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DEFICIT REDUCTION

Opportunities to Address Long-Standing Government Performance Issues

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GAO/T-OCG-95-6

Mr. Chairman and Members of the Committee:

I am pleased to be here today to open a series of hearings presenting GAO work that suggests both the compelling need to continue to reduce annual deficits as well as opportunities to improve the performance of government concurrent with downsizing initiatives. My observations are drawn from a wide range of GAO work evaluating the effectiveness of federal programs and operations over recent years. Taken as a whole, our work identifies opportunities to target cuts on programs with perennial performance problems or excessive costs while making wiser investments in people and systems to improve the effectiveness of the programs and operations that remain.

As you know, continuing large deficits pose significant long-term economic and fiscal consequences for our nation. The aging of America's population threatens to convert today's fiscal commitments into economically unsustainable burdens that may very well undermine the future economic well-being of the nation. Conversely, shifting fiscal policy paths to eliminate these deficits promises to increase the future capacity of the U.S. economy to provide for both the retirement of the baby boom generation and a rising standard of living for the next generation of workers.

How we reduce the deficit is also of great importance for the nation's fiscal and economic future. The prospect of fiscal and programmatic sacrifice is never easy or welcome to those who must bear the burden. However, the pressure of the deficit offers the opportunity for the nation to reexamine and perhaps update its spending priorities, based at least in part on the relative performance of programs and agencies.

As our body of work on deficit reduction strongly suggests, decisions on where and how to cut will determine both whether deficit reduction will be sustainable in the face of continuing demographic pressures and whether the slimmer government that may emerge will also prove to be effective. Addressing the principal drivers of the deficit now and in the future--health care and, ultimately, social security--is important to achieve sustainable fiscal progress over the long term. It will also be important to reassess other large components of spending such as defense, whether their aggregate level is to be changed or whether their composition is changed within an overall top line.

Within these and other areas, the prospect of deficit reduction offers an opportunity to address program and management reforms that have been long overdue. Our work has identified numerous areas where programs have either failed to perform effectively or have suffered from chronic waste and inefficiency. Our work also points to other areas where improved investment in management systems, technology, and people will help ensure more effective and less wasteful operations. A fundamental review and reexamination of our programs and operations is important not only to reach the new demanding budgetary targets but also to promote a more effective government that can regain the confidence of the public.

My remarks today will cover four major issues to consider in the current budget policy debate:

- the compelling importance of continuing to focus on reducing and eliminating the deficit;
- the advantages of targeting budget cuts to those programs and operations that have proven to be ineffective or inefficient in achieving their goals;
- the need to confront the major cost drivers, both short- and long-term, of the federal budget in addressing the deficit to ensure sustainable fiscal progress; and
- the need to develop and use fundamental management tools and systems and better design and evaluate programs to ensure that the government that emerges is also a more effective one that can gain the confidence of the nation's taxpayers.

THE COMPELLING CASE FOR DEFICIT REDUCTION

In 1990, we reported that the nation's long-term economic future depends in large part upon budget decisions made today. We said that failure to reverse current fiscal policy could doom future generations to a stagnating standard of living and hamper the United States' ability to address pressing national needs.[1]

By now, this problem has been recognized. It is encouraging that both the Congress and the President have proposed plans to reverse these fiscal trends and balance the budget. It appears that the conflict is no longer over <u>whether</u> to balance the budget, but rather over <u>when</u> and <u>how</u>.

There are important and compelling benefits to be gained from such a new fiscal policy path. Chronic deficits have consumed an increasing share of a declining national savings pool, leaving that much less for private investment. Most assuredly, lower investment will ultimately show up in lower economic growth. Future generations of taxpayers will pay a steep price for this lower economic growth in terms of lower personal incomes and a generally lower standard of living at a time when they will face the burden

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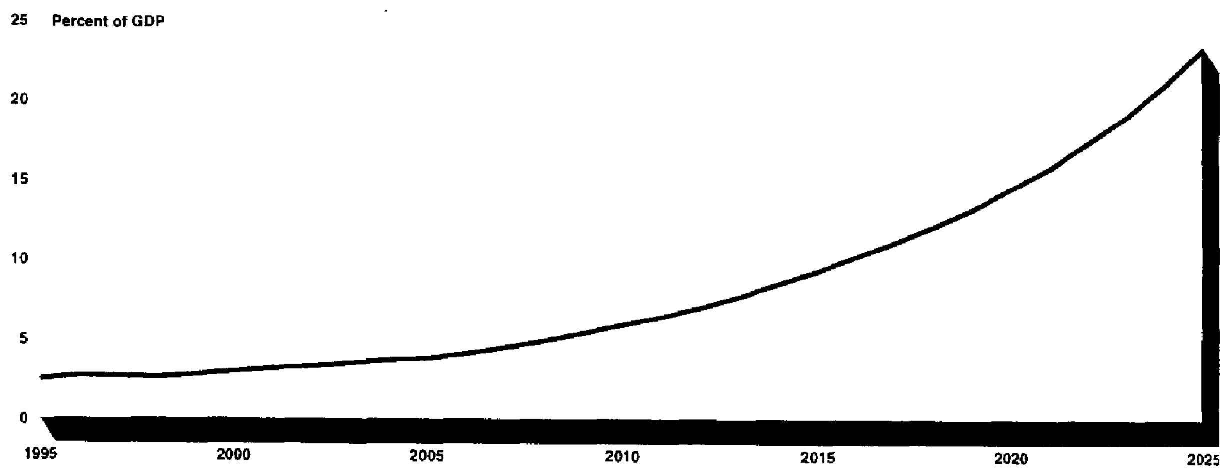
[1]<u>The Budget Deficit: Outlook, Implications, and Choices</u> (GAO/OCG-90-5, September 12, 1990).

of supporting an unprecedented number of retirees as the baby boom generation reaches retirement.

The problem is that the damage done by deficits is long-term, gradual, and cumulative in nature and may not be as visible as the short-term costs involved in addressing it. This presents a difficult challenge for public leaders to mount a compelling case for deficit reduction that can capture public support.

In order to clarify the long-term benefits that could be derived through alternative fiscal policy paths, in 1992 we used an economic growth model to simulate the effects of federal fiscal policy on longer term savings, investment, and real gross domestic product (GDP).[2] Last spring, in a report addressed to you, Mr. Chairman, and to Senator Domenici, Chairman, Committee on the Budget,[3] we updated the simulations presented in the 1992 report. While significant fiscal policy changes have been under active consideration by the Congress, our updated simulation results confirmed that the nation's current fiscal policy path is unsustainable when viewed over the longer term. Specifically, a fiscal policy of "no action" on the deficit through 2025 implies federal spending of nearly 44 percent of GDP and, as figure 1 shows, a deficit of over 23 percent of GDP.

Figure 1: Deficit Path in "No Action" Simulation (1995-2025)



[2]Budget Policy: Prompt Action Necessary to Avert Long-Term Damage to the Economy (GAO/OCG-92-2, June 5, 1992).

[3]The Deficit and the Economy: An Update of Long-Term Simulations (GAO-AIMD/OCE-95-119, April 26, 1995).

Let me explain what is driving these ominous trends. In our updated simulations, we held revenues and all spending, except for health care and social security, constant as a share of the economy for most of this 30-year period. The increased spending is principally a function of escalating federal spending on health care and social security driven by projected rising health care costs and the aging of our population.[4] Spending on interest also rises as annual deficits and accumulated public debt expand. Essentially, current commitments in these areas become progressively unaffordable for the nation over time. Absent any significant changes in spending or revenues, such an expanding deficit would result in collapsing investment, declining capital stock, and, inevitably, a declining economy by 2025.

As emphasized in that recent report, we do not believe that such a scenario would take place. Rather, we believe that the prospect of economic decline would prompt action before the end of our simulation period. Nevertheless, this "no action" scenario, by illustrating the future logic of existing commitments, powerfully makes the case that we have no choice but to take action on the deficit. The questions that remain are when and how.

Our updated simulations also confirm the long-term economic and fiscal benefits of deficit reduction. We assessed the long-term impacts of balancing the budget by 2002, as is contemplated in the fiscal year 1996 budget resolution, and sustaining such a posture through 2025. We also estimated the effects of following a path that we have called "muddling through"--that is, maintaining deficits of about 3 percent of GDP over the next 30 years.

