FEDERAL BUDGET PROCESS REFORM

HEARINGS

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

MARCH 27; APRIL 23, AND 25, 1996

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FEDERAL BUDGET PROCESS REFORM

WEDNESDAY, MARCH 27, 1996

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2154, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Davis and Maloney.

Staff present: J. Russell George, staff director and counsel; Harrison Fox, professional staff member; Andrew G. Richardson, clerk; Mark Stephenson, and Matt Pincus, minority professional staff members.

Mr. HORN. The Subcommittee on Government Management, Information, and Technology will come to order.

It has been at least 10 years since a major budget reform measure, the Gramm-Rudman-Hollings Act, passed Congress. In the current climate in which the Federal Government is still laboring to fund programs that have been operating for nearly 6 months with no permanent funding, many observers both within Congress and elsewhere recognize that the time has come for a re-examination of the budget process.

This morning, the subcommittee will begin the first of three hearings to examine the Federal budget, financial management, and accounting processes of the executive and legislative branches of the Federal Government. The subcommittee will assess the adequacy of current Federal budget law and review recent proposals for reform.

The budget process currently in use by the Federal Government is the result of 75 years of legislative action which resulted in 15 major acts and dozens of supplementary legislative provisions. Starting with the Budget and Accounting Act of 1921, the Federal Government began to establish rules and procedures for budget formulation. In the three decades following the Second World War and the Legislative Reorganization Act of 1946, Congress passed the Accounting and Audit Act of 1950, the Budget and Accounting Procedures Act of 1950, the Federal Claims Collection Act of 1966, the Congressional Budget and Impoundment Control Act of 1974, and the Inspector General Act of 1978.

The 1980's' major budget and accounting initiatives were enacted into law with the purpose of putting the Federal Government's fiscal house in order, making deficit reduction a part of our law. The legislation established systems of internal accounting and administrative controls. Major examples of these laws are the Federal Managers' Financial Integrity Act of 1982; the Balanced Budget and Emergency Deficit Control Act of 1985, more commonly known as Gramm-Rudman-Hollings; and the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987. Each of these acts had the promise of bringing Federal spending under control in reducing the size of government. Unfortunately, this promise was not realized.

During the first half of the 1990's, a number of comprehensive budget and accounting reform bills were crafted. One of them, the Budget Enforcement Act of 1990, added new budget enforcement mechanisms for discretionary spending, entitlement and receipts. These provisions were intended to ensure deficit reduction over the 1991–1996 timeframe. The Chief Financial Officers Act of 1990 provided a new framework for improvement of financial management in the Federal Government. Additional measures are providing for Federal strategic planning, annual performance plans and reports and performance budgeting. They have also required over two dozen Federal agencies to submit yearly audited financial statements.

Even though these bills, taken by themselves, represent major steps forward, they are an eclectic mix. As a result, Congress and Presidents over the last 75 years have had to patch together budgeting, accounting and financial management procedures, rules and practices. When compared to big business and even the ma and pa store, the Federal approach is ineffective, inefficient and, if it were used by any business, would lead to bankruptcy. This is because too many Federal promises have been made totaling trillions of dollars. The current Federal approach must change. A comprehensive bipartisan effort to reform the Federal budget process and law is warranted.

Congress has a three-tiered funding process—authorization, appropriations and budget formulation—that work in tandem with the President's budget recommendations. Most citizens have a hard time making sense out of this process. Members of the House of Representatives and the Senate and their staffs experience frustration with a lack of information and timely enactment of authorization and appropriations bills. There is enough blame for all of us, Republicans, Democrats, Congress and the President, to share in these budget failures.

The proposal before us today seeks to improve, with broad bipartisan support, our Federal budget laws and process. Most current Members of the House have either introduced budget reform legislation or have co-sponsored major reform measures.

Today's hearing will focus on many important proposals by Members of the House. Representatives Chris Cox, Richard Armey and Joe Barton have introduced legislation to achieve comprehensive budget and process reforms.

At this point, I would ask unanimous consent that the rest of the statement be put in the record as if read and we will begin with our first witness this morning, Representative Joe Barton of Texas. Welcome.

[The prepared statement of Hon. Stephen Horn follows:]

OPENING STATEMENT

Representative Stephen Horn

Federal Budget Process Reform

March 27, 1996

A quorum being present, the Subcommittee on Government Management, Information, and Technology will come to order. It has been at least ten years since a major budget reform measure -- the Gramm-Rudman-Hollings Act -- passed Congress. In the current climate in which the Federal government is still laboring to fund programs that have been operating for nearly six months with no permanent funding, many observers, both within Congress and elsewhere, recognize that the time has come for a reexamination of the budget process.

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During the first half of the 1990's a number of comprehensive budget and accounting reform bills were crafted. One of them, the Budget Enforcement Act of 1990, added new budget enforcement mechanisms for discretionary spending, entitlement, and receipts. These provisions were intended to ensure deficit reduction over the 1991-1996 time frame. The Chief Financial Officers Act of 1990, provided a new framework for improvement of financial management in the Federal government. Additional measures are providing for Federal strategic planning, annual performance plans and reports, and performance budgeting. They have also required over two dozen Federal agencies to submit yearly audited financial statements.

Even though these bills, taken by themselves, represent major steps forward, they are an eclectic mix. As a result, Congresses and Presidents over the last 75 years have had to patch together budgeting, accounting, and financial management procedures, rules, and practices. When compared to big business and even the "Ma and Pa" store, the Federal approach is ineffective, inefficient and if it were used by any business would lead to bankruptcy. This is because too many Federal promises have been made totaling trillions of dollars. The current Federal approach must change. A comprehensive bipartisan effort to reform the Federal budget process and law is warranted.

Congress has a three tiered funding process -- authorizations, appropriations, and budget formulation -- that work in tandem with the President's budget recommendations. Most citizens have a hard time making sense out of this process. Members of the House of Representatives and the Senate and their staffs experience frustration with a lack of information and timely enactment of authorizations and appropriations bills. There is enough blame for all of us -- Republicans, Democrats, Congress and the President to share for our budget failures.

The proposal before us today seeks to improve, with broad bipartisan support, our Federal budget laws and process. Most current members of the House have either introduced budget reform legislation or have cosponsored major reform measures. Today's hearing will focus on many important proposals by members of the House. Representatives Chris Cox (R-CA), Dick Armey (R-TX), and Joe Barton (R-TX) have introduced legislation to achieve comprehensive budget and process reforms. In fact, Mr. Cox's bill, H.R. 2929, which was introduced in the 103rd Congress, serves as the frame of reference for the draft bill before you today. In this Congress, Representatives Cox and Steve Largent (R-OK) have convened a budget reform task force to consider a broad range of proposals. They have identified eight measures that will simplify and bring more accountability into the budget process. These measures include an end to all entitlements excepting Social Security, establishing a rainy day fund, and setting up a lock box to capture spending cuts for deficit reduction. Their legislation also calls for an end to a waiver of House rules; an end to baselines, enhanced rescission, and generating -- at least yearly -- a business-like balance sheet for the Federal government. If no budget agreement is reached, then an automatic continuing resolution would be in effect.

Representative Mike Castle (R-DE) has proposed that a budget reserve account be established for emergencies. Representative Sam Johnson (R-TX) proposes look-back treatment for emergencies. Representative Dan Miller (R-FL) seeks to establish a Spending Reduction Commission. In addition, Representatives Jim McCrery (R-LA), John Spratt (D-SC), and Charles Stenholm (D-TX) have made additional proposals for budget law revisions.

