

A presentation featured at the  
2010 Topical Symposium:  
***Economic Security: Neglected Dimension of National Security?***

Hosted by:  
The Institute for National Strategic Studies  
of  
The National Defense University

24-25 August 2010

By  
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Peter G. Peterson  
Foundation

*Our America. Our Future.*

# Comeback America: Turning the Country Around and Restoring Fiscal Responsibility

August 24, 2010  
National Defense University  
The Economic Element of National Power  
Washington, DC

**David M. Walker**  
**President and CEO**  
**The Peter G. Peterson Foundation**  
**and**  
**Former Comptroller General of the United States**

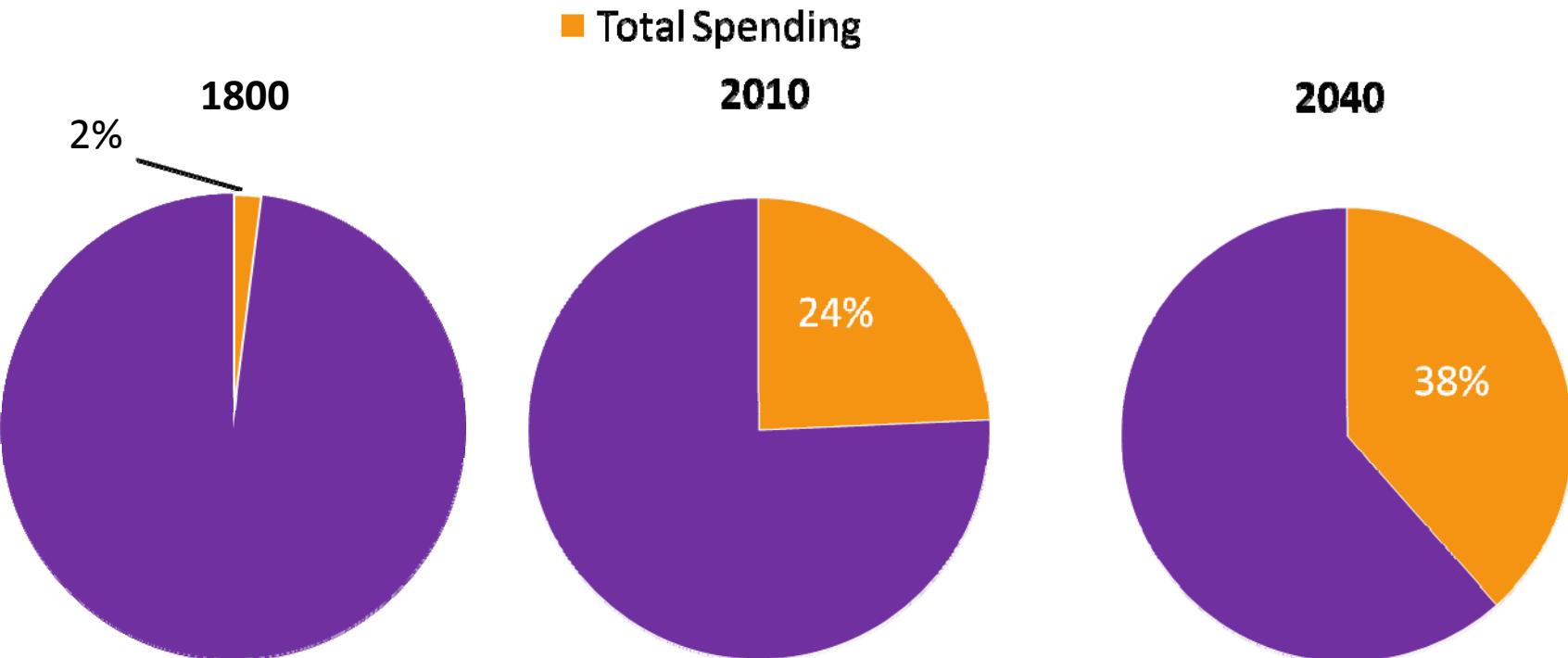
# The Bottom Line

*"If we do not take steps to keep our economy strong for both today and tomorrow, our national security, international standing, standard of living, and even our domestic tranquility will suffer over time."*

*- Hon. David M. Walker, Former Comptroller General of the United States (1998-2008)*

# Total Federal Spending

(As Percentage of U.S. Economy)



Size of the Total  
Economy: \$8.8 Billion  
(Constant 2009 Dollars)

Projected Size of the Total  
Economy: \$14.4 Trillion  
(Constant 2009 Dollars)

Projected Size of the  
Total Economy: \$28.7  
Trillion  
(Constant 2009 Dollars)

SOURCES: Data from the Congressional Budget Office, *Long-Term Budget Outlook: June 2009*; *Long-Term Budget Outlook: June 2010*, alternative fiscal scenario. Compiled by PGPF.

NOTE: The alternative fiscal scenario includes several changes to current law that are widely anticipated to occur (i.e. adjustments to Medicare payment rates).

# Composition of Federal Spending

(% of Total Spending)

■ Medicare and Medicaid

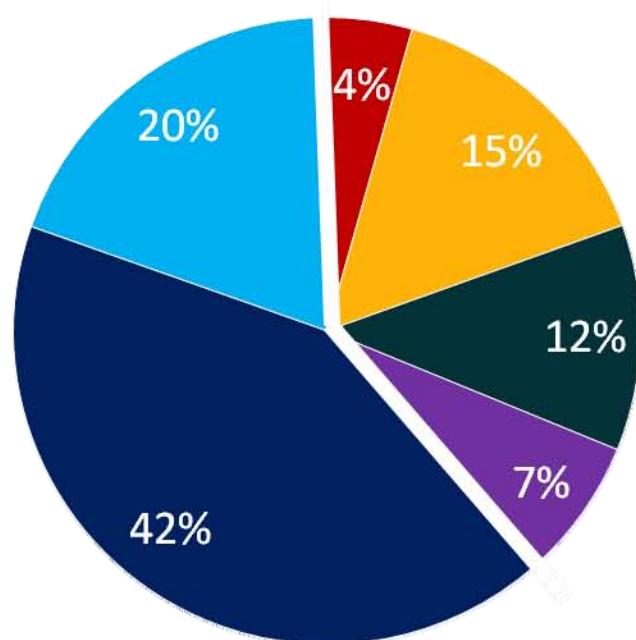
■ Net Interest

■ Social Security

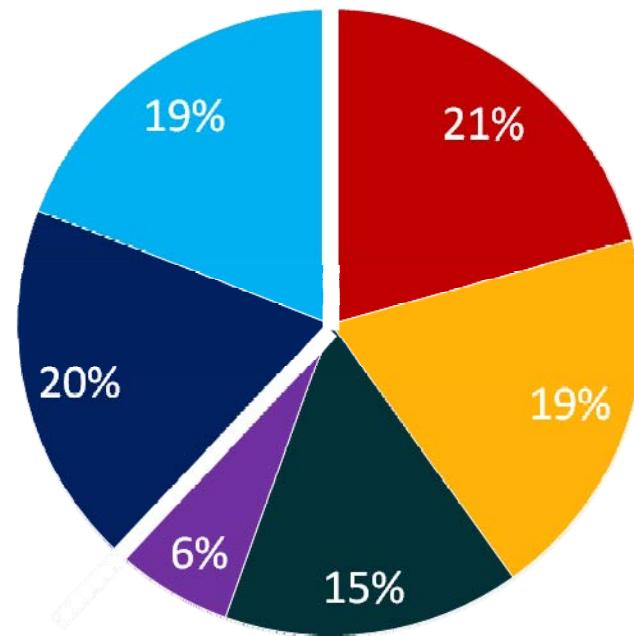
■ Defense

■ Other Mandatory

■ Other Discretionary



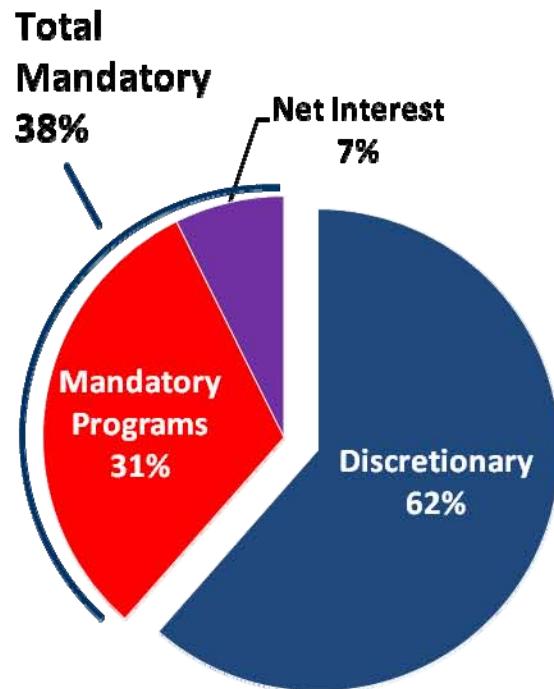
**Total Spending 1970:**  
\$900 Billion (Constant 2009 Dollars)



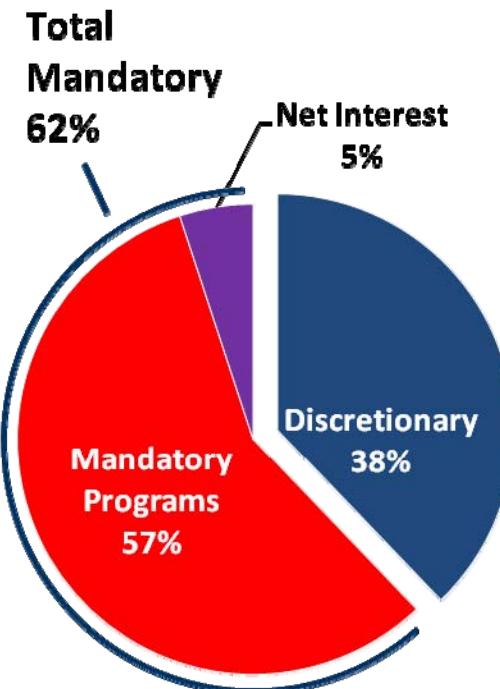
**Total Spending 2010 (estimated):**  
\$3.5 Trillion (Constant 2009 Dollars)

SOURCES: Data from the Office of Management and Budget, *A New Era of Responsibility: The 2011 Budget, Historical Tables*; and the Congressional Budget Office, *Preliminary Analysis of the President's Budget: March 2010*. Compiled by PGPF.

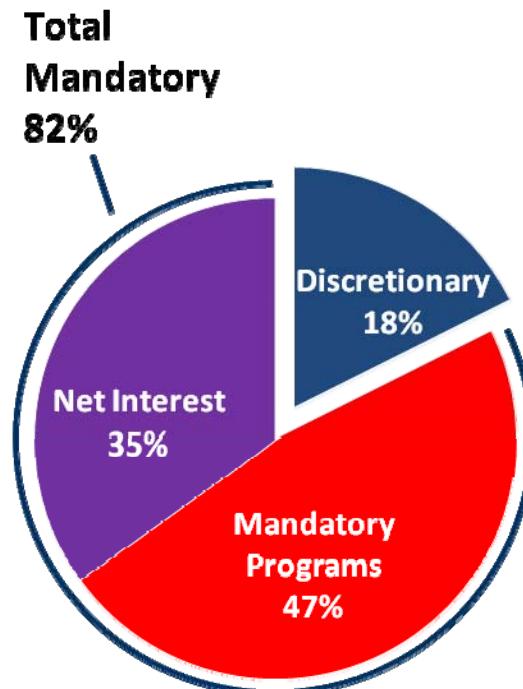
## Mandatory programs and interest costs are taking over more and more of the federal budget, crowding out important discretionary programs



**Total Spending 1970:**  
\$900 Billion



**Total Spending 2010:**  
\$3.5 Trillion (est.)

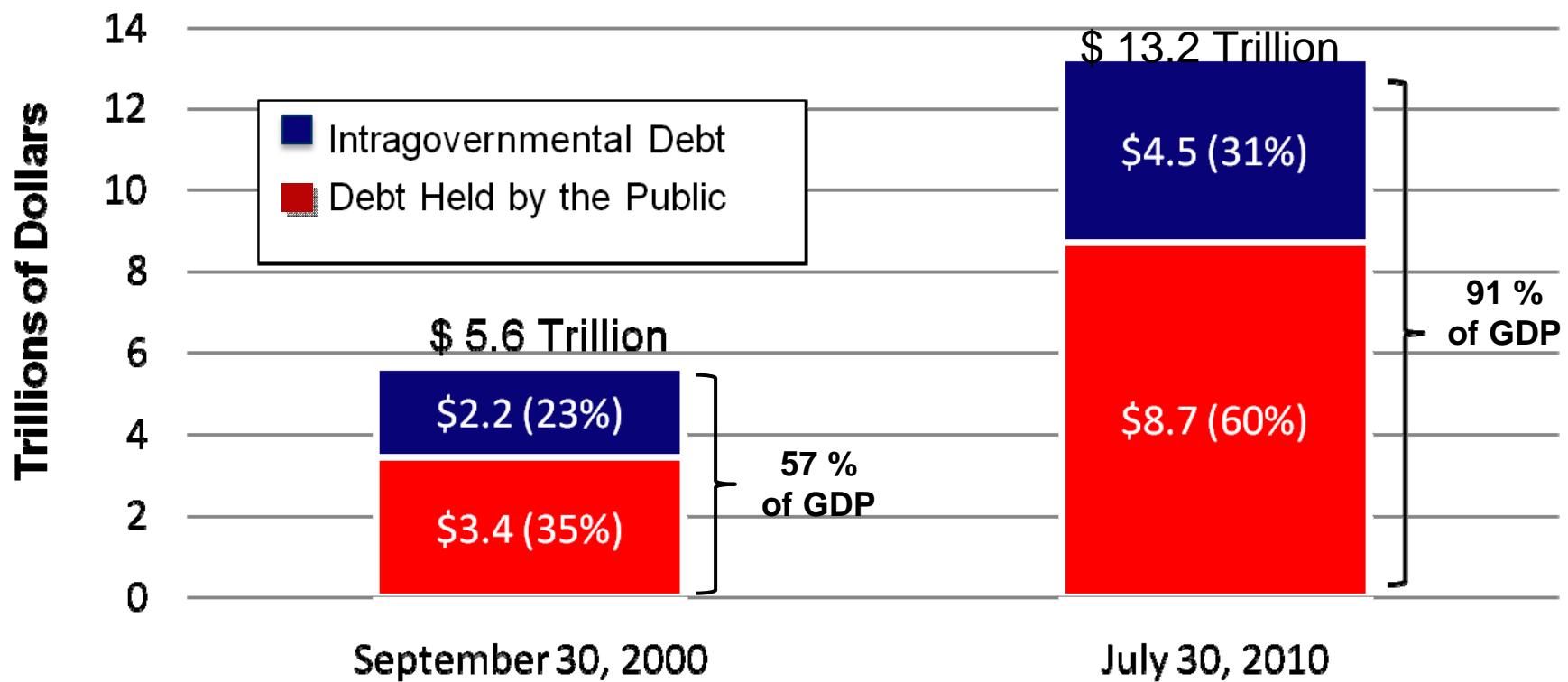


**Total Spending 2040:**  
\$12.3 Trillion (est.)

SOURCES: Data derived from the Office of Management and Budget, *FY 2011 Budget, Historical Tables*, February 2010; and the Government Accountability Office, *The Federal Government's Long-Term Fiscal Outlook*, January 2010 Update, alternative simulation using Congressional Budget Office assumptions. Calculated by PGPF.