A fiscal policy of balance would yield a stronger economy in the long term than a policy of no action or muddling through. Figure 2 shows that a budget balance reached in 2002 and sustained until 2025 would, over time, lead to increased investment. It would also result in a larger capital stock and a higher real GDP per capita than the "no action" and "muddling through" policies we simulated.

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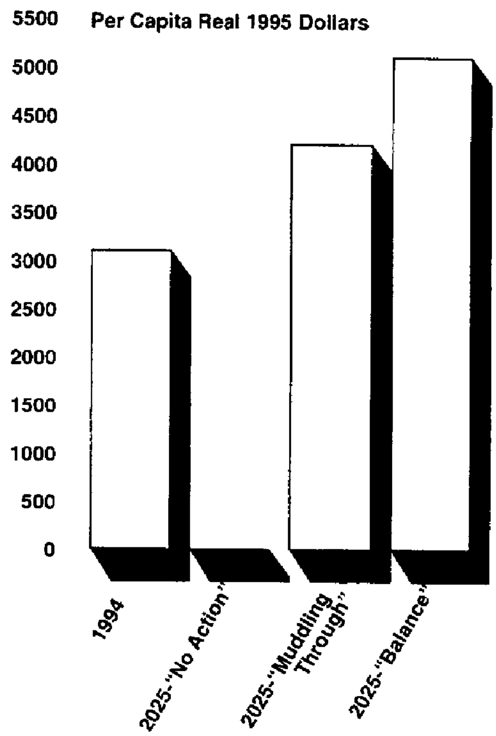
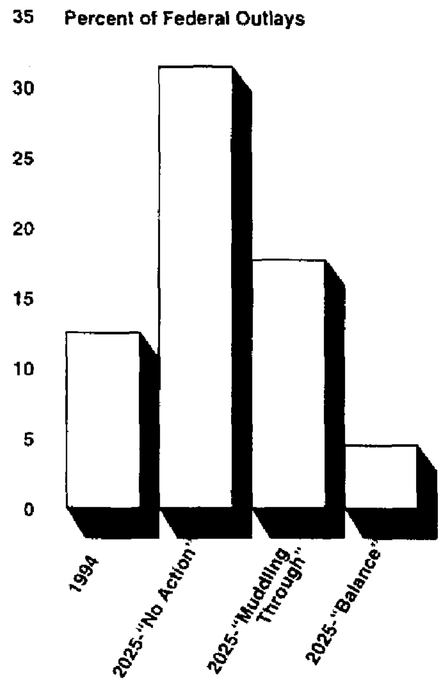
[4]Budget assumptions rely upon the Congressional Budget Office (CBO) estimates through 2004 to the extent practicable. Beyond that, Social Security estimates were based on the April 1995 intermediate projections from the Social Security Trustees. Medicare projections were based on the Health Care Financing Agency (HCFA) long-term intermediate forecast from the Medicare Trustees' April 1995 report. For Medicaid, in the absence of HCFA projections, we used projections developed in 1994 by the Bipartisan Commission on Entitlement and Tax Reform.

Figure 2: Non-Farm Business Investment Under Alternate Scenarios



Reaching and sustaining balance would also shrink the share of federal spending required to pay interest costs, thereby reducing the long-term programmatic sacrifice necessary to attain deficit reduction targets. Even "muddling through" with deficits of 3 percent of GDP would exact a price through higher interest costs and thus require progressively harder fiscal choices as time progresses. As shown in figure 3, by 2025 a balance path could bring interest costs down from about 12 percent in 1994 to less than 5 percent of our budget, compared to about 18 percent under "muddling through" and almost a third of our budget with no action. Under the balance path, debt per person would decline from $13,500 in 1994 to $4,800 in 1995 dollars by 2025 under the balance path.

Figure 3: Net Interest Outlays Under Alternate Scenarios



I would only add that alarming as our model results may appear, they are probably understated. Budget projections for both the near term and assumed in our long-term model results may not tell the whole story. By convention, baseline budget projections do not include all the legitimate claims that may be made on the budget in the future. Rather, budget projections ignore many future claims and the costs of unmet needs unless they are the subject of policy proposals in the budget. Examples of such claims and needs would include the cost of cleaning up and restructuring the Department of Energy's (DOE) nuclear weapons production complex, the cost of hazardous waste pollution cleanup at military facilities, and cost overruns in weapons systems. In short, most of the risks to future budgets seem to be on the side of worse-than-expected, rather than better-than-expected, outcomes. I make these observations not to create despair but to underline the need to act rapidly and decisively.[5]

TARGETED REDUCTION STRATEGIES CAN HELP RESHAPE GOVERNMENT

The budget resolution reflects a congressional decision that the deficit should be eliminated by reining in spending. Achieving the kinds of deficit reduction contemplated in the budget resolution

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[5]Budget Policy: Long-Term Implications of the Deficit (GAO/T-OCG-93-6, March 25, 1993).

obviously will not be easy. Many hard choices will be required. In this process, it will be important to address the large and growing areas of the budget if the deficit is to be eliminated and balance sustained. The largest programs, although inviting fiscal targets, may also be the most sensitive due to their size and their importance to so many Americans.

Although a large share of savings for deficit reduction will need to come from these programs, other areas of the budget should not be excluded. Because so many Americans will be affected by the cuts in these large and popular programs the spotlight should be placed on all of the activities of government. To an important extent, public confidence will depend on the perception that deficit reduction efforts will lead to improved performance of government.

Given the size of the cuts involved, a reassessment of the roles and responsibilities of government can help focus thinking on what government should look like to guide downsizing that the Congress deems necessary. The relative performance of programs and agency operations should be considered as at least one basis for this reassessment by identifying "weak claims" on public resources. By "weak claims," I mean those programs that have been found to be ineffective or inefficient in achieving their goals.

Weak claims can also include programs that have outlived their usefulness--the problems that originally prompted their creation either no longer exist or have been greatly mitigated. Weak claims can also include programs that have demonstrated through their persistent poor performance that they are the wrong solutions to real and pressing public concerns. And weak claims can include spending on federal agency operations as well as programs aiding various sectors of our economy through subsidies such as grants or tax expenditures. All such weak claims might be considered for significant reduction, overhaul, or elimination as part of the deficit reduction process.

In the past, budgetary reductions have all too frequently been achieved through small incremental cuts to many programs or activities without a reexamination of their purpose or scope. Although promoting the appearance of equity, such strategies treat effective and ineffective programs alike and can yield an overextended government trying to do too much with too little.

Targeted reductions based on the relative performance of federal programs can help promote a government whose responsibilities are better matched to the resources available. If congressional decisions bring about a smaller government that is also to be more effective, policymakers will need to engage in a comprehensive assessment of what government should do, who should benefit, and how program services should be delivered, and then use this reassessment to reshape public institutions. Moreover, the federal government desperately needs to put in place fundamental management tools to better ensure accountability for a scarce pool of resources, eliminate waste, and generate much improved cost and performance information to enhance decision-making.

Large deficits can, but sometimes do not, prompt governments to undertake this kind of necessary, but painful, reassessment. I commend to you a recent article by Felix Rohatyn on the New York City fiscal crisis.[6] He observes that the city resolved its imminent fiscal crisis in the mid-1970s through a mix of measures that succeeded in balancing the budget but that largely postponed fundamental reforms in the scope and role of city government. Without this reassessment, the economic prosperity of the 1980s induced the city to restore some of its costly programs and practices. Now in the mid-1990s, the city once again faces a serious structural deficit because permanent declines in the city's revenue base were not matched with commensurate restructuring of governmental roles and responsibilities.

We can help in the process by providing the Congress with feedback on the performance of federal programs and agency operations. Our work has revealed long-standing problems with program performance and agency operations. Responsible reform in many of these areas is long overdue.

In each of the last 2 years, we have issued a report designed to make our audit and evaluation work more useful and accessible to budget decisionmakers.[7] Specifically, these reports describe budgetary savings options by putting the problems we have found into a budgetary context. The Congressional Budget Office (CBO) and Joint Committee on Taxation (JCT) have reviewed these options and, where possible, have provided estimates of budgetary savings or revenue gains.

