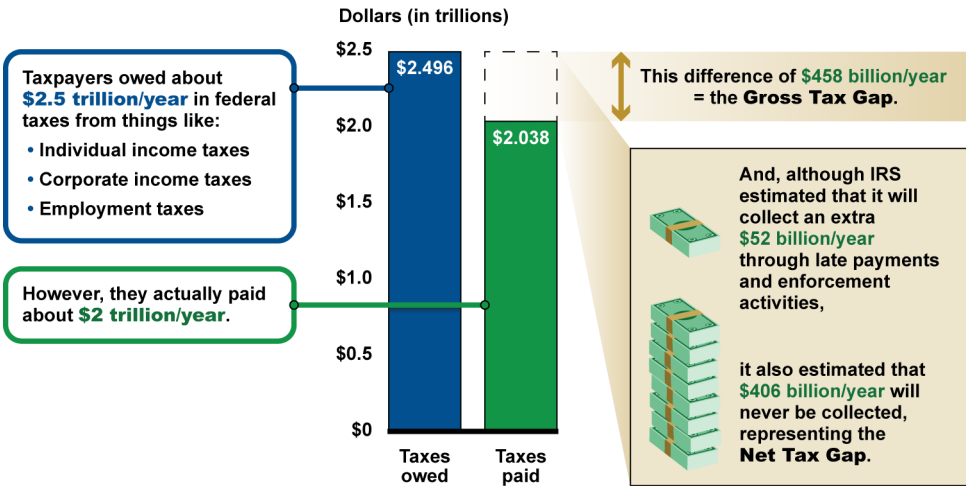
¹⁵GAO, *Medicaid: CMS Needs to Better Target Risks to Improve Oversight of Expenditures*, [GAO-18-564](#) (Washington, D.C.: Aug. 6, 2018); *Medicaid Managed Care: Improvements Needed to Better Oversee Payment Risks*, [GAO-18-528](#) (Washington, D.C.: Jul. 26, 2018); and *Medicaid: CMS Should Take Steps to Mitigate Program Risks in Managed Care*, [GAO-18-291](#) (Washington, D.C.: May 7, 2018).

number reviewing Arkansas’ expenditures, which represents 1 percent of federal Medicaid spending. We made five recommendations to the agency to improve how it identifies and targets risk areas in its oversight of expenditures, which, if implemented, could save hundreds of millions of dollars. CMS agreed with the recommendations, but has not provided a timeframe for implementation.

Multiple Strategies
Needed to Address
Persistent Tax Gap

The tax gap is the difference between tax amounts that taxpayers should pay and what they actually pay voluntarily and on time. The average annual net tax gap was \$406 billion for tax years 2008 through 2010, according to Internal Revenue Service (IRS) estimates (see figure 13).¹⁶ Given the size of the tax gap, even modest reductions would yield significant financial benefits and help improve the government’s fiscal condition. Since any long-term fiscal plan will require consideration of revenue increases, it is important to collect more of what is already owed.

Figure 13: IRS’s Annual Average Tax Gap Estimate for Tax Years 2008–2010



Source: Internal Revenue Service (IRS). | GAO-19-611T

Note: IRS released its most recent tax gap estimate in April 2016 for tax years 2008 to 2010.

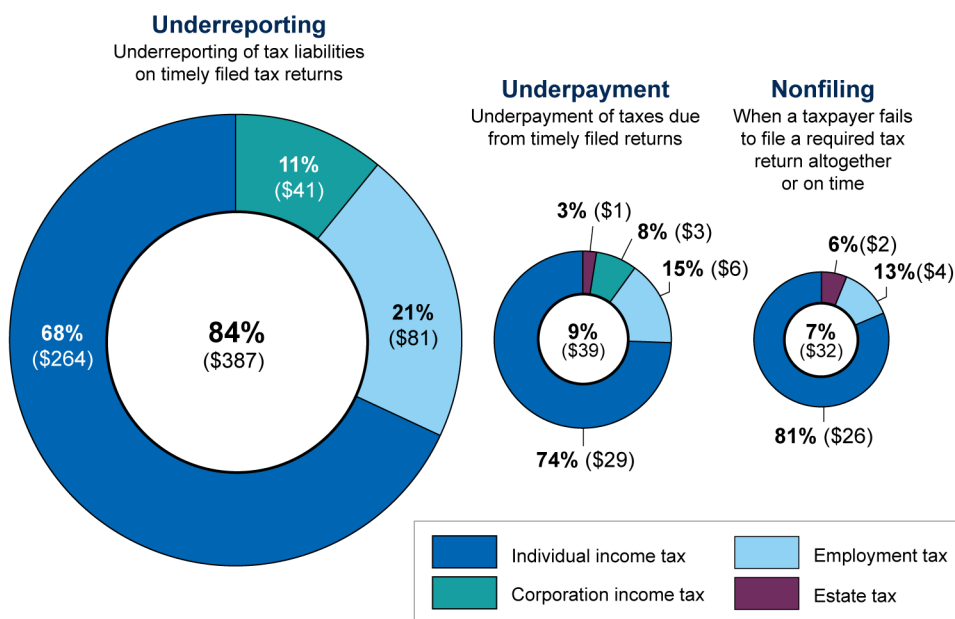
The tax gap arises when taxpayers, whether intentionally or inadvertently, fail to (1) accurately report tax liabilities on tax returns (underreporting),