Budget process updates are included in Mr. Cox's bill. He has proposed a required supermajority to waive a budget law, the prohibition of "blank check" appropriations, and "pay as you go" requirements for new spending.

Additionally, Representatives Mike Crapo (R-ID) along with Charles Schumer (D-NY), Jane Harman (R-CA), Bill Brewster (D-OK), and Mark Neumann (R-WI) have called for placing appropriations bill cuts in a "lock box" for defecit reduction. We will also review various performance, evaluation and citizen involvement proposals.

Over 50 proposals have been referred to this subcommittee that would reform the Federal budget, financial management, and accounting process. These proposals have been folded into the proposal before the subcommittee. This measure is intended to provide a legislative framework for bills and proposals that address Federal budgeting, accounting, financial management and related issues.

The Omnibus Budget Act is a working draft. It presents a broad array of options which have been proposed by dozens of Members of Congress and experts. The draft bill is, in fact, a menu of Federal budget process, accounting, and financial management reform proposals. The Omnibus Budget Act draft bill, as a compilation of disparate proposals, necessarily includes some overlap and conflicting provisions. With the draft bill we seek to present the broadest range of reform proposals. Today, Members of Congress and experts will discuss the merits of budget process and law proposals included in the Omnibus Budget Act. In late April, two additional hearings are scheduled to further discuss Federal financial management and accounting reform recommendations.

Let me draw your attention to three key texts that serve as the foundation documents for this hearing. They are a draft version of the Omnibus Budget Act (OBA) accompanied by two Congressional Research Service (CRS) documents entitled -- "Budget, Accounting, and Financial Management: Legislation and Topics Outline," and "Budget Process Reform: Selected Issues and Options". The first CRS document outlines the budget, accounting, and financial management public law. The second presents concise summaries with pro/con analysis of the major issues before us.

Today's hearing includes several witnesses commenting on specific provisions of the proposal as well as the general priority for budget process and law reform.

Joining us this morning are: Representatives Joe Barton (R-TX), Chris Cox (R-CA), Nick Smith (R-MI), Mike Crapo (R-ID), Charles Stenholm (D-TX), Ray Thornton (D-AR), Mike Castle (R-DE), Ed Royce (R-CA), and Lamar Smith (R-TX).

Grass root organizations will be represented by the Honorable Roger

Zion and James Martin, of the 60 Plus Association; Mike Monroney, former Chairman, Coalition for Fiscal Restraint; and Tom Schatz, of Citizens Against Government Waste.

We will also hear from David Mason of the Heritage Foundation; Stephen Moore of the CATO Institute; Joseph White representing The Brookings Institution; and Richard Kogan of the Center on Budget and Policy Priorities.

We thank you all for joining us and look forward to your testimony.

[Members of Congress are not sworn in!]

Our practice is to include your written testimony in the hearing record after each of you is introduced. We would appreciate having you orally summarize your written statement in five minutes. We will also limit to five minutes, Members' statements and, later, their questioning for each round.

Does the Ranking Member have an opening statement?

Do other Members have an opening statement?

STATEMENT OF HON. JOE BARTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. BARTON. Thank you, Mr. Chairman, and I do appreciate you starting the hearing on time. I know that is something of an anomaly in the Congress and I am glad that you are one of the exceptions.

I share your concern about the budget process. I listened with interest to your opening statement and I agree that we need to fix it. As you pointed out, there are a number of comprehensive reform measures before the House, one of which I am the chief sponsor of, the BEST bill, the Budget Enforcement Simplification Trust Act.

This legislation is really not mine in terms of authorship. It has been put together by a bipartisan group in the country called the Committee for a Responsible Federal Budget. This group is chaired by former Senator Henry Bellman, a Republican from Oklahoma, who was the ranking Republican on the Budget Committee in the Senate, and former Congressman Robert Giaimo, a Democrat from Connecticut who served as the chairman of the House Budget Committee and was also a member of the House Appropriations Committee.

It is the result of approximately 10 years of work. We have a bipartisan list of co-sponsors, including the majority of the Blue Dog Coalition Democratic group.

I am going to go through very quickly the components of the bill because I know that you have a number of other witnesses.

The first thing that the BEST bill does is go to biennial budgeting instead of the annual budgeting process. This is fairly straightforward. The House meets for a 2-year session, it makes sense to have a 2-year budget. Most States have 2-year budgets. If we went to biennial budgeting instead of annual budgeting, we would do all of our arguing in the first year and then we would do oversight and implementation in the second year.

The second thing that we require is that the President's budget be submitted as a joint resolution that would have to be voted on by both Houses of Congress by a date certain. This would make the President a budget participant in the beginning of the process instead of at the end when his choice is to veto or accept. It would make the budget a law instead of simply a sense of the President's priorities.

Mr. HORN. I will note at this point Mr. Davis has arrived. A quorum is present.

Mr. BARTON. I will be a witness that he has arrived. He is here.

So we make the budget submission of the President a joint resolution. It would have to be voted on by April 15th. If the President vetoed that, then there would have to be a veto override vote by May 15th. If we fail to override the President's veto, then the prior 2-year budget would go into effect, so you would never have this situation we have had this year where we had the possibility and sometimes the actuality of a budget shutdown.

We put entitlement caps in place for all entitlement spending. We do not eliminate entitlement programs, obviously, but we do say that even the entitlement bills, entitlement programs have to have a budget and have to have spending caps. We take what they spent last year, adjust for inflation and population, expected population growth, and that is their cap. Any program that spends more than $20 billion would be subject to these caps.

We have sequestration, which is cutbacks in particular programs when those programs overspend. Our sequestration authority is by program so it would be unlike the Gramm-Rudman sequestration where you cut across the board in every government program. If a program that spends more than $20 billion is operating within its budget, it would not be subsequent to sequestration. If a program that spends more than $20 billion is going over budget, the sequestration would be within that program. So this would enhance credibility for those program managers and Cabinet agencies that do live within their budget, but it would serve as a warning to those that do not.

We would eliminate the current dire supplemental appropriation spending bill authority and put in its place a reserve so-called rainy day fund. We would set aside a certain percent each year in our budget for contingencies and that way when there was an earthquake in California or a hurricane in Florida or a drought in Texas or the flood in the midwest, whatever, the money would be there. You would not have to put this emergency spending bill on the table that turns into a Christmas tree for every boondoggle that comes down the pike.

The last thing that we do is eliminate the baselining, so that you do not have a situation where you can actually end up spending more money than you spent last year and have it be trumpeted in the press as a cut. Whatever the program spent last year is the baseline for the coming budget and if you spend more, it is an increase; if you spend less, it is a decrease.

To conclude, as you pointed out in your opening statement, the current budget process is broken. I daresay there is not a Member of the House or the Senate that totally understands it. It is a process that is designed for confrontation rather than cooperation. It is a process in which the President has no legal role to play until very late in the process when he has to threaten appropriation vetos and things like that.

The BEST bill tends to reverse that. It puts the President in the process at the beginning instead of at the end. It puts in place a process that every Member could understand and could participate in and there are real incentives for spending control and there are penalties for spending that is out of control.

Mr. Chairman, I would hope when your subcommittee goes through your Omnibus Budget Act of 1996 that many, if not all, of the elements in the BEST bill are given serious consideration.

