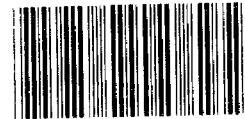


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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
JULY 18, 1986

TESTIMONY OF
CHARLES A. BOWSER
COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
JOINT ECONOMIC COMMITTEE
ON
DEFENSE INFLATION BUDGETING



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Mr. Chairman and Members of the Committee:

Thank you for asking me to appear before you today to discuss budgeting for inflation in the Department of Defense.

In May of 1985, Secretary Weinberger announced that he had found \$4 billion in excess funds that he attributed to management improvements and inflation savings. He requested that these funds be reapplied to meet defense needs identified in the fiscal year 1986 budget. Secretary Weinberger's announcement raised congressional concerns about the size of DOD's inflation dividend and the total amount of excess funds that might still be available.

In analyzing DOD's inflation budgeting system, we found that between fiscal years 1982 and 1986 the administration budgeted more than was needed to cover inflation, resulting in an inflation dividend that we estimate to be about \$44.5 billion.

We are not able to determine the precise amount of excess funds that is still available in DOD. A major difficulty in making such a determination is that the DOD accounting systems that track how funds are being used are not directly linked to the budgeting process. We believe, however, that much of the inflation dividend either has been spent on additional defense programs, or has been reprogramed for other uses. Reprograming actions in fiscal years 1980 through 1985 totaled about \$26 billion. In recent years, frequency of reprograming actions

initiated because surplus funds were available has increased sharply.

We conclude that some funds may remain available as unobligated balances because DOD has been unable to meet its obligation plans. Between fiscal years 1980 and 1985, unobligated balances (net of lapsing funds) grew from \$24.2 billion to \$61.5 billion. At the start of fiscal year 1986, DOD had authority to obligate \$440.4 billion; Gramm-Rudman-Hollings reduced this amount by \$13.3 billion.

CHOOSING THE BEST INDEX FOR BUDGETING
FOR DEFENSE INFLATION

The inflation dividend occurred in all of the DOD appropriations accounts. However, over sixty-five percent occurred in the procurement accounts partly due to the use of a special multiplier approved by the Office of Management and Budget (OMB) for budgeting for inflation in major weapon systems. This multiplier accounted for about one-third of the total dividend. In our September 1985 report, we recommended that this multiplier be eliminated. Our recommendation is supported by data in a recent report of the Department of Commerce's Bureau of Economic Analysis (BEA) which shows that actual inflation in major weapon systems fell below inflation in the general economy in fiscal year 1985. We note that in the fiscal year 1987 budget request OMB set the special multiplier at 1.0 for calculating inflation in DOD's major weapon system accounts.

Some critics of DOD's budgeting system have suggested that projections of the Producer Price Index (PPI) should replace projections of the GNP deflator as the basis for budgeting for inflation. Our analysis shows that the prices of defense purchases have risen at about the same rate as the GNP deflator between fiscal years 1978 and 1984. This analysis also shows that changes in the GNP deflator more accurately predict changes in defense prices than do changes in the PPI. In addition, the GNP deflator is already being used in the budgeting process.

DIFFICULTY IN DETERMINING THE TOTAL
AMOUNT OF EXCESS FUNDS AVAILABLE

We could not determine the amount of inflation savings that were reapplied to new purposes in DOD or that were removed through congressional actions. Nor could we determine the amount of the dividend still available to DOD.

Congressional Actions Reduce
Inflation Dividend

During fiscal years 1982 through 1986, the Congress routinely reviewed and adjusted budget requests. Although some adjustments were related to inflation savings, the historical record does not generally link budget reductions explicitly to inflation. The Congress reported budget reductions of \$3.09 billion between fiscal years 1982 and 1986 in response to decreases in fuel prices. However, we could only find appropriation reductions and transfers directly attributed to

non-fuel inflation dividends in fiscal years 1985 and 1986, totaling \$4.795 billion.

Tracking Inflation Dividends

Although DOD has an elaborate planning, programming and budgeting system, its financial management system used to track the execution of the budget, does not enable us to easily audit either the use of inflation funds or the available funds in excess of program requirements. As a result, we have examined unobligated balances and reprogramming actions as indicators of the existence of excess funds.

Also, as part of our efforts to oversee the defense budget, we examine the justification of selected items in DOD's annual budget requests. Last year we identified potential reductions of \$11.7 billion for items such as ammunition, ships, aircraft, and missiles in DOD's fiscal year 1986 request. Some of the potential reductions were due to overestimates of inflation.

