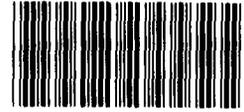


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Major Issues Facing the 102nd Congress

Statement of
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Before the
Committee on Governmental Affairs
United States Senate



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Mr. Chairman and Members of the Committee:

I welcome the opportunity to appear before this committee today in what has become almost a tradition, to participate in a wide-ranging review of issues facing our government, the Congress, and this committee. I find this sort of hearing especially useful because it permits us to discuss matters in a broader context than is usually possible.

In November 1988 we issued a group of reports, the Transition Series, in which we sought to alert a new President and a new Congress to the challenges facing the Nation and its political leadership. The challenges we described were numerous and formidable. I would like to focus my opening remarks on a review of how matters have progressed in the two years since we issued those reports.

When we published the Transition Reports, we knew that the problems we were highlighting did not develop overnight, and we knew that they would not yield to quick, simple, and painless solutions. We repeatedly stressed the need for sustained efforts over a number of years to solve problems that--in some cases--had been decades in the making. Nevertheless, some of those problems, such as the crisis in the thrift industry, have proven to be of even greater magnitude and more difficult to resolve than we thought.

In some cases we can report significant progress, but that is the exception. And many of the problems--including some of the most important ones--have increased in severity rather than diminishing. Rather than burdening this statement with a recitation of all the problems and challenges that still remain unresolved, however, I will highlight a few items--including several where there have been some encouraging developments--that I consider both important and in some sense typical of the situation as I see it today.

I will start with the overall state of the economy and of the budget because our continuing inability to control the deficit and the effects of that inability on the performance of our national economy underlies our difficulties in resolving a host of other problems.

THE BUDGET

In 1988, we were concerned about a consolidated deficit of \$155 billion. In 1990, that deficit exceeded \$220 billion and it seems likely to reach \$300 billion or more in 1991. But, as we also noted in 1988, those numbers understate the magnitude of the problem. We observed that the general fund deficit--excluding the surpluses in the Social Security and other trust funds--reached \$252 billion and appeared to be headed toward \$300 billion in the early 1990s. Some thought we were too

pessimistic. They were wrong. In fact, we were too optimistic. The general fund deficit sailed through the \$300 billion mark in 1990 and is headed toward \$400 billion or more in 1991.

Congress has been struggling with this problem. Last year's budget summit negotiations and the legislation enacted to implement the summit agreement involved real savings of substantial size. If the problem had stood still, the agreement would have brought us substantially closer to an appropriate long term fiscal policy. Unfortunately, that is not what happened. Just as the negotiations were proceeding, the deficit was exploding under the pressure of a softening economy, escalating costs for deposit insurance, and most recently the military buildup in the Middle East.

Now, as we enter a recession while simultaneously engaged in a war in the Middle East, the fiscal situation is deteriorating even further. It now seems clear that the savings achieved in the budget legislation will not produce budget surpluses by 1995 as some thought when the agreement was enacted.

I would remind you that the baseline deficits for 1990 and 1991, taken together, increased by about \$300 billion in the 10 months from the release of the President's budget a year ago to the passage of deficit reduction legislation last fall. A protracted war in the Middle East, recession at home, and further increases

in the cost of deposit insurance could bring an equal or greater rise in the deficit over the next few years.

THE ECONOMY

Our failure thus far to bring the deficit under control has had both short and long term implications for the economy. The need to import capital to replace savings consumed by the deficit is the most important single cause of our persistent trade deficit during the 1980s. In the long term, the budget deficit coupled with a low domestic savings rate will constrict the opportunities for domestically financed economic growth and will ultimately impinge on the standard of living of the American people.

But there is a more immediate implication of the budget deficit for the economy. We are now in a recession. Increasing the budget deficit to stimulate the economy is usually considered as a possible response to the onset of a recession. The deficit will, of course, be increased automatically by the decline in revenues and increases in some spending programs caused by the recession. If we are fortunate, the current recession will be mild and brief. In that event, the automatic fiscal stimulus plus the relaxation in monetary policy that now appears to be underway will turn out to be all that is needed.

There are reasons, however, to wonder if we will be so lucky. At no time in the post-war period have we entered a recession with our financial institutions in jeopardy and with such a burden of debt--both public and private--hanging over the economy. If these and other factors should cause the recession to be deeper and more prolonged than is currently forecast, the constraints on our fiscal policy flexibility imposed by deficits that are already huge will prove to be another important reason to wish that we had dealt effectively with the budget deficit under more favorable circumstances.