Notes: Data is in constant 2009 dollars. Mandatory programs include Social Security, Medicare, Medicaid and other entitlement programs.

The total debt includes debt held by the public (domestic and foreign investors) and debt the government owes to various government programs\*



SOURCES: Data from the Office of Management and Budget, *A New Era of Responsibility: The 2011 Budget*: February 2010, Historical Tables; and the Department of Treasury, *Daily Treasury Statement* (April 30, 2010). Compiled by PGPF.

NOTE: Totals may not add due to rounding.

\*Intragovernmental debt refers to Treasury securities held by federal trust funds (e.g., Social Security and Medicare) and other government accounts. Debt held by the public refers to all federal debt held by individuals, corporations, state or local governments, and foreign entities.

## The following table illustrates the U.S. government's explicit liabilities, commitments, and unfunded social insurance promises

**In Trillions of Dollars**

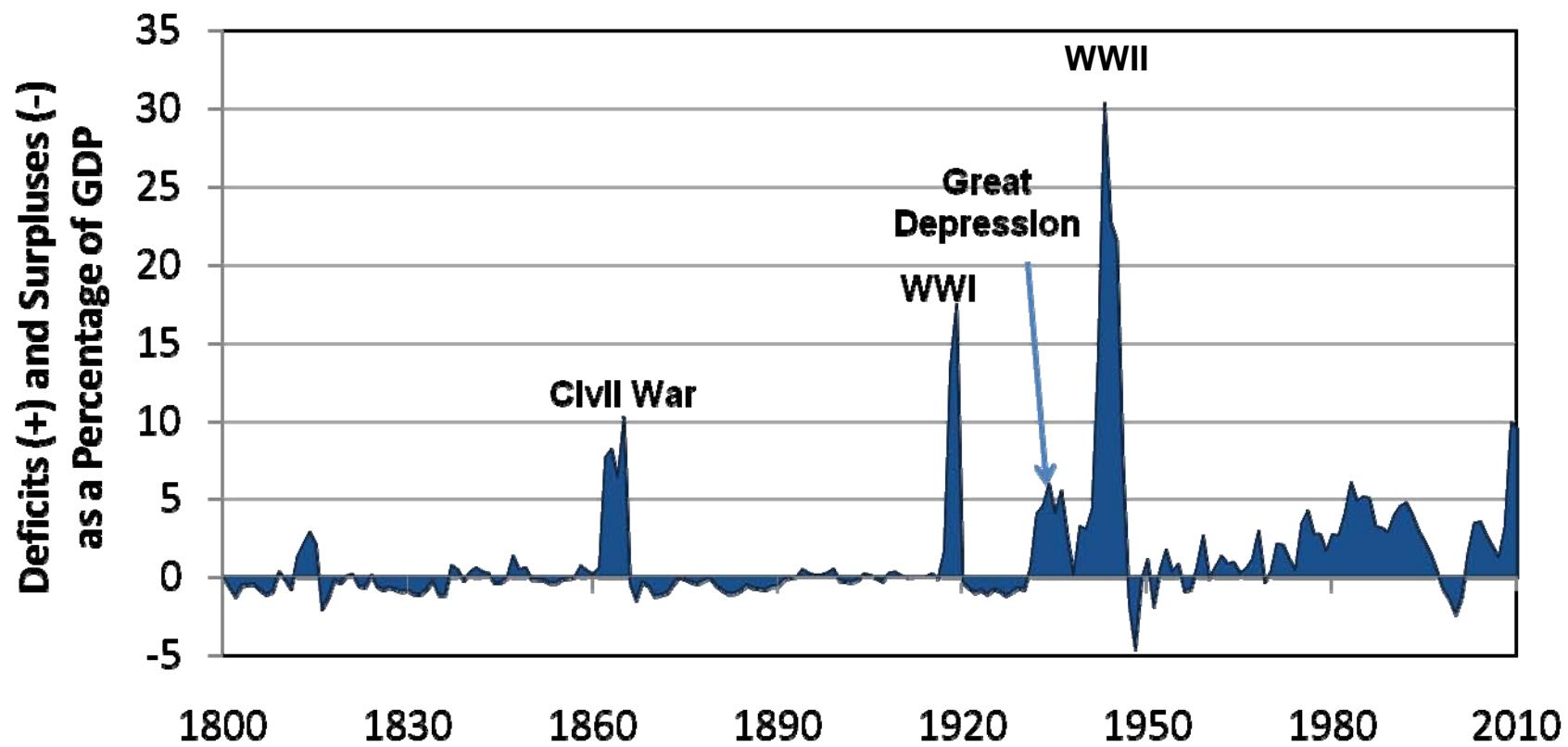
**2000                    2009**

■ Explicit liabilities	\$6.9	\$14.1
■ Explicit liabilities	\$6.9	\$14.1
■ Publicly held debt	3.4	7.6
■ Military & civilian pensions & retiree health	2.8	5.3
■ Other Major Fiscal Exposures	0.7	1.3
■ Commitments & contingencies	0.5	2.0
■ E.g., Pension Benefit Guaranty Corporation, undelivered orders		
■ Social insurance promises	13.0	45.8
■ Future Social Security benefits	3.8	7.7
■ Future Medicare benefits	9.2	38.2
■ Future Medicare Part A benefits	2.7	13.8
■ Future Medicare Part B benefits	6.5	17.2
■ Future Medicare Part D benefits	--	7.2
<b>Total</b>	<b>\$20.4</b>	<b>\$61.9</b>

SOURCE: Data from the Department of Treasury, *2009 Financial Report of the United States Government*. Compiled by PGPF.

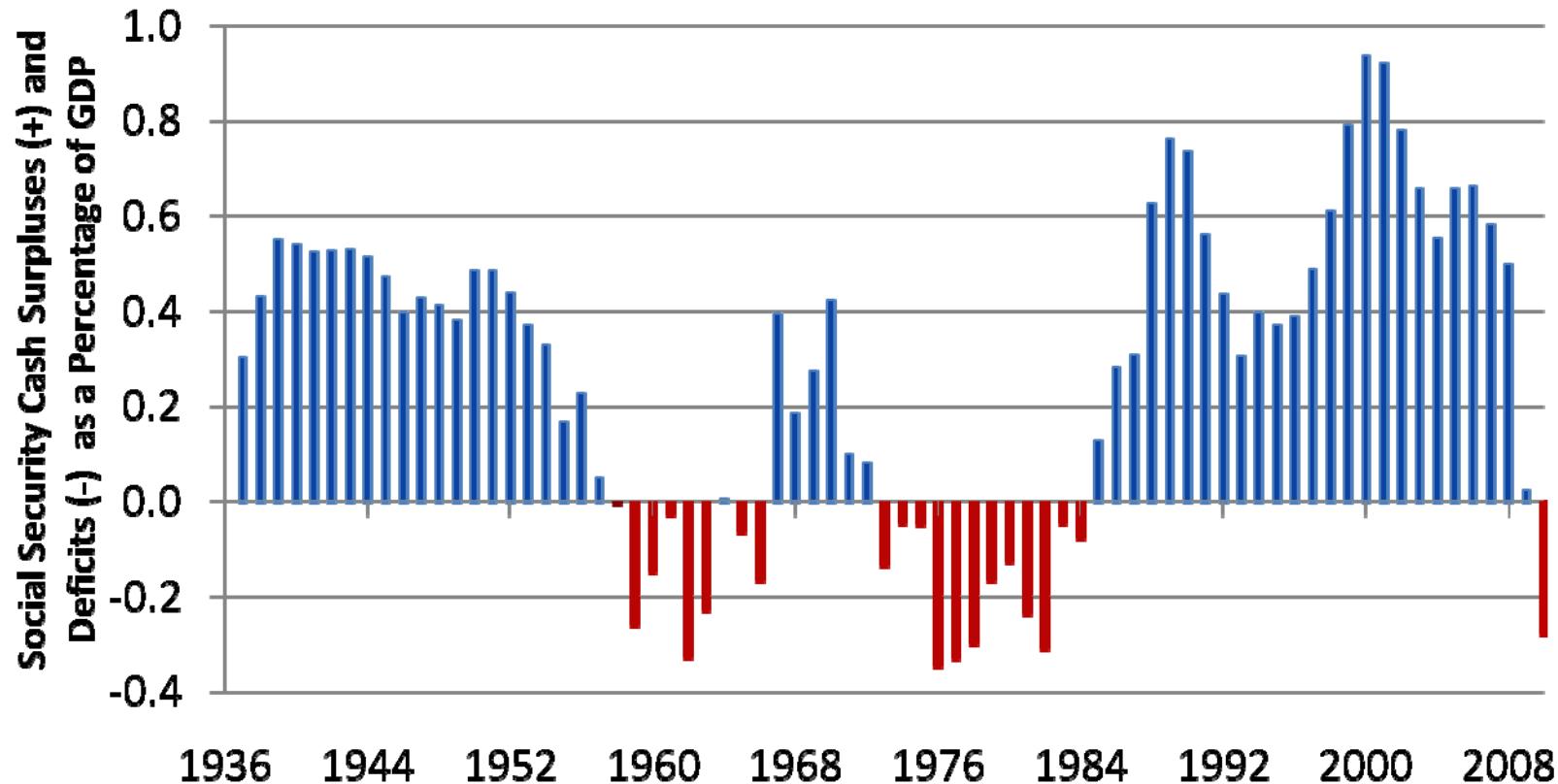
NOTE: Numbers may not add due to rounding. Estimates for Medicare and Social Security benefits are from the Social Security and Medicare Trustees reports, which are as of January 1, 2009 and show social insurance promises for the next 75 years. Future liabilities are discounted to present value based on a real interest rate of 2.9 percent and CPI growth of 2.8 percent. The totals do not include liabilities on the balance sheets of Fannie Mae, Freddie Mac, and the Federal Reserve. Assets of the U.S. government not included. Does not include civil service and military retirement funds, unemployment insurance, and debt held by other government accounts outside of Social Security and Medicare.

Prior to the Great Depression deficits were unusual in the U.S.  
Budget surpluses occurred in over two-thirds of the years  
between 1800 and 1930



SOURCES: Data from the Office of Management and Budget, *A New Era of Responsibility: The 2011 Budget, Historical Tables*, February 2010; the Government Accountability Office, *The Federal Government's Long-Term Fiscal Outlook: January 2010 Update*, alternative simulation using Congressional Budget Office assumptions; and the *Historical Statistics of the United States*, Millennial Edition Online, Cambridge 2006. Compiled by PGPF.

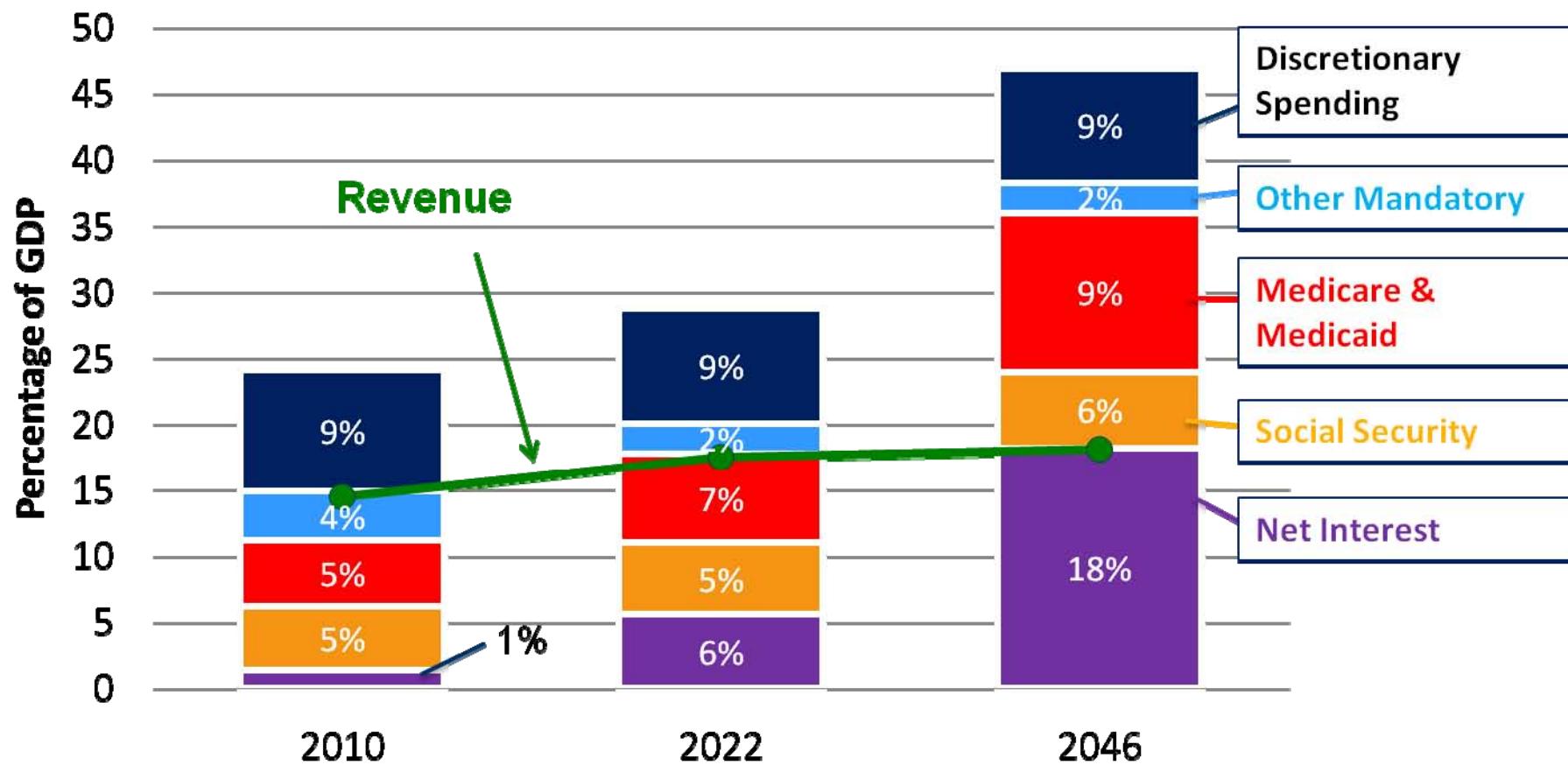
Since its inception, the Social Security program has experienced more surpluses than deficits



SOURCE: Data from the Office of Management and Budget, *FY 2011 Budget, Historical Tables*, February 2010 and Social Security Administration, *2010 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, August 2010. Compiled by PGPF.