[The prepared statement of Hon. Joe Barton follows:]

TESTIMONY OF CONGRESSMAN JOE BARTON

BEFORE THE HOUSE SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY

ON FEDERAL BUDGET PROCESS REFORM

March 27, 1996

I want to thank Chairman Horn, Chairman Clinger and the other members of the Government Reform Committee for holding this hearing on budget process reform and allowing me to testify. I am here before you because I believe that budget process reform is the most important issue facing the 104th Congress. Passage of meaningful process reform would leave its mark on this Nation for generations to come. Last November, I introduced HR 2599, the "Budget Enforcement Simplification Trust" Act, or the "BEST" bill. This legislation had a great deal of input from the "Committee for a Responsible Federal Budget," chaired by former Senator Henry Bellmon (R-OK) who served as Ranking Republican on the Committee on the Budget, and former Congressman Robert Giaimo (D-CT) who served as Chairman of the House Budget Committee, as well as a member of the House Appropriations Committee. The group has included other former Budget Committee Chairmen, former Directors of the Office of Management and Budget, leading economists and businessmen. I share the goals of this group and truly believe that there is a need for discipline and order in making spending and revenue decisions at the federal level.

On a related point, I have been working with Congressman Largent and Congressman Cox over the last several weeks to attach budget process reform to legislation increasing the debt ceiling. I personally believe there is no reason a consensus reform bill could not be considered right now. We were able to get 45 other signatures also voicing their support for this idea in a letter sent to Speaker Gingrich on February 29, 1996. This show of support demonstrates that the time is right to move on this issue.

"BUDGET ENFORCEMENT SIMPLIFICATION TRUST" ACT

The following is a summary of major components of the "**BEST**" **bill:**

1. BIENNIAL BUDGETING- A biennial resolution would permit more focus on oversight and evaluation of program performance. In odd numbered years, the President should propose and Congress should act on the budget, spending, and tax legislation. In even numbered years, Congress should conduct meaningful oversight, monitor and evaluate programs, and authorize/reauthorize programs. This may require that Congress take more of a long term view, focusing more on policy and less on detail. It would require serious impediments to enactment of new/additional spending legislation in even numbered years.

   The biennial budget also may require Congress to give the President more flexibility to execute and implement policy -- fewer set-asides and earmarks, and/or broader reprogramming authority.

2. **BUDGET WITH FORCE OF LAW** - A joint, rather than the current concurrent, resolution would bring the President into Congressional budget deliberations and make him accountable for its success or failure. And, because the President would have the authority to veto an unacceptable resolution, a joint resolution would require Congress to pay attention to Presidential concerns. Unlike the current budget process, this new framework would make both the Executive and the Legislative branches stakeholders in the resolution's outcome and require them to agree on

overall spending and revenue levels, annual deficits, total debt levels, and on the allocation of resources among budget functions and committees.

If Congress and the President do not enact a joint resolution by May 15th in a given year, the amounts and allocations in the previous resolution become binding. This would provide a strong incentive for timely action on the resolution.

The debt ceiling could be revised through the joint resolution rather than requiring separate legislation.

Spending limits could be revised through the joint resolution instead of through separate budget process legislation. Such cap adjustments would require a separate vote and would not be hidden or obscured through an up or down vote on the entire budget resolution.

3. **ENTITLEMENT CAPS** - The bill would create caps on entitlement caps and other mandatory spending. Under current law, entitlement spending is, in effect, a blank check. Under this legislation, the Congress and the President would set budgets for large programs (over $20 billion) and then must find ways to keep the entitlement within its budget. Entitlement programs and mandatory spending account for over two-thirds of total government spending.

4. **SEQUESTRATION** - Once a budget is set, each spending increase must be offset by an equal spending cut. If this requirement is not met, sequestration will take place. Cuts would be made on a pro-rata basis for every program, project and activity in the area that has had an overage. Sequestration is

triggered when prior year spending is higher the that year's cap or if Congress and the President enact legislation which exceeds a spending cap.

5. <u>RESERVE "RAINY DAY" FUND</u> - The BEST bill creates a Reserve Fund which would replace the "emergency" supplemental appropriations bills which have become a catch-all for non-emergency spending schemes. Disbursements will be only for certified natural disasters with tough procedures to ensure spending on only its designed purposes. An "emergency" should not be defined as a requirement lacking budgeted funds. The BEST bill would establish an emergency/contingency reserve fund that would set aside a prudent amount for emergencies. These funds would be included in overall spending limits. Increases in emergency requirements beyond the amounts available in the reserve fund would be offset by decreases in non-emergency amounts. If offsets are not feasible, then Congress could vote for, and the President could sign into law, higher spending limits. This increase in spending would be explicit, and not hidden through an "emergency" designation.

   The use of emergency funds would be restricted to specified purposes. This may require us to differentiate between "emergencies" (i.e., unanticipated and immediate threats to public safety or health, life, or property) and recovery/rebuilding requirements that could be addressed more appropriately through insurance or through better budgeting.

6. <u>END BASELINE CONFUSION</u> - The baseline will reflect current laws and policies. For discretionary programs, it would reflect the discretionary caps. For entitlements it would reflect current laws. For example, the baseline would go up for programs like Social Security, which are indexed for inflation.

Conclusions

The federal budget process is decentralized with a vengeance. Too many Executive branch agencies, too many Congressional Committees and subcommittees, go through too many steps each year, until it seems that no decision on spending and tax policy ever is final. The process is replete with duplication, overlap and redundancy. Complexity compounded by confusion undermines accountability. We speak of so-called "uncontrollable spending" as if those federal outlays resulted from natural laws rather than statutes enacted right here on Capitol Hill.

The thrust of the BEST bill is two-fold: make government and the budget process more accountable: and use public accountability to encourage Congress and the President to live up to the promises made in the budget process every year.

* We need to be concerned about government accountability. The polling booth is the market clearing house of democracy. When government becomes so complex that concerned voters, willing to spend a reasonable amount of time, cannot understand the Federal budget, the system breaks down.

* Public accountability is the most effective instrument we know to assure government accountability. Congress and the Administration often fail to live within the budgets we currently adopt. Passage of the BEST bill would make it very difficult <u>not</u> to live up to what we promise.

I am convinced that real, binding spending limits hold the key to serious budgetary restraint. We can balance the budget any number of ways, but we never will balance the budget unless we agree that there is an amount of money more than which we will not spend, and stay within that limit we have set on spending. To keep spending within binding limits, we should adopt automatic reductions similar to sequestration under the Budget Enforcement Act. This means extending the concept of caps to the entitlements and other mandatory spending in the budget. I believe we should hold individual committees and subcommittees responsible for excess spending in their jurisdictions. And we should force a separate vote any time we want to raise the spending limits in the budget.

This system will work because our constituents will understand it. And that is where public accountability comes into play. Nothing here would keep Congress and the President from "busting the budget". But if we do bust the budget, under this system, the media will know and our constituents will understand, whom to hold accountable. That is the best, most healthy kind of enforcement mechanism in our system of government.

Mr. HORN. Thank you very much.

Does the gentleman from Virginia have any questions of the witness?

Mr. DAVIS. No questions.

Mr. HORN. Let me ask you a couple of questions.

You advocate the 2-year budget. Does that create problems with some departments such as defense when you have a constant change, a substitution of weapons systems, this type of thing? How would you handle that?

