

GAO

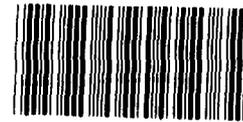
Testimony

For Release
on Delivery
Expected at
11:00 a.m. EST
Thursday
April 2, 1987

The Federal Budget and
the Budget Process

Statement of
Charles A. Bowsher, Comptroller General
of the United States

Before the
Subcommittee on Legislation and
National Security
Committee on Government Operations
House of Representatives



132583

038467

Mr. Chairman and Members of the Committee

I am pleased to have this opportunity to discuss our views on improving budgeting in the federal government. I will later in my statement offer some suggestions on improving the budget's structure and changing governmental budgeting procedures. Before discussing those matters, however, I would like to address what I consider to be the most urgent need--that is, the need for public and institutional support for decisive deficit reducing actions.

THE CRITICAL PROBLEM--A STRUCTURAL DEFICIT

In the six years that I have been Comptroller General, I have been struck by the increasing number of bills introduced each year to change the way the government budgets. Your committee has referred many of these proposals to us for comment. I think that the growing number of such bills reflects concern by members about the time-consuming annual budget process and, probably more importantly, its outcome. It's easy to get discouraged over the missed budget calendar deadlines and huge deficits.

Many of these proposed changes deserve serious consideration. However, I think we should start by recognizing that we have been facing a special fiscal-political situation that would make it difficult for any budget process, no matter how well designed, to work well.

Two events coincided in the 1980's to place severe strains on the budget process. The first was the emergence of a

structural deficit of unprecedented peacetime proportions. Whether figured in current or constant dollars, or as a percentage of the nation's gross national product (GNP), our deficit grew enormously in the 1980's.

From fiscal year 1979 to 1986, the deficit grew in current dollars from about \$40 billion to about \$221 billion, a 450 percent increase. That equated to spending each day a little over \$600 million more than we were taking in. As a percentage of GNP, the deficits in the early 1980's grew from under 2 percent to a little over 6 percent--higher than the level in the mid-1930's during the Great Depression. In short, our policymakers have been faced with a deep and persistent deficit that reflected a fundamental imbalance between governmental receipts and expenditures.

The second occurrence, coinciding with this major fiscal imbalance, was a lessening of the institutional give-and-take that normally keeps our branches of government working together to solve the nation's problems. Compromise has often given way to confrontational politics and budgeting between the branches of government. And within the Congress itself over the 1981-86 period, matters were complicated by the development of split party control--the first situation of this kind since 1931-32 during the last years of the Hoover administration.

It is no wonder, then, given these fiscal and institutional pressures, that budgeting in recent years has become troublesome

and time-consuming. Furthermore, I would suggest that the budget process will remain in this state until we successfully tackle the major imbalance of receipts and expenditures that is at the heart of the problem. That will not be easy. Let's consider for a minute what makes up the budget. I think it will show how difficult it will be to address the problem simply by additional funding reductions.

Our government's receipts are running at about \$800 billion a year. The Congressional Budget Office's (CBO) recent baseline estimate for the current fiscal year is \$834 billion. What does that cover? Using CBO's figures, we could say that it covers net interest costs (\$135 billion), social security (\$206 billion), medicare (\$78 billion), and national defense (\$280 billion). That's \$699 billion, leaving about \$135 billion of the receipts to cover all other programs of the government--the National Institutes of Health, the Federal Bureau of Investigation, the Customs Service, the Federal Aviation Administration, the National Park Service, the Internal Revenue Service, etc.

According to CBO, though, we will spend far more than that--closer to \$309 billion--on the other programs. And most of that \$309 billion (almost \$200 billion) will be for various entitlement and mandatory spending programs, such as veterans pensions, many of which the Congress shielded in some way from the full effects of the Gramm-Rudman-Hollings law.

Clearly, there are large funding requirements for

maintaining the nation's defense and the basic services and entitlements that most citizens consider important, and these requirements can not be greatly reduced simply by improving management efficiency or selling governmental assets. We in GAO have always pushed hard to eliminate waste in the government, and our work has identified how billions of dollars could be saved. I have to say, though, that the government can not solve its fiscal problem simply by stopping those who buy thousand dollar coffee makers or make overpayments on entitlements. Also, while sometimes appropriate, selling the government's assets won't solve it. For example, what we gain through loan asset sales, we lose in future foregone receipts, and in many cases we may give up more than we gain.