NOTE: Excludes interest earnings.

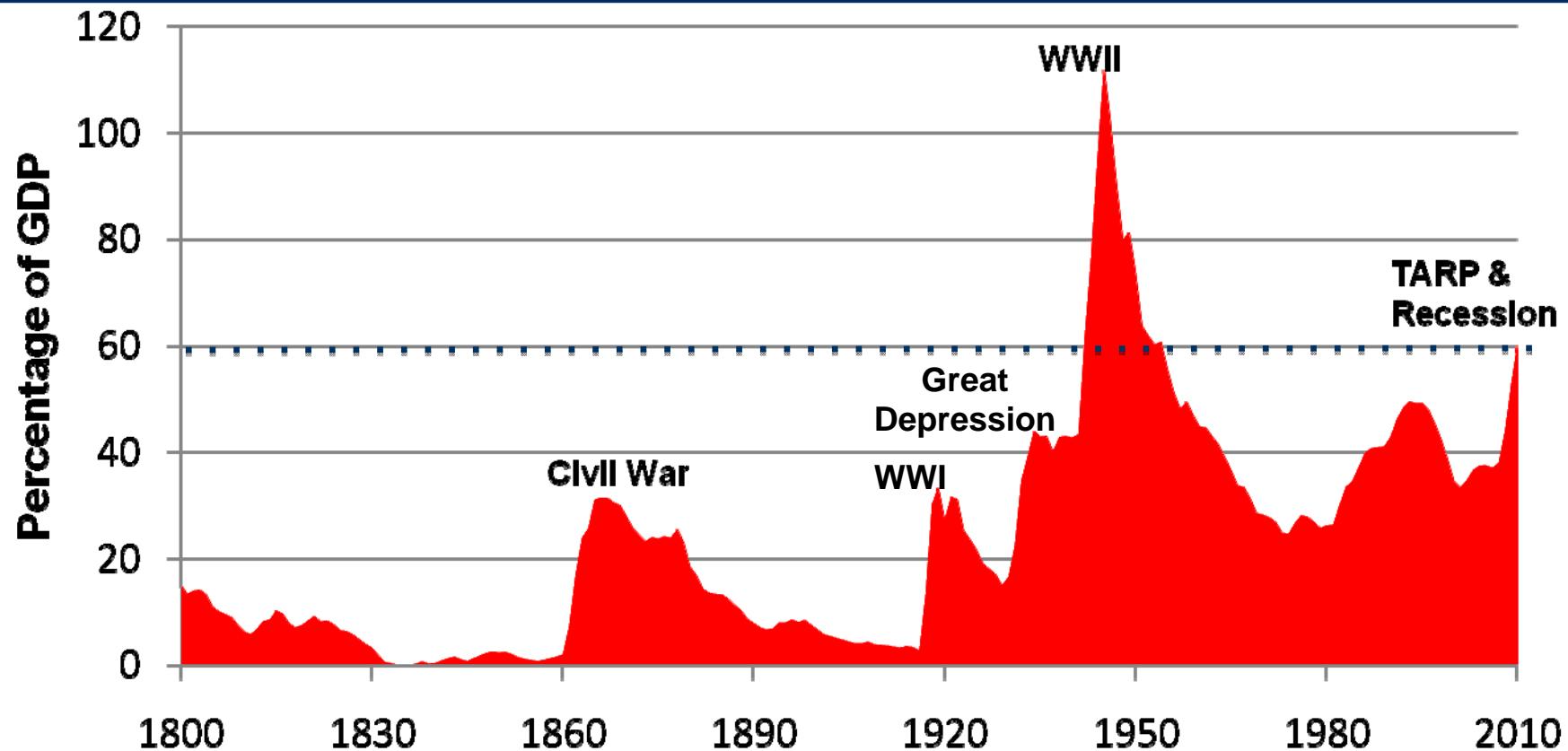
Without reforms, by 2022, future revenues will only cover Social Security, Medicare, Medicaid, and interest on the debt. By 2046, revenues won't even cover interest costs.



SOURCE: Data from the Government Accountability Office *The Federal Government's Long-Term Fiscal Outlook: January 2010 Update*, alternative simulation using Congressional Budget Office assumptions. Compiled by PGPF.

NOTE: Baseline interest rate is assumed to be 5.0 percent.

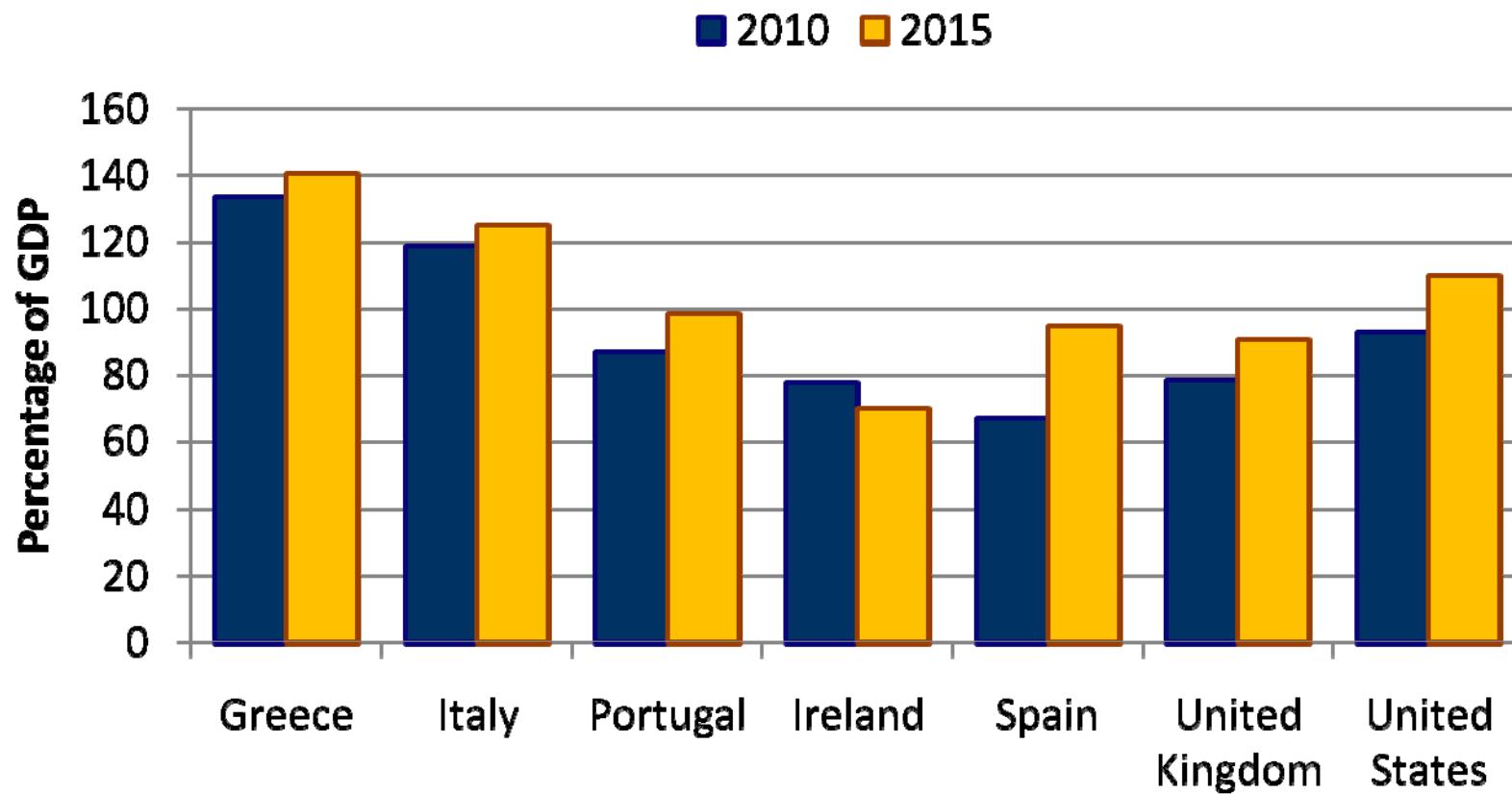
Since 1800, U.S. Debt Held by the Public has exceeded 60 percent of GDP (the maximum debt ceiling used by the European Monetary Union) only during World War II



SOURCES: Data from the Congressional Budget Office, *Long-Term Budget Outlook: June 2009*; the Government Accountability Office, *The Federal Government's Long-Term Fiscal Outlook: January 2010 Update*, alternative simulation using Congressional Budget Office assumptions. Compiled by PGPF.

NOTE: Debt held by the public refers to all federal debt held by individuals, corporations, state or local governments, and foreign entities.

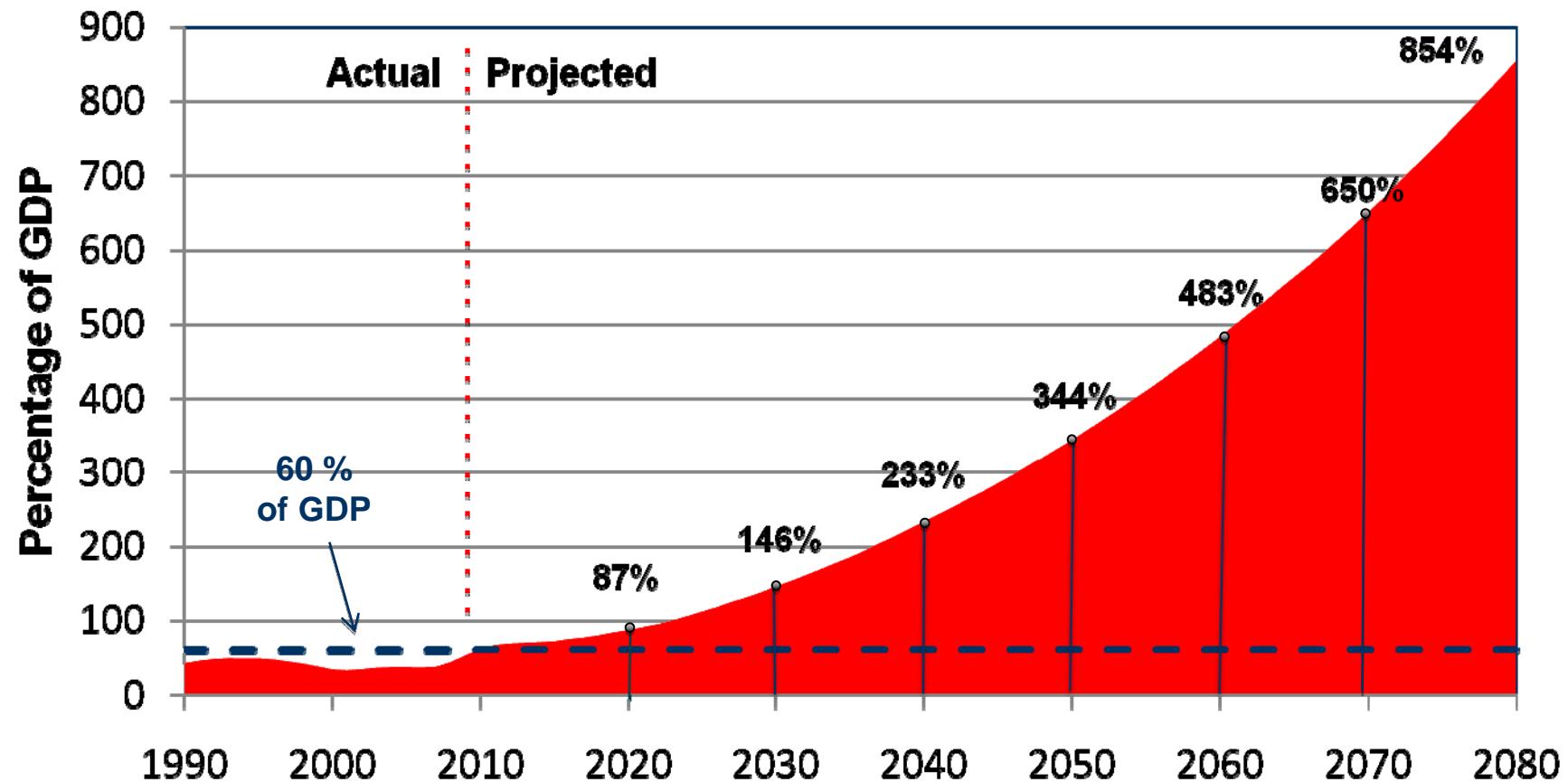
## Total government debt in the U.S is higher than some of the most financially troubled countries in Europe



SOURCE: Data from the International Monetary Fund, *IMF Fiscal Monitor Series: Navigating the Fiscal Challenges Ahead*, May 14, 2010. Compiled by PGPF.

NOTE: Both 2010 and 2015 figures are estimates. Total Government debt (also referred to as general government gross debt) measures all liabilities that require payment or payments of interest and/or principal by the debtor to the creditor at a date in the future. This includes central, state and local government debt.

## Future U.S. Debt Held by the Public is projected to soar if current policies remain unchanged



SOURCES: Data from the Congressional Budget Office, *Long-Term Budget Outlook: June 2009*; *Long-Term Budget Outlook: June 2010*, alternative fiscal scenario. Compiled by PGPF.

NOTE: Debt held by the public refers to all federal debt held by individuals, corporations, state or local governments, and foreign entities. The alternative fiscal scenario includes several changes to current law that are widely anticipated to occur (i.e. adjustments to Medicare payment rates).

