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GOVERNMENT MANAGEMENT

Major Issues Facing the Congress

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Mr. Chairman and Members of the Committee:

I am pleased to appear again before you to provide an overview of some of the major issues facing our government, the Congress and the Committee. I continue to find this sort of hearing very useful because it permits us to discuss matters in a broader context then is usually possible.

As I pointed out in my testimony before this committee last year, the challenges faced by the Nation and its political leadership are numerous and formidable and are not susceptible to quick, simple, and painless solutions. Rather, these challenges require sustained efforts over a number of years.

This past year has seen a number of dramatic changes that at once present both challenges and opportunities: the failure of our domestic economy to rebound from recession; the apparent end of the Cold War, the changes in the Middle East as a result of the Gulf War, the rebuilding of the economic and political structures of Russia and the former members of the Warsaw Pact, and the increasing economic dominance of Japan, not to mention the evolving economic and political integration of Western Europe. Unfortunately, our ability to respond to these challenges and opportunities is constricted by the persistently high deficits we continue to ring up. We need to address the deficit problem and better manage the Nation's affairs if we are to maintain our living standards and our influence in a changing environment.

Eighteen months ago, the President and the Congress made a serious attempt to bring our deficits under control. The Budget Enforcement Act was expected to produce $500 billion in deficit reductions by 1995. While we would have been in worse shape without this legislation, it clearly will not achieve its objective of balancing the budget by the middle of the decade.

Mr. Chairman, you asked us to discuss our findings and analysis of the current state of government management and its impact on federal services. As you requested, my testimony this morning addresses:

-- the impact of the current recession on the federal government's receipts and the growth of the deficit.

-- the major components of the President's 1993 budget submission, including the issues related to defense, health care, and financial institutions.

-- an update and status of progress regarding the government's high-risk list and

-- progress in implementing the Chief Financial Officers Act.

Lastly, I will highlight some domestic areas that deserve close attention because of their long-term implications for our standard of living--deteriorating infrastructure of this country and the quality of education provided to our people.

THE BUDGET PROBLEM

It is most unfortunate that the deficit reduction goals of the original 1985 Gramm-Rudman-Hollings (GRH) legislation and its subsequent amendments have not been met. During fiscal year 1985, the year that just preceded GRH, the government registered an overall deficit of $212 billion. It was in this context that GRH set forth the goal of eliminating the deficit by 1991. When that goal later proved unattainable, GRH was amended in 1987, slipping the date for a balanced budget to 1993.

But only three years later, in 1990, when the government was facing the prospect of an $85 billion to $106 billion sequester for fiscal year 1991 under GRH, the law was changed once again. The new Omnibus Budget Reconciliation Act (OBRA 90) threw out the fixed deficit target of GRH and, through a combination of changes in entitlement and revenue legislation plus limits on future discretionary appropriations, provided for an estimated $500 billion in budgetary savings over fiscal years 1991 through 1995. Adherence to the new procedures was intended to at least result in a balanced budget by 1995. From Congressional Budget Office (CBO) data available at the time, it was possible to conclude that OBRA 90's savings could even produce a surplus of $22 billion by 1995.

But now, 18 months later, it is apparent once again that the government is not going to achieve its latest balanced budget goal. The 1991 fiscal year that just ended posted a record high $269 billion deficit and the Office of Management and Budget (OMB) projects that, assuming an economic recovery that begins this spring and adoption of the President's budget proposals, 1992's deficit will reach $399 billion. A delay in the recovery could easily send the deficit over $400 billion. But even at $399 billion, the deficit for 1992 would be about 6.7 percent of the Gross Domestic Product (GDP), the highest since the end of World War II.

For 1995, OMB reports that adoption of the President's policies would result in a $192 billion deficit, almost the level 10 years earlier just before the original GRH kicked-in. For comparison purposes, CBO projects that if current laws are not changed, the 1995 deficit will be $194 billion--a $216 billion swing from the $22 billion surplus indicated at the time of OBRA 90's enactment. And if past projections are a guide, we may safely assume that the $194 billion will grow significantly by the time 1995 rolls around.

Once again, we are forced to ask, what happened? Why has the problem grown to the point that even after enactment of OBRA 90, and even if the President's policies are adopted, OMB reports that the government will still fall short of the 1995 balanced budget goal by almost $200 billion?

According to CBO reports, the change from a surplus to a huge deficit clearly does not result from legislative increases in spending or tax cuts. Legislation enacted since OBRA 90 has only increased CBO's 1995 deficit estimates by about $4 billion. Most of the change results from decreased revenues and correction of estimates. Revenues are now expected to be about $114 billion less--$88 billion due to the recession and $26 billion because of an original estimating problem. Similar estimating problems cause CBO to include another $35 billion for Medicaid and Medicare expenditures and $35 billion for net interest payments in its new estimates.

