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UNITED STATES GENERAL ACCOUNTING OFFICE
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STATEMENT OF
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COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
COMMITTEE ON THE BUDGET
UNITED STATES SENATE
ON
THE GRACE COMMISSION'S
MAJOR PROPOSALS TO CONTROL FEDERAL COSTS



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Mr. Chairman and Members of the Committee:

I am pleased to join with CBO today in presenting the results of our respective analyses of the major proposals of the President's Private Sector Survey on Cost Control--commonly known as the Grace Commission. At the outset, I would like to comment that the Commission's charter to identify excessive federal expenditures and improve federal government management closely parallels our own. We share the Commission's concern over extraordinary budget deficits and the need to shrink them to manageable proportions.

Recognizing the importance of the mission, GAO cooperated with the Commission's 36 task forces in their efforts to identify areas of savings potential. We provided hundreds of GAO reports and made our staff available for further information as needed. While GAO had no role in developing the Commission's findings, conclusions, or recommendations, many of its proposals are consistent with those we have made in the past.

The 48 separate Commission reports contain many management improvement recommendations and many that require policy and program changes. These latter recommendations will undoubtedly be the focus of considerable congressional debate. We hope our assessments will prove useful.

SCOPE OF GAO/CBO PROJECT

On November 7, 1983, your Committee requested CBO and GAO to analyze the Grace Commission recommendations and related budgetary savings estimates. To be of value to your budget deliberations, the analysis was to be completed by February 15,

later extended until today. Within the short time available, we could not analyze all of the Commission's recommendations. Therefore, we limited our analysis to those proposals having major savings potential--essentially those the Commission said could be expected to save \$1 billion or more over 3 years. While this scope dealt with only about 400 of some 2,500 recommendations, it captured about 90 percent of savings potential estimated by the Commission.

In conducting our work, we focused on the merits of the Commission's proposals. We also assessed whether legislative or executive action would be needed to implement the proposals, and the reasonableness of the Commission's savings estimates, where prior work permitted.

RESULTS OF OUR ANALYSIS

Before presenting the details of our analysis let me underline two fundamental concerns we have about the results of the Grace Commission's work. First, we share CBO's finding that many of the Commission's savings estimates are considerably higher than can reasonably be expected. Our fear is that action on many worthwhile Commission recommendations will be jeopardized by widespread recognition that the associated savings estimates are significantly overstated.

Second, we are concerned that the Commission, in its final report and elsewhere, characterized its proposals as actions needed to reduce waste, abuse, and inefficiency in the federal government, when much of its work and identified savings

potential more precisely concern policy and legislative readjustments. A number of the proposals with the largest savings estimates involve such policy issues as taxing federal subsidies, revising military retirement pay and extending the retirement age for federal civilian personnel. It is our hope that the Commission's efforts to promote its work will not be counter-productive and detract from the cost cutting and management improvement proposals presented.

These concerns notwithstanding, we found a good deal to agree with in the 400 Commission recommendations we examined. In fact, we found that nearly two-thirds of the individual recommendations have overall merit. For about one-third of the recommendations we examined, GAO had made a related recommendation in the past.

It is important to note, however, that our general agreement with about two-thirds of the individual recommendations does not translate into agreement with a proportionate amount of the estimated savings. A number of the proposals with the largest associated savings estimates were those we could not support. I will cite examples later in my statement.

Of the recommendations we examined, we found that about one half could be accomplished by executive branch action with the remainder requiring congressional action. In this regard, we agreed with the Commission's assessments of implementation authority in all but about ten percent of the cases. Areas where

we disagreed were about evenly split between cases where the Commission said congressional action was required while we believed only executive action was required and vice versa.

To facilitate consideration of the 400 individual recommendations, GAO and CBO grouped them into 90 sets of related proposals and then grouped those proposals into the 5 broad areas of national defense, entitlements, nondefense discretionary programs, federal civilian employment and compensation, and revenue enhancing measures.

DEFENSE

In the area of national defense, GAO examined 21 sets of proposals. We identified 8 proposals that we could generally support on their merit, 7 proposals which we could not support, and 6 others where we had to qualify our support or had no strong opinion. CBO was able to estimate savings for only 1 of the 8 proposals we could support, dealing with recovering medical care costs from private health insurers. CBO estimated the savings potential for this proposal to be about \$700 million over 3 years.

Improved weapons system acquisition was one of the Commission's major thrusts in the defense area. We agree that improved weapons system procurement practices would result in savings, and just as importantly, in better quality weapon systems. GAO has performed considerable work on the effectiveness of the weapon system acquisition process. GAO reports have emphasized areas

where the Commission also found problems, particularly in the need to affirm requirements, reduce cost, improve program management, and improve disclosure to Congress.