¹⁶The average annual net tax gap equals the average annual gross tax gap (\$458 billion) minus the amount IRS expects to recover through enforcement actions and late payments (\$52 billion).

(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 estimate across tax years 2008 to 2010, as shown in figure 14.

Figure 14: Estimated Average Annual Gross Tax Gap by Type of Noncompliance and Tax, Tax Years 2008-2010

Dollars (in billions)



Source: GAO analysis of Internal Revenue Service (IRS) information. | GAO-19-611T

Note: Data may not sum to totals because of rounding. Individual income tax includes individual business income tax. Estate tax underreporting noncompliance is not shown in this graphic because it represents less than 0.5 percent of total underreporting noncompliance. Excise tax is not shown in this graphic because the IRS does not have excise tax underreporting noncompliance or nonfiling noncompliance estimates, and its estimate for excise tax underpayment noncompliance represents less than 0.5 percent of total underpayment noncompliance. In addition, IRS does not have a corporation income tax estimate for nonfiling noncompliance.

Reducing the tax gap will be a challenging task requiring action on multiple fronts.¹⁷ Our work has identified a number of strategies and specific actions IRS and Congress can take to reduce the tax gap.

¹⁷For more information on the tax gap, see GAO, *Tax Gap: Multiple Strategies Are Needed to Reduce Noncompliance*, [GAO-19-558T](#) (Washington, D.C.: May 9, 2019).

- **Enhanced electronic filing.** Requiring additional taxpayers, such as corporations, to electronically file tax and information returns could help IRS improve compliance in a resource-efficient way.¹⁸
- **Additional third-party information reporting.** Expanding the information reported to IRS by third parties could increase voluntary tax compliance. For example, reporting could be required for certain payments that rental real estate owners make to service providers, such as contractors who perform repairs on their rental properties.¹⁹
- **Math error authority.** Providing IRS with authority—with appropriate safeguards—to correct math errors and to correct errors in cases where information provided by a taxpayer does not match information in government databases, among other things, could help IRS correct errors and avoid burdensome audits and taxpayer penalties.²⁰
- **Paid preparer regulation.** Providing IRS with the authority to regulate paid tax return preparers could improve the accuracy of the tax returns they prepare.²¹
- **Leveraging the Return Review Program.** Evaluating the costs and benefits of expanding IRS's Return Review Program—a tool to detect potentially fraudulent returns—could streamline the detection and treatment of other types of noncompliance.²²
- **Compliance research strategy.** IRS should develop and document a strategy that outlines how IRS will use National Research Program data to update compliance efforts. Such a strategy would help IRS determine resource trade-offs in its compliance research, while

¹⁸GAO, *Partnerships and S Corporations: IRS Needs to Improve Information to Address Tax Noncompliance*, [GAO-14-453](#) (Washington, D.C.: May 14, 2014).

¹⁹GAO, *Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements*, [GAO-09-238](#) (Washington, D.C.: Jan. 28, 2009) and *Tax Gap: Actions That Could Improve Rental Real Estate Reporting Compliance*, [GAO-08-956](#) (Washington, D.C.: Aug. 28, 2008).

²⁰GAO, *Recovery Act: IRS Quickly Implemented Tax Provisions, but Reporting and Enforcement Improvements Are Needed*, [GAO-10-349](#) (Washington, D.C.: Feb. 10, 2010)

²¹GAO, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors*, [GAO-14-467T](#) (Washington, D.C.: April 8, 2014). A previous study found similar results: see *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, [GAO-06-563T](#) (Washington, D.C.: Apr. 4, 2006).