A word of caution should be added at this point. Under CBO's current projections, the deposit insurance programs will not add to the deficit in 1995 (beyond the pre-OBRA projection). But the history of these programs has seen a persistent pattern of underestimating costs and overestimating the pace of resolution activity. For example, over fiscal years 1991 to 1994, the government will outlay about $77 billion more for deposit insurance than was included in CBO and OMB projections at the time of OBRA 90. We would therefore treat any projections for 1995 with caution given the uncertainty of deposit insurance.

Significantly, most of the changes in the estimates have occurred in the budget's general funds, which leads me to the next point. The magnitude of the deficit problem is only partially revealed in the overall deficit number. I often prefer to focus on the deficit in the general funds part of the budget, which does not include the surpluses of social security and other trust funds. This is where the core deficit problem exists today.

Table 1 shows that the general funds deficit problem is really almost a $500 billion problem, if one looks at the OMB current law projections for 1992 and 1993. Unless the severe imbalance in this part of the budget is addressed, real progress on the deficit will be unlikely in the foreseeable future.

Table 1: General and Trust Funds

	Fiscal year				
	1985[a]	1991[a]	1992[b]	1993[b]	1995[b]
	(Dollars in billions)				
Total Deficit					
Revenues	$ 734	$1,054	$1,081	$1,168	$1,347
Outlays	946	1,323	1,475	1,524	1,559
Total	(212)	(269)	(394)	(356)	(212)
General funds deficit	(267)	(381)	(493)	(475)	(362)
Trust fund surpluses					
Social Security	9	53	50	63	87
Other trust funds	45	59	48	56	63
Subtotal	54	112	98	119	150
Total deficit	$(212)	$ (269)	$ (394)	$ (356)	$ (212)

[a]Actual figures

[b]Estimates only

Notes: Totals may not add due to rounding. Estimates are OMB projections assuming continuation of current law.

Source: Budget of the United States, Fiscal Year 1993.

With this in mind, let's look at the major components of the general funds budget. These may be seen as the "drivers" of that deficit, and significant budget savings actions in these areas would greatly help reduce the overall deficit. Table 2 identifies four major components which account for about 70 percent of all general fund 1993 outlays estimated by OMB under current law.

Table 2: Fiscal 1993 General Funds Outlays

Major components		Estimated outlays (in billions)
Defense		$296
Interest (gross)		315
Health		
Payments to Medicare trust funds	$43	
Grants to states for medicaid	85	
Other health	23	
Total health		151
Deposit insurance (cash basis)		76
All other		332
Total		$1170

Notes: Totals may not add due to rounding. Estimates are OMB projections assuming continuation of current law.

Source: Budget of the United States, Fiscal Year 1993.

I would now like to discuss the four main "drivers" of general funds outlays--Defense, Health, Deposit Insurance, and Interest--as well as Social Security, which is producing surpluses to fund part of the general funds deficit.

DEFENSE

Many believe that the Soviet Union's dissolution and the reality of changed threats justify further reductions in the administration's defense spending proposals. These reductions would be in addition to the $50 billion in savings proposed by the President in his fiscal year 1993 budget, which reflects the recent Presidential initiative to cut nuclear weapons, and the administration's 25 percent cut in the force structure announced last year. The force structure cuts included reductions by fiscal year 1995 of 6 active Army divisions, 9 active fighter wings, an aircraft carrier, 95 battle force ships, about 425,000 active duty military personnel, and about 85,000 civilians from the fiscal year 1990 force levels.

The President's budget proposal reflects the administration's determination of the kind of military the United States needs to protect its vital interests in the future. This would produce a defense budget of $274.6 billion in fiscal year 1997 or about 3.4 percent of projected gross domestic product (GDP). However, a different set of policy choices could result in lower defense spending that could approach or even fall below 3 percent of GDP. A defense budget representing 3 percent of GDP would require

$33 billion in additional cuts in fiscal year 1997 defense spending. Alternatively, defense spending of 3 percent of GDP could be achieved by continuing the President's proposed 4 percent annual decline in defense spending for two more years - to fiscal year 1999.