We also agree that inefficient weapon production rates result in higher unit costs, reduce DOD's purchasing power, and result in program instability. It is not practical, however, to produce all weapon systems at the most economical production rate because of many competing requirements for defense dollars. We believe that, for each weapon system, it is important to establish the various levels at which economies can be achieved so congressional and DOD decisionmakers are aware of the economic impacts when they alter program funding.

GAO further agrees with the Commission that commonality of subsystems, equipment, and parts hold the promise of reducing life cycle logistics costs and many maintenance problems which can impair military readiness. Standardization of equipment, however, is not a panacea and each case needs to be considered on its own merits. Generally, GAO has found over the last decade that DOD could and should increase its efforts to improve commonality of equipment, parts, and subsystems.

We are concerned about a number of the Commission's defense proposals. For example, the Commission recommended that biennial budgeting be instituted for major weapons systems procurement. We support efforts to alleviate problems of planning and budgeting for major weapons systems, which the Commission believes biennial budgeting will accomplish. We believe, however, that the results of adopting biennial budgeting without

other needed improvements in the financial management structure of the government as a whole would be disappointing.

We also have concern over the Commission's military retirement system proposals. There is widespread agreement that the system is expensive. Beyond this, however, there is less agreement on whether the system benefits are too generous. Many of the Commission's proposals to revise military retirement pay are new and go far beyond the scope of previous recommendations to reform retirement pay. Our basic concern is that the proposals focus exclusively on one element of the total life cycle cost of military manpower, i.e., retirement pay. The Commission did not estimate the specific manpower force profile changes that would result from its recommendations, whether these profile changes would adversely affect military effectiveness, or whether offsetting costs would be incurred to maintain a militarily effective force profile. Looking at the retirement system in isolation, and making cost reduction recommendations without knowing what effect such changes will have on the force profile and life cycle manpower costs, could result in a less effective and/or a more costly military force, even though the retirement account may be less.

ENTITLEMENTS

In the entitlements area, almost all of the cost saving potential identified by the Commission involves policy initiatives designed to reduce benefits to individuals or businesses, and to redefine the federal role in health care. While we agree with some of the Commission's proposals, we have reservations

about some of those which it said would result in the largest savings.

Specifically, of the 16 sets of proposals in the entitlements area, we generally agreed with 10, generally disagreed with 4, and had to qualify our support or had no strong views on 2. For those 10 proposals that we could support, CBO estimated potential savings totalling about \$6 billion.

The most significant savings estimate proposed by the Commission in the entitlements area involved limiting the growth in federal health care costs to the growth in the gross national product (GNP)--a fundamental change in the federal role in health care. The Commission estimated this proposal would save almost \$29 billion in savings over 3 years. In GAO's opinion, it is not appropriate to implement the Commission's proposals at this time because (1) limiting federal health care cost to the growth in the GNP could require dramatic changes in the way medical care is provided, (2) the level of health care provided to most people would have to be lowered or beneficiaries would have to pay more for their health care, and (3) the ability of at least some Medicare and most Medicaid beneficiaries to pay the additional cost is questionable.

We also have concerns regarding the merits of the Commission's proposal to change the appeals process for persons denied social security disability benefits. The Commission proposes that the initial disability examiner review new evidence and make reconsideration decisions. Administrative law judge decisions would be based on the evidence presented at the initial

and reconsideration hearings, without the claimant having an opportunity to appear before the administrative law judge. The Commission assumes that the change would restrict the number of people getting on the disability rolls and thus result in savings. We believe that this approach represents a fundamental departure from longstanding agency practices as well as Administrative Procedures Act requirements. Administrative law judges now have the right to review new evidence and to have the claimant appear before them. Savings alone are not sufficient reason, in our opinion, to change that process.

NONDEFENSE DISCRETIONARY

We also addressed a wide variety of proposals in the broad area of nondefense discretionary spending and offsetting receipts. Proposals in this area include cash management, debt collection, housing, energy, and others. We found 20 of the 30 sets of proposals generally to have merit, generally disagreed with only 2 proposals, and had to qualify our support or had no basis for an opinion on the 8 others. For the 20 proposals we found to have overall merit, CBO's estimated savings potential totalled nearly \$10 billion.

The Commission made numerous recommendations for federal agencies to develop and use good management practices in collecting debts owed the government, and we have long endorsed stronger federal management in this area. However, some of the Commission's recommendations are for actions already in progress and already addressed by the enactment of the Debt Collection Act of 1982. Nonetheless, we agree that savings opportunities still exist.

One opportunity involves offsetting delinquent debts against federal tax refunds due debtors. We have supported the use of IRS offset, and the Commission acknowledged that the use of IRS offset is a viable means of collecting debts owed the government. Our support of the IRS offset, however, should not be interpreted as a recommendation that IRS become a debt collection "clearinghouse." Debt collection is primarily the responsibility of each federal agency.