Mr. BARTON. Mr. Chairman, we actually require that the budget be submitted for three 2-year cycles so the President would submit 6 calendar years, three budget cycles, of budgets when he submits his budget so that you are always looking out for the 2 years that you are about to vote on, plus two more 2-year cycles. So a multiyear program, like an aircraft carrier or a weapons system, would be budgeted for 6 years and we think that would be sufficient.

Mr. HORN. On the prospect of reprogramming authority, which some of the authorization committees do give to the agencies for which they are responsible, do you think the President should have a basic reprogramming authority within certain firewalls?

For example, the traditional problem is presumably Republican Presidents want more less defense and less social programs and Democratic Presidents want more social programs, less defense. So you maybe have certain minimums or maximums they could not move money between them but within a given budget category, should they have that authority to reprogram?

Mr. BARTON. Our bill, Mr. Chairman, is silent on that. Within any given program area, we would continue existing law. If the President wants to reprogram from one particular area to another budget function, he would have to come to the Congress for that authority. And, as a Member of the House, I would support that he would continue, he or she, would continue to have to come to the Congress. But our bill is silent on reprogramming.

It does say, though, we have sequestration for any program that spends over $20 billion and we have spending caps for any program that spends over $20 billion including the entitlements, so we would make it very difficult without acts of Congress to move money between programs that spend over $20 billion.

Mr. HORN. How do you feel about the reconciliation process as it is now working? Do you think that needs substantial change?

Mr. BARTON. I think it does. I have to say, though, that if the current system, if you are going to keep the current system, reconciliation is the one thing we have that does force change. It forces the appropriation committee and the authorizing committee to work with the budget committee and the Ways and Means Committee to come up with real change when there have been votes earlier in the year that such changes have to occur.

Mr. HORN. Your bill certainly addresses one of the key problems, which is the entitlement situation. As you know, some of the Federal courts have ruled that you cannot simply cut a percentage, as any State Governor would and does, to balance the budget; that you have to go and give specific directions on how a Cabinet officer will reduce that program.

Mr. BARTON. Well, there are a number of provisions out in different bills for entitlements. There is one bill that eliminates entitlements. I do not do that. I maintain the entitlement programs and we do not per se cut the entitlements. We maintain that it is an entitlement, but we do subject it to some budget discipline because we do allow an inflation adjustment for entitlements and a population growth adjustment, but anything above that would be subject to sequestration if the entitlement program spends more than $20 billion. So we do not go down on entitlements, we do not try to cut them, but we do try to prevent them from out-of-control growth, above inflation and population, and I think that is one of the advantages of our approach compared to some of the other approaches that are out there.

Mr. HORN. Well, there is no question, if you could get away with capping entitlements you would get some of the budget under control, but the question comes, "Will the courts let us do that?" And I think that is still pretty murky.

Mr. BARTON. I would give a qualified—in fact, I would almost make it unqualified, that the approach that is in the BEST bill is sure to withstand any court challenge. I mean, because we are not—again, we are not eliminating the entitlement, but I do not think there is anything in the Constitution that allows program managers and Presidents to continue to expand the programs beyond the intent of the Congress.

Mr. HORN. Yes. I would hope you are right, but I sometimes wonder on some of the decisions that have been made by district courts.

Well, if there are no further questions, we thank you very much.

Mr. BARTON. Thank you, Mr. Chairman.

Mr. HORN. I know you have a hearing to preside over and you are going to make it.

Mr. BARTON. Yes. I appreciate that.

Mr. HORN. Next is the distinguished Member from Michigan, Mr. Smith, expert on the public debt, the national debt and all debts. Welcome.

STATEMENT OF HON. NICK SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. SMITH OF MICHIGAN. Mr. Chairman and members of the committee, thank you. I brought my handy chart here that I will just hold up with your permission.

I appreciate the willingness of you, Mr. Chairman, and the committee to hear out some of the concern of the Members.

Last session, I did introduce a budget reform bill but today rather than address the particulars of budget reform, I would like to address the larger issue of some of the reasons that we do need budget reform to regain congressional control over spending.

I now serve as chairman of the Speaker's House Task Force on the Debt Limit and the Misuse of Trust Funds. One of the major conclusions of the task force has been that Congress has to re-establish its direct control over spending in this country.

In the Constitution, Article 1, Section IX of the Constitution gives the Congress the authority and control over the purse strings of this country. We have in effect lost that control as we see more and more of the spending being on, if you will, automatic pilot. That is where, Mr. Chairman, I would like to hold up my chart.

We made this chart to visually demonstrate what Congress now has control of in spending. I have separated the discretionary spending into defense and nondefense because as we look at the last 40 years, we see that the hawks and the doves, liberals and conservatives, have very rarely been more than plus or minus 8 percent deviation apart in defense spending. So defense spending is pretty much on automatic pilot.

What Congress has control of is the little red piece of pie representing 18 percent of the budget. That is the 12 appropriation bills where if these appropriation bills are not passed by Congress or passed at a lower spending level by Congress or not signed by the President do not go into effect.

The white triangle represents the net interest on the debt. Net interest on the debt this current fiscal year is $233 billion. Interest on the gross debt, or including the interest that is owed to Social Security Trust Funds and the other trust funds is approximately another $90 billion, so our interest on the debt this year, if you include the interest that we owed Social Security, was the largest expenditure item of the U.S. Congress.

Now, the reason for the chart is the blue area at the bottom. That represents 50 percent of government spending and that is the welfare and entitlement programs. In 1995, Congress had control over 90 percent of the total spending. Now we have control over only one-third of Federal spending. And so we have relinquished our power to the administrative branch of Government.

I think that is good for the chart. Thank you.

Mr. HORN. I wonder if we could get some copies made of that in color for the Members. I think that would be handy for all Members, frankly, to walk around and have those recent figures.

Mr. SMITH OF MICHIGAN. OK. We also have the charts for the current fiscal year, we just have not put them in color yet, but we will do that hopefully by the time we conclude this.

Mr. HORN. Even if they were 8½ by 11 for small meetings, you could pass it around or whatever, but I think we do need the accurate figures and what I am particularly impressed with is the fact that you are including the interest on the Social Security trust funds and other governmental trust funds from which all Presidents have borrowed and that is the one that nobody ever talks about.

Mr. SMITH OF MICHIGAN. Yes.

Mr. HORN. What you are talking about is $323 billion interest tab.

Mr. SMITH OF MICHIGAN. Because there is an inextricable link between the entitlement and welfare programs and how much government spends, therefore there is an inextricable link to the entitlement programs and how deep we go in debt. I think there is an absolute tie between increasing the debt ceiling and trying to regain some control by Congress over that part of the budget that is now on automatic pilot.

And I would suggest, Mr. Chairman, Mr. Davis, that it is not a partisan issue. It is a question of how much should we regain control of our constitutional responsibility to control spending. I think it is important.

As we look at Article 1, Section VII of the Constitution, we see Congress has a control over the borrowing and how deep we go in debt. Tomorrow, this Congress is going to be asked to increase yet again the debt ceiling for the 78th time since the 1940's. And it is reasonable, I think, to include in that discussion the fact that we want to put some controls on the increase in the entitlement programs of this budget.

There is no possible way, I have studied this for the last 3 years, Mr. Chairman, there is no possible way that we can reduce the discretionary spending in these 12 appropriation bills to ever accommodate a balanced budget. The only way you can possibly get to a balanced budget is to make some changes in the so-called welfare entitlement programs.