Although the President has made choices regarding the military the United States will need in the future, the Congress has just begun to address the policy choices that will shape the future military. Before the magnitude and mix of defense reductions can be fully determined there should be a national dialogue aimed at producing a new conceptual foundation on which to base our future military requirements and defense budgets. Such a dialogue should address the nature of U.S. vital interests and commitments, the kinds of events that might prompt U.S. involvement in the future, the number of contingencies the United States should be able to respond to at any one time, the strategies and tactics that will be used in future wars, and the weapons to meet the threats posed by future conflicts.

We believe there are additional considerations that need to be taken into account in making further reductions in defense. Reductions in budget authority that quickly result in outlay reductions occur in the military personnel and operations and maintenance accounts. However, there is a broad consensus that reductions in military personnel should be made gradually and with sensitivity for the lives of the servicemen and women affected by them. Deep annual reductions in the size of the armed forces would involve a large number of involuntary separations and raise questions about the quality of life of service personnel as well as the readiness of U.S. forces.

Also, reductions in defense budgets will continue to have important repercussions for the defense industrial base and the people employed in it. The defense industrial base is an essential component of the nation's ability to rebuild our forces if the world again turns more threatening. The Department of Defense is often the single customer for the weapons it buys and regulates profits, product design, and other factors, but it has taken the position that (1) free market forces generally will guide the restructuring of the industrial base and (2) the ability of the base to meet its future needs will depend largely on the ability of individual companies to shift from defense to commercial production--and then back again, when required.

One key question is whether this is a realistic strategy for ensuring that government decisions and industry adjustments will result in the industrial and technological capabilities needed to meet our national security requirements. Another key question is whether such a "free market" strategy will appropriately balance the national security risks of overreliance on foreign sources versus the benefits of foreign sourcing, including access to advanced technology in other countries. As decisions are made with regard to future defense budgets, the Congress needs to consider the effects on our defense industrial base and address the adequacy of the base.

One area, however, that represents an opportunity to achieve substantial and rapid savings in defense spending is in DOD inventory. We have testified numerous times about excess DOD inventory. With the planned drawdown of forces, the buildup of inventories for Operation Desert Storm which have now been returned to the United States, and past excessive inventories that we have identified, it may be possible for DOD, for many items, to live off-the-shelf for some time to come, reducing inventory budget requirements. We have not yet seen the details in support of the DOD inventory budget, but based on past work, we believe the amount budgeted for secondary items for fiscal year 1993 should be at least $5 billion less than the amount budgeted in fiscal year 1992. Again, however, the effects on the industrial base of massive reductions in purchases need to be factored in.

Reductions in budget authority in the other major accounts, research, development, test, and evaluation (RDT&E) and procurement, produce only small initial reductions in outlays, but can have the largest impact on the budget over the long run. Our work on major DOD weapons programs indicates that a serious weapons affordability problem exists because DOD cannot afford to build all the weapons currently under development.

Significant reductions in research and development budgets do not significantly reduce initial outlays in the near term, but a reexamination of our approach to R&D is an essential part of long-term plans for the defense budget. We recognize the importance of research and development in assuring that not only are our security interests adequately addressed, but our technological competitiveness is maintained. Therefore, alternatives to wholesale program cancellations should be considered. These alternatives could include the research and development of selected systems without their movement into large scale production, an approach similar to that recently announced by DOD.

We are now conducting a variety of studies which we believe will assist the Congress in addressing policy issues that will shape our future military as well as in overseeing the transition to a smaller defense force.

HEALTH

While the United States has some of the best physicians and health care facilities in the world, it is becoming evident that the U.S. health care system is in crisis. The crisis is related to three intertwined issues facing the Congress and the administration: access, cost to society, and the resulting strain on federal, state, and local governments as well as private corporations and small businesses.

The United States has a serious problem in access to health care. An estimated 35 million people lack any health insurance, while millions of others are underinsured, with serious limitations in coverage. Yet, the United States spends more on health care than any other nation. Between 1970 and 1990, the share of national income spent on health care grew by almost 70 percent, from 7.3 percent of gross national product in 1970 to 12.3 percent in 1990. Projections to the year 2000 imply a share that would most likely exceed 16 percent.

These costs are reflected in the federal government's health care responsibilities, which are large and growing rapidly. Direct federal outlays constitute the health sector's most obvious source of pressure on the federal budget. Federal health spending from trust and general funds in 1991 is estimated to have been about $215 billion. Of that total, Medicare accounted for about $121 billion and Medicaid, about $50 billion. If current trends persist, health spending will consume an ever increasing share of the federal budget. While the federal government spent 15 cents of every dollar on health care in 1991, it will spend 24 cents of each dollar on health care by the year 2000, according to the Department of Health and Human Services. Similarly, state governments are reeling under escalating Medicaid costs, even though most provide very low reimbursement rates to physicians and hospitals.