²²GAO, *Tax Fraud and Noncompliance: IRS Could Further Leverage the Return Review Program to Strengthen Tax Enforcement*, [GAO-18-544](#) (Washington, D.C.: Jul. 24, 2018).

providing Congress with a better understanding of the merits of the research.²³

- **Improving IRS strategic workforce planning.** Addressing IRS's fragmented human capital activities—through fully implementing its workforce planning initiative—would help the agency better meet challenges to achieving its mission.²⁴

Increased Attention to the Results from Tax Expenditures

Evaluating the significant amount of revenue forgone through tax expenditures could help aid fiscal decision-making. In fiscal year 2018, tax expenditures reduced income tax revenues by approximately \$1.38 trillion based on Treasury estimates.²⁵ Tax expenditures (e.g., tax credits, exemptions) are provisions of the tax code that reduce taxpayers' tax liability and therefore the amount of tax revenue paid to the government. They are sometimes used to provide economic relief to selected groups of taxpayers, to encourage certain behavior, or to accomplish other goals.

Although they are routinely used as a policy tool, tax expenditures are not regularly reviewed and their outcomes are not measured as closely as spending programs' outcomes. We have made recommendations in this area that remain open.

- **Evaluation of tax expenditures.** 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.²⁶ However, OMB has not developed this framework and

²³GAO, *Tax Gap: IRS Needs Specific Goals and Strategies for Improving Compliance*, [GAO-18-39](#) (Washington, D.C.: Oct. 31, 2017).

²⁴GAO, *Internal Revenue Service: Strategic Human Capital Management is Needed to Address Serious Risks to IRS's Mission*, [GAO-19-176](#) (Washington, D.C.: Mar. 26, 2019).

²⁵We calculated the total amount based on Treasury's estimates of each tax expenditure. The sum of the tax expenditure estimates is useful for gauging the general magnitude of revenue forgone through provisions of the tax code, but aggregate tax expenditure estimates must be interpreted carefully. Summing revenue loss estimates does not take into account possible interactions between individual provisions or potential behavioral responses to changes in these provisions on the part of taxpayers. Additionally, Treasury's tax expenditure estimates include the effect of certain tax credits on receipts only and not the effect of the credits on outlays, which Treasury reports separately, but does not take into account interactions between individual provisions.

²⁶GAO, *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).

has not reported progress in evaluating tax expenditures since the President's fiscal year 2012 budget.

- **Identify contributions to agency goals.** In July 2016, we recommended that OMB work with agencies to identify which tax expenditures contribute to agency goals. OMB generally agreed with the recommendation but had not taken action as of March 2019.²⁷ Absent such analysis, policymakers have little way of knowing whether these tax provisions support achieving the intended federal outcomes. Policymakers also lack information to compare their costs and efficacy with other policy tools.

Improving Stewardship over Defense-Related Resources

The Department of Defense (DOD) accounts for about half of all discretionary spending. In addition, DOD is responsible for more than 70 percent of the government's Property, Plant, and Equipment. It is therefore important for DOD to exercise careful stewardship over its resources and manage these resources efficiently and effectively. DOD has six areas on our High-Risk List representing some of the fundamental functions of the agency.²⁸ Several government-wide high-risk areas also have direct implications for DOD and its operations, including (1) the government-wide personnel security clearance process, (2) ensuring the cybersecurity of the nation, (3) improving management of IT acquisitions and operations, (4) strategic human capital management, and (5) managing federal real property. We have made recommendations to help DOD make progress addressing these challenges.

DOD's six high-risk areas are:

- **DOD Weapon Systems Acquisition.** DOD can get better returns on its over one trillion dollar weapon system investments by following knowledge-based practices and developing an action plan for performance measures.
- **DOD Approach to Business Transformation.** DOD should accurately track efficiencies gained and costs reduced as it transforms its business functions through a transition to shared services and other efficiency initiatives.

²⁷GAO, *Tax Expenditures: Opportunities Exist to Use Budgeting and Agency Performance Processes to Increase Oversight*, [GAO-16-622](#) (Washington, D.C.: July 7, 2016).

²⁸[GAO-19-157SP](#).

- **DOD Business Systems Modernization.** DOD needs to improve management of its business system acquisitions, improve management of its portfolio of business system investments, and leverage its federated business enterprise architecture to identify and address potential duplication and overlap across systems.
- **DOD Contract Management.** DOD faces challenges in how it defines, strategically manages, and budgets for its contracted services, which typically account for about half of the department's \$300 billion in annual contract obligations.
- **DOD Support Infrastructure Management.** DOD needs to better align its infrastructure capacity with its force structure needs and achieve efficiencies by reducing both excess infrastructure and base support costs, and maximizing the use of its underutilized facilities.
- **DOD Financial Management.** DOD needs to assure that leaders across the department continue to improve their efforts to address long-standing financial management problems.