Our work suggests the following three broad areas of program choice and reform:

- reassess program objectives and operations based on either persistent performance problems or successful completion of missions;

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[6]"Big MAC To Go; Hold the Lies: New York's Recipe For Recovery--and What D.C. Can Take From It," The Washington Post, August 13, 1995.

[7]Addressing The Deficit: Budgetary Implications of Selected GAO Work (GAO/OCG-94-3, March 11, 1994) and Addressing The Deficit: Budgetary Implications of Selected GAO Work for Fiscal Year 1996 (GAO/OCG-95-2, March 15, 1995).

- improve targeting of resources to those beneficiaries or providers with the greatest needs and lowest capacity to provide services from their own resources; and

- improve efficiency in the way programs are structured, delivered, or managed.

I would just add, Mr. Chairman, that many of the options flowing from our work are currently under consideration within the Congress, either as part of the appropriations process or the reconciliation process.

Reassessing Objectives

Our first theme encompasses audit findings or evaluations that suggest the need to reassess the objectives and purposes of government programs. Such reassessment would involve periodically reconsidering a program's original purpose, the conditions under which it continues to operate, and its cost-effectiveness.

Under this approach, programs would be considered for termination if our work has shown that they (1) have succeeded in accomplishing their intended objectives and, therefore, the needs have been met, (2) have persistently failed to accomplish their objectives, (3) have program objectives that are no longer valid because the underlying conditions have changed, or (4) have cost estimates that have increased significantly above those associated with original objectives, or have benefits that have fallen substantially below original expectations.

An example of the need to reassess program objectives is the Davis-Bacon Act. Davis-Bacon requires workers on federally assisted construction projects to be paid wages at or above levels determined to be prevailing in the area. The current dollar threshold for projects covered by Davis-Bacon is $2,000, an amount that has not changed since 1935.

In 1979, we expressed major concerns about the accuracy of wage determinations and its impact on federal construction costs.[8] Critics of the act believe that it inflates the costs of federally funded construction projects. Additionally, CBO has noted that repealing Davis-Bacon or raising the threshold would increase employment opportunities for less-skilled workers, although it would lower the wages of some construction workers. While Davis-Bacon regulatory changes have addressed some specific concerns

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[8]The Davis-Bacon Act Should Be Repealed (GAO/HRD-79-18, April 27, 1979).

raised in our 1979 report, other concerns remain, most notably the potential for basing wage determinations on low-quality data.[9]

In weighing the opportunities to reduce federal construction costs and increase work opportunities for less skilled workers against higher wage levels, the Congress could consider repealing or reducing the scope of this act as part of its deficit reduction strategy. CBO has estimated that if the Congress repealed Davis-Bacon, the 5-year savings would be about $2.6 billion.

We have also reviewed a variety of programs and functions that have been identified by the Congress as candidates for privatization. Privatization can range from contracting out certain activities to selling entire entities to private sector concerns. One example of privatization through the sale of an entity is the proposal to privatize the United States Enrichment Corporation (USEC). The 1992 legislation which established USEC as a government corporation called for USEC to develop a privatization plan by 1995 and for GAO to review the plan before its implementation. We have supported legislation for years to create a government corporation as an initial step toward the eventual privatization of DOE's uranium enrichment program.[10] Our work also has a bearing on the current deliberations concerning the possible sale of the Naval Petroleum Reserve-1,[11] changing how federal needs for helium are met,[12] and

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[9]Changes to the Davis-Bacon Act Regulations and Administration (GAO/HEHS-94-95R, February 7, 1994).

[10]See UEC Cash Flow Projection (GAO/RCED-92-292BR, September 17, 1992); Comments on Proposed Legislation to Restructure DOE's Uranium Enrichment Program (GAO/T-RCED-92-14, October 29, 1991); Comments on H.R. 2480, The Uranium Enrichment Reorganization Act (GAO/T-RCED-91-3, October 11, 1990); and Comments on Smith Barney's Uranium Enrichment Analysis (GAO/T-RCED-90-101, July 31, 1990).

[11]Naval Petroleum Reserve: Opportunities Exist to Enhance Its Profitability (GAO/RCED-95-65, January 12, 1995).

[12]Mineral Resources: H.R. 3967--A Bill to Change How Federal Needs for Refined Helium Are Met (GAO/T-RCED-94-183, April 19, 1994).

privatizing the Power Marketing Administrations (PMAs).[13] While we have not taken a position on the current privatization proposals, from our work we have concluded that each proposal merits individual examination to ensure the integrity of the privatization process and to protect the taxpayer from an undervalued sale.

We have identified many other examples of weak claims that may be identified by reassessing program objectives. Examples from our work include the following.

The role and missions of DOE should be reassessed. We have recently testified on proposals to abolish DOE, and the need to reassess the role and missions of DOE is the central message in our August report.[14] Previously reported issues under this broader heading have included the need to restructure the national laboratories[15] to better match recent shifts in national priorities--principally, the dramatic reduction in the arms race and proposed cutbacks in energy and nuclear research--and negotiating more realistic environmental agreements[16] to establish milestones that would allow the agency to employ more advanced cleanup technologies in the future and to reduce inefficient administrative and management functions. CBO has estimated that these two actions alone would, over 5 years, save over $900 million and $2.5 billion, respectively.

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[13]Although GAO has not evaluated or taken a position on current proposals to either sell or corporatize PMAs, GAO issued a report entitled Federal Electric Power: Views on the Sale of Alaska Power Administration Hydropower Assets (GAO/RCED-90-93, February 22, 1990) and has reported on policies governing the repayment of the federal investment as well as the borrowing practices and financial condition of the Bonneville Power Administration in Bonneville Power Administration: Borrowing Practices and Financial Condition (GAO/AIMD-94-67BR, April 19, 1994). GAO is currently preparing a report on the operating and financial conditions of each of the PMAs.

[14]Department of Energy: A Framework for Restructuring DOE and Its Missions (GAO/RCED-95-197, August 21, 1995); Department of Energy: Need to Reevaluate Its Role and Missions (GAO/T-RCED-95-85, January 18, 1995); Government Restructuring: Identifying Potential Duplication in Federal Missions and Approaches (GAO/T-AIMD-95-161, June 7, 1995); and Program Consolidation: Budgetary Implications and Other Issues (GAO/T-AIMD-95-145, May 23, 1995).

[15]National Laboratories Need Clearer Mission and Better Management (GAO/RCED-95-10, January 27, 1995).

[16]Department of Energy: National Priorities Needed for Meeting Environmental Agreements (GAO/RCED-95-1, March 3, 1995).

Our commodity program reports have shown that some government programs foster the dependency of farmers on federal subsidies. As a result, government costs for these programs have remained high. Moreover, agricultural sectors that are dependent on subsidies are generally not responsive to market forces and the majority of federal payments have benefitted a small number of producers. We have reviewed federal programs for rice, cotton, peanuts, sugar, and dairy products and recommended that the Congress consider options to move these sectors to a greater market orientation by reducing or phasing out these programs over a number of years.[17] In response to our report recommendations, the Congress phased out the wool and mohair program and eliminated all funding for the honey program in 1994 and 1995. While the action on the honey program did not remove the program from the authorizing farm legislation, it banned all payments and loans to producers for 2 years.[18]

The food aid program, Public Law 480 Title I Food Aid Program, could be reduced or eliminated.[19] The program has yet to demonstrate its ability to achieve the objectives of promoting sustainable development and creating new markets for U.S. goods abroad. Despite streamlined management adopted in 1990 amendments to the Title I program, multiple and sometimes competing objectives, as well as contradictory program requirements, continue to encumber the Title I program, making it difficult to create and implement an effective program strategy. CBO estimated the 5-year savings from not extending program authority beyond fiscal year 1996 to be $938 million.

Funding for the export credit guarantee programs could be limited or the Department of Agriculture's Commodity Credit Corporation

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[17] See, for example: Rice Program: Government Support Needs to Be Reassessed (GAO/RCED-94-88, May 26, 1994); Cotton Program: Costly and Complex Government Program Needs to Be Reassessed (GAO/RCED-95-107, June 20, 1995); Peanut Program: Changes Are Needed to Make the Program Responsive to Market Forces (GAO/RCED-93-18, February 8, 1993); Sugar Program: Changing Domestic and International Conditions Require Program Changes (GAO/RCED-93-84, April 16, 1993); Dairy Industry: Potential for and Barriers to Market Development (GAO/RCED-94-19, December 21, 1993); and Milk Marketing Orders: Options for Change (GAO/RCED-88-9, March 21, 1988).