Because this issue is so important, we have been reviewing the experience in our competitor nations and the initiatives being advanced in several states. Our analysis raises serious questions about the adequacy of continued piecemeal approaches; too often they fail to increase insurance coverage significantly and lead to further cost shifting.

We have found no single alternative model for providing health insurance that is not without its own set of shortcomings. Nevertheless, foreign experience suggests that access can be broadened and costs contained when the following conditions are met: (1) everyone is guaranteed access to at least a minimum level of health insurance benefits, (2) payments for physician and hospital care are governed by a uniform, coordinated payment system, and (3) policies are adopted to limit total spending on health care in general or on particular segments of the health care industry. But the foreign systems we have studied often lack the incentives found in the U.S. for efficiency in the provision of health care and continuation of the progress in new medical techniques.

The states are testing the effectiveness of various reform initiatives, some of which share many features of foreign systems and others of which emphasize greater reliance on managed care and state-sponsored insurance pools to increase access and control costs. We are now conducting several studies which we believe will help the Congress evaluate how our current health financing system can be improved without sacrificing its unique strengths.

FINANCIAL INSTITUTIONS

The financial condition of our banks and savings institutions continues to be worrisome. Also, our insurance industry has begun to suffer sizeable losses that the states may be unable to handle and could result in requests for federal assistance.

Banking Industry

Since 1990, when we sounded the alarm about the deteriorating condition of the Bank Insurance Fund, we have continued to advise the Congress of the Fund's precarious condition. The recently enacted Federal Deposit Insurance Corporation Improvement Act of 1991 provides the Federal Deposit Insurance Corporation (FDIC) with $70 billion in borrowing authority to enable bank regulators to resolve problem institutions. Of this amount, $30 billion is for insurance losses that the banking industry is to repay through premium assessments. The other $40 billion is for working capital needs of the Fund and is expected to be recovered through selling the assets of failed institutions.

These funds will probably be needed, based on the level of known exposure facing the Bank Insurance Fund. The FDIC's estimates show 375 institutions failing or requiring assistance over the next 2 years, with losses to the Fund totaling as much as $43 billion and working capital needs totaling as much as $59 billion.

However, as we have reported, these estimates are subject to significant uncertainties which could affect the Fund's ultimate funding needs and costs from bank failures. The amount of funds ultimately needed to resolve failing institutions will depend on current and future economic conditions and the oversupply of commercial real estate on the market. Also, the quality of financial reports prepared by banks play a large role in any analysis to determine the potential exposure facing the insurance fund.

Savings and Loan Industry

The government continues to experience heavy costs in resolving the savings and loan problems. Since the enactment of the Financial Institutions, Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the Resolution Trust Corporation (RTC) has made substantial progress in closing failed savings institutions, but the cost has been high. To date, RTC has received $105 billion which it expects to use for resolving all institutions currently identified as probable failures by the end of 1992. RTC had requested an additional $55 billion last fall, which was not approved by the Congress.

At this time, it is difficult to predict how much additional funding RTC will need and the timing of those needs. The reliability of long-term predictions will be affected by significant uncertainties, including the future condition of the economy. If the interest rate spread continues to be favorable, many poorly capitalized thrifts may remain marginally viable long after their current expected failure dates. If this happens, RTC could be holding funds intended for resolving thrifts that fail after its resolution responsibility ends at September 30, 1993.

On the other hand, given the continuing weakness in the economy and the seriously overbuilt real estate market, RTC may be significantly overstating expected sales proceeds for assets in receivership. Actual income flows for many of RTC's assets may not support projections.

Under current legislative guidelines, the Savings Association Insurance Fund (SAIF) will assume responsibility for resolving troubled thrifts after September 30, 1993. Our preliminary calculations indicate that SAIF will have about $1 billion at that time. If there is a significant backlog of thrifts to be resolved, the Fund may be insolvent when it assumes its responsibilities.

The conditions of the troubled financial institutions industries are a serious threat to rebuilding the stability of the deposit insurance funds in the foreseeable future. The Federal Deposit Insurance Corporation Improvement Act of 1991 provided much needed auditing, accounting, and early warning safeguards (tripwires) to improve corporate governance and financial reporting and to minimize losses to the insurance funds. This year is a critical time period for the regulators to prepare the necessary regulations to implement these reforms.

Insurance Industry

During the 1980s, the number, size, and costs of insurance company failures grew significantly compared with previous decades. Recently, state regulators have taken over several very large insurance companies with the costs expected to be in the billions. The true condition of the industry may be masked by accounting deficiencies, such as those related to recognizing real estate losses.