All of this, Mr. Chairman, points to difficult choices that will have to be made, and I do not see how a lasting solution can be found without some additional revenues and a close look at all programs, including defense and entitlement programs for possible reductions. As I stated to this committee in 1985, before the Gramm-Rudman-Hollings law was enacted, we need to put all revenue options and programs on the table for examination.

It is very important that we do so without much delay, because we are already paying a stiff price for failing to act on this sooner. Every taxpayer is paying some of that price today, and will be paying a lot more in the future if something is not done. The \$135 billion net interest cost does not buy us a

thing, except the privilege of paying it again next year. Instead of being used to replace obsolete bridges or help farmers in distress, it is a transfer of income from average taxpayers to holders of Treasury securities, many of whom live in other countries.

Another part of the deficit's price is our growing international debt burden. I am convinced that the large budget deficits have been a real cause of the massive inflows of foreign capital and the dangerous foreign trade imbalance.

Our growing dependency on foreign business and investors may not be perceived or felt by most Americans at this time. After all, with some major exceptions, many Americans are living fairly well. The problem is, we are living well by borrowing the output of other countries' factories and financial institutions. When we have to pay it back, we will have to consume less as a nation. Then we all will feel it in a lower standard of living than we otherwise would have enjoyed.

There is yet another element to the price we are paying, and that is the structural deficit's restriction of policy options available to our elected officials. As long as the government must increasingly tighten its purse strings to handle a growing debt burden, it has fewer opportunities to respond to emerging problems at home and abroad. We have been seeing sectors of our society and economy experience new problems in recent years. The

problems of our increasingly aging population or farmers come to mind. How can we adequately respond to such developments and future ones that we can not foresee when increasing billions are siphoned off in unproductive debt service?

I am afraid that any reluctance to face the deficit problem we have will lead to a proliferation of proposals for unrealistic, mechanistic approaches to budgeting. This would include rigid formula limitations on budgetary outcomes, such as a constitutional amendment limiting spending growth and requiring a balanced budget.

I would prefer to think that a constitutional amendment is not needed to get our fiscal house in order. In my opinion, it is healthier for our form of government when budgetary decisions can be made through open legislative debate and actions. Furthermore, a constitutional amendment could have unforeseen institutional, economic, and budgetary consequences. This is why it is important to make significant progress on correcting the structural deficit we now face. Unless that is done, we can expect a growing demand for such an amendment.

I should also mention proposals for giving the President line-item veto authority or enhanced rescission powers. These clearly would shift the long-standing balance-of-power over the government's purse toward the executive branch. Exactly how far that shift would go would depend upon the specifics of the proposals. There is a wide variety of line-item veto authorities

at the state level--some broader than others. I am sure that the Congress will want to study the various proposals carefully to weigh the institutional and budgetary implications.

There are, however, steps we can take that do not raise such balance-of-power questions, such as improving the budget's structure and numbers, and streamlining the congressional budget process. These should not be seen as "solutions" to our budget problem, but rather as steps that can help our lawmakers in making decisions and taking actions on the budget and the deficit.

IMPROVE THE BUDGET'S STRUCTURE

I think that it's time to rethink the budget's structure. It has been 20 years since the last major reform, when the government's administrative and trust funds were merged into one budget. This was the principal recommendation of the 1967 President's Commission on Budget Concepts. The development of a unified budget was unquestionably a step forward, and we certainly should preserve the unified budget concept in any new reforms we undertake.

There is a problem, however, with the current unified budget. It often confuses rather than clarifies many issues. It should better portray the costs of various programs. Some might say that we should not change what we've become used to, but I think that changes are necessary for a better understanding of our budgetary situation.

Governmental programs and options have evolved over the last 20 years, and the policy choices are now more complex. Officials today engage in more complicated analyses as they consider alternative means of accomplishing policy objectives. For example, there are analyses of whether to aid certain economic sectors by grants, loans, loan guarantees, tax credits, or some combination of these. If we do not periodically update and improve the budget's content, the budget begins to lose its relevance to policymakers and the public.