[18] Opportunities for Budget Savings in Domestic Agriculture Programs (GAO/T-RCED-90-93, June 28, 1990); Wool And Mohair Program: Need for Program Still in Question (GAO/RCED-90-51, March 6, 1990; Honey Program (GAO/RCED-94-244R, June 8, 1994); and Federal Price Support for Honey Should Be Phased Out (GAO/RCED-85-107, August 19, 1985).

[19] Public Law 480 Title I: Economic and Market Development Objectives Not Met (GAO/T-GGD-94-191, August 4, 1994).

could be allowed to raise its fees to high-risk countries.[20] We have reported that since the programs began in the 1980s, and as of May 1993, the government had paid out approximately $4.2 billion because of loan repayment defaults by foreign country buyers. We have been unable to find any empirical evidence that demonstrates that the export credit guarantee programs resulted in increased agricultural exports. Also, there is a history of poor management control of these programs.

Amtrak's financial condition has rapidly deteriorated, creating a situation that could seriously affect Amtrak's ability to meet its objective of providing high-quality passenger rail service nationwide.[21] If substantially increasing the level of federal subsidy for Amtrak is not possible in today's budget environment, then now may be the time for the Congress to consider refocusing Amtrak's efforts and reducing its current route system, retaining service in locations where Amtrak can carry the largest number of passengers in the most cost-effective manner. Since Amtrak announced its initial route reduction plans in December 1994, the Congress has generally favored retaining a national system. However, such a system has its costs, and the Congress may need to reassess this support if Amtrak does not achieve its plans and operating subsidies are to be eliminated as envisioned by the Concurrent Budget Resolution for 1996.

The Foreign Housing Guaranty Program has not achieved its goals and is in poor financial condition. We recently reported that although the program has contributed to housing reforms in many participating countries, it has not stimulated increased private investment in low-income shelter, one of the program's long-range objectives. Further, in nearly every country in our study program-financed shelter projects were outside the reach of the poorer families that the program was intended to cover. Additionally, the program is in serious financial condition because program fees have not been sufficient to cover costs. In 1995 dollars, program losses due to loan defaults have already cost the U.S. government over $540 million, and we estimate that the cost of future defaults is likely to be an additional $600 million.[22]

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[20]Former Soviet Union: Creditworthiness of Successor States and U.S. Export Credit Guarantees (GAO/GGD-95-60, February 24, 1995) and GSM Export Credit Guarantees (GAO/GGD-94-211R, September 29, 1994).

[21]Intercity Passenger Rail: Financial and Operating Conditions Threaten Amtrak's Long-term Viability (GAO/RCED-95-71, February 6, 1995) and Amtrak: Key Decisions Need to Be Made in the Face of Deteriorating Financial Condition (GAO/T-RCED-94-186, April 13, 1994).

[22]Foreign Housing Guaranty Program: Financial Condition Is Poor and Goals Are Not Achieved (GAO/NSIAD-95-108, June 2, 1995).

Redefining Beneficiaries

This theme is intended to focus on the question: Who should benefit from public programs? When first authorizing new programs, the Congress defines the intended audience for any program or service based on some perception of eligibility or need. As time passes and conditions change, these definitions could benefit from periodic review and be revised to better target increasingly limited resources. Considering changes in distribution formulas, eligibility rules, fees and charges, and tax preferences could form the basis for such improved targeting.

For example, we have issued many reports over the past decade showing that the distribution of federal grants to state and local governments is not well-targeted to those jurisdictions either with the greatest programmatic needs or with the lowest fiscal capacity to meet those needs.[23] As a result, program recipients in areas with relatively lower needs and greater wealth may enjoy a higher level of services than is available in harder pressed areas, or the wealthier areas can provide the same level of services at lower tax rates. At a time when federal domestic discretionary resources are constrained, better targeting of grant formulas offers a strategy to bring down federal outlays by concentrating reductions on wealthier localities with fewer needs and greater capacity to absorb the cuts. Targeting could be accomplished by changing formulas or by changing program eligibility only to those places with lower fiscal capacity or greatest programmatic needs. CBO has estimated that a 10-percent reduction in the aggregate total of all closed-ended or capped formula grant programs exceeding $1 billion would produce a savings of over $18 billion over 5 years.

The Community Development Block Grant (CDBG) provides a good example of targeting problems in formula grant programs. The primary goals of the CDBG program are to develop viable communities, provide decent housing and a suitable living environment, and expand economic development principally for people with low and moderate incomes. Funding levels are determined through formulas designed to take into account factors such as population, poverty levels, housing overcrowding, age of housing, and population change. A recent Department of Housing and Urban

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[23]Medicaid: Alternatives for Improving the Distribution of Funds to States (GAO/HRD-93-112FS, August 20, 1993); Remedial Education: Modifying Chapter 1 Formula Would Target More Funds to Those Most in Need (GAO/HRD-92-16, March 28, 1992); Drug Treatment: Targeting Aid to States Using Urban Population as Indicator of Drug Use (GAO/HRD-91-17, November 27, 1990); Local Governments: Targeting General Fiscal Assistance Reduces Fiscal Disparities (GAO/HRD-86-113, July 24, 1986); and Highway Funding: Federal Distribution Formulas Should Be Changed (GAO/RCED-86-114, March 31, 1986).

Development (HUD) study[24] suggested that, given recent population shifts, the formula could be adjusted to redistribute funds to communities with the greatest need by, among other things, increasing the weight of poverty as a factor in the formula and lowering the weight on population. Similarly, replacing pre-1940 housing in the formula with pre-1950 housing occupied by a poverty household would improve the extent to which the formula directs funds to needy places. Looking solely at poverty rate, Camden, New Jersey has a percentage of its population in poverty that is about 10 times greater than that of Greenwich, Connecticut. Yet, for fiscal year 1995, Greenwich was allocated CDBG funds of $0.69 per person in poverty--over 5 times more than Camden's $0.13. Greenwich could much more easily afford to fund its community development needs than Camden, which has a per capital income ($7,276) of about half the national average.

Another example is the Vaccines for Children Program. Our June 1995 report concluded that the program could be refocused and better targeted to more cost-effectively address those children most in need of immunization.[25] The program currently attempts to lower the cost of immunization for all children, but our study found that most children had already been immunized and that cost was not a significant barrier. However, because disproportionate numbers of children in underserved areas were not immunized, we suggested that the Congress consider shifting the program's goal from improving general immunization rates of all children to achieving higher rates in these pockets of need.

Additional examples of programs that should be examined based on the intended beneficiaries include the following.

Veterans disability compensation could be reduced without affecting veterans affected by disabilities they received as a result of their military service. During 1986, the Department of Veterans Affairs (VA) paid approximately $1.7 billion in disability compensation payments to veterans with diseases neither caused nor aggravated by military service. In 1994, CBO reported that about 250,000 veterans were receiving about $1.5 billion annually in VA

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[24]Effect of the 1990 Census on CDBG Program Funding, Office of Policy Development and Research, U.S. Department of Housing and Urban Development, February 1995.

[25]Vaccines For Children: Reexamination of Program Goals and Implementation Needed to Ensure Vaccination (GAO/PEMD-95-22, June 15, 1995).

compensation for these diseases. Our study of five countries shows that they do not compensate veterans under these circumstances.[26]

The Market Promotion Program (MPP) could be better targeted to companies most adversely affected by unfair trading practices abroad.[27] Under MPP, payments are made to partially offset the costs of market building and commodity promotion. To help ensure that the program assists only those companies that truly need help, we believe that the program should target small, generic, new-to-export companies and not extend assistance to large companies. Further, we believe that participants should be graduated out of the program within 5 years. The Congress could also decide that the program can no longer compete with other higher priority programs and should be eliminated.