## U.S. dependency on foreign lenders to finance the public debt has risen sharply

**1970**

Total Debt: \$283 billion

**Foreign Holdings:**

5%



**1990**

Total Debt: \$2,412 billion

**Foreign Holdings:**

19%



**2010 est.**

Total Debt: \$8,633 billion

**Foreign Holdings:**

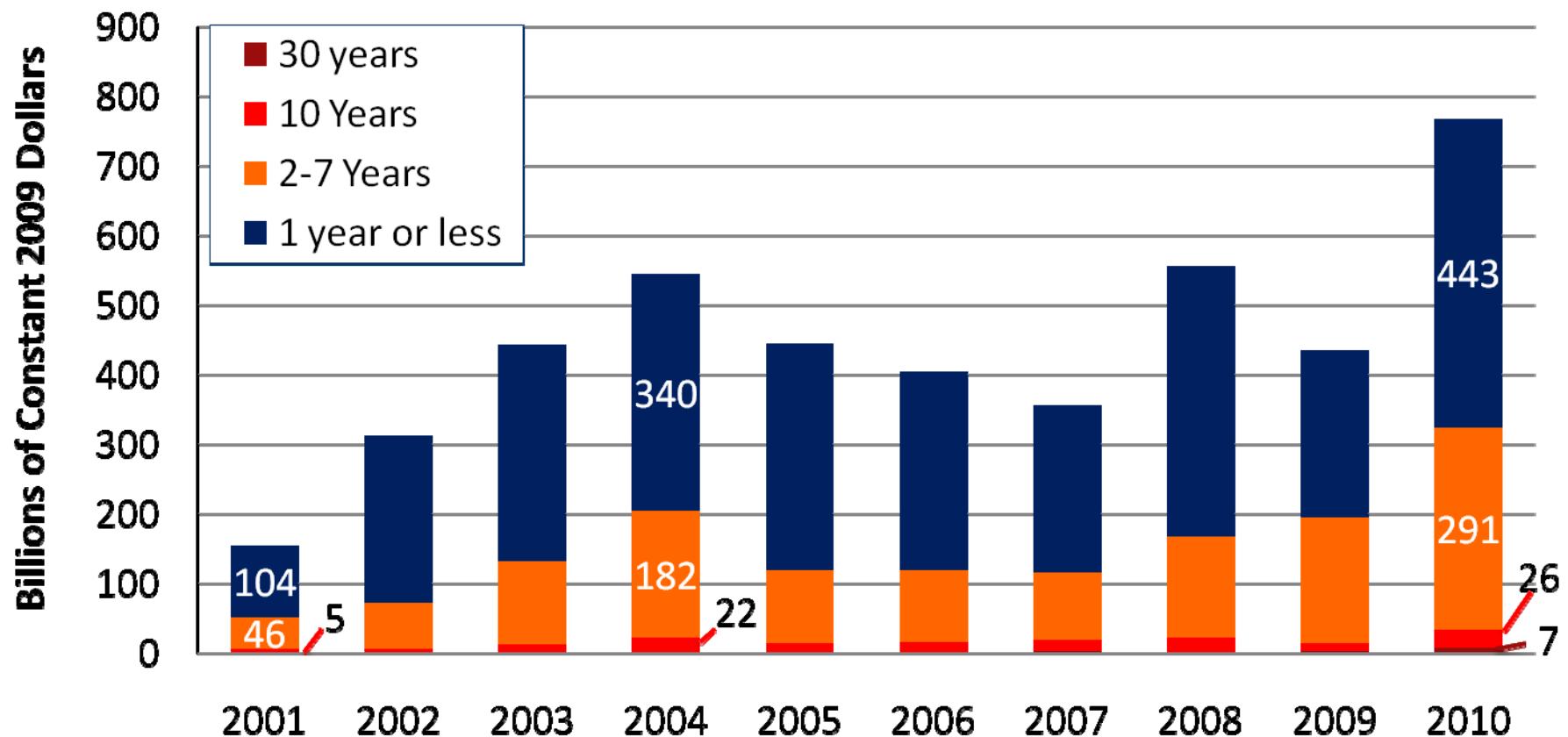
46%



SOURCES: Data for 1970 and 1990 from the Office of Management and Budget, *A New Era of Responsibility: The 2011 Budget*, Analytical Perspectives, February 2010. Data for 2010 from Department of Treasury, *Daily Treasury Statement* (June 30, 2010) and Treasury International Capital Reporting System, April 15, 2010 release. Compiled by PGPF.

NOTE: 2010 data reflects debt levels through February 2010.

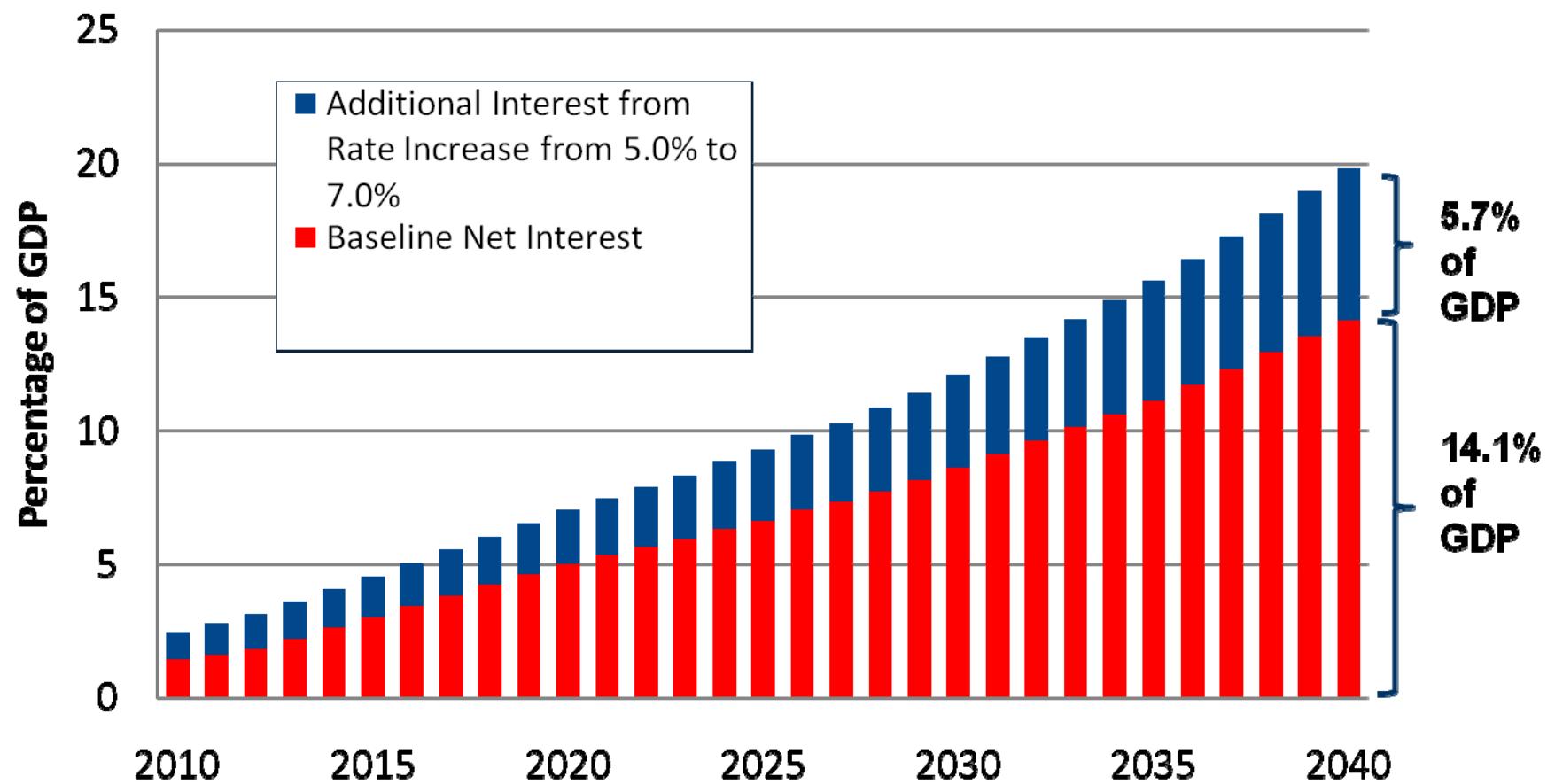
## Foreign purchases of marketable Treasury securities are overwhelmingly in shorter maturities, indicating sizeable interest-rate risk upon rollover



SOURCE: Data from the U.S. Treasury, Office of Debt Management, Investor Class Auction Allotments. Compiled by PGPF.

NOTE: Purchases reflect gross foreign purchases of bills (4-week, 13-week, 26-week, 52-week, and cash-management bills); notes (2-year, 3-year, 5-year, 7-year, and 10-year) and bonds (30-year). Data excludes sales of Treasury Inflation Protected Securities (TIPS), and also is not net of sales. Foreign purchases for 2010 as of June 2010.

## A rate increase of just two percent from baseline levels of 5.0 percent have a dramatic effect on interest costs

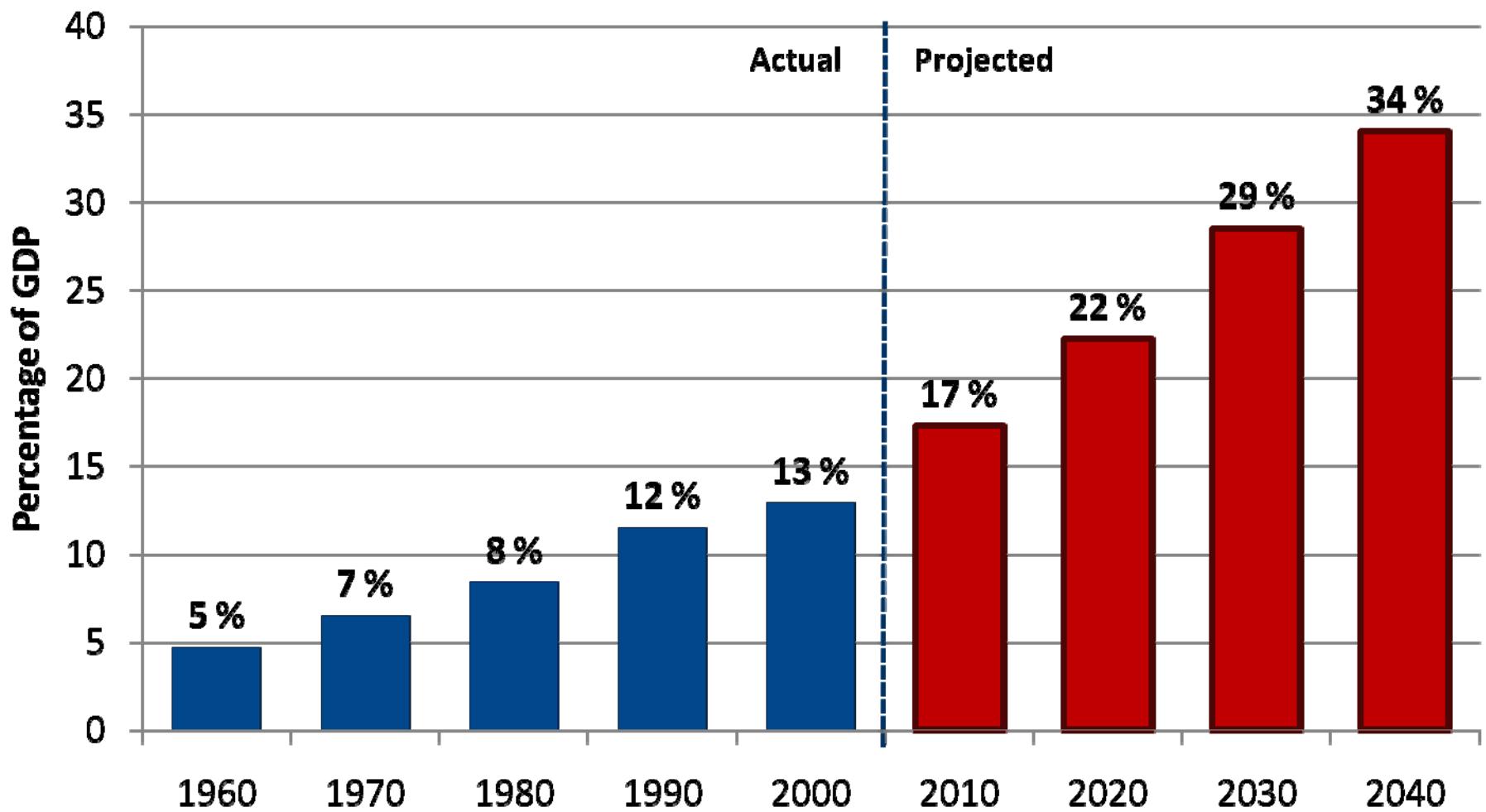


SOURCE: Data from the Government Accountability Office *The Federal Government's Long-term Fiscal Outlook*: January 2010, alternative simulation using Congressional Budget Office assumptions. Compiled by PGPF.

NOTE: The projections use implied CBO interest rates through 2020, and an interest rate of 5.0 percent thereafter.