The treatment of credit programs is one area where we need to do something. Such programs play a much bigger role today than they did in the 1960's, and it is time to make appropriate adjustments in the way the budget measures and reports credit program amounts. Mr. Wolf from our office touched upon some of this last week, Mr. Chairman, in testimony before this subcommittee.

The budget now treats loan outlays the same as regular outlays, even though true loans (unlike regular outlays) entail a flow of funds back to the government. This means that in the initial years of a loan program, the program's outlays in effect overstate costs by not taking into account the repayments. An opposite problem develops in subsequent years as loan repayments flow back to the program. The repayments are netted against new outlays and result in understating the costs.

We therefore need a new reporting procedure that focuses

upon the net cost to the government of its credit programs, including both direct loans and loan guarantees. It is this net amount that should be estimated and budgeted for in advance. That would put credit amounts in the budget on a comparable basis with regular amounts. This, by the way, was a recommendation of the 1967 President's Commission on Budget Concepts.

A similar problem exists in the area of capital investments. Basically, I think we need to treat expenditures for tangible assets the way we propose treating expenditures for loan programs. There should be some budgetary recognition of the fact that the government gets something of value for its initial outlay. In a loan program, the government receives a promissory note and future repayments. In a capital program, it receives a physical asset that has economic value for several years.

In both cases, it makes sense for the budget to focus each year upon the net cost. This is what a capital budget would do for us. The practical effect would be to correct a certain budget scorekeeping bias against capital projects, focus attention on the long-range infrastructure needs of the government, and, I might add, give legislators an additional option for targeting their budget deficit reductions. We should at least consider the practice of many states, where the focus of balanced budget requirements is on the operating side of the budget. Such states generally permit debt financing of their capital projects.

I have to acknowledge, however, that we would need to proceed carefully in developing a capital budget approach. It would be important to keep the capital budget within the unified budget. This would ensure a full disclosure in the budget of all governmental activities and costs. It also would permit account listings and schedules that provide a reporting of total program costs where programs involve both capital and non-capital items. We would not want to go back to the days before program budgeting, when object class budgeting prevailed and it was hard to ascertain total program costs.

We also would need good standards on what to classify as capital and independent auditing of how those standards are applied. This would minimize the chances of officials misclassifying operating amounts as capital amounts, a gimmick that was used in New York City in the mid-1970's and earlier.

I would like to address another concern about capital budgeting. Some believe that it could "take the lid off" of spending for capital projects, and hurt or destroy our deficit reducing efforts. I do not subscribe to that. I think it would help those efforts. As long as we keep capital amounts within the unified budget, we will not lose sight of the impact of capital decisions on governmental outlays and borrowing requirements. Furthermore, as I stated earlier, it would give us an additional option for targeting our deficit reduction efforts.

There are a couple of other budget content matters that I

will only briefly mention at this point. Current reporting is not very informative about the annual surplus or deficit trends within the various fund types of the budget. I am thinking mainly of differences between general and trust funds. Many would be surprised to learn that the annual surpluses in the Highway Trust Fund have produced a fund balance at the end of fiscal year 1986 of about \$12.8 billion. The balance in social security's Old Age and Survivors, and Disability Insurance funds was \$45.9 billion.

It would be helpful to have better budget reporting on the annual trust fund surpluses (or deficits), how these are affected by intrabudgetary transfers involving the non-trust fund accounts, and how the budget's reported overall deficit is affected. There needs to be a better understanding of how the annual trust fund surpluses are used to hold down the reported deficit total. For example, in fiscal year 1986, when the government's reported budget deficit was about \$221 billion, the non-trust part of the budget really ran a much larger deficit--a \$283 billion deficit (after intrabudgetary transfers)--and it was only by counting the trust fund surpluses of about \$62 billion against this that the government was able to bring that reported deficit down to \$221 billion. We continue to believe that governmental trust funds should remain in the unified budget, but think that budget reporting should be improved to better show the effects of the trust funds on the totals.

I am also concerned about the lack of full budget reporting on the future costs of today's commitments. The liabilities of the pension plans come to mind. There are billions in unfunded pension liabilities that must, at some time, be paid for. I think that its critically important that we get a better handle on the accrual each year of these and similar liabilities.