Changing the fee structure for child support enforcement services could reduce federal costs without adversely affecting program goals. The purpose of the Child Support Enforcement Program is to strengthen state and local efforts to obtain child support for both families eligible for Aid to Families with Dependent Children (AFDC) and non-AFDC families. Since 1992, we have reported on opportunities to defray some of the costs of child support programs.[28] On the basis of this work, we believe that mandatory application fees should be dropped and that states should charge a minimum percentage service fee on successful collections for non-AFDC families. Application fees are administratively burdensome, and a service fee would ensure that families are charged only when the service has been successfully performed. Rates could vary from as little as half of 1 percent to 15 percent, depending on cost recovery targets desired by the Congress. CBO has estimated that a 15-percent service fee on collections for non-AFDC families--a percentage sufficient to fully cover the administrative costs of the program--would result in savings of about $4.7 billion over 5 years.

The multibillion dollar passenger cruise market in the United States is almost exclusively served by foreign-flagged cruise vessels. This is a very lucrative privilege, made more so by U.S. tax laws and the shoreside services federal agencies must provide to cruise ships and their passengers. While most agencies fully

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[26]Disabled Veterans Programs: U.S. Eligibility and Benefit Types Compared With Five Other Countries (GAO/HRD-94-6, November 24, 1993) and VA Benefits: Law Allows Compensation for Disabilities Unrelated to Military Service (GAO/HRD-89-60, July 31, 1989).

[27]International Trade: Changes Needed to Improve Effectiveness of the Market Promotion Program (GAO/GGD-93-125, July 7, 1993).

[28]Child Support Enforcement: Opportunity to Defray Burgeoning Federal and State Non-AFDC Costs (GAO/HRD-92-91, June 5, 1992).

recover the costs of providing these services, the Coast Guard and the Immigration and Naturalization Service (INS) do not. The Congress may wish to extend fees for cruise vessel services to these two agencies by enacting legislation that would authorize the Coast Guard to charge fees for its services and by lifting the INS exemption for passengers arriving at a port of entry in the United States on a cruise originating in Canada, Mexico, a territory or possession of the United States, or any adjacent island.[29]

Veterans' long-term care costs could be reduced and comparability among retirees increased if veterans' co-payments for these services were increased.[30] State veterans' homes recover as much as 50 percent of the costs of operating their facilities through charges to veterans receiving services. In contrast, in 1990 VA offset less than one-tenth of 1 percent of its costs through beneficiary co-payments. Targeting of long-term care benefits could be improved by increasing cost-sharing for VA nursing home care by (1) adopting cost-sharing requirements similar to those imposed by most state veterans' homes and (2) implementing an estate recovery program similar to those operated by many states under their Medicaid programs. CBO has estimated that over $1.9 billion could be saved over 5 years if VA recovered 50 percent of its costs for providing nursing home and domiciliary care through these measures.

Crop price supports could be better targeted to aid individual farmers actively engaged in farming as was their original intent.[31] Change is needed because price supports have increasingly gone to large farming operations, despite federal efforts to limit such payments. Reducing the maximum payment and targeting it to individuals actively engaged in farming would reduce federal costs. If the Congress wants to further tighten payment limits as a means to reduce program costs, one option would be to limit payments to $50,000 per individual and only provide benefits to individuals actively engaged in farming. CBO has estimated that this would save $457 million over 5 years.

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[29]Addressing the Deficit: Budgetary Implications of Selected GAO Work for Fiscal Year 1996 (GAO/OCG-95-2, March 15, 1995).

[30]VA Health Care: Potential for Offsetting Long-Term Care Costs Through Estate Recovery (GAO/HRD-93-68, July 27, 1993) and VA Health Care: Offsetting Long-Term Care Cost By Adopting State Copayment Practices (GAO/HRD-92-96, August 12, 1992).

[31]Agriculture Payments: Number of Individuals Receiving 1990 Deficiency Payments and the Amounts (GAO/RCED-92-163FS, April 27, 1992) and Agriculture Payments: Effectiveness of Efforts to Reduce Farm Payments Has Been Limited (GAO/RCED-92-2, December 5, 1991).

Targeting of tax expenditures could be improved as well. For example, Industrial Development Bonds (IDB) and Qualified Mortgage Bonds (QMB) issued by state and local governments or governmental authorities could be better targeted. IDBs finance capital projects, such as manufacturing facilities. QMBs are used to allow homebuyers to receive below-market rates on their mortgages. Interest earned by investors on IDBs and QMBs is exempt from federal taxes. We found that (1) the job creation attributed to IDB projects would likely have occurred without the issuance of these bonds, (2) there is no evidence to support the contention that IDBs achieve significant public benefits, and (3) most developers said they would have proceeded with their projects even without the subsidy. Similarly, we have found that QMBs (1) do little to increase homeownership, (2) are usually provided to those who do not need them, and (3) are not cost-effective.[32] To improve the efficiency of these tax expenditures, IDBs could be limited to distressed areas or start-up companies. Similarly, QMBs could be limited to homebuyers who could not reasonably qualify for conventional financing.

Improving Efficiency

I would like to move now to our third theme in the framework, improving efficiency, which focuses on delivery methods and performance--how government does its work. Under the broad theme of improving efficiency are the following four general areas of change:

- making specific changes in particular programs to reduce duplication and overlap, streamline delivery of service, or otherwise reduce the cost of service provision;
- reducing the opportunities for fraud and waste by improving program design and management controls for critical government functions;
- reengineering operations by making wiser investments in modern information technology that improve services and reduce costs; and
- improving the design of subsidy tools used to engage third parties in federal programs.

Specific Program Changes

[32] Industrial Development Bonds: Achievement of Public Benefits Is Unclear (GAO-RCED-93-106, April 22, 1993) and Home Ownership: Targeting Assistance to Buyers Through Qualified Mortgage Bonds (GAO/RCED-88-190BR, June 27, 1988).

We have reported on the overlap and duplication that appears to exist in federal employment and training programs.[33] We identified 163 programs and funding streams spread across 15 departments and agencies that provide employment and training assistance costing the government about $20 billion annually. Many of these programs have similar goals and provide similar services to similar populations using separate, yet parallel, delivery structures. Efficiencies resulting from consolidating some of these programs could be expected to reduce administrative costs. CBO has estimated that if funding for these programs were reduced by 10 percent each year as part of a consolidation effort, the 5-year cost savings from both direct and discretionary programs could exceed $2.2 billion.

The number and quality of Social Security continuing disability reviews should be increased. Between 1987 and 1994, the Social Security Administration (SSA) completed less than half the disability reviews required by law. Such reviews often find that Disability Income (DI) beneficiaries are no longer disabled and may be removed from the rolls. We believe that SSA should continue to examine ways to increase the number of continuing disability reviews (CDRs). About $1.7 billion in savings--net of the increased costs for more CDRs--are possible by eliminating the review backlog in the DI program. These savings are based on SSA's estimate that CDRs would terminate 3 percent, after appeals, of the cases reviewed where medical improvement was expected or possible and that each termination would save an average of $90,000 in cash and medical benefits that would have been received over the average length of stay on the rolls.[34]

In 1992, people who were not entitled to benefits, or not entitled to the level of benefits provided, received and estimated $4.7 billion in benefit overpayments by three of the nation's largest welfare programs--AFDC, Food Stamp, and Medicaid. These overpayments represented about 4 percent of the total benefits paid by these programs. Some states do a better job of recovering

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[33] Multiple Employment Training Programs: Major Overhaul Is Needed to Create a More Efficient, Customer-Driven System (GAO/T-HEHS-95-70, February 6, 1995) and Multiple Employment Training Programs: Overlap in Programs Raises Questions About Efficiency (GAO/HEHS-94-193, July 11, 1994).

[34] Social Security Disability: Management Action and Program Redesign Needed to Address Long-Standing Problems (GAO/T-HEHS-95-223, August 3, 1995); Disability Insurance: Broader Management Focus Needed to Better Control Caseload Growth (GAO/T-HEHS-95-164, May 23, 1995); Social Security: Federal Disability Programs Face Major Issues (GAO/T-HEHS-95-97, March 2, 1995); and Social Security: New Continuing Disability Review Process Could Be Enhanced (GAO/HEHS-94-118, June 27, 1994).

overpayments than others because they use a broader array of practices or tools, including more timely efforts to verify potential overpayments and establishing claims for overpayments on more difficult cases, such as those involving clients who subsequently moved out of state. If all states had recovered overpayment at the same rate as the high-performing states we studied, we estimated that an additional $262 million could potentially have been recovered in 1992, the year used for our analysis.[35]

The Census Bureau should pursue several cost-saving options to reduce the cost of the 2000 decennial census. These options include simplifying and streamlining the census questionnaire, using multiple mail contacts, using the Postal Service to identify vacant and invalid addresses, and gathering data on only a sample of nonresponding households.[36] CBO has estimated that using sampling for nonresponse follow-up and incorporating other changes could result in 5-year savings of about $826 million.

