



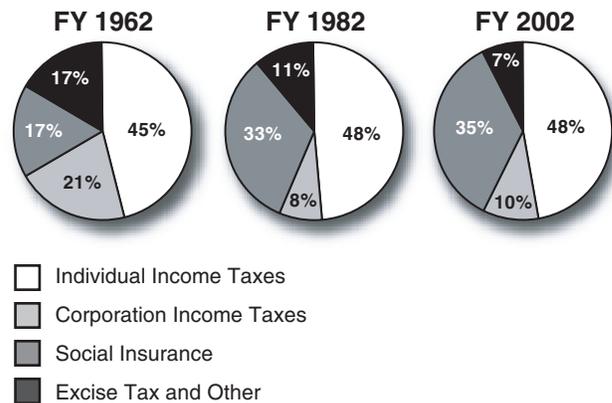
Strategic Objective:

Analyze the Government's Fiscal Position and Strengthen Approaches for Financing the Government

Issue: The federal budget is the principal annual vehicle through which the Congress and the President balance competing views about the allocation of federal resources, accountability for those resources, and the allocation of responsibility between the public and private sectors and among levels of government. After many years of attempting to balance the federal budget in the face of chronic deficits and mounting federal debt, federal fiscal policy in recent years focused on saving surpluses and reducing debt. In the past year, however, the near-term budget outlook has worsened with deficits projected for the next few years. GAO's long-term budget model has consistently suggested that without changes for the major retirement and health care programs, large deficits and mounting debt will emerge over the long term. It will be difficult to address today's urgent need to deal with terrorism and to increase national preparedness without unduly exacerbating the nation's long-term fiscal challenges. The budget controls instituted to achieve balance have recently expired, but no agreement has been reached on the appropriate structure or process for focusing on the fiscal challenges that now move to center stage.

To understand the context for near-term budget decisions more fully, it is important to look at trends in revenue sources and the distribution of expenditures. These trends show (among other things) growth in the relative share of revenues derived from employment taxes, such as those for Social Security (Old-Age Survivors and Disability Insurance), and a dramatic change over time in composition of spending, with a growing share devoted to health and interest on the debt, as figures 3.5 and 3.6 show.

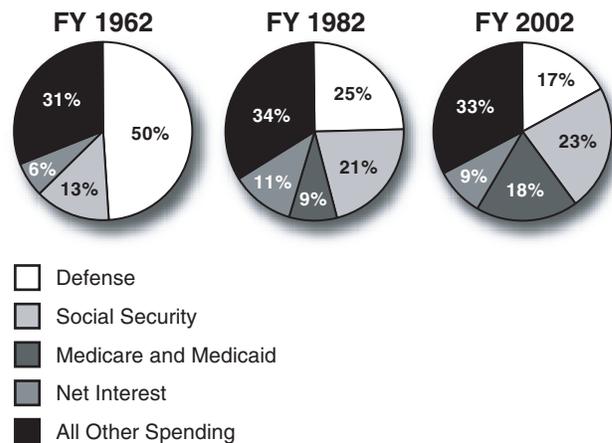
Figure 3.5: Composition of Federal Receipts by Source, Fiscal Years 1962, 1982, and 2002



Note: Fiscal year 2002 data are the current services estimates of the Office of Management and Budget.

Source: Budget of the U.S. Government, fiscal year 2003.

Figure 3.6: Composition of Federal Spending by Budget Function, Fiscal Years 1962, 1982, and 2002



Note: Fiscal year 2002 data are the current services estimates of the Office of Management and Budget.

Source: Budget of the U.S. Government, fiscal year 2003.

In rethinking federal fiscal policy and preparing for the long-term budgetary challenges, policymakers have the opportunity to consider what the federal government does and how to finance those activities. American taxpayers annually pay about \$2 trillion in taxes to fund the federal government. The federal tax system includes numerous tax provisions intended to influence taxpayers' behavior throughout the economy, but little is known about the effects of many of these provisions. Given the size and complexity of the federal tax code, the Congress remains interested in tax reform, particularly simplification. As the nation's chief tax collector, the Internal Revenue Service (IRS) interacts with more Americans than any other government agency, and compliance with tax laws is a significant burden imposed on businesses and individuals. IRS is in the midst of implementing major legislatively mandated reforms in how the nation's tax system is administered, and congressional interest remains focused on what progress IRS is making.

Congressional attention will also continue to focus on controlling spending. A key to making resource decisions is having reliable, useful, and timely

financial information routinely available. Such information is also necessary to ensure financial accountability and to improve the economy, efficiency, and effectiveness of government actions that have a direct effect on achieving a more results-oriented government.