Unobligated Balances

Unobligated balances are a natural part of the concept of full funding that DOD applies in budgeting for major weapon systems. The aggregate level of unobligated balances should be the minimum funding needed to fulfill outyear contracts for the sum of the individual programs.

We could not determine the amount of funds required to cover contracts to be awarded in any year after the budget year. We also could not determine precisely why unobligated balances have

grown significantly in recent years or why actual balances have far exceeded DOD estimates.

In our analysis of aggregate data on unobligated balances, we found that some funds remain available as unobligated balances because DOD has been unable to meet its obligation plans. Between fiscal years 1980 and 1985, unobligated balances as a percentage of total authority available for obligation grew from 10.8 to 14.5 percent.

Throughout the 1980s, DOD has underestimated its unobligated balances. Recently, however, DOD has adjusted its estimates upward, reflecting more realistic obligation plans. We believe that actual unobligated balances in fiscal years 1986 and 1987 will likely remain higher than those in past years, but DOD estimates may more closely reflect the actual figures than has been the case in the past.

DOD Reprogramming Actions

The Congress has given DOD limited authority to reprogram and transfer appropriated funds. The total dollar value of reprogramming actions for fiscal years 1980 through 1985 was about \$26 billion. Yearly reprogramming actions remained a relatively constant percentage of DOD's obligational authority throughout the period.

Reprogrammings fall into three broad categories: above-threshold, below-threshold, and internal reprogrammings. In general, above-threshold reprogramming actions require either prior approval by the Congress or notification to the Congress.

Below threshold actions (those that fall below designated limits) do not require notification to the Congress, except when follow-on costs exceed the threshold. Internal reprogramings include those actions that reclassify or realign funds and are not subject to threshold limitations.

Between fiscal years 1980 and 1985, above-threshold actions accounted for approximately 39 percent of the \$26 billion total; below threshold actions represented 36 percent of the total dollar value, but accounted for about 92 percent of the reprogramming actions. Internal reprogramings accounted for the remaining 25 percent.

Our analysis of above threshold actions showed that in recent years DOD reprogramed fewer dollars to solve program problems. Instead, the rationale for reprogramming has shifted to the acquisition of unplanned requirements and other items, primarily those needed by classified programs. Funds that DOD identified as not needing reinstatement (in excess of the original purpose) have increased sharply. This suggests that these funds were in excess of original program requirements. Eighty-four percent of the funds reprogramed above threshold in fiscal year 1985 or about \$1.84 billion was in excess of original program requirements.

LEGISLATIVE PROPOSAL TO CHANGE THE
INFLATION BUDGETING SYSTEM

We believe strongly that the DOD financial management system needs reform. Changing the way DOD budgets and accounts for inflation is a part of the reform needed. Mr. Chairman, you have requested our comments on draft legislation which changes the DOD inflation budgeting system.

Your proposal offers a three-pronged approach to ending inflation dividends in the defense budget. First, it calls for information on the inflation amounts requested for each budget appropriation account in DOD and the defense portion of the Department of Energy budget and for each weapon system covered by the Selected Acquisition Reporting (SAR) System. Second, your proposal would earmark appropriations for inflation within each budget appropriation account and for each weapon system in the SAR system. It would also constrain the amount of inflation funds that may be used by limiting overall expenditures to actual inflation in the economy. The third prong which deals with reporting and auditing, requires the Secretary of Defense and the Secretary of Energy to track inflation funds separately and to report annually on how the funds are being spent. We would be required to periodically audit and report to the Congress on whether the amount of inflation funds used are reconciled to actual inflation experienced in the economy.

One of my primary goals as Comptroller General is to build an effective financial management structure in our government

that provides reliable and consistent information for policy formulation and management control. Successful reform requires that an integrated approach be taken in developing this structure. There are a whole range of reforms needed in order to build an effective financial management system.

In my letter dated July 17, 1986, I gave you my assessment of the most critical financial management problems facing the Nation. It would be preferable for the executive agencies to correct these problems on their own initiative. Absent that, however, I also made some suggestions in my letter about the type of legislation needed to facilitate correction of the financial management problems.

Your legislative proposal contains the components that we believe are needed to correct the immediate financial management problem concerning DOD inflation funding, and for that reason I support the proposal. Undoubtedly, DOD and others have ideas on how to improve budgeting for defense inflation, and we need to develop an effective method cooperatively. In the meantime, your proposal should be given serious consideration.

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Mr. Chairman, this concludes my prepared remarks and I would be happy to respond to your questions.