Unlike insured depository institutions, no federal safety net protects policyholders against losses on their policies, even though many insurance products are equivalent to the savings accounts offered by federally insured banks. Guaranty funds do exist in various states to honor policyholder claims for losses.

But they vary enormously in the coverage they provide, and their capacity to honor claims on a timely basis is limited. There is a risk that the federal government might be expected to cover policyholder losses that cannot be covered by the guaranty funds. Whether this will occur, and under what circumstances, is a key public policy issue that we are addressing.

INTEREST

Unfortunately, interest costs, while they are estimated to be the largest part of the general funds' outlays in 1993, are the least amenable to direct control. They are mainly controlled over time by actions on other items in the budget that reduce the deficit. Over the past decade, interest on debt held by the public was one of the most rapidly growing components of government spending, rising to $196 billion in 1991, or 3.5 percent of GDP. This is understandable, in view of the enormous rise in publicly held debt--$2.7 trillion at the end of 1991. But this is only part of the story. The Treasury now owes another $912 billion in debt to the trust funds (predominantly social security and the military and civil service retirement funds) and other government accounts. This entailed another $90 billion in interest payments, bringing the total interest bill on the public debt to $286 billion in 1991.

So long as the huge deficits continue, the interest bill can only go up, consuming a growing portion of revenues that are badly needed for investment. For example, OMB projects that by 1995 under the President's policies, total outstanding debt (including the portion owed to governmental accounts) will have risen to $5.2 trillion, and the comparable interest costs will have risen to over $355 billion, or 5 percent of GDP.

The recent drop in interest rates associated with the recession has had a modest effect on constraining the growth in total interest costs, but this is likely to be only temporary. When the economy enters the recovery stage, interest rates are likely to move back up to the levels we saw in the late 1980s. Those levels should probably be viewed as the norm until the Congress and the President bring the budget deficit under control, eliminating the drain on savings and the resulting shortage of capital for investment.

Indeed, in view of the potentially huge demands to rebuild the economies of Eastern Europe and the new republics of the former Soviet Union, there is reason to believe that we may be entering an era of a growing world-wide shortage of capital. If that is the case, the rest of the 1990s could see real interest rates that are even higher than those of the 1980s, with a potentially adverse effect on the federal government's interest costs and deficit.

THE SOCIAL SECURITY TRUST FUND

The existing social security trust fund surplus could pose a significant threat to deficit reduction if the public decides it does not want to continue to pay the level of taxes generating that surplus. The payroll tax increases enacted in 1977 and 1983 will lead to social security trust fund balance accumulations of about $8 trillion in 2027. We concluded in a 1989 report that to accumulate social security reserves as a means of making additional saving available for capital investment is a reasonable and responsible policy. However, in order for the social security surpluses to serve the purpose of adding to national saving, they must be accompanied by approximate balance elsewhere in the budget. Currently, payroll taxes are being used to finance the operations of the government and are masking the size of the general funds budget deficit. In our judgment, so long as the deficit continues, the changes to social security enacted in 1983 are not producing the result of lessening the burden of paying for the retirement benefits of the baby boom generation.

In the 1989 report we said that if the Congress and the President are unable to agree upon and implement a strategy for restoring fiscal balance in the non-social security part of the budget, the Congress should reconsider the pattern of payroll tax increases that is producing the current and projected social security surpluses. In this regard, it would be appropriate to consider a return of the social security program to a pay-as-you-go financing basis once the social security reserves have reached a desirable contingency level of about 100 to 150 percent of annual outlays. The reserve is projected to reach the 150 percent level by 1996 under current tax rates. A return to a pay-as-you-go financing basis would require reducing payroll taxes below current levels beginning in the mid-1990s, then raising them above current levels beginning around 2020. However, without offsetting measures such action would result in an increase in the federal deficit of $100 billion in 1996.

ACCOUNTABILITY ISSUES

While it is obviously important for the government to get control over the big budget drivers, it must also get better fiscal control over its own operations. The people of this country would have more confidence in their government and be more likely to accept some of the hard decisions that must be made to bring our deficits under control if they saw it operating more efficiently and effectively. This issue, of course, is of special concern to this Committee, as shown by its interest in targeting programs at high risk for fraud, waste, and abuse and by its leadership on the Chief Financial Officers (CFO) legislation.

