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"The Leadership Gap and America's Fiscal Future"

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In my remarks today, I'd like to address two key concepts – leadership and stewardship. Both are of critical importance in both the public and private sectors and yet we don't hear much about stewardship anymore. That's a big problem which needs to be addressed. I'll start with the federal government and then address selected corporate governance and executive compensation issues before summing up.

When speaking of the federal government, the best place to start is our Constitution. It's no accident that the Constitution starts with three simple but powerful words: "We the people." Today, our nation faces a series of current and emerging issues with profound implications for our collective future. To successfully address these issues, each of us, no matter whether we are working in the public sector, private sector or not-for-profit sector must do our part. We the people must begin to focus more on the word "we" rather than the word "me." This includes speaking up and demanding meaningful change in our companies, communities, and country. What's at stake is nothing less than America's continuing role as a superpower, the engine of global economic growth, and the envy of the world. What's also at stake is the future quality of life for our children and grandchildren.

With the impending retirement of the baby boomers, rising health care costs, and relatively low revenues as a share of the economy, the federal government is facing a fiscal challenge unprecedented in American history. Unfortunately, our public officials have done little to prepare us for this reality. Some policymakers are concerned, but so far there have been few calls for sacrifice or dramatic and fundamental reform. Instead, the government's continuing lack of fiscal discipline in recent years has made our long-term situation much worse.

And yet, our demographic tsunami is already on the horizon. The change in the elderly dependency due to our aging population and lower birth rates threatens to swamp our ship of state if we fail to act. Unlike natural tsunamis, evacuation isn't an option in connection with this massive demographic challenge. Tough choices will be required.

The United States currently has three interrelated deficits. The first is the federal budget deficit, which in fiscal 2004 reached a record $412 billion on a unified basis. But the truth is that every dime of the Social Security and other trust fund surpluses went to pay for other government operating expenses. As a result, the federal on-budget deficit for fiscal 2004 was actually closer to $567 billion of which less than $100 billion related to Iraq, Afghanistan and incremental homeland security costs. Even more troubling, the federal government's long-term liabilities and commitments rose by more than $13 trillion in fiscal year 2004 alone to over $43 trillion, largely because of the new Medicare prescription drug benefit. While the fiscal 2005 numbers have not been announced yet, I expect that the total federal liabilities and unfunded commitments will be in excess of $46 trillion.

Even with the recent run-up in housing prices, the combined net worth of every American, including Microsoft founder Bill Gates, stock market investor Warren Buffett, and other billionaires, is only about $48 trillion. That means that every American would have to give up over 90 percent of his or her net worth just to cover the government's current liabilities and unfunded commitments.

In recent years, we've heard calls to relieve Americans of burdens like the so-called "death tax," but we need to talk more about the very real, very large, and ever increasing "birth burden." That's what I call the staggering number of current federal commitments that every American, including newborns, will at some point have to pay for. Based on the numbers I mentioned previously, as of September 30, 2004, every new birth certificate came with a tab of nearly $150,000, up from $72,000 in just four years. It's no wonder that newborn babies cry! Unfortunately, this birth burden is growing every day due to recurring deficits, known demographic trends, and compounding interest costs. In addition, the federal budget deficit and our growing fiscal imbalance are only the beginning.

The second deficit is our savings deficit. Put quite simply, too many of us – from individual consumers to elected officials – are spending today as if there's no tomorrow. At the same time, America has the lowest overall savings rate of any major industrialized nation.

The fact is that many Americans are saving next to nothing. The annual U.S. saving rate has fallen in recent years to around 1.4 percent of disposable personal income. In fact, in July, the personal saving rate was negative! Following their government's poor example, many Americans are living beyond their means and are deeply in debt. The average American household now carries a credit card balance of thousands of dollars. Last month we also hit an all time record in personal bankruptcies. These trends are particularly alarming because personal savings are critical to an aging society such as our own. Those Americans who save more will certainly live better in retirement. Those who fail to plan, save, and invest for retirement are rolling the dice, and the odds aren’t in their favor, especially given the inevitability of entitlement reform.