The efficiency of state automated welfare systems would be improved if problems we have identified in these kinds of systems are corrected early in the development process and there is better system integration and use of models to guide state development. Ineffective oversight of state-developed, but federally subsidized, systems has resulted in systems that do not work or do not meet federal requirements. Moreover, even though millions of dollars have been spent, the benefits of these systems in reducing administrative costs and mistakes have not been determined.[37]

Centralizing the DOE procurement of laboratory testing services in a similar manner to that used by the Environmental Protection Agency (EPA) would improve the efficiency of DOE's operations. Both DOE and EPA are responsible for large environmental clean-up efforts and both contract for analyses of hazardous contaminants. Under its decentralized procurement approach, DOE pays higher prices to its commercial laboratories than EPA does for the same

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[35]Welfare Benefits: Potential to Recover Hundreds of Millions More in Overpayments (GAO/HEHS-95-111, June 20, 1995) and Benefit Overpayments: Recoveries Could Be Increased in the Food Stamp and AFDC Programs (GAO/RCED-86-17, March 14, 1986).

[36]Decennial Census: 1995 Test Census Presents Opportunities to Evaluate New Census-Taking Methods (GAO/T-GGD-94-136, September 27, 1994) and Decennial Census: Promising Proposals, Some Progress, But Challenges Remain (GAO/T-GGD-94-80, January 26, 1994).

[37]Automated Welfare Systems: Historical Costs and Projections (GAO/AIMD-94-52FS, February 25, 1994) and Welfare Programs: Ineffective Federal Oversight Permits Costly Automated System Problems (GAO/IMTEC-92-29, May 27, 1992).

analyses and methods, partly because decentralized purchasing practices do not produce volume discounts. Also, DOE's decentralized approach results in duplication of contractor efforts in the award and management of commercial laboratory subcontracts, which adds inefficiencies and increases administrative costs. CBO has estimated that by centralizing its laboratory analyses, DOE could save about $280 million over 5 years.[38]

Duplication could be reduced and operations streamlined through a collaborative federal land management strategy. Four primary federal agencies--the National Park Service, the Bureau of Land Management, the Fish and Wildlife Service, and the Forest Service--all have responsibility for federal lands. Considerable opportunities exist for economies and efficiencies by combining and consolidating field locations, programs, and activities, and reconsidering agency roles mission.[39]

Eliminating Fraud and Abuse

Fundamental management problems have needlessly caused the government to lose billions of dollars and miss huge opportunities to achieve federal objectives at less cost and improved quality. Our high-risk series has identified key areas where critical governmental responsibilities are vulnerable to fraud, abuse, and higher costs.[40] Inefficient, wasteful, and abusive spending practices have flourished in an environment of weak internal controls where reliable information is not available to ensure accountability and provide effective oversight.

At the heart of these high-risk situations is a lack of fundamental accountability, which has led to pervasive management weaknesses throughout government, many persisting for years. A common response to the waste and inefficiency in government is across-the-board reductions, but the danger in this approach is that accountability can be weakened even further. For example, staff may be cut, but responsibilities remain.

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[38] Addressing the Deficit: Budgetary Implications of Selected GAO Work for Fiscal Year 1996 (GAO/OCG-95-2, March 15, 1995).

[39] Forest Service Management: Issues to Be Considered in Developing a New Stewardship Strategy (GAO/T-RCED-94-116, February 1, 1994) and Forestry Functions: Unresolved Issues Affect Forest Service and BLM Organizations in Western Oregon (GAO/RCED-94-124, May 17, 1994).

[40] See High-Risk Series: An Overview (GAO/HR-95-1, February 1995).

We have identified six broad high-risk categories that require concerted attention by the Congress and agencies over the next several years. These categories include the following:

- providing for accountability and cost-effective management of defense programs;
- ensuring all revenues are collected and accounted for by the Internal Revenue Service (IRS);
- obtaining an adequate return on multibillion dollar investments in information technology;
- controlling Medicare claims fraud and abuse;
- minimizing loan program losses, which is especially important given that the federal government is this country's largest source of credit; and
- improving management of federal contracts at civilian agencies to ensure that the government gets what it pays for.

A more specific and in-depth discussion of these areas will be provided in future testimony before this committee.

Missed Opportunities in Technology Improvements

Today's information technology offers unprecedented opportunities to improve the delivery of government services and reduce future program costs. Unfortunately, the government has not been able to take full advantage of these opportunities. The result has been wasted resources and a frustrated public unable to get quality service. Despite an estimated $200 billion investment over the last 12 years, federal information systems projects are frequently developed late, fail to work as planned, and cost millions--even hundreds of millions--more than expected. For example:

- Despite having spent or obligated over $2.5 billion on IRS' $8 billion Tax System Modernization (TSM) initiative, the overall design of TSM remains incomplete. Furthermore, IRS continues to automate existing functions, even though there has been little demonstration of how it will improve tax processing.[41]

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[41] Tax System Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is to Succeed (GAO/AIMD-95-156, July 26, 1995) and Tax System Modernization: Unmanaged Risks Threaten Success (GAO/T-AIMD-95-86, February 16, 1995).

- The Veterans Benefit Administration's $680 million modernization effort to speed processing of veterans' compensation claims could potentially eliminate only 6 to 12 of the average 151 days currently needed to process an original compensation claim.[42]

The federal government will never be able to greatly improve its operations and services to taxpayers unless it takes better advantage of the tremendous opportunities offered by modern information technology. Proposed legislation on information technology management reform contained in the fiscal year 1996 Department of Defense (DOD) Authorization Bill offers many constructive ways to strengthen the government's management of information and technology.[43] This proposed legislation would require the appointment of a Chief Information Officer in each agency; mandate planning processes to select, control, and evaluate the results of major information system investments; simplify the acquisition of information technology; and integrate technology plans with the agencies' strategic and annual performance plans required under the Government Performance Results Act. These and other provisions in the bill could help reduce the many low-value, high-risk information systems projects that continue to be developed at great expense without fully applying modern management practices. Finally, the Paperwork Reduction Act of 1995 can also help agencies perform critical strategic information planning activities and acquire technology.

Design of Subsidy Tools Is Critical to Effective Implementation

Over the past 30 years, the major burden of implementing federal programs has been borne by third parties--state and local governments, private nonprofit agencies, and private corporations--whose participation is engaged through a variety of subsidy tools, such as grants, loans, and tax expenditures. The actions or inactions of these nonfederal actors have as much, or more, to do with the effectiveness of most federal programs as the management of the federal agencies themselves.

However, all too often, the design and implementation of these subsidy tools has left much to be desired. The consequences include uneven implementation of federal program objectives across the country by third parties with varying interests and support for

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[42]Government Reform: Using Reengineering and Technology to Improve Government Performance (GAO/T-OCG-95-2, February 2, 1995).

[43]Government Reform: Legislation Would Strengthen Federal Management of Information and Technology (GAO/T-AIMD-95-205, July 25, 1995).

federal objectives. Scarce federal resources are also wasted when federal subsidies provide windfalls to recipients who would have engaged in the activity anyway. And federal subsidies, particularly insurance and grant programs, have often prompted a form of moral hazard in which the recipient is actually induced to increase their exposure to risks or reduce their own financial effort.

These kinds of subsidies, then, can become "leaky buckets" where the impact of the federal dollar is fully or partially lost as it is transmitted through the network of third party recipients. Mr. Chairman, we will provide more in-depth information on and examples of these problems from our work in your future hearings.