High-Risk Areas

In response to widespread congressional concerns, and because we also believe that the government continues to be plagued by serious breakdowns in its internal control and financial management systems, we have undertaken a special audit program to detect mismanagement, fraud, and abuse. To date, we have identified 16 target areas that we have designated as being at high risk for fraud, waste, and abuse. These areas include the management of seized and forfeited assets; guaranteed student loans; Department of Defense (DOD) major systems acquisitions; and contractor oversight and related practices at the Department of Energy (DOE), the Environmental Protection Agency (EPA), and the National Aeronautics and Space Administration (NASA).

We have initiated over 200 jobs in these 16 areas. Although many of these assignments have not yet been completed, we have had a number of initial successes. For example,

-- Work at DOD has identified ways to reduce excess inventory, including using economic order quantities, eliminating excessive lead times for delivery, terminating orders for excess items, and following commercial practices more. Due in part to these efforts, DOD reduced its fiscal year 1991 materiel acquisition requirements by $1.3 billion.

-- Work on Medicare has resulted in numerous suggestions for changes in payments to providers for laboratory services, emerging technology, indirect medical education, and physician payments. If the Congress acts on these and other GAO recommendations, over $1 billion in program outlays could be eliminated.

-- Audits at FDIC and analyses of several hundred large financial institutions helped to alert the Congress to the need for significant accounting and auditing reforms and pointed out that, without a recapitalization plan, the insurance fund would, in all likelihood, be insolvent by the end of 1991. The result was significant banking reform legislation enacted late last year.

-- Our work on seized and forfeited asset programs prompted legislation to permit administrative forfeiture of cash amounts over $100,000. This change should help expedite drawn out and costly forfeiture proceedings.

The problems in the high-risk areas have been long-standing and are not easily solved. We need to continue a concerted effort to identify and overcome the root causes of the problems. Some examples of the problems we are working on follow.

-- Education's Guaranteed Student Loan Insurance Fund does not have reliable information in its financial systems on its program costs, loan and interest losses, or losses in origination fees.

-- Medicare contractors have large backlogs in collecting payments made on behalf of Medicare beneficiaries that should have been made by primary health insurers. The Health Care Financing Administration is not devoting sufficient resources to recover these mistaken payments.

-- Several of the government's major contracting agencies, DOD, NASA and DOE, have been the subject of long-standing criticism for poor contractor oversight, cost overruns, schedule slippages, production of defective parts, acquisition of unneeded goods and services, and illegal activities.

-- The Farmers Home Administration's loan-making and servicing policies, designed to help farmers stay in farming, have increased the government's losses. Of the $24 billion in outstanding direct and guaranteed loans to farmers, as much as $15 billion, or 60 percent, is held by problem borrowers who may not meet their obligations.

As you know, OMB also has an active program which now includes 98 high-risk areas. Currently, 18 OMB staff members devote some portion of their time to the effort.

We are reviewing OMB's program at the request of the House Committee on Government Operations and expect to complete our work in late spring or early summer. Also, at some future time, we intend to issue a series of status reports to the Congress on the 16 areas in our program.

Chief Financial Officers Act

One of the issues that continues to plague government as it attempts to address the deficit and management problems is the lack of good financial management. Agency financial systems, operations, and controls have been woefully inadequate for at least the past decade. Major reform is long overdue. The CFO Act, which resulted from the leadership of this Committee and its House counterpart, is beginning that process of reform and change. We have seen some important progress in the first year under the act, which I will highlight today, together with some perspectives as to the future challenges we face under the act.

We have worked closely with OMB, the agencies, and the inspectors general during the past year on all facets of the act to help frame the issues and to assure the issuance of appropriate implementing guidance. Overall, OMB's guidance covering CFO authorities, qualifications, financial statements, and auditing have been on target. OMB has put its management team in place and has established the Office of Federal Financial Management as required by the act, although we continue to be concerned that OMB may not have enough resources in this function.

In all of this, we see a foundation developing for successful implementation. But, the real work has just begun. Implementation will not be easy and will take time. I would now like to highlight the issues the Congress needs to focus on as it oversees implementation of the CFO Act.

First, Mr. Chairman, we share your desire for a strong team of agency CFOs and the concerns you raised regarding the appointment of only highly qualified financial managers to these positions. The act envisions a cadre of trained financial management professionals who have the requisite expertise and demonstrated ability in financial management. The CFOs themselves are critical to changing the way financial management is viewed today in the agencies. In the selection of its management team, OMB has set a standard by selecting highly qualified individuals. The goal should be for agency CFO selections to emulate this model.

Second, agencies need to establish their CFO organizations as envisioned in the act and called for in OMB's guidance. At last count, OMB had approved 21 of 23 agency reorganizations plans, but the questions remain on how these plans will be carried out and whether there will be substantial changes in relationships and organizational authorities to carry them out.