So who’s been underwriting America’s recent spending spree? The answer is foreign investors. That brings me to the third deficit—our overall balance-of-payments deficit. In 2004, the U.S. trade deficit hit a record $618 billion, up $121 billion from the year before.

Overseas money has been pouring into the United States. Many of these funds are coming from Asia, where U.S. treasury securities have historically been prized. Thanks to the high savings rate in China, Japan, and elsewhere, it’s relatively cheap for Americans to borrow. But there’s a catch, and it’s a big one. Increasingly, we’re mortgaging our collective future, and some of our leading foreign lenders may not share our long-term economic, foreign policy, and national security interests. Imagine what would happen to the stock and bond markets if these foreign investors suddenly lost confidence in U.S. securities and decided not to buy or, worse yet, started to sell off their holdings.

In my view, the greatest ethical issues facing the federal government today are the lack of fiscal discipline in Washington and the continuing unwillingness of public officials to face up to the fiscal realities I just described. The longer we put off making difficult but necessary policy choices, the more we threaten our collective future. Right now, we need more policymakers who have the courage to do the right thing and who are willing to put the needs of the next generation ahead of the next election cycle.

Facing Financial Facts

Historically, Americans have shrugged off warnings about impending deficit and debt problems. Today, too many people are either uninformed or in denial about the seriousness of our situation. After all, interest rates are still low and inflation is modest. This false sense of security is reinforced by the government's financial statements and "official" budget projections, which fail to provide a full or fair view of our nation's current financial condition and long-term fiscal outlook. As the federal official who signs the audit report on the U.S. government's financial statements, I'm here to tell you that America's financial condition is worse than advertised.

In the past, particularly in the decades since World War II, America has been the world's engine of economic growth. We still are, but our long-term fiscal gap is so great now that there's no way we can simply grow our way out of the problem.

While the current deficit numbers are big and bad, I'm much more concerned about the decades of structural deficits that lie ahead. What do I mean by structural deficits? A structural deficit isn't caused by temporary economic cycles or one-time emergencies. Instead, a structural deficit is driven year after year by powerful underlying factors that affect both the spending and the revenue sides of the budget. As I mentioned earlier, these factors include known demographic trends, such as an aging population, longer life spans, and lower birth rates. Another key factor is the rising cost of health care, which is affecting the government, employers, and individuals. We also don't have enough revenue to pay our current bills or deliver on our future promises.

Clearly, a crunch is coming, and eventually all levels of government and every sector of the economy will feel its impact. Long-range budget simulations from my agency, the U.S. Government Accountability Office (GAO), show that, without meaningful changes, increasingly drastic actions on spending and taxes will be required to balance the budget. By 2040, if nothing is done, federal revenues may be barely adequate to pay the interest on the national debt. Candidly, absent dramatic change, the day of reckoning will come way before then.

But it's the real-life consequences of unchecked deficits that are truly frightening. If we continue as we have, inflation and higher interest rates are inevitable. It's only a matter of when and how high. As government is forced to borrow more and more money to finance its debt, less money will be available for companies to invest to stay competitive. Eventually, long-term economic growth will suffer, and along with it American jobs, purchasing power, our overall standard of living, and even our long-term national security.

So, despite what anyone says, deficits do matter—at least from an economic perspective. It also matters how a nation keeps score. After all, if our elected representatives don't have timely, comprehensive, and reliable information on the government's current finances and long-term fiscal outlook, how will they ever make the tough choices that will be required to help save our collective future?

Reinventing Government

Beyond our growing fiscal imbalance, the United States also confronts a range of other emerging challenges.   We're seeing globalization on many fronts. Markets, technologies, and businesses everywhere are increasingly linked and geo-political boundaries are becoming less significant. In fact, many elected officials and other individuals have yet to realize that multi-national companies do not have duties of loyalty to a country. Furthermore, with today's international air travel, infectious diseases can spread from one continent to another literally overnight.   This is one reason public health experts are so concerned about avian flu. Obviously, we also confront a range of new security threats in the post 9/11/01 world.