One obvious solution, I think, is to reinstate the ability of Congress to substantially control the budget process, either on a year-to-year or, as was mentioned by the previous witness, on a 2-year to 2-year basis.

Our debt limit task force report recommended pursuit of reform in the budget process to restore Congress' authority over the issuance of debt.

I know you, Mr. Chairman, have spoken several times and have researched the problem of the debt that we owe, in addition to the traditional summation or additions of annual deficits of our current debt that is now $4.9 trillion, plus what Secretary Rubin again has discovered that he can take more congressional control over the debt ceiling by using certain gimmicks of Treasury to add to the Federal debt, such as under-investing or dis-investing the trust funds or selling some of the assets of the Federal Government.

I think it is incumbent on this Congress, Republicans and Democrats, to try to gain some congressional control over spending and that is why this needs to be considered, I think, Mr. Chairman, in budget reform.

In those other areas that you have mentioned, Steve, in our office, we figure that there is a $1.5 trillion unfunded liability in the Federal retirement system. My office has calculated that the net present value of the unfunded Medicare program, the unfunded liability in Medicare is $6.7 trillion. This is using a 2.3 percent discount rate.

Also with a 2.3 discount rate we figured that the unfunded liability of Social Security is $3.85 trillion, so it is not just the $4.9 that we need to be concerned about, it is the tremendous over-obligations that we have made in an effort to convince people that we are doing the right thing for people so we have over-committed ourselves in many areas.

In conclusion, Mr. Chairman, I think your committee is taking on a vitally important task and we did not lose our congressional power overnight. It has been given away piecemeal.

My personal opinion is that in this budget reform discussion, a bill that is coming up tomorrow to increase the debt limit, includes giving the President line item veto authority. But when you examine this somewhat more closely, you see that again it is a relinquishing of power by Congress to the administrative branch.

I served under three Governors in Michigan all having line item veto authority. In every case, even the conservative Governors used their line item veto leverage to encourage the legislative branch to spend more money. So I think it is a very serious problem as we try to achieve a balanced budget, as we try to look at generational accounting or, if you will, generational impact statements to see what our current actions are doing to future generations. It is important that these matters, I think, be included in the discussions and thought of how we reform our budget process.

Thank you.

[The prepared statement of Hon. Nick Smith follows:]

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COMMITTEE ON THE BUDGET
COMMITTEE ON AGRICULTURE

Congress of the United States
House of Representatives
Washington, DC 20515–2207

Testimony of Congressman Nick Smith before the Subcommittee on Government Management, Information and Technology, Committee on Government Reform and Oversight

March 27, 1996

Mr Chairman, members of the committee:

Thank you for the opportunity to come before you today. Rather than address the particulars of a budget process reform bill, I would like to address the larger issue of why we need budget reform.

I served as Chairman of the House Task Force on the Debt Limit and Misuse of the Trust Funds. One of the major conclusion of the task force was that Congress has given up much of its direct control of the appropriations process, an enumerated power given to Congress under Article !, Section IX, of the Constitution. This is because over the years we have allowed so called "mandatory spending" to become a major portion of the budget. Annual appropriations bills in 1955 accounted for nearly 9/10 of federal outlays. Today, only about 1/3 of the budget is discretionary. Under current law, using the December baseline, in 2002 discretionary spending will be less than 30% of the budget. Although it is true that through budget reconciliation Congress does authorize mandatory spending, and can thus make changes, Congress recently offered such legislation under the guise of the Balanced Budget Act of 1995. This legislation was vetoed by the President. Unlike an appropriations bill, which if vetoed results in no spending and no additional debt, a veto of changes in mandatory spending results in continued spending under the old program. This means that, in the case of mandatory spending, Congress cannot affect a change in its spending patterns without either a two-thirds majority, or the consent of the President.

Because there is an inextricable link between the entitlement programs and the future spending of the federal government, there is an inextricable link between the budget bills and another enumerated power of Congress--the power to "borrow money on the credit of the United States," as found in Article I, Section VIII of our constitution. Because the amount of debt that will be needed in the future is directly related to the amount of spending that will occur, we can only gain control over our debt issuance if we can gan control over spending. This means that budget reform is crucial to the separation of power between the executive and legislative branches.

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One obvious solution to this is to reinstate the ability of Congress to substantially control the appropriations process on a year-to-year basis. The Debt Limit Task Force Report recommended pursuit of reform of the budget process to restore Congress' authority over the issuance of debt. We have raised the debt limit 77 times since 1940. We are going to be asked to raised it a 78th time later this week. The primary reason that there is so much pressure to increase the debt limit is because we must finance prior spending. This means that the debt limit has been reduced from a true Congressional authority over the amount of borrowing this country will undertake, to leverage for enacting changes in the entitlement programs.

In addition to the $4.9 trillion debt subject to the limit, there is a $1.5 trillion unfunded liability in the federal retirement system. My office has calculated the net present value of the unfunded liability of the Medicare program at $6.7 trillion, using a 2.3% discount rate and official assumptions. We have calculated the net present value of the unfunded Social Security liability as $3.853 trillion using the assumptions of the Social Security Administration and a discount rate of 2.3%. As you are aware, Mr. Chairman, these are the entitlement programs which are driving a large amount of our spending. I will shortly be introducing a bill which has been scored by the Social Security Administration as making the Social Security system solvent and allowing for a private account for each retiree. I know you are very interested in this area and I look forward to discussing this with you.

Your committee is taking on a vital and difficult task. We did not lose our Congressional power overnight. As I mentioned earlier, fifty years ago annual appropriations covered ninety percent of what were spending. I hope it will not take us fifty years to regain what we have lost. This is not a partisan issue. It is not even an issue about what the proper size of government is, or the that we are going to spend. This is a consitutinal issue. Democrats and Republicans should be concerned about which branch of government is going to control the spending and borrowing power of our national government. I wish you all the best in your efforts at restoring the balanced government that the fo'unding fathers intended.

Mr. HORN. Let me just put an exhibit in the record at this point on this discussion. We will not hold you responsible for it, we will hold me responsible for it. But our estimate is that there is $50 trillion in potential liabilities, unfunded, at this point using the Social Security formula but applying it to all of the entitlements and everything else you can think of where the Federal Government has an obligation. So we are going to put that in the record at this point and now I yield to the gentleman from Virginia, Mr. Davis.

Mr. SMITH OF MICHIGAN. May I ask a question?

Mr. HORN. Yes.

Mr. SMITH OF MICHIGAN. Does that include, Mr. Chairman, the legislation that was recently passed several years ago in terms of making private pension funds whole in the case they become insolvent?

Mr. HORN. It does include it, I am informed by staff. Yes.

The gentleman from Virginia.

Mr. DAVIS. Nick, I know you have given this a lot of thought through time. A better way to portray the budget deficit and what it is doing to the country today is to talk about of every tax dollar what percent is going to pay for interest on the national debt. And when you take out the surpluses that created through Social Security and others, it is almost 20 cents on the dollar.

Mr. SMITH OF MICHIGAN. Yes.

Mr. DAVIS. So no wonder people do not feel they are getting their money's worth from government, when 20 cents or nearly 20 cents is getting taken off the top to pay for the excesses of the previous generation, and that is going up. So when you raise taxes, you are only getting 80 percent value at best. Would you agree with that?