Those who said we should deal with the deficit while the economy was strong have been proven right. Waiting has only made the job harder.

Our failure to bring the deficit under control is matched by our failure to resolve a number of critical policy problems in specific program areas.

DEFENSE

The disintegration of the Warsaw Pact as a unified threat to Western Europe permits--indeed, it requires--a fundamental reexamination of the national security policy that has guided our defense budgets for the past four decades. The force structures and weapons systems that were appropriate for the Cold War era

are not necessarily appropriate for the new environment in which we find ourselves.

A year ago, there was evidence that this reassessment was beginning. Although the budget summit agreement incorporated a downward trend in real defense spending, the extent to which that will be implemented through the sort of reexamination we believe to be needed will be discernible only when we see the President's 1992 budget in February. Meanwhile, the massive military response to the Iraqi invasion of Kuwait means that the fiscal benefits from any reassessment will be offset to some degree--and perhaps totally swamped--by the costs of Desert Shield and Desert Storm.

In the past few years, there has been increasing recognition of one of the problems we raised in the Transition Reports--that the U.S. could not afford the costs of all the new weapons systems being proposed. We have stressed not only that tough choices would have to be made among systems under development, but that those systems which do go forward should be slowed down from the highly concurrent pace of the 1980s, with performance fully tested before major investments are made.

We are all justly proud of the successes of the weapons being used in Desert Storm and of the skilled, dedicated men and women who are operating those systems. I think we all agree that our

troops must be supported, no matter what the cost. But our pride in our troops and the necessity to support their efforts should not blind us to the management failures, cost growth, and overall affordability issues that continue to be major problems for weapon system development.

The Navy's well-publicized problems with the A-12, leading to the announced decision to terminate the program, is but one example. Other programs have also evidenced cost growth and schedule slippage. These include the Air Force's B-2 and C-17, the Navy's T-45 trainer, and the Army's fiber optic guided missile. Problems such as these, particularly if they emerge in a period of more tightly constrained defense procurement budgets that make it difficult to absorb cost overruns, could well mean that we will be faced with calls for bailouts similar to the Lockheed situation in the 1970s.

Replenishment of certain munitions now being used in the Middle East, including the Tomahawk cruise missile, the Patriot surface to air missile, and other systems, are critical to the support of our own troops and those of our allies. However, such replenishment will not solve the problems of some defense firms facing a potential loss of business in the event of cancellation of major weapons systems.

FINANCIAL INSTITUTIONS

When we issued the Transition Reports, we were concerned about the cost of restoring stability to the thrift industry. FSLIC was hopelessly insolvent and unable to pay the estimated \$50 billion in additional costs required to resolve failed and failing institutions. It became widely recognized that action had already been postponed too long. The enactment of FIRREA was an important step forward in building the needed framework for resolving the crisis in the thrift industry. Additional reforms affecting internal controls, accounting, and auditing are still needed, but the critical first steps have been taken.

Meanwhile, however, costs have continued to escalate. We now estimate that the total bill for resolving the thrift industry crisis will reach \$370 billion. That could rise to \$400 billion if additional institutions fail, or half a trillion dollars in a severe recession. But the prospect of these costs must not be allowed to bring the resolution process to a halt. The losses incurred by insolvent institutions that continue operating add directly to the eventual resolution costs. Delaying action on such problems can be terribly costly, as we have seen in recent years.

That lesson is equally applicable to recently disclosed problems in the banking industry and in the Bank Insurance Fund (BIF, the

new name for the old FDIC insurance fund). Last September, we reported that BIF had potentially more than \$6 billion in unrecorded liabilities at the end of 1989 associated with a number of vulnerable large banks. We noted that a recession could escalate bank failures, leading to losses that could deplete BIF. Congress responded by eliminating the assessment rate restrictions in FIRREA. This is a sound first step, but additional action will be needed to recapitalize BIF, and other reforms are needed to strengthen both BIF and the banking industry. If sufficient resources cannot come from the industry, taxpayer support may turn out to be needed.

HEALTH

In our Transition Reports, we noted with concern the high and rising costs of Medicare and Medicaid. Progress had been made on some issues, such as assuring greater equity in Medicare prospective payment systems for hospitals, and in conducting the research needed to develop guidelines for physician services.

It is now evident, however, that the problem is far deeper than this. The effect on the federal budget is but one symptom of an overall health care system in need of fundamental reform. The U.S. spends 11 percent of its GNP, headed for 15 percent by the turn of the century, on health care services, more than any other industrialized nation.