To keep pace with these changes, our government must also change. It's time to ask a series of basic questions about what government does and how its does business. Nothing less than a top-to-bottom review of federal activities is needed to determine whether they are meeting their objectives and to free up resources. Many current federal programs and policies reflect conditions that existed when Dwight Eisenhower and John Kennedy were in the White House. Congress and the President need to decide which of these programs and policies remain priorities, which should be overhauled, and which have outlived their usefulness.

To help in this effort, GAO recently published an unprecedented report that asks a series of basic questions about both mandatory and discretionary spending and tax policy. GAO's report is called "21st Century Challenges: Reexamining the Base of the Federal Government," and you can find it on our website at www.gao.gov.

My hope is that the GAO's 21st Century publication will help policymakers and the public begin to think more strategically about where we are; where we're headed; and, more importantly, what we need to do to get back on a more prudent path. But the time to start is now. After all, there's a real payoff for prompt action. By making tough choices sooner rather than later, we can minimize the need for drastic measures down the road and we can give everyone time to adjust to any changes. We can make the miracle of compounding work for us rather than against us, as it is now. We can avoid a dangerous upward spiral of debt and inflation. Importantly, we can also fulfill our stewardship obligation to future generations.

Ensuring Accountability

Today, too many key players in both the public and the private sectors suffer from the dual afflictions of myopia and tunnel vision. Too many elected officials tend to dwell on things like this year's budget and next year's elections. Too many corporate leaders tend to obsess over quarterly and annual results along with their implications for the company's stock price and their personal compensation. Myopia and tunnel vision are not only unhealthy for the individual, they're also at odds with the long-term viability of any organization, whether it's a government or a business. If leaders are overly concerned about today's bottom line or public opinion polls, they're probably not paying enough attention to their stewardship responsibilities and the challenges that lie ahead. They may also be taking steps that result in short-term gain but long-term pain.

So what needs to be done? At the federal level, we must have more fiscal discipline. We need to change the current federal accounting and reporting model and budgeting systems to better reflect the government's true financial condition and fiscal outlook. In my view, our elected representatives need more explicit information on the long-term costs of major spending and tax bills—before they vote on them. The time has also come to reinstate budget controls, such as spending caps and "pay-as-you-go" rules that would require any new spending increases or tax cuts to be paid for by equivalent tax increases or spending cuts. Likewise, we need to establish additional reconsideration triggers over mandatory spending. Ultimately, we also need to engage in entitlement reform and undertake a base-line review of all major federal spending programs and tax policies.

For now, we need greater transparency and accountability in all aspects of government operations. By providing Congress with the best available information on whether federal programs and policies are working, GAO helps to ensure the economy, efficiency, and effectiveness of government. Adopting a set of key national outcome-based indicators may be key to this effort, and GAO is working with the National Academies, the business community and others to help make this a reality.

GAO is also working to ensure that no one is above the law and that every government official, no matter who they are, must answer to the American people. We've never wavered in our belief that the public deserves to be fully informed about what their government is doing and how well government is doing it. After all, ours is a government of the people, by the people, and for the people.

Accountability in the private sector has also been a challenge. Various accountability failures relating to firms like Enron, WorldCom, Tyco, HealthSouth and others led to the passage of Sarbanes-Oxley. Sarbanes Oxley was essentially the federal government's reaction to the failure of market forces to act. After all, government actions are normally a lag indicator. At Enron, WorldCom, and other companies, the actions and inactions of various corporate executives, auditors, and other key players harmed countless shareholders, employees, and retirees. People lost their investments, their jobs, and their pensions.