Mr. SMITH OF MICHIGAN. Well, with the new attitude to balance the budget, actually, we will see interest on the Federal debt increase slightly but what increases even faster is the entitlement programs. So the entitlement programs increase slightly faster than the interest on the debt but exactly the point you are making, it eats up more of the budget and leaves less for the things that government should do.

Mr. DAVIS. If you took out the interest on the debt today, we could balance.

Mr. SMITH OF MICHIGAN. Yes.

Mr. DAVIS. If we were not saddled with, though, the spending from previous generations——

Mr. SMITH OF MICHIGAN. Yes.

Mr. DAVIS [continuing]. Then that would mean money in taxpayers' pockets and be able to fund some of these programs.

Mr. SMITH OF MICHIGAN. Yes. Some other countries have talked about monetizing the debt. We have talked about it here. You are aware of the negatives of monetizing the debt or printing more money.

Mr. DAVIS. It is just easier to get some fiscal discipline into the process and do it the hard way, like you do in business or anything else.

The other thing, it seems to me is that if you have to live within your budget, you set different priorities than if you do not worry about it. And what has bothered me for some time is that we have not had to make hard decisions because we just add a little bit at the end of the road every year and the debt keeps piling up, so we are not getting the most efficient decisions out based on a priority basis, because we run away from that because of this huge entitlement spending that is kind of—that we do not address directly.

Any other suggestions for how we can address the entitlement reform? These are automatic escalators, they seem to be on autopilot every year and the President and Congress just kind of walk away from it. It means that we are putting more pressure on the discretionary side of the House and you can only squeeze that so far. It is not getting answered.

Mr. SMITH OF MICHIGAN. Well, maybe it is because I have four grandchildren and I keep their picture on my wall and I look at the grandchildren every time I go out to make a vote, every vote is a transfer of wealth. There is no question that most American people do not feel the impact and their responsibility for the huge debt load that we have accumulated. It has been an easy way to expand Government and services without having the negative impact of paying taxes.

Borrowing has obscured the true size of Government. If we had to pay taxes for this size of Government, there would be a revolt among taxpayers.

Now the complications as you suggest, Mr. Davis, of simply the interest and the price of servicing that debt is becoming so awesome that it is forcing us to step back and look at the reasonableness of changes in our budget process.

Mr. DAVIS. I thank the gentleman for his leadership on this issue and your testimony today.

Mr. SMITH OF MICHIGAN. Thank you.

Mr. DAVIS. Thank you.

I yield back.

Mr. HORN. I thank the gentleman. I do not have four grandchildren but as of last Friday I have the first grandchild.

Mr. SMITH OF MICHIGAN. I thought you looked a little older.

Mr. HORN. So I am going to put his picture on the wall.

One more question. The freeze. You and I have talked about that over the several years we have been here. The way Governors solve their budget problems is often to level an across-the-board freeze on State expenditures. Governor Deukmejian solved that when a billion dollar deficit was left by Governor Jerry Brown. He solved it in 45 minutes of taking the oath. All State agencies had to give back 2.5 percent of the budget for the year and since we had gone through half a year already and Government is labor intensive, we gave back 5 percent of the remainder of the budget for the last 6 months. The deficit was solved.

Governor Wilson inherited a deficit from Governor Deukmejian that was much greater because of the collapse of the economy in 1988 through 1994 and he had more difficulty in closing the $15 billion gap in a $60 billion budget and that took a lot more legislation.

But generally State Governors balance their budget that way. Why cannot the President of the United States and Congress balance the budget that way? Have you given it some thought?

Mr. SMITH OF MICHIGAN. I think it is gaining greater credibility, Mr. Chairman. I know you have advocated this process. Picking out different areas to have greater cuts has ended in the vulnerability of demigoging those particular interest groups that are receiving those funds. If we were to say that just assume for 2 years that our spending is reasonable in terms of the prorating of available dollars and simply cut back on a freeze, even accounting for the growth in populations of Social Security, Medicare and even the Medicaid and welfare programs, accounting, even allowing for the increased population, I think it still figures out that we could balance the budget in something like a year and a half with a freeze.

Mr. HORN. Well, it would be pretty tough. We would have to go maybe more than a year and a half.

Mr. SMITH OF MICHIGAN. Right now, revenues, if I am not mistaken, lag behind expenditures about 3 years.

Mr. HORN. Right.

Mr. SMITH OF MICHIGAN. In other words, if we could simply freeze spending for 3 years——

Mr. HORN. Then there would be catch-up with the revenue. Yes. And, of course, I think the other point which is very important is while people might be upset that you have frozen their account, they say, well, I do not like it but they did it to everybody and at least it is perceived as fair. Whereas the sort of who is in the room at midnight philosophy that some of our current budget decisions are made are not perceived as fair, by me and by a lot of Members of this House in both parties.

So I am going to put in the record at this point a copy of H.R. 1099 of the 103d Congress and its various co-authors, which include the current Speaker of the House and the current majority leader of the House. I am not saying they would be for it now. Responsibility does strange things to people. So we will see, but it is something we ought to be considering, I think. So, without objection, that is going in the record.

[Note.—The information can be found in subcommittee files.]

Mr. HORN. Thank you very much, Nick. We appreciate it. You are really dedicated and we appreciate all your knowledge in this area.

Mr. SMITH OF MICHIGAN. Thank you, Mr. Chairman, Mr. Davis and members of the committee.

Mr. HORN. We are now delighted to welcome the distinguished chairman of the House Republican Policy Committee, Chris Cox of California, who has probably spent more time on the budget process and reform of it than any other Member of Congress. And he has even drafted his own portions of the bill rather than leave it solely to a legislative counsel, so welcome.

STATEMENT OF HON. CHRISTOPHER COX, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. COX. Good morning, Mr. Chairman. I am sure that you and I are two of the earliest Californians to return to Washington after yesterday and last night's elections.

Mr. HORN. I hope we won. I have not checked yet. I think we have. I was unopposed, so I think we have.

Mr. COX. I certainly hope we did, since there was no one else on the ballot.

I want to begin by congratulating you and our colleague Congressman Davis because it is important that we spend time on this. It is important that we make this a priority. There are so many things that we can spend our days with in Congress. Nothing, and I mean that precisely, is more important to our constituents, to the country and to our responsibility than this issue.

This year, 1996, as it happens marks the 75th anniversary of the 1921 Budget and Accounting Act. That was the Nation's first comprehensive budget process. It gave us the Bureau of the Budget and the General Accounting Office for the purpose of improving oversight of Federal spending and bringing discipline to the annual budget process.

Like 1921, 75 years ago, 1996 can be and by rights ought to be a watershed year in bringing discipline to the budget process. That is because the current political circumstance offers a unique opportunity. No better illustration could be imagined of the need for an overall reform of the budget process than what we have just lived through 1995.

The current budget system suffers from the following deficiencies.

First, it is complex, it is understandable only to a handful of experts inside the beltway. That handful of experts indeed excludes most Members of the Senate and the House of Representatives.

Second, it discourages cooperation and early consultation between the legislative and executive branches, between the Congress and the White House. Instead, the President's budget, through all the permutations of a Democratic White House and a Republican Congress, Republican White House and Democratic Congress and on and on, the budget has been declared dead on arrival. The President's latest budget is no different. It was dismissed as a nonbinding political statement.

The third thing that is wrong with our budget process is that it puts off limits a significant majority of spending. It is not considered in the annual budget process. It is deemed, therefore, uncontrollable spending even though it is just uncontrolled.