FOCUSING ON THE LARGE OR GROWING AREAS OF THE BUDGET

No discussion of deficit reduction would be complete without discussing health care, social security, and defense--three of the largest areas of federal spending. Gramm-Rudman-Hollings failed to reduce the deficit in part because it did not fully address the drivers of the deficit. Similarly, the Budget Enforcement Act, while successful in limiting discretionary spending and curbing program expansions, does not address the existing structure of major entitlement programs.

Moreover, the long-term sustainability of deficit reduction can be undermined if the long-term drivers are not fully addressed. Even if a balanced budget is achieved early in the next century, deficits could reemerge if cost growth in health care and social security remain unchecked. Our long-term model shows that if a balanced budget is achieved by 2002 without changing the growth path of health care or social security, the deficit would increase again in the following years. Although defense is not expected to significantly increase in the next several years, cost pressures will nonetheless make it difficult to afford the plans and programs suggested by the current defense strategy.

Health Care and Social Security

Medicare and Medicaid are particularly volatile programs whose spending has been rising faster than the rate of GDP growth, placing serious pressure on other areas of the budget now and jeopardizing our ability to meet future commitments. The 1996 budget resolution reflects the fact that Medicare and Medicaid must be part of any solution to the deficit problem. Our simulations suggest that Medicare and Medicaid's share of the economy could more than triple, from 3.7 percent of GDP in 1994 to 12.1 percent in 2025 assuming no action is taken. Addressing health care as part of deficit reduction has the advantage of yielding greater savings over the long term due to its rapid projected growth.

Over the long term, the problem goes deeper and reflects the aging of our population. The continuing growth of the program and the need to accommodate the coming onslaught of baby boomers demonstrates the need for serious cost containment and program reform.

New approaches and perspectives will be needed. Delivery approaches to health care in America are currently being reassessed, and any changes to Medicare and Medicaid will need to be a part of these efforts. With respect to Medicare, the manner in which the vast majority of beneficiaries obtains services mirrors indemnity plans that began to lose their dominant position a decade ago. By contrast, today within the private health insurance market, upwards of 50 percent of the insured participate in one form or another of "managed care." Traditional fee-for-service creates the incentive for providers to oversupply services. Managed care systems--especially those that deliver care in exchange for a fixed, prepaid amount--significantly change these incentives and offer potential for reduced costs. However, translating these cost savings into federal budget savings will require skillful design of how Medicare pays these health plans. Moreover, issues of access and adequacy of service will also need to be addressed more successfully than in the past.

In addition to its reliance on fee-for-service, Medicare is often constrained in using market forces to control program costs. The Health Care Financing Administration (HCFA) is generally unable to negotiate with providers for discounts, promptly change prices to match those available in the market, or competitively bid prices for widely used items such as pacemakers, intraocular lenses, and wheelchairs. As a result, Medicare often pays higher prices than other large payers for many services and supplies.[44] HCFA also cannot provide incentives to recognize providers meeting utilization, price, or quality standards, or to penalize those who do not.

Overall, we believe a viable strategy for remedying the program's weaknesses includes adapting the health care management approach of private payers to Medicare's public payer role. Such a strategy would include, at the least, more competitively developed payment rates, enhanced fraud and abuse detection efforts, and more rigorous criteria for granting health care providers authorization to bill the program.

For Medicaid, too, changes are afoot. Although program spending growth has recently slowed, Medicaid growth outpaces that of most

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[44]For further discussion of these issues, see Medicare Claims (GAO/HR-95-8, February 1995) and Medicare: Modern Management Strategies Could Curb Fraud, Waste, and Abuse (GAO/T-HEHS-95-227, July 31, 1995).

major items in the federal budget and, without modification, spending is likely to double over the next 5 to 7 years. Pressures for cost containment also affect the states, some of which have used waivers to implement managed care systems for their programs. However, some of the savings from managed care waivers have been employed to expand coverage to individuals not normally eligible for Medicaid. As I testified before this Committee several months ago, if the authority to grant these waivers continues, the Congress should be involved in considering whether any such savings should be used for program expansion or budgetary control.

Currently, the Congress is considering restructuring the Medicaid program to moderate disparities across states and limit federal budgetary exposure. This is a fundamental policy decision for the Congress that involves many important implications for states, beneficiaries, and providers. Careful monitoring and evaluation will be important to provide the Congress with reliable and consistent information on the impacts of any shift in authority and funding. Changes in how federal aid is allocated should also be considered to help compensate for some of the existing disparities among states in program coverage, services, and fiscal burdens borne by state taxpayers.

The Social Security program is now the single largest federal program. Although the program is expected to grow at about the same rate as the economy over the next 10 years and is currently contributing a surplus, Social Security faces a longer-term problem that needs attention. The program is projected to start running a cash deficit starting in 2013 as the baby boomers begin to retire, and the fund itself is expected to deplete all of its reserves of Treasury securities by 2030. Action to reinstate an actuarially balanced Social Security system must begin soon to permit the phasing that will give future beneficiaries time to adjust their financial plans. Our examination of other nations' deficit reductions found that similar phased strategies were important.[45] The United Kingdom, for example, scaled back benefits in one of its public pension programs by phasing in the change over the longer term; although few savings were achieved in the short run, by 2021 the program's costs are expected to have fallen by 50 percent compared with pre-reform estimates. Phased-in program changes that facilitate societal adjustments call for a longer-term budget horizon than the federal government has traditionally adopted.

Moreover, as long as the government is running a deficit, the surpluses earned by the Social Security program will go to subsidize ongoing government programs and operations. Until the deficit is eliminated, these surpluses will not achieve their purpose of boosting national savings and long-term growth to better

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[45]Deficit Reduction: Experiences of Other Nations (GAO/AIMD-95-30, December 13, 1994).

enable the next generations to pay for the baby boomers' social security benefits.

National Defense

Since national defense will continue to be a high federal priority in an increasingly constrained fiscal environment, I believe that it is essential to spend wisely and in a way that addresses both immediate and long-term concerns. Within the overall funding levels provided by the budget resolution, there is substantial room for savings and enhanced performance through more effective acquisition of weapon systems, increased efficiencies in operations, and improvements in financial management within the Department.

Mr. Chairman, since the mid-1980s we have reported that DOD has had an imbalance between programs and projected funds.[46] This imbalance tends to obscure defense priorities and delay tough decisions and trade-offs. The imbalance stems from the fact that DOD has used overly optimistic planning assumptions. When these assumptions confront budgetary realities, the result is stretch-outs and program terminations. In July 1994, we reported that the imbalance between projected programs and funds in the 1995 Future Years Defense Plan (FYDP) could exceed $150 billion.[47] Some of that imbalance is being addressed by additional funds from the Administration and the Congress. However, it is clear that there will continue to be budgetary pressures on defense spending over the coming decade.

A new pressure involves the recapitalization of military equipment and weapon systems. The 1996 DOD procurement budget request is $39.4 billion, which, when adjusted for inflation, is a decline of 71 percent from the high water mark in 1985. Concerns have been raised about the present low level of procurement and the need to replace or upgrade weapon systems to maintain an effective and modern force. DOD plans to reverse this decline and increase its procurement budgets starting in fiscal year 1997. The procurement accounts are projected to increase in budget authority by almost $19 billion from fiscal years 1996 to 2001. If Defense budgets cannot be increased by this amount, this increase will have to come

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[46]See Defense Programs And Spending: Need for Reforms (GAO/T-NSIAD-95-149, April 27, 1995); Roles And Functions: Assessment of the Chairman of the Joint Chiefs of Staff Report (GAO/NSIAD-93-200, July 15, 1993); and Underestimation of Funding Requirements in Five Year Procurement Plans (GAO/NSIAD-84-88, March 12, 1984).

[47]Future Years Defense Program: Optimistic Estimates Lead to Billions in Overprogramming (GAO/NSIAD-94-210, July 29, 1994).

from other DOD programs or the procurement plan would have to be changed.[48]

We have identified other significant opportunities for additional savings and reduced costs across a number of important defense programs and operations. In our report Addressing the Deficit: Budgetary Implications of Selected GAO Work for Fiscal Year 1996, we identified about 30 options for reducing spending that were related to national defense.