Third, agencies will have to examine the state of their financial systems and where they want to be long term. The first 5-year plan called for in the act is due this month and should represent OMB's vision of its objectives and direction. Overall, the government has to be a lot smarter in the systems area, and OMB's leadership will be key. Greater use of standard systems and cross-servicing arrangements is needed. Also, agencies need to look for incremental improvements through manageable sized efforts rather than huge projects which usually fall short of expectations or eventually die of their own weight.

Next, financial reporting and auditing will have to go beyond traditional bounds. Agencies have to be able to report each year where they stand financially and what the future holds in financial terms. This is one area where we need to see strong linkages between accounting, programs, and budgets. The development of cost information and the systematic measurement of performance will be critical. We fully support OMB's guidance in this area, which expands management's reporting and the expectations of the auditor. We intend that our pilot audits of the Department of the Army, the Internal Revenue Service, the Customs Service, and the Guaranteed Student Loan program will be models for demonstrating the usefulness of financial auditing. We are also working closely with a number of the inspectors general as they begin performing financial audits.

Fifth, agencies need to deal with their people problems, which have long hampered effective financial management operations. The government has to attract and retain people with the skills needed to manage large and complex financial operations.

Finally, strong congressional support, along with sustained leadership and continued Executive Branch commitment to reform is crucial. Appropriations, authorizing, and oversight committees will have to keep up the pressure and will need to be supportive of efforts to change the way agencies operate today. If agencies perceive otherwise, the mandate of the CFO Act will not be fulfilled.

INFRASTRUCTURE

A last item which you asked me to address today deals with the need to make investments in America's future. There is a growing awareness of the numerous physical infrastructure needs of the country, in particular the deteriorating conditions of our transportation, environmental treatment, and nuclear energy facilities. Another very important issue facing the country is the depth and quality of the education provided to our people. Let me highlight the issues regarding each of these needs and some of the costs that are involved.

Transportation

Until quite recently, federal spending on roads, bridges, and airports has not kept pace with the needs, and the effects of this are being seen in outmoded, noncompetitive, and sometimes dangerous transportation facilities. Continuing this short-sighted policy would have eroded even further our economy's capacity to produce the standard of living that Americans have come to expect.

The recently enacted Intermodal Surface Transportation Efficiency Act of 1991 provides substantial growth in highway and mass transit programs by authorizing a $155 billion, 6-year package to boost investment in the nation's infrastructure. To finance the $155 billion plan, the federal gas tax will be 14 cents per gallon until fiscal year 1996, when it will decrease to 11.5 cents per gallon.

Compared to the 1991 spending limitation of $15 billion for highways, the act allows highway spending to grow from about $17 billion in 1992 to about $18 billion in 1993 and annually through 1997. If the Congress makes the newly authorized levels fully available for states to spend, then significant implications will result for the other programs with which surface transportation program spending must compete. If, on the other hand, the Congress and the President cannot find sufficient reductions in other programs to accommodate the large increases in surface transportation spending authorized by the act, the anticipated growth in infrastructure investment will be limited.

Environment

Meeting current and future environmental quality standards will require a multibillion dollar investment in facilities to treat sewage and other types of waste products. The Environmental Protection Agency (EPA) now expects annual capital expenditures for pollution control to reach $47 billion to $51 billion in 1998, nearly twice as much as was spent during most of the 1970s and 1980s. These outlays--for facilities to treat wastewater and drinking water, for disposal and treatment of solid and hazardous waste, and for upgrading and replacing underground storage tanks, among other things--are in response to greater public demand for environmental improvements and more stringent federal standards.

The federal government's contribution to infrastructure investment, however, will be relatively small and will ultimately disappear altogether as grants to states for construction of wastewater treatment plants are completely phased out. Even the President's proposed increase this year in construction grants--to $2.5 billion from just under $2 billion in recent years--would provide a small share of all that will be needed. Instead, the financing burden will fall heavily on states and localities. Local governments, in particular, will see a dramatic growth in their environmental infrastructure capital and operating costs, which EPA projects will exceed 1987 levels by 69 percent in the year 2000. Not all communities are expected to face financial difficulties, but without assistance, some local governments may have to choose between unattractive alternatives--either to fall into noncompliance with environmental regulations or to give up other important community needs in order to meet these mandates.