Fourth, when we pass a budget in the Congress, it is not binding. The budget itself is not an external discipline on the subsequent spending decisions.

And, finally, our current system as we now know so well provides no safeguard against the very real contingency that the President and the Congress do not come to an overall agreement. No safeguard against government shutdowns.

Madison said, "If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary." Obviously this Congress is not comprised of angels. Our government is only as good as the people that we represent and, as Madison recognized and people have recognized for millennia, men and women are not angels. We do need external controls.

I was very interested in the conversation that the three of you Members just had, including Representative Smith, about the parts of the government's budget that are running out of control, the parts that need to be reined in and so on. I have in this budget process exercise found it essential to discriminate between the numbers and the process that we use to arrive at those numbers.

We may or may not be spending too much on entitlements. I think most people in fact have focused on that, rightly so, but I do not think you need to answer that question in order to do a proper job of budget process reform.

We may or may not be spending too much on defense. We may or may not be spending too much on welfare. And, frankly, for purposes of reforming the budget process, I do not care. I do not think a proper budget process reform act will include numbers. It will not tell the Congress to spend more or less on guns or butter. I will not tell the Congress you have got to cap your entitlements at this level or that level because those are the decisions that the people's Representatives ought to be making in their exercise of the power of the purse.

What the budget process reform exercise should be all about is rationalizing that process because right now it is so irrational. Much of it, in fact, is on autopilot.

And I want to congratulate you, Mr. Chairman, for the work that I know you have been doing on marshalling all of the different proposals for budget process reform and making a very thorough going exercise of this because that is what is required now that we have this unique opportunity and I would just like to stress a couple of things that I think are vitally important if we are to get a grip on this.

The first of those two is that we have got to make macroeconomic decisions first. In the budget system that we presently employ, we do not make macroeconomic decisions. We cannot. We go immediately to the substance of the program under discussion. Should we spend more or less on Medicare? That is a programmatic decision, it is a very important one, but it has not nearly enough to do with the macroeconomic decision about the budget overall.

We hear an awful lot about budget cuts and yet government spending is going up and up and up and up. So without prejudicing even that discussion, maybe government spending ought to be going up and up and up, it is just merely obvious that when people are talking about budget cuts, they are not talking about macroeconomics because in the macro picture government spending is getting bigger.

We have got to have some part of our budget discussion, and it ought to be the up front part, focused on the macroeconomic picture and the truth is if you are trying to forge an agreement among people from all over the country, from different States with different parochial interests, different partisan interests and so on, the only way that you are likely to do that in a $1.8 trillion budget is to start with the big picture first and say, all right, here is what we have, here is what we are going to spend, let us fix our sights on this amount of money and divide up this pie. And take a vote first on that big budget. Later on get to the issue of whose ox is going to be gored.

In the Budget Process Reform Act that, as you know, I have introduced in past Congresses and will soon introduce again——

Mr. HORN. I might add that that has formed the basis for the document before this subcommittee.

Mr. COX. And I have had a chance to look at a discussion draft that we got from the committee and I am thrilled by it. I think it is wonderful and I am in wholehearted support.

What we have done in that Budget Process Reform Act in the past and what I will continue to press for in the future is focus on a one-page budget. That sounds like a gimmick, put the whole budget on the United States on one page, but the truth is that the concurrent resolution on the budget that we already passed is one page long, so we are not inventing anything new here, we are simply investing it with new meaning.

The one-page budget, no more detail, just that one page and the 19 functions of the Federal Government that it comprises, will be passed in the form of a law and sent to the President for his signature or veto.

Mr. DAVIS. At least Members would read it if it was one page, right?

Mr. COX. It has been referred to in some——

Mr. HORN. With aid.

Mr. COX [continuing]. Humorous articles as congressional length.

Mr. HORN. Well, let me ask you right on that point.

Mr. COX. Yes.

Mr. HORN. As you know, when the Office of Management and Budget reviews and prepares the Executive Budget submitted by the President, there are basically five categories that they deal with in programmatic areas such as national security, which would involve Defense, State, International Operations, so forth and so on. I remember once when I did a book on the Senate appropriations process 30 years ago I suggested maybe we ought to be thinking in our subcommittee structure of the same five categories and give it that type of intensive scrutiny where you have integrated like programs, either on community development, urban renewal, so forth.

Right now, as you know, and this is historic, we have basically 13, sometimes 14, subcommittees on each side of the rotunda that are the subcommittees of the Committee on Appropriations. So when the President has combined and his staff has combined all these basic functions, broken their budget down that way, what do we do? We split it up into our historic 13, 14, as the case may be, subcommittees.

I mean, should we look at that part as a way to get integration in the budget in some places and the aggregate that? I mean, they are doing it with five areas, basically, we are doing it with 13, some of which is a hodgepodge and does not even match the Senate. And the authorization committees, sometimes as you know, being on Commerce, do not match the Senate.

Mr. COX. We should look at that. We should fix it, in fact. Rationalizing the categories into which we divide our Federal spending is a very common sense approach to budget process reform.

The way that the Appropriations Committee divides up its spending responsibilities into subcommittees, the way the Senate does it slightly differently, the way the executive branch does it a third way, are heavily institutionalized parts of Washington.

As you know from our experience watching the bipartisan, bicameral commission on reform of the Congress itself, it is very difficult to, at the end of the day, succeed in altering the way the Congress organizes itself. Trying to do both chambers at the same time and trying to rope the executive into it and perhaps to change it as well, is thus the most difficult task that one could take on.

I am all for it. I have discussed this in recent days, in fact, in going over the latest iteration of the Budget Process Reform Act, asking myself whether we should not reorder the functions into which Congress divides the budget, the House, the functions into which the President divides it, and match them all up. They ought to all be the same. But because that confronts directly the Appropriations Committee structure——

Mr. HORN. There would be eight fewer cardinals.

Mr. COX. Yes.

Mr. HORN. Cardinals do not give up power easily.

Mr. COX. And because it confronts directly the way the Senate organizes itself, my suggestion would be that we take that up in a free-standing bill so that if somebody hits it with a cannonball the whole ship of budget process reform is not sunk.

Mr. HORN. Right. I agree.

Well, as you know, the only time this place has reformed itself in the 20th century, they will cite other dates, but they are baloney, is the Legislative Reorganization Act of 1946. It was simply amazing, cutting from 80 committees down to 17 or so. People had to give up chairmanships. And by chance, there was a change in power so what happened in a Democratic Congress was implemented in a Republican congress, the 80th Congress. And, by and large, it worked.

Mr. COX. Well, I suspect that the next time that men and women in Congress are chastened and humbled by the experience of a world war that they may well find it within their imagination to reorganize the Congress.

Mr. HORN. Yes.

Well, Mr. Davis, do you have any questions?

Mr. DAVIS. I just had one question. I was looking at the bullets in terms of some of the changes you would make and one of them talked about to avoid further shutdowns that if Congress and the President could not agree, you would get an automatic CR at the level of the year before. But does that not dictate a winner in the contest if we are talking about times when discretionary spending may be cut? In point of fact, if you play that out, the side, whether congressional or executive, that does not want the change and does not want the cuts ultimately wins by having a deadlock.