Not surprisingly, public confidence in the integrity of corporate financial reporting took a big hit. In fact, one of the largest and most respected accounting firms, and one that I was partner at for almost ten years, paid the ultimate price. In less than two years, Arthur Andersen went from the CPA profession's gold standard to gone. Yes, the decline and fall of Arthur Andersen came quickly from an external perspective. Its demise was caused by some people not doing their job, Andersen's leadership not taking the firm's situation seriously enough, and the Justice Department's indicting the firm rather than responsible individuals. However, the seeds of Andersen's decline began years earlier when too many partners began to focus on current partner compensation rather than on the core values that made the firm great.

We also need to face the fact that the governance model for some public companies is broken. We need to ask some hard questions about the proper role of the board of directors, audit committees, and top corporate management. Boards should provide strategic advice to management to help maximize shareholder value over the long term. Boards should also help to oversee institutional risk and oppose actions that might undermine a company's reputation and long-term viability. Finally, boards also have a clear responsibility to hold management accountable for results, not just for today, but over time.

When it comes to selecting board members, education and experience are important, but character also counts. Frankly, a board member of ability but who lacks adequate courage and integrity isn't worth much. Furthermore, board independence doesn't require the removal of all insider directors, but it does call for a supermajority of board members who are truly independent in both fact and appearance. It's also appropriate to question whether the CEO should also serve as chairman of the board of directors—which is the case today at many publicly held companies.

Effective boards need adequate resources. They also need access to qualified and independent experts who can provide unbiased opinions on issues that come before the board. Audit committees should oversee both internal and external auditors. These committees should meet with internal and external auditors several times a year in sessions that don't include management. During these meetings, auditors should be able to speak freely about the risks facing a company, the appropriateness of various accounting policies, and the quality of accounting and auditing personnel. Audit committees should be able to understand complex business matters and, when necessary, challenge management's major past and pending decisions.

One example of the potential failure of boards to be fully effective is the dramatic escalation in CEO compensation largely due to a dramatic increase in stock-based compensation. I should point out that according to Business Week's annual executive compensation survey, about 25 years ago, the ratio of average CEO pay to rank-and-file worker pay was about 40 to 1. Today, that same survey reveals a ratio more like 400 to one. Candidly, these ratios don't pass the straight face test. After all while the quality of the CEO is of critical importance, the CEO is not the only leader in an organization.

Executive compensation arrangements need to be more reasoned and reasonable. They need to focus more on results over time and in relation to others and be subject to reasonable limitations. They also need to avoid paying huge sums to individuals who fail to perform adequately or otherwise just don't work out.

Not only are U.S. executives paid far better than U.S. workers, but they also earn a lot more than CEOs in other industrialized nations. According to data from the Economic Policy Institute in Washington, U.S. CEOs earn three times what their counterparts in Europe and elsewhere make.

What's truly shocking about this trend is that from the shareholder's point of view, big pay for the big boss is no guarantee of great returns. This is one reason strong, independent, and adequately resourced corporate boards are so important.

In addition to ensuring an appropriate governance structure, we also need to overhaul the financial reporting model to ensure that investors receive accurate data that reflect a company's overall performance, risk profile, and expectations for future performance. Current financial statement disclosures are often lengthy and hard to understand. Also, too many investors mistakenly believe that reported figures are more precise than they really are.

A key lesson from these Enron, WorldCom, and other business failures is that our free-market system cannot survive, let alone thrive, if the public lacks timely and reliable information on the companies they're considering investing in. In this regard, corporate earnings restatements should be rare.

Restoring public trust is going to take a lot of work by a lot of players over many years. But as damaging as recent accountability failures have been, they also offer a chance to strengthen corporate governance systems, oversight mechanisms, and the accountability profession. Those at the top need to ensure that key players have integrity, the information provided to the public is timely and reliable, and that anyone signing off on financial information is both qualified and independent. I can't stress enough the importance of integrity. In the final analysis, it's the ability and integrity of people that matter most, and these qualities can't be legislated. This is why we need systems in place to provide incentives for people to do the right thing, that promote transparency to ensure that people will do the right thing, and that incorporate appropriate safeguards that hold people accountable for their actions.