Performance Goals: To analyze the government's fiscal position and identify ways to strengthen approaches for financing the government, GAO will

- analyze the long-term fiscal position of the federal government,
- analyze the structure and information for budgetary choices and explore alternatives for improvement,
- contribute to congressional deliberations on tax policy,
- support congressional oversight of IRS's modernization and reform efforts, and
- assess the reliability of financial information on the government's fiscal position and financing sources.

Analyze the Long-Term Fiscal Position of the Federal Government

Key Efforts

- ❑ Update and refine GAO's long-term budget model to highlight future budgetary and economic consequences of current and alternative fiscal policy paths, and examine the potential relevance of new fiscal policy targets or sustainability measures
- ❑ Monitor the implications of current fiscal policy for federal debt management and continue analysis of trust fund investment and financing issues
- ❑ Identify approaches to enhancing long-term economic growth through an examination of alternative ways to increase national saving and investment and through an examination of policies affecting the future size of the labor force
- ❑ Define a taxonomy of different types of federal budgetary commitments and identify ways to promote greater transparency of the costs of long-term commitments, such as environmental liabilities and social insurance programs

Significance

GAO's long-term budget model has consistently shown that current fiscal policy is unsustainable over time as the population ages and workforce growth slows. Social Security and Medicare largely drive this outlook, but other programmatic and budgetary decisions also have long-term cost implications. In the aftermath of the terrorist attacks and the short-term economic downturn, recent 10-year budget estimates are less optimistic and the long-term outlook will be correspondingly worse. GAO's contribution to addressing the long-term fiscal health of the federal government recognizes three important elements. First, major entitlement programs—as currently structured—will greatly constrain future budgetary flexibility. Second, fiscal policies promoting higher national saving and investment can help expand the economic resources and incomes of future generations, thereby enhancing their capacity to finance long-term commitments. And, third, full recognition of the future costs inherent in current commitments can prompt decision makers to address the difficult choices involved in making major programs more affordable and economically sustainable.

Potential Outcomes that Could Result when GAO's Work Is Used

A better informed Congress and public on the long-term implications of current and alternative fiscal policies on the budget surplus, the national debt, national saving, and other budgetary and economic measures of fiscal position

An informed debate about the consequences of demographic change on existing and proposed long-term budgetary commitments

More informed congressional decision making resulting from the greater transparency of the budgetary implications of long-term commitments

Analyze the Structure and Information for Budgetary Choices and Explore Alternatives for Improvement

Key Efforts

- ❑ Review annual compliance with the Budget Enforcement Act and evaluate ways to extend or adapt the budget enforcement regime beyond its expiration in fiscal year 2002
- ❑ Analyze alternative ways to consider federally owned capital and federal spending on physical capital investment in the budget and international experiences in making physical capital investment decisions
- ❑ Analyze scorekeeping rules for capital assets and develop alternatives to help ensure the best economic value
- ❑ Examine the capital planning process at agencies investing in major capital projects
- ❑ Periodically report on the budget and oversight implications of GAO's audits and evaluations and work to develop tools to identify major budget drivers and budgetary challenges facing key federal agencies or programs

Significance

Long-standing rules and budget conventions drive congressional decisions about resource allocation. The expiration of current statutory control mechanisms in 2002 will provide an opportunity to revamp the congressional budget process. The combination of short-term pressures for economic stimulus, greater resources for national preparedness, pent-up demands from years of deficit reduction, and longer-term fiscal challenges is likely to lead either to extending the current system or to a major overhaul. For example, the unified budget was created to bring together all federal spending and taxing activity to both understand fiscal policy and permit a global view of trade-offs within the budget. Various movements to change the budget include proposals to isolate Social Security, wall off various trust funds, move from cash to accrual, and change the focus from deficit/surplus to debt burden. Whatever the fiscal goal, the budget structure and process must continue to provide information that the Congress and the President need to evaluate both overall fiscal policy and the cost implications of individual decisions.

Potential Outcomes that Could Result when GAO's Work Is Used

An informed debate about alternative budgetary structures and control mechanisms, both for the short term and for the long term, and congressional understanding of the implications of current budget structures for the kinds of trade-offs that can be considered in the budget

Increased congressional and executive branch dialogue about capital investment alternatives to facilitate better-informed decisions about such investments

Informed congressional reviews of agency budget requests that are supported by information on emerging cost pressures and funding gaps and the identification of more cost-effective approaches to meeting current and future needs

*Contribute to Congressional Deliberations on Tax Policy**Key Efforts*

- ❑ Determine the potential affects of proposals to reduce the compliance burden for individuals and small businesses and to simplify the tax system
- ❑ Assess the effectiveness of selected tax incentives, including deductions for tax exempt organizations and the earned income tax credit, at meeting their goals
- ❑ Determine the potential effect of various options for taxing electronic commerce

Significance

The Congress has had a long-standing interest in reforming the tax code, including tax simplification for individuals and small businesses. Given the code's size and complexity, there is considerable room for improvement. The federal tax system includes hundreds of billions of dollars in tax incentive programs—such as exclusions for employee benefits and the earned income tax credit—passed by the Congress to influence taxpayers' behavior throughout the economy. However, little is known about the effects of many of these programs or their contribution to the complexity of the tax code.