For those who can be sure of access to the American system, it provides the highest quality care in the world. Overall, however, we are not getting our money's worth. Around 15 percent of the population--30 million or more--has difficulty gaining access to the system because they have no health insurance. (That number will probably rise as people are laid off in a recession.) And measurable health outcomes are not what one would expect from our level of spending. Life expectancy is on a par with other industrialized nations that spend far less, while our infant mortality rates are far higher.

TRANSPORTATION

In 1988, we identified a number of challenges facing a newly-appointed Secretary of Transportation, including the need to come to grips with an over-stretched and deteriorating transportation infrastructure. Since then, DOT has developed a National Transportation Plan, the first since the Department's establishment a quarter century ago and a significant achievement. The plan effectively articulates the needs and the consequences of failing to meet those needs, but does not explain how those needs will be financed. This will be a major challenge for the 1990s, since highway and bridge needs alone have been estimated to cost half a trillion dollars through the year 2000, dwarfing DOT's current \$12 billion per year highway budget.

Our Transition Reports also highlighted the problems of FAA'S faltering \$30 billion Air Traffic Control modernization program. This program has faced some of the same cost, schedule, and performance problems as are seen in DOD weapons systems. DOT has initiated several reforms, including a commitment to testing before making major financial commitments. This is clearly a step in the right direction, but it will take time before we can be confident that this huge program has been turned around.

AGRICULTURE

Since 1985, U.S. agriculture has been moving away from subsidization and towards a more market-oriented system. In 1988, we said continuation of this trend required greater flexibility in our production control programs. The 1990 farm bill provided this flexibility, but the budget agreement made the resulting savings contingent on success in the GATT negotiations. The current impasse in those negotiations suggests that the savings are in jeopardy.

ENERGY

The current Middle East crisis requires us to focus on our failure to contain our demand for imported oil. We must now relearn the lessons we should have learned from earlier oil shortages. An effective national energy policy would

require--among other things--more spending on research and development and on conservation. Finding that money will be very difficult in the present budget situation, particularly because of competing demands, such as the need to clean up the enormous environmental, safety, and health problems in DOE's nuclear weapons complex, which we have estimated to cost as much as \$150 billion over several decades. As you well know, Mr. Chairman, because of your extensive involvement in this area, dealing with the nuclear weapons complex will require, in addition to money, some tough decisions about what sort of weapons production capacity will be needed in the post-Cold War era.

ENVIRONMENT

Congress reauthorized the Clean Air Act last year. This was an important accomplishment, but meeting the requirements and deadlines of the act, along with those of other environmental legislation, will be costly and challenging for EPA, states, localities, and industry. Because of severely constrained federal resources, costs have been shifted to states and localities, many of which are in dire fiscal straits themselves and unable to assume that burden. And there are other obstacles. EPA's myriad of separate authorities limits its ability to shift resources to achieve maximum reduction of environmental risk. At the same time, inadequate resources for research constrains efforts to measure results and identify emerging risks.

FINANCIAL MANAGEMENT

In some areas, particularly financial management, the news is much more encouraging. We saw a major step forward with the enactment of the Chief Financial Officers Act of 1990, under the leadership of this committee and its House counterpart. Now we must implement that legislation effectively, building a modern financial management structure while putting aside old ways that have not done the job. This will require sustained oversight and support in the Congress. In this connection, I urge this committee and others to consider regular hearings with agency heads and CFOs, both to stay abreast of developments and to emphasize to the agencies the necessity of implementing this legislation diligently.

We should learn from the experience of the Federal Managers Financial Integrity Act. It has never achieved its potential because too many people focused on the process, rather than the objective. Learning from that experience, we must hold top agency management accountable from the start for achieving the substantive changes envisioned in the CFO act. As I have emphasized on other occasions, those changes must include producing more reliable, timely, and useful measures of program performance, as well as financial data. This will continue to be one of my top priorities and I look forward to working with the

Congress to assure effective implementation of this important legislation.

As you know, we have identified 14 areas where we believe there may be especially high risk of large losses to the taxpayer. We are applying substantial resources to an in-depth examination of these program areas. This "high risk" program, the subject of previous hearings of this committee, is an attempt to attack the root causes of problems. In part, at least, it reflects the failure of the FMFIA process to come to grips with those root causes. We hope it will bear some of the fruit that we originally expected from FMFIA and reduce the likelihood of repeating the HUD experience.