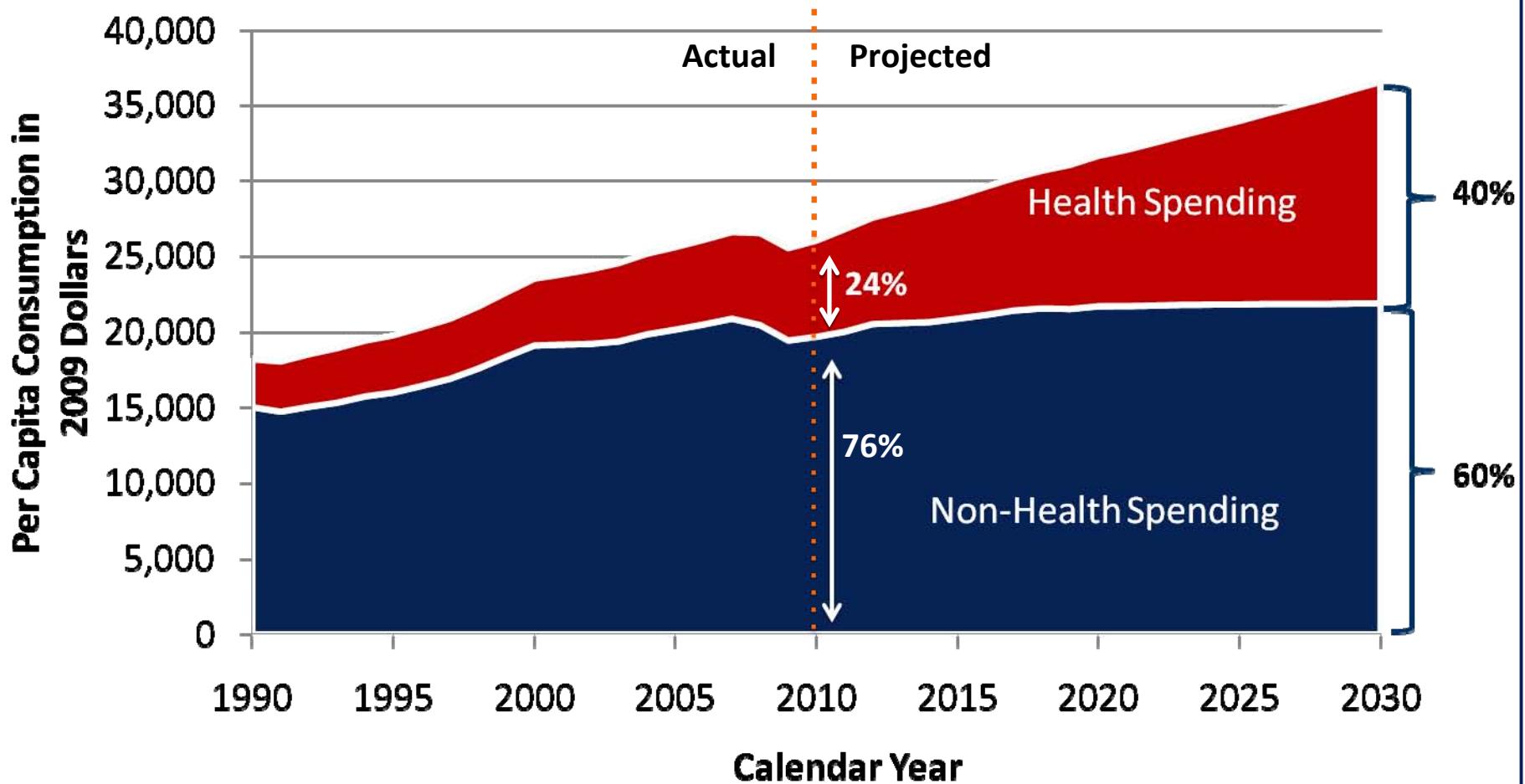


Total U.S. health expenditures (both public and private) are projected to soar to more than one-third of the economy by 2040



SOURCE: Data from the Congressional Budget Office, *The Long-Term Fiscal Outlook*: June 2009. Compiled by PGPF.

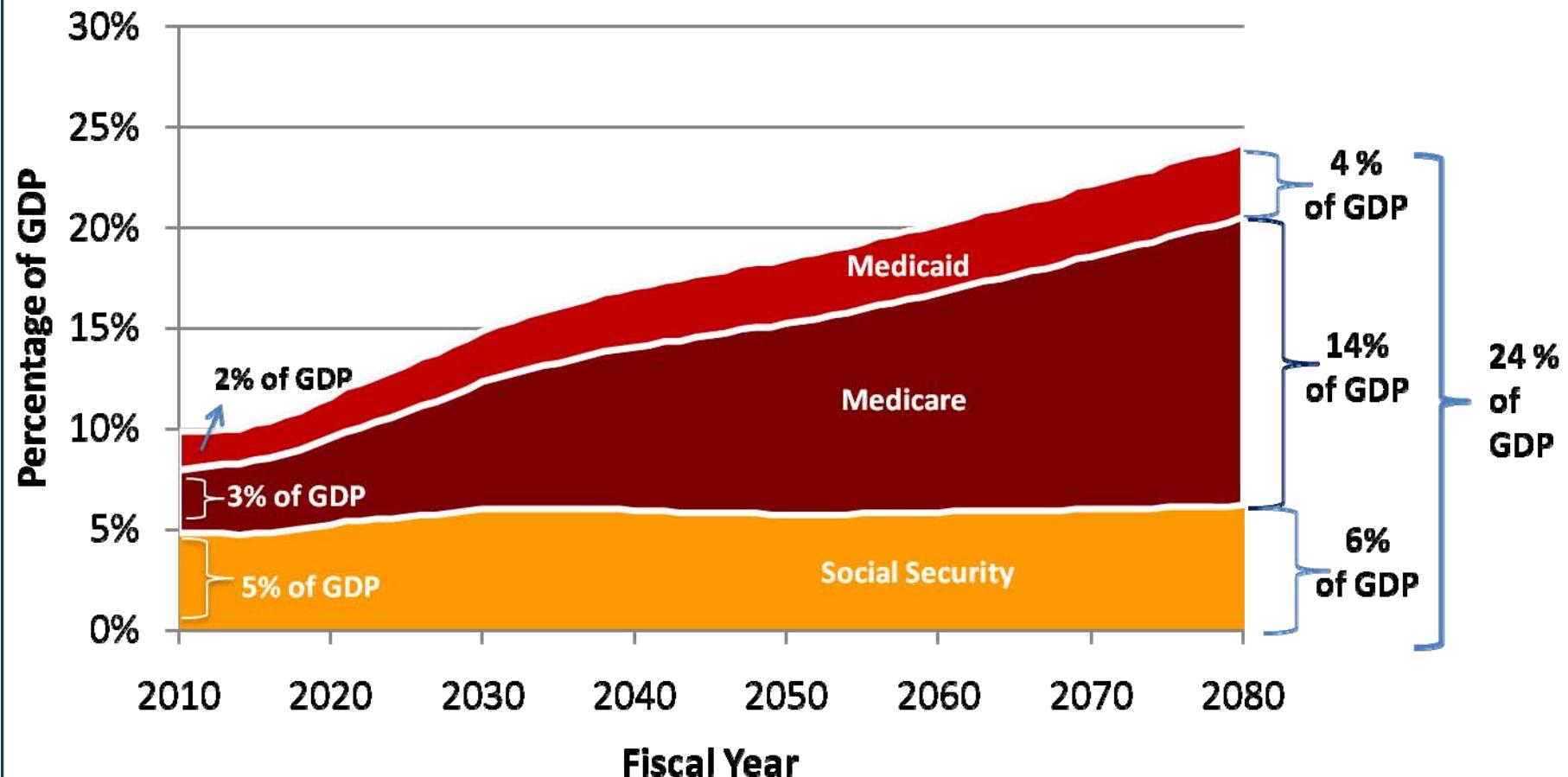
In the future, the share of per capita consumption that is devoted to health care will rise from 24 percent in 2010 to 40 percent in 2030. It was 17 percent in 1990.



SOURCE: Data from the Congressional Budget Office, *The Long-Term Budget Outlook*, June 2009. Compiled by PGPF.

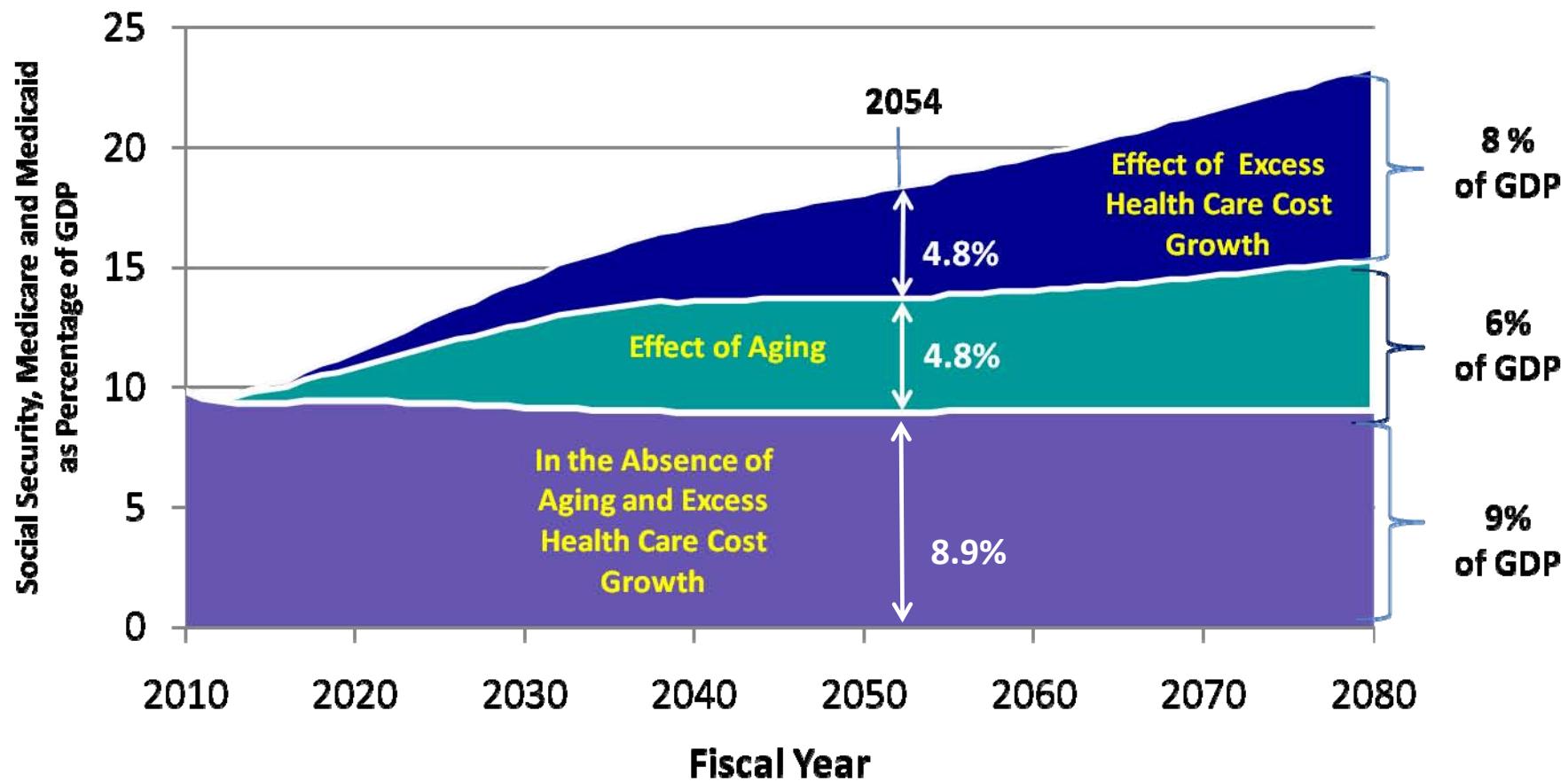
NOTE: Total spending is equal to the sum of personal and government consumption as defined by the Bureau of Economic Analysis.

Social Security, Medicare, and Medicaid, the three largest entitlement programs, are projected to more than double as a percentage of GDP under current policies



SOURCE: Data from the Government Accountability Office, *The Federal Government's Long-Term Fiscal Outlook: January 2010 Update*, alternative simulation using Congressional Budget Office Assumptions. Compiled by PGPF.

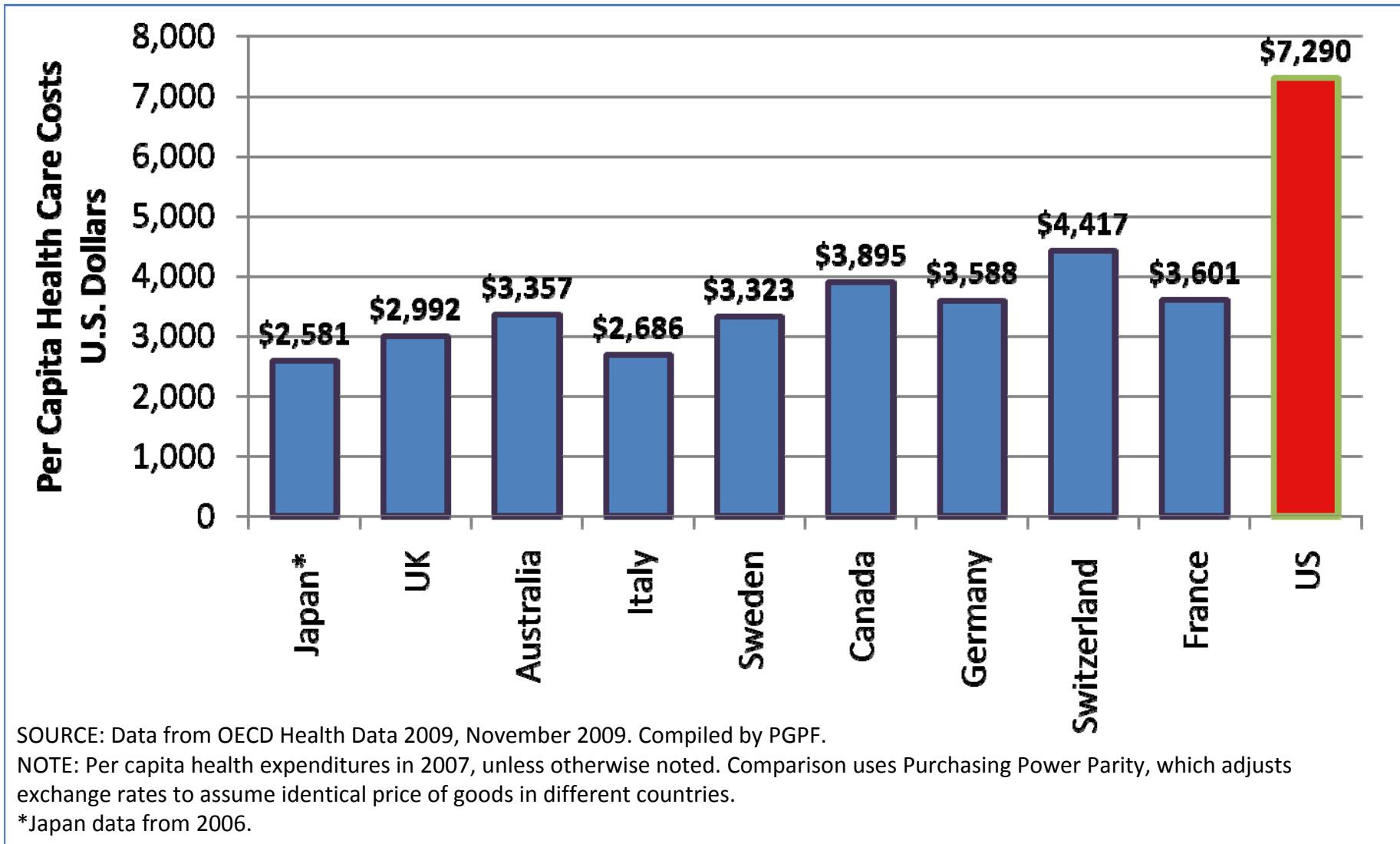
Aging drives most of the projected cost growth in Social Security, Medicare, and Medicaid until 2054. After that year, health care costs takes over as the leading driver of spending growth.