For example, we have reported over the years on the persistent problems that have plagued weapons acquisition. Many new weapons cost more, are less capable than anticipated, and experience schedule delays. Moreover, the need for some of these costly weapons is questionable, particularly since the collapse of the Soviet Union.[49]

One example is the production of F-22 fighter aircraft. Since the F-22 program entered full-scale development in 1991, the severity of projected military threat in terms of quantities and capabilities had declined. However, DOD is still currently planning to procure a significant number of aircraft before completing operational tests and evaluations, thereby increasing the cost, schedule, and performance risks within the system.[50] Another example is the B-2 bomber. We recently reported that after 14 years of development and evolving mission requirements, including 6 years of flight testing, the Air Force has yet to demonstrate that the B-2 design will meet some of its most important mission requirements.[51] We have also raised serious questions about the Hunter Unmanned Aerial Vehicle,[52] the F/A-18E/F

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[48]Future Years Defense Program: 1996 Program Is Considerably Different From The 1995 Program (GAO/NSIAD-95-213, expected September 1995).

[49]For a summary of these issues see Defense Weapons Systems Acquisition (GAO/HR-95-4, February 1995).

[50]Tactical Aircraft: Concurrency in Development and Production of F-22 Aircraft Should Be Reduced (GAO/NSIAD-95-59, April 19, 1995).

[51]B-2 Bomber: Status of Cost, Development, and Production (GAO/NSIAD-95-164, August 4, 1995) and B-2 Bomber: Cost to Complete 20 Aircraft Is Uncertain (GAO/NSIAD-94-217, September 8, 1994).

[52]Unmanned Aerial Vehicles: No More Hunter Systems Should Be Bought Until Problems Are Fixed (GAO/NSIAD-95-52, March 1, 1995) and Unmanned Aerial Vehicles: Performance of Short-Range System Still in Question (GAO/NSIAD-94-65, December 15, 1993).

questions about the Hunter Unmanned Aerial Vehicle,[52] the F/A-18E/F fighter,[53] and the C-17 military transport.[54]

Other opportunities for savings and efficiencies exist. For example, concerning roles and missions of the services, these opportunities include (1) using less costly options for satisfying forward presence requirements, (2) replacing active support forces with reserve support forces, and (3) providing depot maintenance through cross-servicing, reducing excess capacity within the depots, and increased use of the private sector.

Reducing infrastructure costs is important to make the defense program more affordable. DOD stated in its Bottom-Up Review report that $160 billion, or approximately 59 percent, of its total obligational authority for fiscal year 1994 was required to fund infrastructure activities and that a key defense objective was to reduce this infrastructure. Our work shows that, on the basis of current program plans, infrastructure funding, as a percent of DOD's total budget, stays relatively stable through 2001 and shows no improvement over the 59 percent reported earlier by DOD. This occurs because the infrastructure savings that have occurred from base closures and realignments have been offset by increases in other infrastructure areas such as family housing and operations and maintenance.

In the area of inventory management, notwithstanding the sizable force structure change in recent years, DOD's inventory funding levels have remained constant, with the military services spending about $25 billion annually. While we have seen some improvements over the past several years, DOD continues to waste billions of dollars buying, maintaining, and storing supplies that are no longer needed.[55]

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[52]Unmanned Aerial Vehicles: No More Hunter Systems Should Be Bought Until Problems Are Fixed (GAO/NSIAD-95-52, March 1, 1995) and Unmanned Aerial Vehicles: Performance of Short-Range System Still in Question (GAO/NSIAD-94-65, December 15, 1993).

[53]Naval Aviation: F/A-18E/F Acquisition Strategy (GAO/NSIAD-94-194, August 18, 1994) and Naval Aviation: Consider All Alternatives Before Proceeding With the F/A-18E/F (GAO/NSIAD-93-144, August 27, 1993).

[54]C-17 Aircraft: Cost and Performance Issues (GAO/NSIAD-95-26, January 26, 1995); Military Airlift: Comparison of C-5 and C-17 Airfield Availability (GAO/NSIAD-94-225, July 11, 1994); and Military Airlift: The C-17 Proposed Settlement and Program Update (GAO/T-NSIAD-94-172, April 28, 1994).

[55]For a summary of these issues see Defense Inventory Management (GAO/HR-95-5, February 1995).

Lastly, DOD has suffered from long-standing problems in the area of financial management. It has been perennially unable to provide adequate stewardship over taxpayers' monies or assets. The services so far have been incapable of complying with the Chief Financial Officers Act, which requires the production of auditable financial statements. Financial management problems are manifested in the $25 billion in vendor payments that cannot be matched to supporting documentation, billions in overpayments voluntarily returned by contractors, and $11 million in payments to unauthorized persons--almost $8 million in improper military payroll payments as of March 1994 and $3 million in false claims by a former Military Sealift Command supply officer. Until DOD's antiquated financial systems are fixed, overhead costs will continue to be excessive and decisionmakers will continue to receive inaccurate and unreliable information.[56]

IMPROVING TOOLS AND SYSTEMS TO IMPROVE DECISION-MAKING

Targeting cuts to the weak claims in the budget is only part of what we need to do to make government work better. Making the tough choices to reduce the deficit is never easy. But the challenge is exacerbated by the general absence of good information on the effectiveness, performance, and costs of our programs and operations.

Reducing the deficit is an ongoing process that will unfold over a number of years. Decisionmakers need better tools and information to help them determine the areas where cuts are most appropriate and where wiser investments can yield the greatest benefits in relation to the costs. To do this, significant improvements are needed in financial management, program evaluation, performance measurement, and information systems. Such improvements, if implemented properly, can also stem waste and improve management of programs to better control costs and improve the confidence of the public in government accountability and stewardship.

However, we do not currently have the kinds of budgetary and financial information that fully disclose current financial condition or program costs. Financial accounting information, in particular, has not been reliable enough to use in federal decision-making or to provide the requisite public accountability. We have repeatedly found that agency financial statements and the underlying systems and transaction data are not adequate and, in many cases, have been so unreliable that we could not render any opinion as to the fairness of the statements. The audits that have been done have also revealed substantial financial management weaknesses in programs and agencies including unrecognized liabilities and costs, failure to ensure that all revenues are

[56]For a summary of these issues see Defense Contract Management (GAO/HR-95-3, February 1995).

collected and properly accounted for, and poor controls over government-owned assets.

Improved financial information and accounting can ultimately strengthen budget decisions. For example, better financial information on liabilities and long-term commitments can help the Congress address the sustainability of current budget policies. In particular, use of accrual cost concepts like those now used for federal credit programs could be used in the budget for those areas, such as federal insurance programs, where the cash approach fails to fully capture the long-term cost consequences of today's decisions. Finally, our budget account structure reflects multiple needs and uses and does not always capture the full costs of all direct and indirect resources used to carry our programs or operations.

Improved information on program performance and effectiveness will also enable decisionmakers and the public to better understand what has been accomplished with federal resources and what remains to be done. Many federal agencies do not have a clear understanding of their missions, and most lack basic information needed to gauge progress, improve performance, and establish accountability. Over the past two decades, the federal government's evaluation capability has eroded to a point where the effects of many major programs are unknown.

The Congress has taken steps to provide the tools needed to address these issues. The Chief Financial Officers (CFO) Act, as amended, and the Government Performance and Results Act (GPRA) have established a basic framework that should begin providing the kind of information agencies need to make better decisions. Effective implementation of the CFO Act and GPRA can provide the Congress and agency managers with better and more reliable information to manage programs and make difficult spending decisions. Furthermore, we can dramatically improve the government's ability to eliminate fraud, waste, and abuse and to properly safeguard its assets. Although much improvement is still warranted, the CFO Act has already led to improvements in the accuracy and utility of financial data. In addition, GPRA will use a phased approach to establish better links between agency missions, performance, and budgeted levels. Finally, effective implementation can establish the financial organization structures necessary to provide strong leadership into the next century.

CONCLUSIONS

Mr. Chairman, it goes without saying that you have embarked on an ambitious and critically important effort to change the course of fiscal policy. As daunting as the challenge is, we have no choice but to move forward and address the deficit. By now, the problem is well understood. What is less clear are the solutions and consequences of different choices.

As painful and difficult as these choices are, a robust body of information can be brought to bear on these choices. And these choices provide an opportunity to address long-standing performance and management problems that erode the confidence of the American people in their government. Mr. Chairman, this completes my statement. I would be happy to answer any questions you and the other members of the Committee may have at this time.

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