Potential Outcomes that Could Result when GAO's Work Is Used

Reduced compliance burden for small businesses, private pension plans, and individual taxpayers and more informed congressional decisions related to tax complexity

Improved governance of tax incentive programs and better understanding of the effect of these programs on taxpayers and the U.S. economy

More efficient and equitable treatment of e-commerce by the tax system

Support Congressional Oversight of the Internal Revenue Service's Modernization and Reform Efforts

Key Efforts

- ❑ Determine what progress IRS has made with modernization, including restructuring, and whether these efforts are contributing to IRS's organizational goals, including improvements in service to taxpayers
- ❑ Evaluate IRS's expenditure plans for systems modernization
- ❑ Appraise IRS's human capital management strategies, including its efforts to develop managers
- ❑ Assess the progress IRS has made in implementing a system of balanced performance measures to assess the progress made in meeting the agency's goals
- ❑ Assess IRS's submission processing, examination, and collections programs in light of mandates to protect taxpayers' rights and to improve service
- ❑ Assess IRS's research and data analysis operations

Significance

Addressing concerns about the Internal Revenue Service's (IRS) poor management of its operations and relations with taxpayers, the Congress passed reform legislation in 1998 requiring IRS to reorganize its operations to place greater emphasis on serving the public and meeting the needs of taxpayers. In response, IRS has embarked on an agencywide modernization effort that seeks to balance providing service to taxpayers and ensuring compliance with tax laws. The IRS Commissioner estimates that modernization efforts will take at least a decade to complete. Changes include reengineering business practices, refocusing the organizational structure, establishing performance-based management, and building appropriate information technology to support IRS's mission.

Potential Outcomes that Could Result when GAO's Work Is Used

Mitigation of the risks inherent in the reorganization and modernization of IRS's operations

Enhanced IRS strategies for improving human capital and performance management

Improved service to taxpayers and improved compliance with tax laws

Assess the Reliability of Financial Information on the Government's Fiscal Position and Financing Sources

Key Efforts

- ❑ Annually audit and report on the U.S. government's financial statements and the adequacy of internal control and on financial information reported for major components of the government's financial operations
- ❑ Work cooperatively with the Office of Management and Budget (OMB) and the Department of the Treasury in addressing impediments to forming an opinion on the U.S. government's consolidated financial statements
- ❑ Work cooperatively with OMB, Treasury, and agencies to (1) suggest solutions to material control deficiencies and compliance issues, (2) improve the auditability of agency financial information, and (3) reduce the use of nonsubstantive efforts to prepare financial statements

Significance

GAO has been statutorily required to audit the U.S. government's annual consolidated financial statements, prepared pursuant to statute, since fiscal year 1997. For the past 4 fiscal years, GAO has been unable to give an opinion on the U.S. government's consolidated financial statements because of material deficiencies in systems, record keeping, and documentation. In addition, because of the significance of certain information reported in the consolidated financial statements, GAO has, for the past several years, conducted audits of the entities responsible for most of the government's revenue, the federal debt, and central cash activities. Beginning with fiscal year 1996, the Congress has also required annual audited financial statements for 24 major federal departments and agencies. The number of these agencies that were able to attain an unqualified audit opinion on their financial statements from their auditors increased to 18 for fiscal year 2001, up from just 6 agencies 4 years ago. Many agencies, however, only achieved their unqualified opinions through extraordinary efforts that are very costly, time-consuming, and inefficient.

Potential Outcomes that Could Result when GAO's Work Is Used

Enhanced assessment of the government's overall fiscal position and financing sources based on information that is timely, accurate, and useful

Improved financial reporting for making budgetary decisions on and effectively managing areas significantly affecting the government's fiscal position, such as credit program costs and environmental liabilities

Assurance as to the reliability of financial information covering major government financing sources, such as tax revenue and receivables, and the effectiveness in managing tax refund and collection activities

Actions to address agencies' material control weaknesses and to help ensure compliance with laws and regulations in key areas