SOURCE: Data from the Congressional Budget Office, *The Long-Term Budget Outlook* (June 2009). Compiled by PGPF.

NOTE: "Excess health care cost growth" is the amount growth in age-adjusted health care costs per person exceeds the growth in per capita GDP.

Currently, Americans spend about twice as much per capita on health care than other OECD countries with no appreciable difference in health outcomes

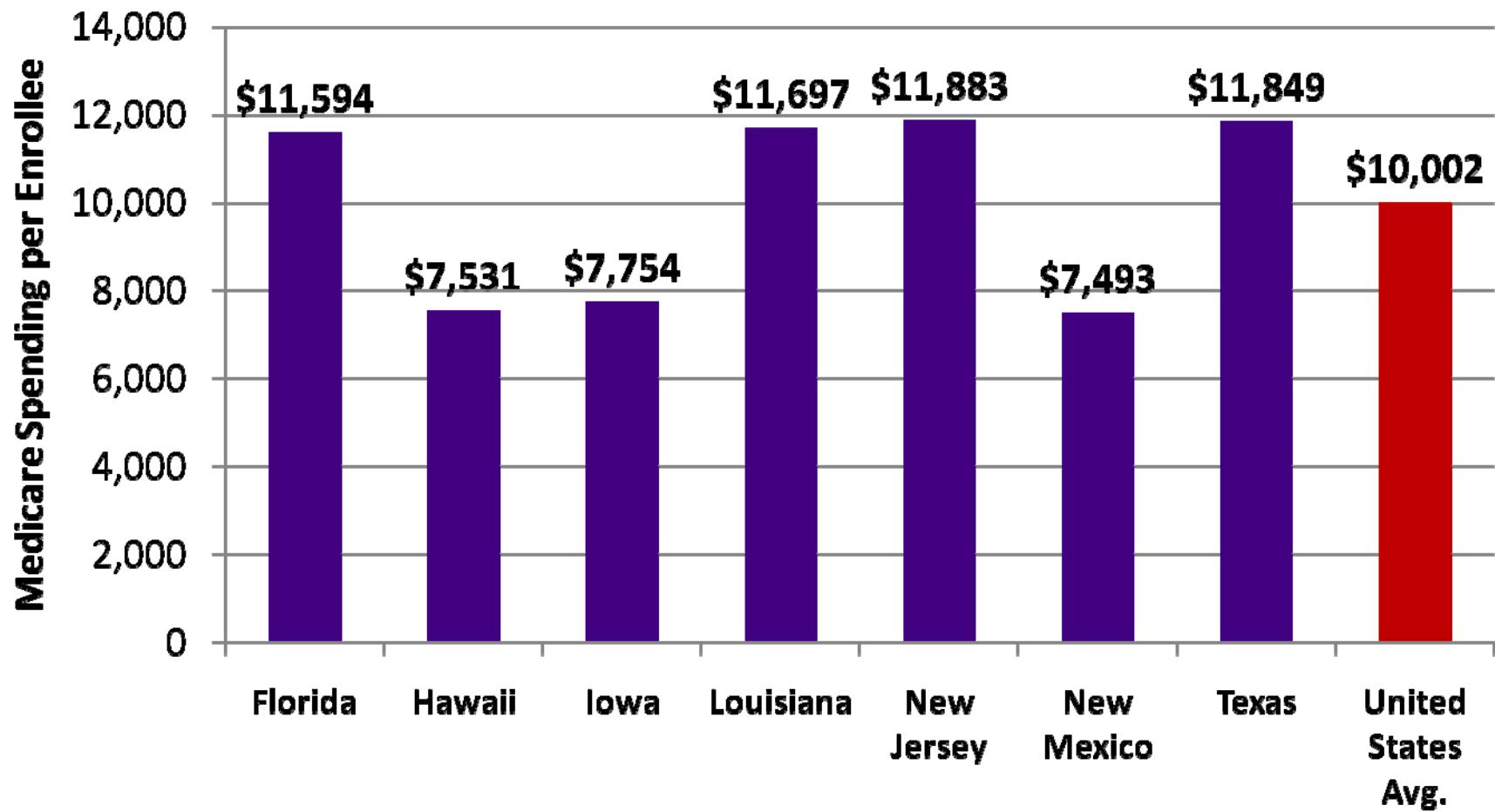


SOURCE: Data from OECD Health Data 2009, November 2009. Compiled by PGPF.

NOTE: Per capita health expenditures in 2007, unless otherwise noted. Comparison uses Purchasing Power Parity, which adjusts exchange rates to assume identical price of goods in different countries.

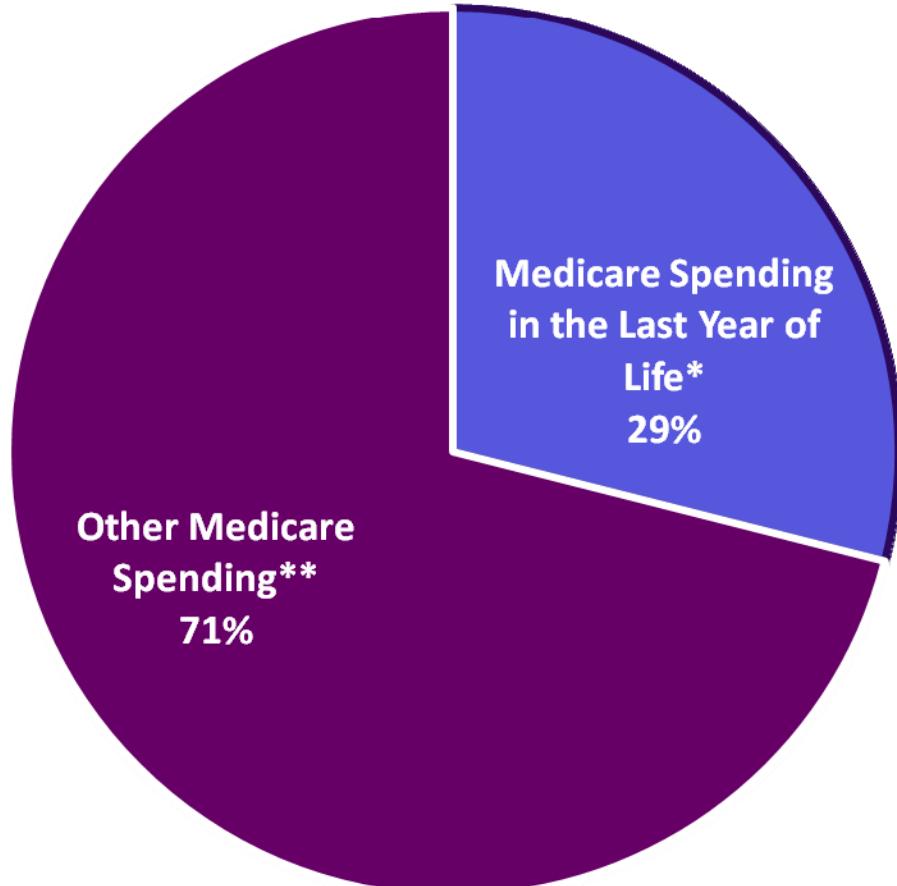
\*Japan data from 2006.

## Medicare spending per beneficiary varies substantially across states



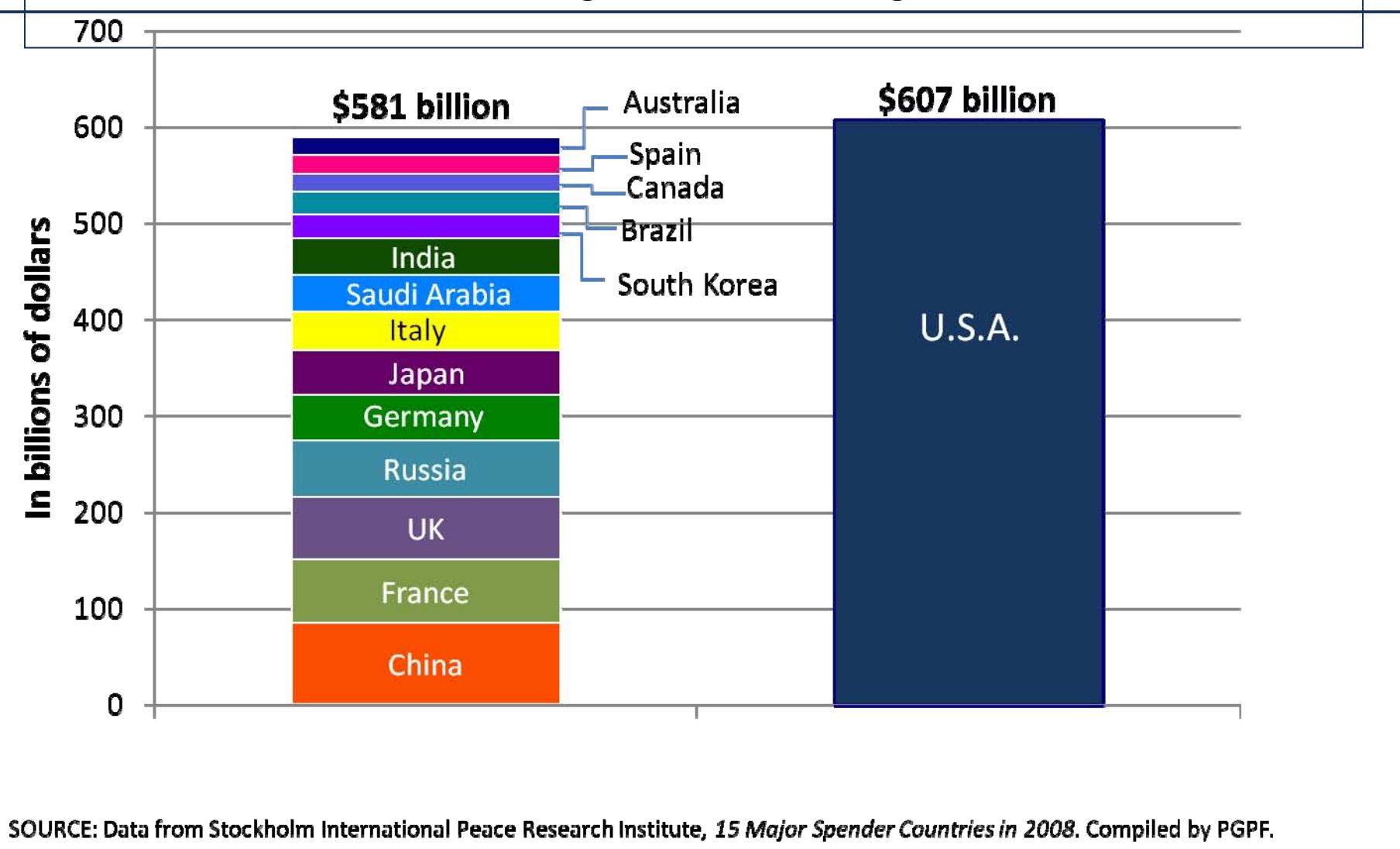
SOURCE: Data derived from the Center for Medicare and Medicaid Services, *National Health Expenditures: 2008*. Calculated by PGPF.  
NOTE: Data estimated for 2009, the most recent available, uses average annual growth rates from 1991-2004.

Almost three out of every ten Medicare dollars is spent for people who are in the last year of life

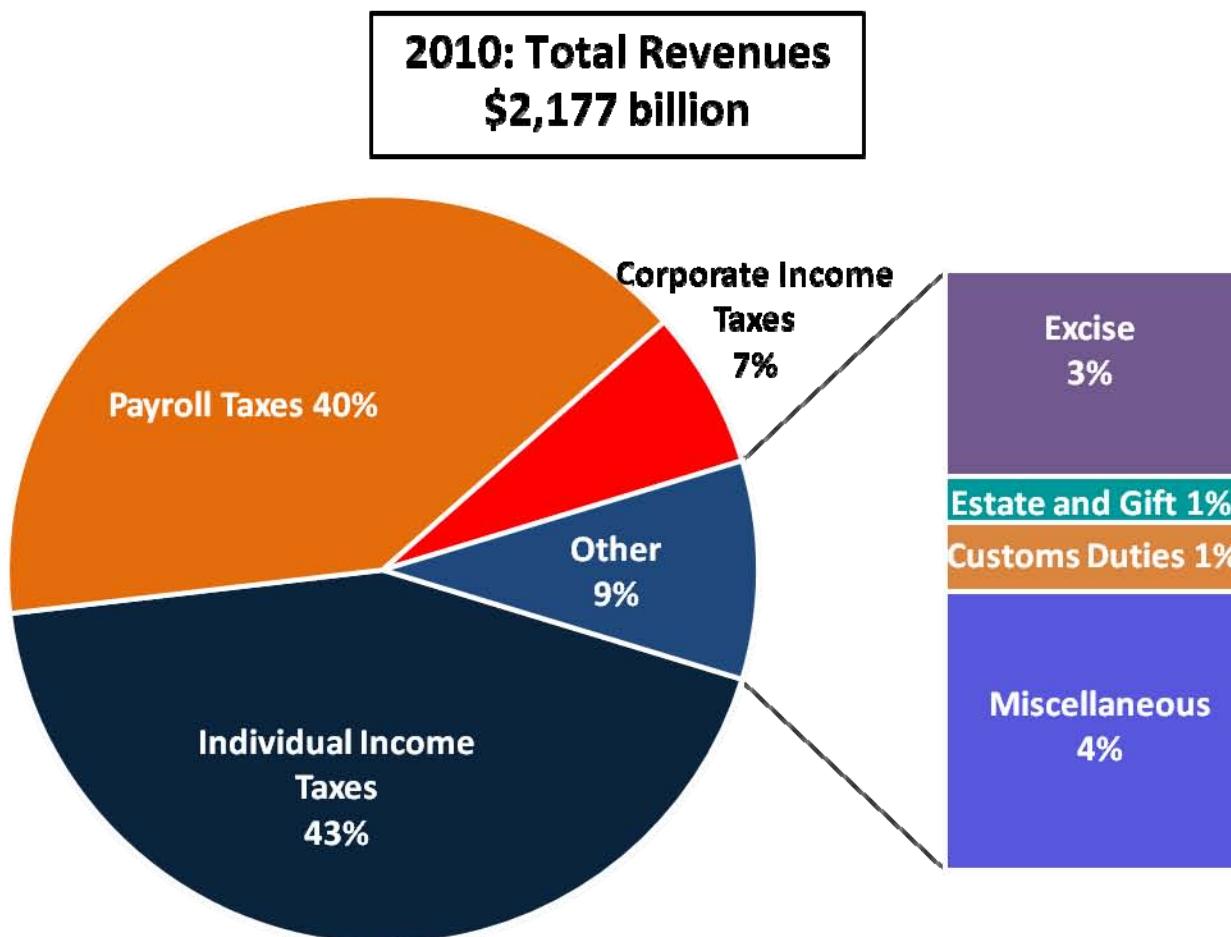


SOURCE: Data from the Center for Medicare & Medicaid Services, Office of the Actuary *Last Year of Life Study*. Compiled by PGPF.  
NOTE: Data estimated for 2009, the most recent available. \*Decedents. \*\*Survivors.