One area where we can only partially support the Commission's positions concerns the federal power marketing administrations. The Commission proposes reducing the costs associated with the power marketing administrations by (1) requiring them to repay federal investments on a timely basis and at market interest rates; (2) charging a user fee for water used to produce electricity; and (3) eventually selling the PMAs to nonfederal entities. While we have strongly supported the first recommendation over the last several years, we have reservations about the second because of recent changes that have significantly increased the power marketing administrations' power rates.

With respect to selling the PMAs to nonfederal entities, we note that the Commission based its analysis only on electricity production and did not address the actions needed to assure that other purposes of these facilities, such as irrigation, navigation, flood control and fish and wildlife protection will continue to be met. We also note that federally generated power,

sold in 38 states, is generally lower in cost than other alternatives and changing the preference rights to this power of public bodies and electric cooperatives would represent a significant policy change.

FEDERAL CIVILIAN EMPLOYMENT

In the area of federal civilian employment and compensation, we addressed 12 sets of proposals. We generally agreed with 5, disagreed with 3, and either qualify our support or had no strong views on 4. CBO estimated that over the next 3 years implementing the 5 proposals we generally supported would cost the government about \$400 million.

The largest Commission savings estimate involves a proposal to reduce civil service retirement benefits--estimated by the Commission to save \$30 billion over 3 years. The Commission proposed sweeping changes in the system based on its view that prevailing retirement benefits in the private sector are much less liberal. In the Commission's view, the civil service system is three times more costly and generous than the best private sector plans.

We cannot agree with the Commission's conclusions nor endorse its recommendations as being representative of private sector practices. In our opinion, adopting the Commission's proposals could result in lower benefits for federal employees than those received by their private sector counterparts. Moreover, some of the proposals would reduce the amounts now being paid to retirees and the benefits that active employees have already earned. We question the equity of such retroactive cuts and believe they could be subject to question in the courts.

A major shortcoming in the Commission's analysis was that it limited its benefit comparison to pension plans and social security. It did not consider the capital accumulation plans that many private employers sponsor to provide additional retirement income to their employees. Some of the proposals would deserve consideration if the federal retirement package were reconstructed to include all three elements of retirement income available in the private sector, but the Commission did not recommend that this be done.

In addition to its proposals to change the retirement system's benefit structure, the Commission recommended that the system's accounting practices be changed to achieve better recognition of accruing costs. We endorse this recommendation. It is consistent with our long-held position that current practices cause accruing costs to be understated.

REVENUE ENHANCEMENTS

Finally, I would like to briefly address the Commission's proposals in the area of revenue enhancement.

In this area we either qualify our support or have no basis for an opinion on 7 of the 11 proposals. We generally agreed with 2 proposals and generally disagreed with the remaining 2. CBO's savings estimate for the 2 proposals we supported totalled about \$500 million.

One of the proposals with which we disagree--taxing means-tested benefits--represents \$59 of the total \$76 billion in revenue enhancements estimated by the Commission. The Commission indicated that its proposal was necessary because many federally

subsidized programs, especially means-tested programs, have not been effective in reducing the poverty gap and they serve individuals who have incomes above the poverty level. However, we believe that the means-tested programs included by the Commission were not primarily intended to reduce the poverty level and we question whether they should be included. For example--Medicaid--is designed to meet health needs for people without sufficient resources or income to pay for medical health services. In addition, the Medicaid payment goes to the provider, not to the beneficiary.

Notwithstanding the merits, implementation of the Commission's proposal in this area would be difficult because many means-tested programs are jointly administered by the federal government and the states. The Commission also did not resolve the problem of how to determine the cash value to a beneficiary of an in-kind benefit, such as medical services under Medicaid, which would be essential for the purpose of taxation. For these reasons, we believe it may be inappropriate to consider that the government could achieve any dollar savings in this area when drafting legislation.

On the other hand, we generally support the Commission's proposal to improve federal administration of our tax laws by increasing the number of IRS staff auditing tax returns.

CONCLUSION

In summary, Mr. Chairman, based on our assessment of 90 Commission proposals, we are able to endorse 45, or half, on the basis of their conceptual merit. The Commission's estimated savings for these proposals totalled \$128 billion over a 3-year period. CBO was able to develop 3-year budget impact estimates for 32 of these proposals totalling \$17 billion. The other 13 proposals with which we agree, were valued at \$53 billion by the Commission, but neither CBO nor GAO could develop a budget reduction estimate.

Additional savings may be possible by adopting some or all of the 27 Commission proposals for which we had to qualify our support or had no basis to offer an opinion. The Commission's estimated savings for these proposals totalled \$126 billion.

In closing, I believe congressional and administrative action is necessary to reduce the federal deficit and the Commission's report serves a useful purpose in focusing attention and stimulating necessary debate on some of the possible actions. GAO is prepared to assist the cognizant congressional committees in analyzing further any of the Commission's recommendations not covered by the CBO/GAO report. I would be happy to respond to questions at this time.

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