I have no doubt that a vast majority of the people working in the public and private sectors are honest and well-intentioned individuals. However, effective enforcement efforts are essential in order to deter dishonest behavior and to hold "bad actors" accountable. For example, the Securities and Exchange Commission already has an array of civil enforcement powers to punish violators of securities laws. Unfortunately, these civil sanctions are often too weak to discourage highly paid individuals from unethical behavior. Obviously, someone who's paid millions of dollars a year isn't going to be shaking at the prospect of paying a $100,000 fine or doing a couple of months of community service. Another problem is that civil sanctions are often imposed directly or indirectly on the company, so it's the shareholders who end up paying for the misbehavior at the top.

Stiffer and better targeted civil penalties can help to discourage shady behavior. But I'm not convinced that civil penalties by themselves will do the trick. We need to treat certain unethical practices in both government and corporate America as the serious crimes that they really are. The government's has recently issued wide-striped suits to several government officials and corporate executives, and I have no doubt that the government will issue more in the future. You don't need to issue many in order to send a powerful signal. Let's face it. Nothing focuses the mind like looking at the world from behind a set of iron bars.

The Way Forward

In closing, effective leadership and sound stewardship are essential for any entity to survive and prosper over the long-term. In the private sector, of the 12 companies that comprised the Dow Jones Industrial Average in 1900, only one has survived as an independent entity today – General Electric. From a government perspective, no republic has lasted more than 300 years. In addition, the "too big to fail concept" has proven to be untrue in both cases.

America is at a critical crossroads. The choices that leaders in both the public and private sectors make or fail to make in the next 10 years will have profound implications for the future of our country and its citizens. To help us make the right choices, we need more leaders with three key attributes: courage, integrity, and the ability to innovate. We need leaders who have the courage to speak the truth and do the right thing, even though it may not be popular. We need leaders who have the integrity to lead by example and to practice what they preach, leaders who recognize that the law is the floor of acceptable conduct and who strive to meet a higher standard. We also need leaders who can see new ways to address our many challenges and who can help show others the way forward.

Leadership is important and without it you can't go anywhere fast. We're going to need many leaders to help forge a more positive future. My hope is that each of you will become part of the solution. I hope that each of you will be leaders who understand that all power is fleeting. Leaders who understand that power is given in order to make a positive difference for those who are counting on you. Leaders who understand that they have a stewardship responsibility to not just focus on today but to prepare for a better tomorrow. Leaders who strive to not just leave their office or organization in a better position when they leave than when they came, but also better positioned for the future.

Lately, I've been studying our founding fathers, particularly the life of George Washington during his two terms as our nation's first CEO. As the first to hold that office, George Washington was very aware that the eyes of history were upon him. Our first President made a conscious effort to lead by example, and to focus on the future. Washington set many precedents that have stood the test of time. He was a true steward.

What's often overlooked is that George Washington was a teacher and great believer in fiscal discipline. In his farewell address in 1796, Washington spoke to the issue of public debt. He urged the new nation to avoid "ungenerously throwing upon posterity the burden which we ourselves ought to bear." This advice is as sound today as it was over 200 years ago. By ignoring George Washington's words of wisdom and postponing difficult policy decisions, our government is, in fact, making a choice—a choice with unacceptable fiscal and ethical consequences.

With a few notable exceptions like Pete Peterson, the business community has largely been silent on our nation's fiscal and stewardship challenges. It's time for business leaders to join this effort. It's time for all of us, as "we the people", to face the facts, speak the truth, and help ensure that appropriate steps are taken to better position our country, American companies, our communities, our children, and our grandchildren for this and other 21st century changes and challenges. The time for action is now!

Thank you for your time and attention. Now, I'd be happy to take your questions.