To digress for a moment, we are following up, as you requested, on the high risk area of inventory management and are assessing the impact of the Middle East crisis. Our work has been slowed somewhat by the crisis, but preliminary results indicate that the magnitude of the inventory and its related problems are greater than previously reported. We think that the problems can be alleviated, readiness enhanced, and costs reduced through further improvements to the systems and methods DOD uses to manage its inventories.

THE PUBLIC SERVICE

In the Transition Reports, we expressed our alarm at the growing inability of the government to acquire and retain good people. This is another area in which developments have been encouraging. President Bush has reversed the years of "fed-bashing" which had such a devastating effect on the image of the public service and the ability of government agencies to attract able young people. Equally important has been executive and congressional support, especially from this committee, for pay reform, including higher pay for senior officials and the introduction of locality pay to assure that we can compete more effectively for talent in areas with especially high living costs.

CONCLUSION

In contrast to the mixed results I have portrayed here, one remarkable story stands out: the transformation of Europe, especially Eastern Europe. Enormous hurdles remain as the former members of the Warsaw Pact struggle to build functioning economies and, we hope, stable democratic forms of governance. The new Eastern Europe is not without risk. Resurgent nationalism and the inevitable unrest may threaten these countries and their neighbors. But from the perspective of U.S. national interests, the news is good.

Most would agree that the news was also totally unexpected. Two years ago, almost no one anticipated that we would shortly enter an era in which the USSR posed a substantially reduced conventional military, political, and economic threat to the West, and in which the former client states of the Warsaw Pact posed virtually none at all. Even now, no one can say with certainty how much this outcome stemmed from the policies of the U.S. and its western allies and how much was the inevitable result of conditions endemic to the Soviet bloc. But it is clear that, for more than 40 years, the U.S. pursued a consistent set of policy goals, the containment of communism in Europe; that it pursued these goals in a patient and sustained manner; and that those goals were ultimately achieved.

There is a lesson in this. We face a host of stubborn perplexing problems. Today's challenges and dangers are perhaps more ambiguous and complex than those of the Cold War, but they are no less real and are just as demanding of our national commitment and resolve.

Here it is worth noting another transformation that is underway. EC 92 will be a watershed in the economic and political integration of Western Europe. It signals that we are in a new world, one partly of our own making, but one in which our role is changing and our preeminence is no longer assured. We must prepare ourselves, not for military competition with another

superpower, but for vigorous economic competition with other economic powers whose vitality rivals, and may eventually exceed, our own. We must equip ourselves for that competition or we will be left behind.

It is time to begin a healthy debate over what is required of our government if the nation is to succeed in this new era. I would like to offer a few suggestions whose importance lies in the fact that they are prerequisites to accomplishing other objectives:

1. We must have a government that works, one that operates efficiently and effectively, both in its internal functions and in its delivery of services to the American people. The taxpayer deserves no less. The continuing problems enumerated in this statement, and the many others that we noted in our Transition Reports that remain unresolved, demonstrate that our government does not yet meet this test. To reach that goal, we must begin to invest again in government, in its people, its facilities, and its technology. This issue, of course, is one which is of special concern to this committee, as is evidenced by its leadership on the CFO legislation.
2. We must have a government whose financial performance relates properly to the national and world economy. For that to be achieved, we must move toward a long term fiscal

policy that recognizes the need for a much higher level of national savings.

3. We must have a financial system in whose safety and soundness the American people can have complete confidence, so that our market economy can effectively allocate capital to the most productive uses. To accomplish that, we must complete the task of resolving the thrift industry crisis, restore the soundness of the banking industry, and assure an efficient and effectively regulated structure of capital markets.

Other objectives are important, but these are of overriding importance to assuring the competitiveness of the American economy. Neither the current recession nor war in the Persian Gulf can be permitted to distract us from these vital long term goals.

In this connection, 1992 is possibly a key date, perhaps a turning point because of the likely confluence of events:

- We hope, by then, to have emerged from the current recession. A more vigorous economy provides the right environment in which to tackle, once more, the budget deficit.

-- Desert Shield/Desert Storm will be behind us, and we will be able to refocus our efforts on determining the size and shape of our armed forces in the post-Cold War era.

-- EC 92 will bring home to us the reality of a new world marketplace in which we must be prepared to compete.

It could be argued that in the past two years we have seen some constructive shifts in attitude, but only slight tangible progress in resolving many of our long-standing problems. I am confident, however, that if we can clarify our priorities and resolve to deal with the matters we agree are most important, there is no reason that this nation cannot keep pace with a changing world.

That completes my prepared statement. I would be pleased to respond to any questions.