Nuclear Energy

The government's nuclear weapons complex represents some extremely difficult and expensive problems ranging from safely restarting nuclear weapons production to dismantling thousands of existing warheads. The dramatic reduction in our nuclear weapon arsenal raises new questions about what kinds of facilities the Department of Energy (DOE) needs and how we can safely handle, dispose, and/or store excess radioactive material from retired weapons. In addition, there are serious long standing environmental and safety issues concerning DOE's aging nuclear facilities and radioactive waste disposal sites whose clean up is now estimated to cost as much as $160 billion or more. Even with such large expenditures, some locations may never be returned to unrestricted use.

Education

Another very important issue facing the country is the depth and quality of the education provided to our people. Education is the cornerstone of our democracy and, more than anything else, the key to our long-term economic competitiveness. Yet, something is wrong with America's public elementary and secondary education system when large numbers of young people leave school inadequately prepared for today's job market.

The President and the governors have established a set of education goals for the year 2000. Last September, the National Education Goals Panel issued its first report on these goals, which documents how far we have to go to achieve them. The National Council on Standards and Testing has developed plans for setting national standards and developed new systems of assessment to measure student progress in meeting these standards. In addition, the Congress is now considering a number of proposals to stimulate improvements in education.

While establishing national goals and setting high standards are a good start, and critical to success, the real challenge is to change the nation's schools so that all students can be productive adults who are prepared for the challenges of the 21st century. The nation needs to address school system deficiencies and problems, such as outmoded curricula and instructional practices, policies that impede innovation, and an inadequate match between what is taught and what jobs of the future will require.

Improvements in schools will take place in the context of a diverse population of students. While many of the nation's students go on to college, most do not, and we have not adequately addressed their needs for training. Furthermore, schools continue to serve a changing population. Increasingly, the student population is comprised of minorities, immigrants, or non-English speakers. Each year, the nation's schools serve more students who are poor, and live in circumstances that make learning difficult.

As a nation, we are attempting to reform education institutions in the context of a system--comprising 50 states and 16,000 school districts--that is decentralized and diverse. The federal government can play a role in this context by stimulating reforms in state and local education institutions, encouraging innovative educational practices in schools, supporting the use of existing knowledge about what works, and strengthening the links between education and jobs.

CONCLUDING REMARKS

In my concluding remarks, I would like to return to the $500 billion general funds budget deficit. As we have stated in prior reports, successful action on bringing this part of the budget into approximate balance during this decade, which could produce a total budget surplus of about 2 percent of GDP, is the key to long-term economic growth. Of course, achieving this budget surplus will not be easy, given the fragile condition of our current economy and the many demands placed on future budgetary resources by the country's many unmet needs. To those demands we have already touched upon today, we should add the increasing fiscal plight of many of our states and local communities. Prudent planning requires that we consider the probability that the federal government might be asked to provide extensive financial help to states and municipalities in the future years.

The simple fact is that many of the problems we have touched upon here today cannot be successfully addressed in the absence of a stronger economy. There are, as you know, proposals to respond to the current weakened state of the economy with a fiscal stimulus package that increases the deficit. If such a package is adopted, it is important that it not add to the government's long term debt burden. Whatever measures are put in place should not prove counterproductive over the long-run.

This morning, we outlined for you the need for attention to the large general funds policy areas: Defense, Health, and Deposit Insurance. The dollar amounts involved in these few areas are enormous, and in some cases seemingly out of control.

The changing international security environment gives us an opportunity to continue our defense restructuring and achieve significant budgetary savings from that part of the budget. But it is important that this occur in a sound manner, proceeding from a new overall security design and paying careful attention to the implications for the defense industrial base and well being of our military families.

We must get the deposit insurance problem behind us. There are still considerable uncertainties in that area making it doubly important that the reforms set forth in the 1991 Deposit Insurance Corporation Improvement Act be implemented properly.

The health area presents a different kind of challenge. We do not yet have an agreed upon federal policy for resolving the problems in the health field. We have not suggested a particular plan, but rather have set forth some conditions that, if met, could permit access to health care to be broadened and costs contained. We know that the Congress will be looking at this matter carefully in coming months, and we at GAO will be doing further studies on this important question.

Finally, it will take more than agreement on the nature of the problems, or even the solutions, to get the problems behind us. Our elected and appointed officials also need to have solid financial management information upon which to base their decisions. This is why we attach considerable importance to successfully implementing the Chief Financial Officers Act and continuing our work on the high-risk programs in the government.

Many Americans, including myself, perceive that our country and its government are at an historical crossroads where there are unprecedented peacetime challenges to our continued economic strength and well-being as a nation. Our success in managing our peacetime resources must receive the same intellectual and energy levels we gave to managing the Cold War. This is both a challenge and opportunity that we simply cannot fail to address successfully.

This concludes my prepared statement, Mr. Chairman. I would be glad to answer your questions.

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