The U.S. spent more on defense in 2008 than did the countries with the next 14 highest defense budgets combined

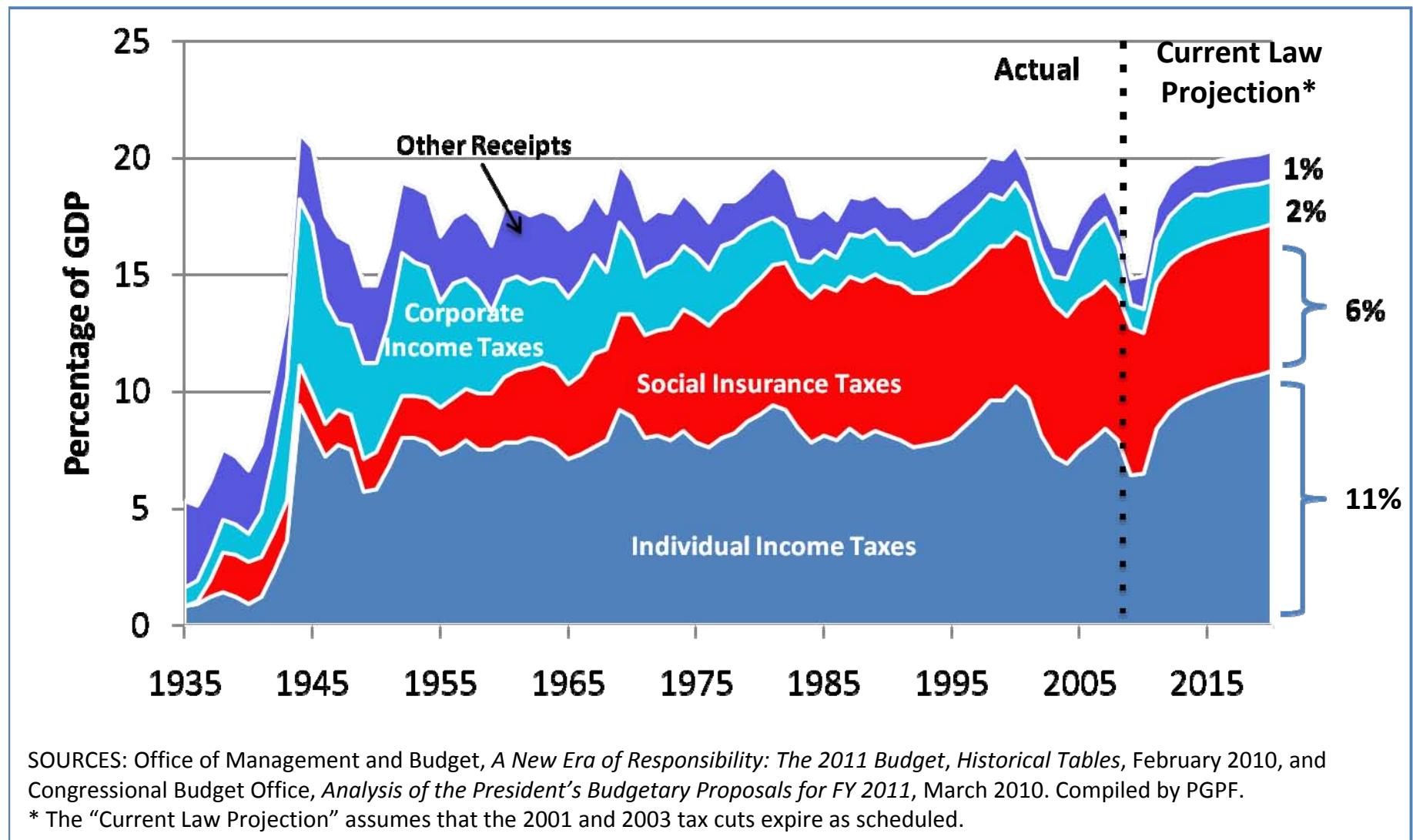


Individual income and payroll taxes comprise most of federal receipts



SOURCE: Data from the Congressional Budget Office, *Preliminary Analysis of the President's Budget*, March 2010. Compiled by PGPF.

The composition of federal revenues has been relatively constant since the mid-1970s





“Tax expenditures,” (deductions, credits, and other special provisions) total an estimated \$1 trillion annually and provide substantial benefits that are not reflected in the budget

Top 5 Tax Expenditures	Estimated Tax Revenue Foregone (FY 2010)
1. Exclusion of employer provided health insurance from taxable income.*	\$262 billion
2. Exclusion of pension contributions and earnings.**	\$122 billion
3. Deduction of mortgage-interest on a primary residence.	\$92 billion
4. Deduction of non-business state and local taxes (includes income, property and sales taxes)	\$53 billion
5. Capital gains (except agriculture, timber, iron ore, and coal).***	\$45 billion
<b>Total of Top 5</b>	<b>\$573 billion</b>

SOURCE: Data from the Office of Management and Budget, *A New Era of Responsibility: The 2011 Budget, Analytic Perspectives*, February 2010. Compiled by PGPF.

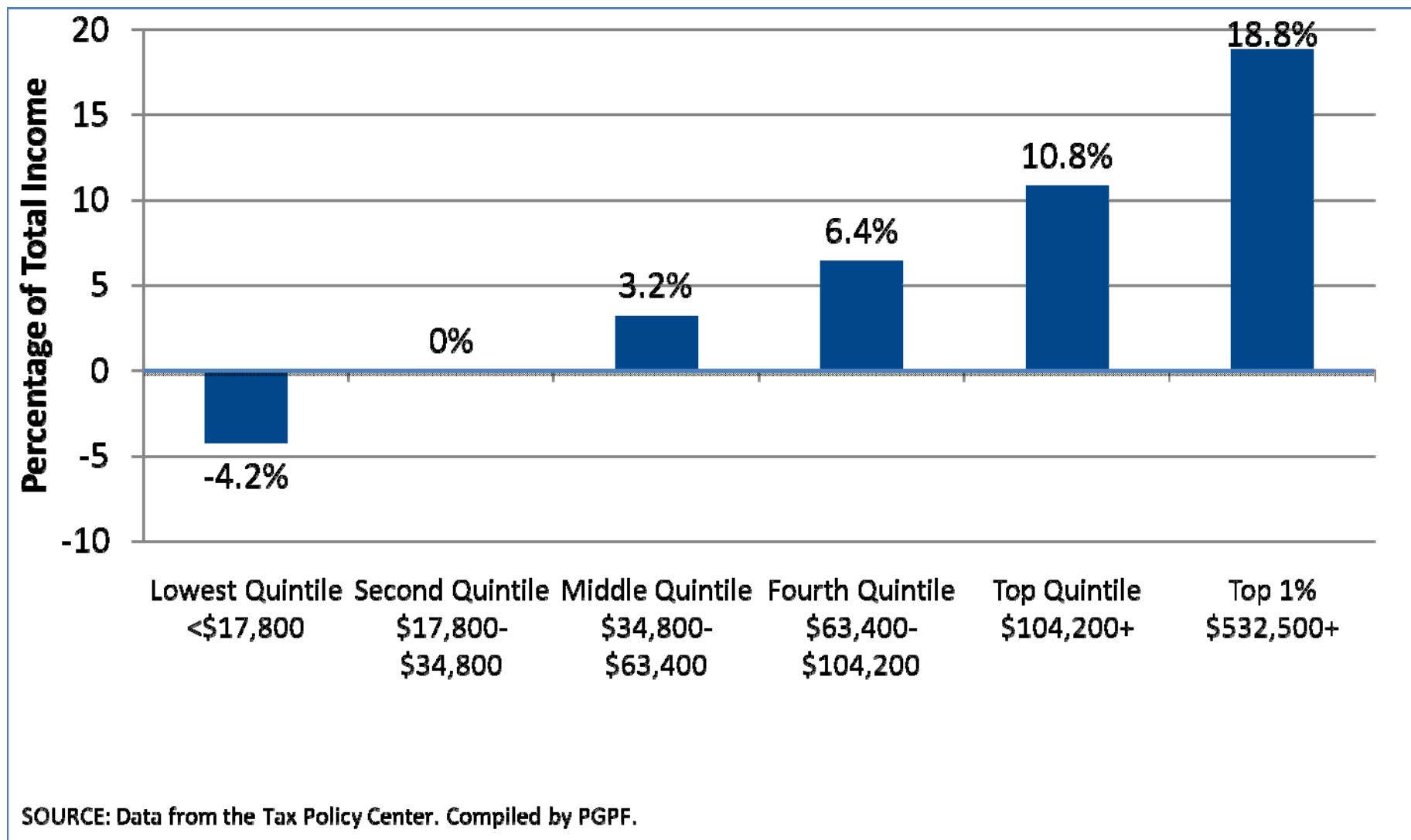
NOTE: Numbers may not add due to rounding.

\* Includes the exclusion from payroll taxes and income taxes.

\*\* Includes employer pension plans, employee and employer contributions to 401k plans, IRAs, and Keough plans.

\*\*\* In addition, the biodiesel producer tax credit results in a \$200 million reduction in excise tax receipts in 2010.

Effective median individual income tax rates are negative or zero for households with incomes below \$34,800





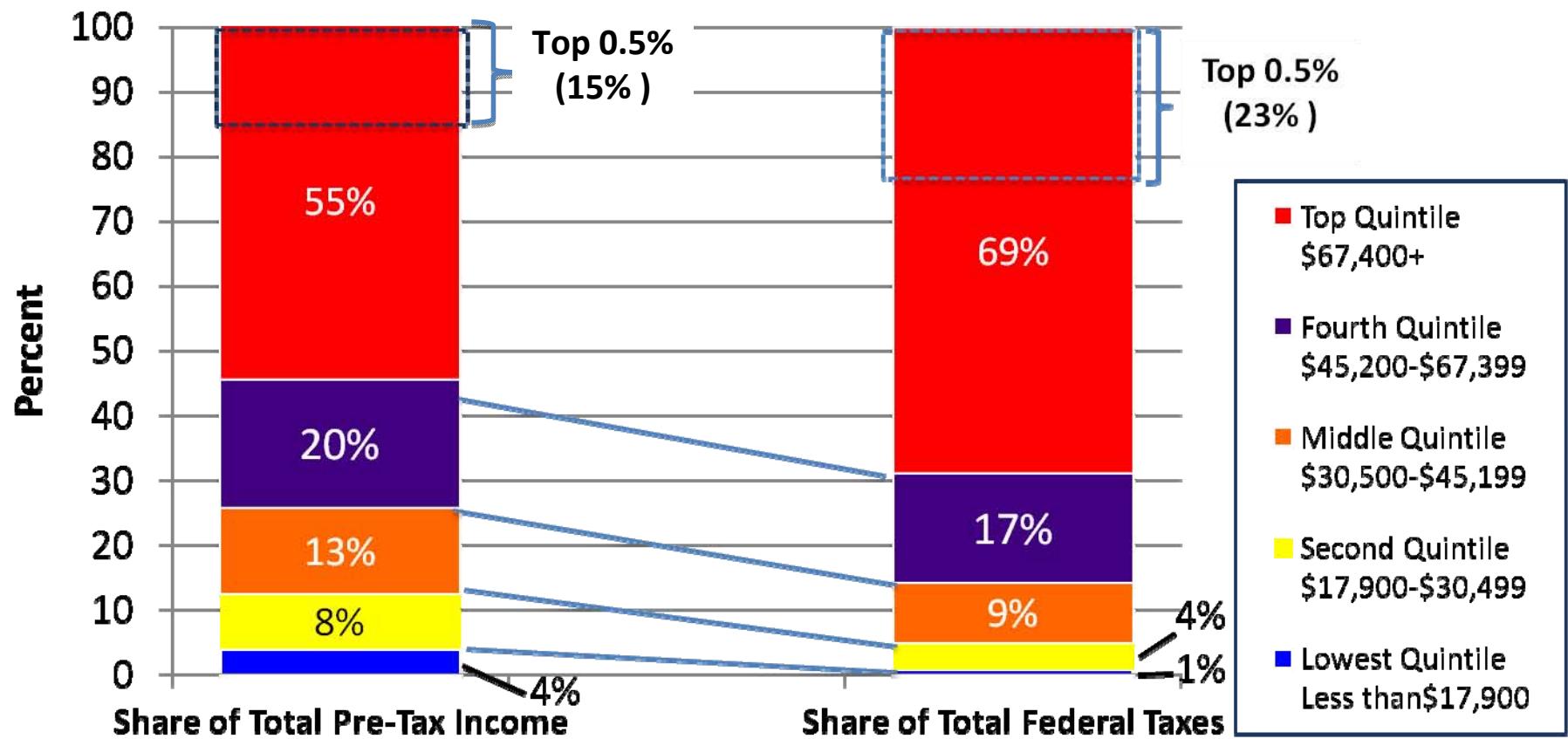
The top 5 corporate tax expenditures, deductions, credits and other special provisions are relatively small compared to the largest tax expenditures

Top 5 Corporate Tax Expenditures	Tax Revenue Lost (FY2010)
1. Deferral of income from controlled foreign corporations	\$31 billion
2. Deduction for U.S. production activities	\$8.8 billion
3. Credit for increasing research activities	\$5.8 billion
4. Deferred taxes for financial firms on certain income earned overseas	\$5.5 billion
5. Credit for low-income housing investments	\$ 5.4 billion
<b>Total of Top 5</b>	<b>\$56.4 billion</b>

SOURCE: Data from the Office of Management and Budget, *A New Era of Responsibility: The 2011 Budget, Analytic Perspectives*, February 2010. Compiled by PGPF.

NOTE: Numbers may not add due to rounding.