Added to GAO's High-Risk List in 1995, DOD's financial management continues to face long-standing issues, such as ineffective processes, systems, and controls. DOD remains one of the few federal entities that cannot accurately account for, and report on, its spending or assets. In a positive development, DOD underwent the first agency-wide financial statement audit for its fiscal year 2018 financial statements. However, the auditors were unable to express an opinion due to insufficient evidence.

DOD has acknowledged that achieving a clean audit opinion will take time. DOD established a process to remediate any audit findings and ultimately to improve the quality of financial information that is most valuable in managing the department's day-to-day operations. It stated that over the next several years, the resolution of audit findings will serve as an objective measure of progress toward that goal. DOD will need to develop and effectively monitor corrective action plans to appropriately address audit findings in a timely manner.

In addition, our work has identified a number of actions DOD can take to help improve the federal government's fiscal condition:

- **Defense distribution centers.** In June 2017, we found that, while DOD had taken steps to increase the use of the Defense Logistics Agency's U.S. distribution centers, the department also has other

opportunities to use its entire network of U.S. centers more efficiently such as by minimizing unnecessary overlap and duplication.²⁹ We recommended that DOD assess and direct the implementation of actions, as appropriate, that can be taken using existing authorities to close, realign, or dispose of existing infrastructure to more efficiently use the department's network of U.S. distribution centers. DOD concurred with this recommendation and in July 2017 began to assess options to close, realign, or dispose of existing infrastructure to more efficiently use its network of U.S. distribution centers. DOD estimated by taking such actions, it could potentially save approximately \$527 million over 5 years.

- **Department of Defense special and incentive pays.** The Department of Defense obligates billions of dollars annually on special and incentive pay programs to compensate and incentivize servicemembers for occupations that are dangerous, less desirable, or require special skills. In February 2017, we found that DOD needed to take actions to fully ensure the effectiveness of these programs.³⁰ These actions include incorporating key principles of effective human capital management in its special and incentive pay programs to ensure that the programs are effectively designed and that resources are optimized for the greatest return on investment. For example, using non-monetary incentives to increase retention could lead to program savings totaling tens of millions of dollars annually.
- **Foreign military sales administrative account.** The U.S. government sells defense equipment and services worth tens of billions of dollars each year to its foreign partners through the Foreign Military Sales (FMS) program. To cover the program's operating costs, DOD collects an administrative fee from purchasers and places it into the administrative account of the FMS trust fund. Since 1989, a portion of FMS program operating expenses, for military pay and unfunded civilian retirement and other benefits, have been paid instead from other appropriated funds.

In 2018, we found that the FMS administrative account had grown to contain over \$4 billion and that it likely would continue to have sufficient funds to pay for program expenses through at least fiscal year 2024 even if the account were to cover more annual expenses

²⁹GAO, *Supply Chain Management: DOD Could More Efficiently Use Its Distribution Centers*, [GAO-17-449](#) (Washington, D.C.: June 21, 2017).

³⁰GAO, *Military Compensation: Additional Actions Are Needed to Better Manage Special and Incentive Pay Programs*, [GAO-17-39](#) (Washington, D.C.: Feb. 3, 2017).

than expected.³¹ Congress could enhance federal revenue by at least tens of millions of dollars annually through expanding the definition of allowable expenses authorized to be covered by the FMS administrative account, thereby likely reducing the need to cover these expenses with other appropriated funds.

³¹GAO, *Foreign Military Sales: Controls Should Be Strengthened to Address Substantial Growth in Overhead Account Balances*, [GAO-18-401](#) (Washington, D.C.: May 10, 2018).

Related GAO Products

2019 Annual Report: Additional Opportunities to Reduce Fragmentation, Overlap, and Duplication and Achieve Billions in Financial Benefits. [GAO-19-285SP](#). Washington, D.C.: May 21, 2019.

Tax Gap: Multiple Strategies Are Needed to Reduce Noncompliance. [GAO-19-558T](#). Washington, D.C.: May 9, 2019.

The Nation's Fiscal Health: Action Is Needed to Address the Federal Government's Fiscal Future. [GAO-19-314SP](#). Washington, D.C.: April 10, 2019.

Financial Audit: Fiscal Years 2018 and 2017 Consolidated Financial Statements of the U.S. Government. [GAO-19-294R](#). Washington, D.C.: Mar. 28, 2019.

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