The 1967 President's Commission on Budget Concepts recommended that the budget be put on an accrual basis to permit better control over such amounts, and I think that the federal government should move in that direction. A good first step would be developing a new section on accruals in the budget's Special Analysis document. It would summarize the budget's accrued liabilities, and provide a cross-walk or reconciliation to the budget's cash numbers. This would be a modest but potentially very important step toward better controlling the budget's future costs.

IMPROVE THE NUMBERS

We also should do something to improve the timeliness, consistency, and accuracy of the numbers. This is not a new problem, but one that has taken on new importance as the Congress and the administration attempt to address the deficit. For example, we have expressed concern that many of the deficit reduction "savings" for fiscal year 1987 are questionable, since they only shift outlays or collections from one fiscal year to another, with no enduring effect on the deficit. Our concerns

are shared by others, in both houses of the Congress and on both sides of the aisle, who have spoken out about the "blue smoke and mirrors" being used to meet the deficit targets. We could easily see a repeat of the 1986 experience, when optimistic estimates were followed by a dramatic worsening of the deficit situation as the year progressed.

I think we can make progress on this numbers problem in at least two areas. First, we should consider ways of improving the economic and spending projections put forth in various budget documents. This will not be easy, because legitimate differences of opinion exist on such matters. Nevertheless, I am convinced that we can do better. This subcommittee heard suggestions last month for improving economic projections, and I would urge serious consideration of those proposals. I would say that a starting point for achieving better economic and spending estimates would be for officials to base their estimates more on stable economic and financial patterns, and less upon optimistic policy and economic goals.

A second area of possible improvement would be upgrading agency financial management systems and reporting procedures. We can not expect good budget numbers if the needed data simply are not there. Too often agency officials develop their budgets on the basis of antiquated systems and poor data. For example, we've recently reported that one agency couldn't identify the amount of its prior funding for inflation that was no longer

needed because price increases turned out to be less than expected. In that case, the potential excess funding totalled \$55.8 billion.

One final note on the numbers. We think that the discipline and integrity of the budget's amounts would be helped if more federal agencies had audited financial statements. Many statement amounts find their way into the budget, and our GAO financial audits have turned up several discrepancies and problems with these reported amounts. Continued auditing efforts along these lines should have beneficial effects for the budget. At the state level, many states now routinely issue audited financial statements, and, thanks to this committee's Single Audit Act, federal monies provided to states also are audited.

STREAMLINE THE CONGRESSIONAL BUDGET PROCESS

Finally, let me turn to the congressional budget process itself. I think that most observers and participants would agree that the budget process needs some streamlining. I think that the objectives should be to reduce the number of revisited decisions, to free-up time for oversight activities, and to ensure an orderly delivery of governmental services. Along these lines, I would like to offer some suggestions.

One possibility is biennial budgeting. There seems to be a revival of interest in this, perhaps stimulated in part by the Department of Defense (DOD) trial effort for the fiscal years

1988-89 period. In the past, I have stated that biennial budgeting warrants consideration as a way of reducing budget workload and improving oversight activities. I think that if adopted, it probably should be tried first on a selected basis, maybe for some of the procurement activities of the government. A possible drawback is that it may lessen congressional budget control. I continue to believe that biennial budgeting deserves consideration, and that the government should proceed carefully on it. I would like to see how the DOD case works out, and then consider future courses of action.

Some form of an automatic continuing resolution also warrants consideration, as a means of minimizing funding gaps and disruption to basic governmental services. We have previously recommended a procedure that would allow the government to obligate but not expend funds until appropriations were passed. Another option would be to allow automatic funding but at decreased or decreasing levels. I must say, though, that none of these automatic funding options is very attractive. I would rather see an emphasis on figuring out how to get the appropriations passed on time.

Finally, the Congress may want to review the layering of functions and committees that has occurred over the years, producing seemingly duplicative, revisited decisions on the same programs. Many programs are addressed each year in the budget resolution discussions and actions, again when the authorizing

legislation is considered and passed, and yet again during the appropriations process. I think that this allocation of workload may get the Congress bogged down in too much detail.

CONCLUSION

This concludes my prepared statement, Mr. Chairman. I would be glad to respond to any questions you may have.