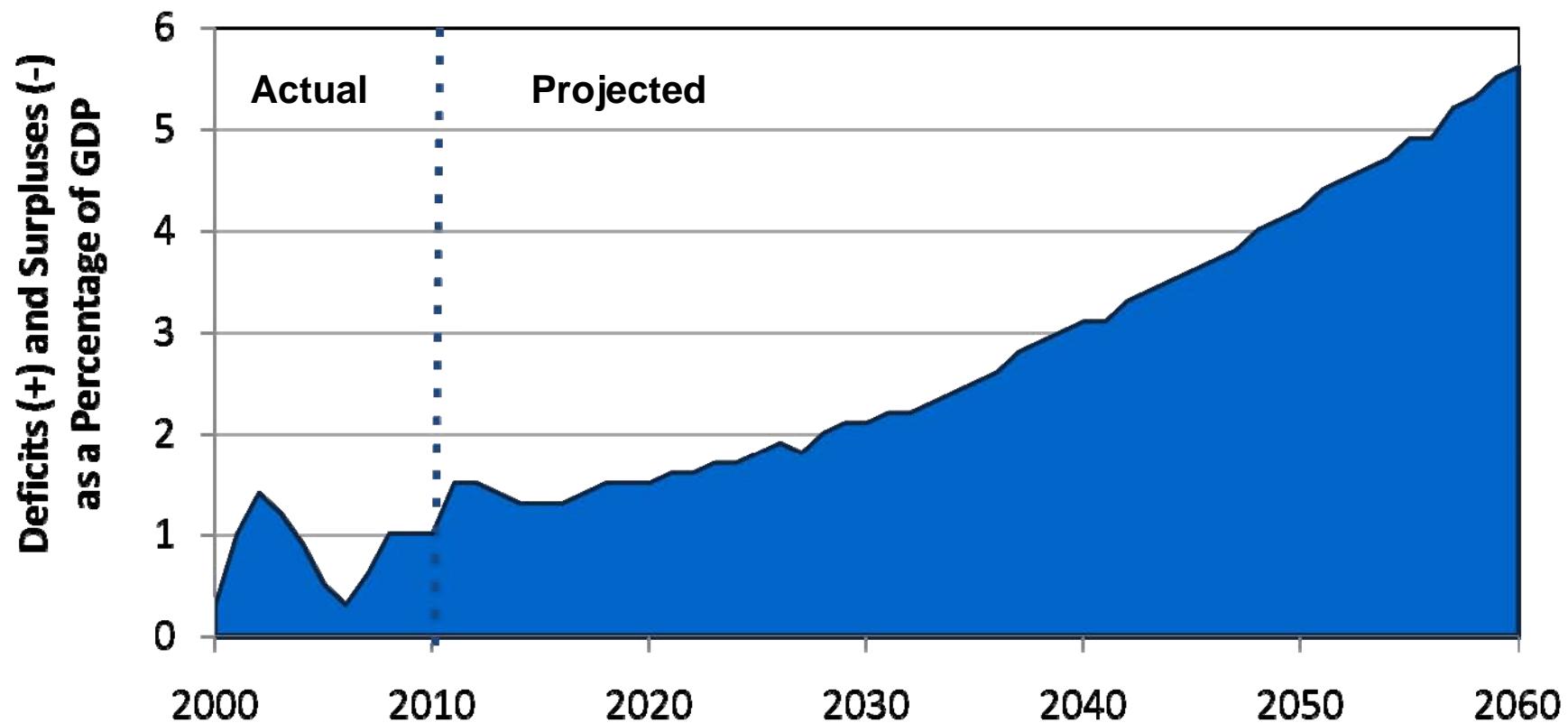
## High-income households earn a disproportionate share of pre-tax income and pay a disproportionate share of total federal taxes



SOURCE: Congressional Budget Office, *Historical Effective Tax Rates: 1979- 2005: Additional Data on Sources of Income and High-Income Households* December 2008. Compiled by PGPF.

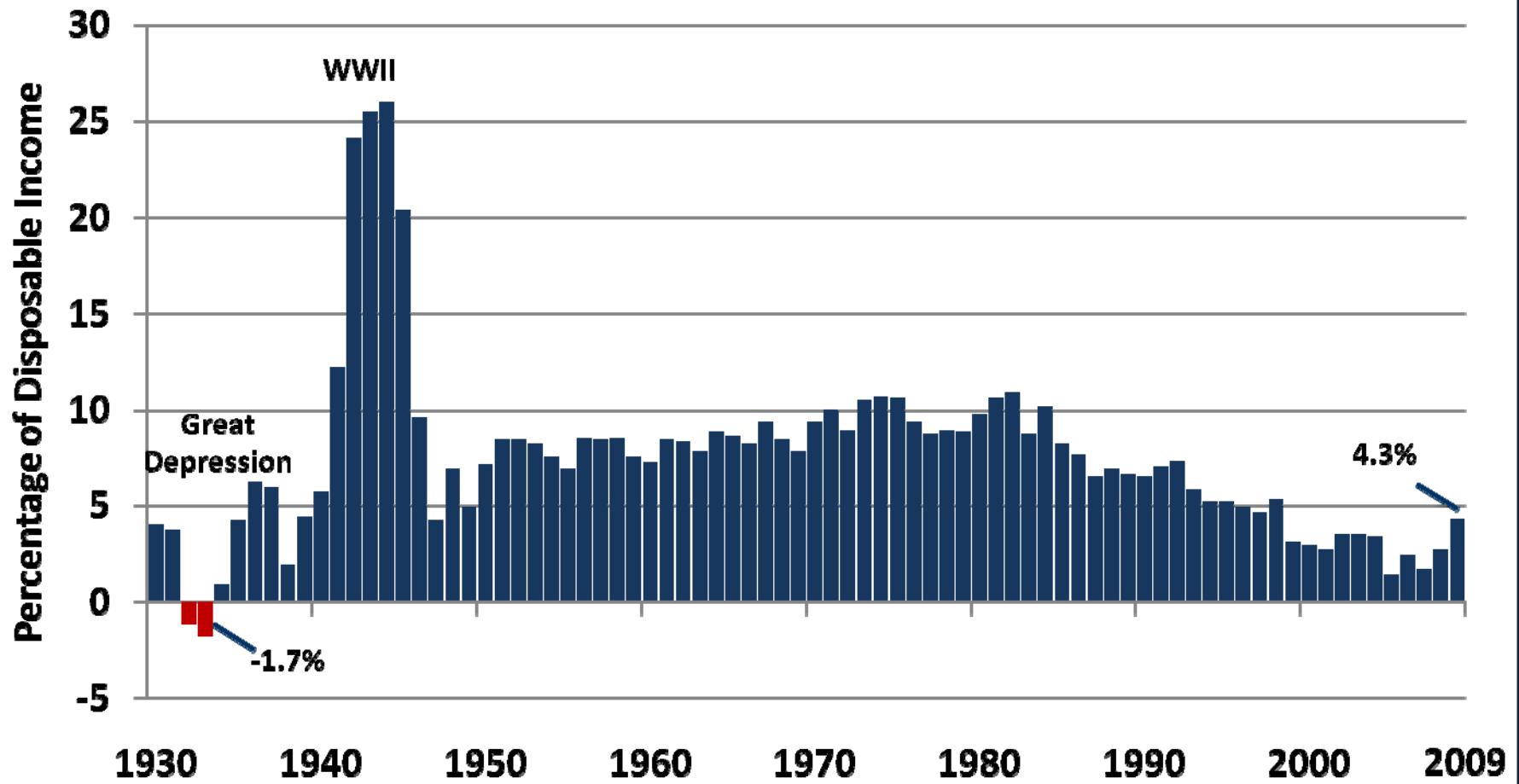
NOTE: Data for 2005 in 2005 dollars.

Under current policies, state and local deficits are projected to more than double as a percentage of GDP, even after the economy recovers



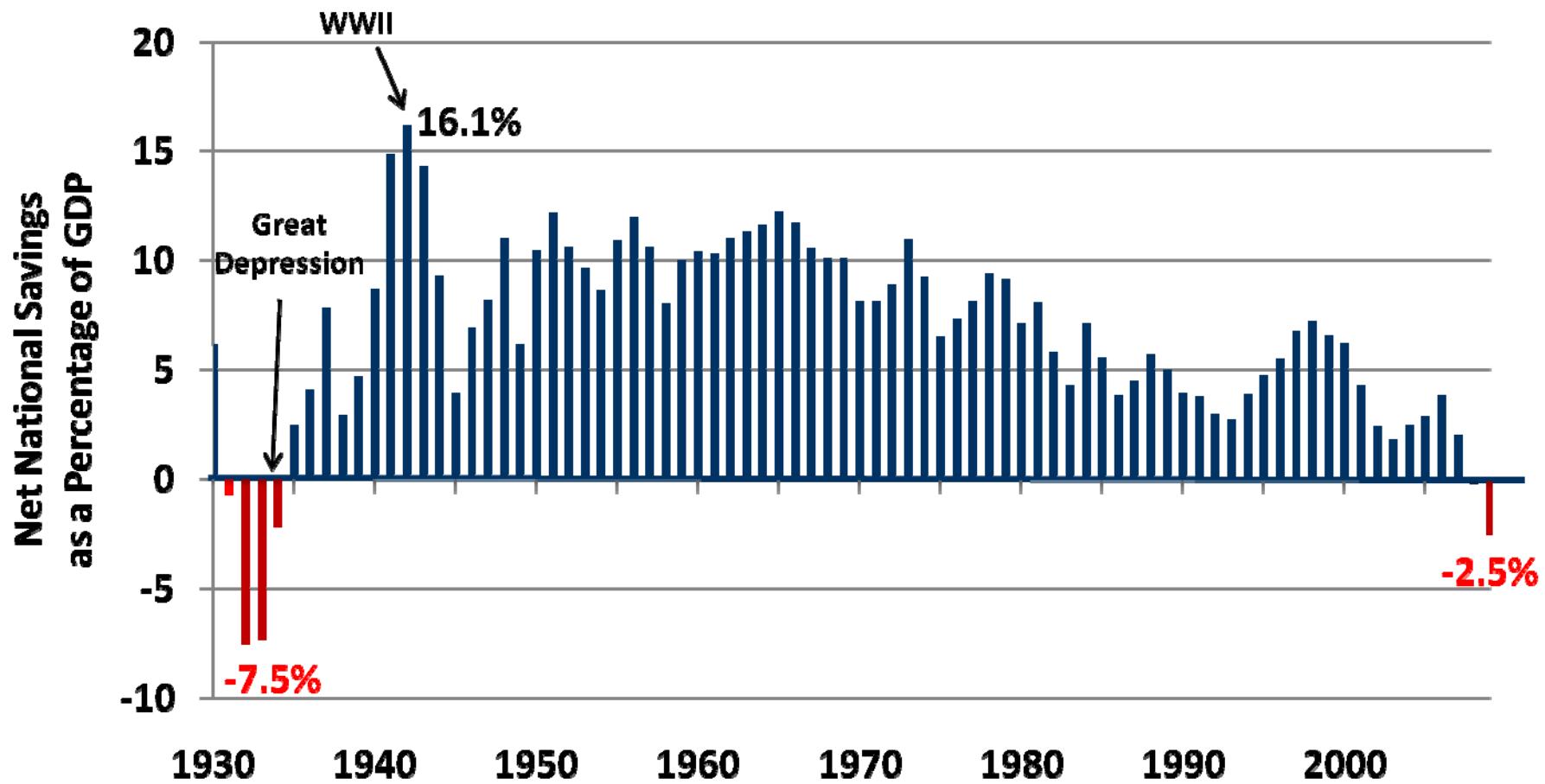
SOURCE: Data from the General Accountability Office *State and Local Government's Fiscal Outlook* March 2010 Update. Compiled by PGPF.

## Current U.S. personal savings as a percent of disposable income has fallen to historically low levels



SOURCE: Data from Bureau of Economic Analysis, *Personal Income and Its Disposition*: February 2010. Compiled by PGPF.

## The net national savings rate is at its lowest level since the Great Depression



SOURCE: Data from the Bureau of Economic Analysis, National Income and Product Accounts. Compiled by PGPF.

NOTE: The net national savings rate comprises both public and private savings net of consumption-related expenditures.

## Key Systematic Factors Driving Deficits and Debt at the Federal, State and Local Levels of Government

- Expansion of government at all levels
- Health Care Costs
- Retirement Income Costs
- Disability and Welfare Related Costs
- Critical Infrastructure Needs
- Education Costs
- Outdated and Inadequate Revenue Systems
- Myopia, tunnel vision, special interests and self-interest.

## A Way Forward

### Federal:

- Implement statutory budget controls that address discretionary and mandatory spending as well as tax preferences in order to stabilize our debt/ GDP at a reasonable level
- Achieve Social Security reform that makes the program solvent, sustainable, secure and more savings oriented
- Reduce the rate of increase in health care costs and more effectively target related taxpayer subsidies and tax preferences
- Ensure that all future health care reforms adequately consider coverage, cost quality and personal responsibility

## A Way Forward- Continued

- Pursue comprehensive tax reform that makes the system more streamlined, understandable, equitable and competitive while also generating adequate revenues
- Review, re-prioritize and re-engineer the base of the federal government to focus on the future and generate real results
- Ensure that we have process that will enable us to achieve the above objectives within a reasonable period of time

### State and Local:

- Reform pension and health systems to make them reasonable, affordable and sustainable
- Review, re-prioritize and re-engineer the base of government.
- Pursue comprehensive tax reform in coordination with the federal government.
- Consider an exchange of primary roles, functions and revenue sources as part of a new federalism or devolution effort (e.g., health care, education, infrastructure)

## Illustrative Defense Budget Options: Estimated 10-Year Savings Per CBO

Illustrative Proposals	Savings 2011-2020
Withdrawal from Iraq and Afghanistan*	\$1.7 Trillion
Reduce nuclear arsenal and cancel modernization*	\$139 Billion
Reduce size of Navy	\$127 Billion
Reduce troop presence in Europe and Asia	\$80 Billion
Scale back missile defense and related space programs*	\$55 Billion
Cancel F-35*	\$45 Billion
Reduce size of Air Force	\$40 Billion
Increase out-of-pocket costs in TRICARE for Life	\$33 Billion
Enhance cost-sharing in TRICARE for early retirees	\$20 Billion
Cancel Maritime Prepositioning Force Ships	\$17 Billion
<b>TOTAL SAVINGS</b>	<b>\$2.26 Trillion</b>

\* Contrary to the current Administration's express policy position at the present time.  
Inclusion on this list does not indicate whether or not the proposal is or is not meritorious.



## Other Illustrative Defense Budget Options: Non-Costed Proposals

Illustrative Proposals	Savings 2011-2020
Reduce Overhead at the Pentagon	?
Convert to a national public service requirement	?
Limit TRICARE eligibility in the National Guard	?
Limit use of military personnel for non-warfighting duties (e.g., administration)	?