Mr. COX. That would be true in the current environment where the CR does not reach more than half of Federal spending, but in the context of the Budget Process Reform Act, there is no longer any such thing as blank check spending. The whole category of permanent indefinite appropriations is abolished so that every single Federal program has to be voted on each year by the Congress. That means that all of the Federal budget, 100 percent of it, is included in the CR and if you were talking about a hard freeze at current levels, you would be talking about what by Washington parlance these days has meant a cut of significant magnitude.

When I explained this to Alice Rivlin in her office a few months ago, having read the bill, she made the comment that you did, should we not have a CR at 90 percent or what have you. When I told her that it was 100 percent of the government, she did not press the point at all. She recognized that that is a much deeper cut than—a "cut," I want to put that in quotations for the record because by definition it is a hard freeze, not a cut, but it is considered in Washington to be a substantial cut.

Mr. DAVIS. So it is not just appropriated funds from the appropriation bills at this point.

Mr. COX. It includes the over half of the budget that right now is off limits.

Mr. DAVIS. OK. Thank you.

Mr. HORN. I thank the gentleman and I thank you very much.

Mr. COX. Mr. Chairman, I just want in conclusion to thank you for including in the discussion draft that is before your committee the following items: A two-thirds requirement to enforce over-budget spending, just to reiterate, the Congress ought to be able to do whatever it wants by majority vote, but if a budget is to have any meaning, if we are to be serious about living within a budget, then we have to make it more difficult for ourselves to break that budget, at least within the same year.

You have line item reduction, which is going to be very important even after we pass the line item veto in the next few days. Line item reduction is going to give the President the added power to pare back over-budget spending to the level originally set by the Congress in its own budget.

And then, finally, the point that Mr. Davis and I were just discussing now, the prohibition of blank check appropriations. As long as we have the concept of a blank check, such sums as may be necessary, we will not have a budget.

[The prepared statement of Hon. Christopher Cox follows:]

MARCH 27, 1996
TESTIMONY OF REP. CHRISTOPHER COX
BEFORE THE GOVERNMENT REFORM AND OVERSIGHT
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT

Thank you, Mr. Chairman, for holding this important hearing today on the urgent need to overhaul Congress's badly-broken budget process.

1996 marks the 75th anniversary of enactment of the Budget and Accounting Act of 1921. This Act--the nation's first comprehensive budget process law--created the Bureau of the Budget and the General Accounting Office in order to improve oversight of federal spending and to bring more discipline to the annual budget process.

Like 1921, 1996 could also be a landmark year for bringing discipline to the federal budget-making system.

That's because the current political circumstances present a unique opportunity to change the deeply-flawed budget process so that it will help, rather than hinder, efforts to bring the federal budget into balance. This has become all the more apparent in the wake of the collapse of budget negotiations, as both Congress and the President have come to realize the distinct disadvantages of a system that:

- Is complex and understandable only to a handful of experts "inside the Beltway".
- Discourages early consultation and cooperation between Congress and the White House. Instead, the President's budget is derided as "dead on arrival," and Congress' budget is dismissed as a non-binding political statement.
- Allows two-thirds of the budget--those programs arbitrarily deemed "uncontrollable"--to escape the discipline of annual budget review.
- Fails to produce binding decisions on overall budget levels early in the budgeting year.
- Provides no safeguard against the contingency that Congress and the White House fail to agree on a budget by October 1.

Mr. Chairman, James Madison once famously said: "If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary." It was the genius of the framers of our Constitution that they did not rely on the self-abnegation of American politicians.

This past year's budget battle has made it clear to the American people (if ever there was any doubt) that members of Congress are no angels. It is clearer than ever that we need a budget-making system that reflects the framers' realism about human nature and political organization. We need a budget process that will ensure that even if individual legislators aren't all fiscally responsible, the Congress overall will be.

This is the aim of the Budget Process Reform Act. From my days as a Counsel in President Reagan's White House through my efforts as co-chairman of the Task Force on Budget Process Reform, I have drawn upon the experience and ideas of Republican and Democrat Administration officials, congressional leaders, and academic experts in drafting this legislation. In the last Congress, more than 200 members of the House and Senate--including the distinguished Chairman of this panel--had signed on as co-sponsors.

The hallmarks of the Budget Process Reform Act are clarity, evenhandedness regarding the role of the President and Congress, and strict discipline. I've prepared a more detailed summary of the bill for the record, but in the brief time I have remaining I'd like to focus on two particularly important elements of my bill which fall within the jurisdiction of this Committee: making the budget resolution a binding law, and establishing line item reduction as a specific means of enforcing the budget law.

- o Budget First; Spend Second.

The Budget Process Reform Act would require that Congress enact a legally binding budget (in the form of a joint, rather than a concurrent resolution) by April 15 of each year. Until the budget is signed into law, no authorization or appropriations bill could come to the House or the Senate floor, or before any committee. The Budget Process Reform Act also calls for a budget that will fit on a single page--setting specified ceilings on government spending for each of 19 summary functional categories currently used. The President's detailed, phone book-sized budget submission will not come until 15 days after enactment of the one-page budget.

A simplified and binding budget law will do much to promote consultation and cooperation, early in the budget year, between Congress and the President. Since the budget debate will focus at a higher level of abstraction--specifically, on the total spending in each of the 19 functional categories--it is much more likely that the Congress and the President will be able to agree on how much the federal government should spend in the ensuing fiscal year.

- o Line Item Reduction.

The Budget Process Reform Act will also give the President "enhanced rescission authority"--that is, the authority to rescind spending in excess of the budget ceilings. This "line-item reduction" authority is applicable only to the over-budget portion of the proposed spending. The President would also get the same authority to cut back any spending in excess of the previous year's levels in the event that Congress failed to adopt any budget at all.

This "line item reduction" authority is thus quite different from the "line item veto" power that Congress is expected to approve later this week as part of the debt ceiling extension. It serves an entirely different function: to enforce the budget law. As such, the scope of this power is severely limited.

And because it's designed as a means of enforcing the budget law, it does not raise difficult questions of constitutionality. In fact, to maintain the integrity of congressional control over the legislative process, the Budget Process Reform Act designates the Congressional Budget Office--not the Office of Management and Budget--as the "scorekeeper" for determining whether particular authorization and appropriations measures are consistent with the budget ceilings.

In addition to this "line item reduction" authority, I have written into the Budget Process Reform Act a number of other enforcement mechanisms which will, in effect, lock the door on all the exits--and deny Congress and the President the tools to pick the locks. In brief, these other enforcement mechanisms include:

- No More Budget Act Waivers.
- Supermajority Requirements. Congress would be permitted to enact spending legislation in excess of the budget ceilings only by a two-thirds vote of both houses.
- No More "Blank Checks." Fixed-dollar appropriations will be required for all so-called "entitlement" programs, except Social Security and interest on the national debt.
- Avoiding Government Shutdowns. If a budget law is not enacted by October 1, an automatic "continuing resolution" at the previous year's funding level will immediately take effect.

Through the Budget Process Reform Act, we will enforce the law. We will require cooperation between the President and Congress. We will bring entitlement programs under control. Above all, we will make the system clear and understandable to the people whose money we are spending.

Thank you again, Mr. Chairman, for giving me the opportunity to testify here today. I look forward to continuing to work with the members of this Subcommittee on the urgent task of reforming the institution of the United States Congress.

Mr. HORN. Let me just ask you on the waiver a bit. As you know now, the Rules Committee generally in its rule preceding most bills but particularly appropriations bills, they waive the rule of the House that says you cannot legislate on an appropriations bill so it is not subject to a point of order. Do you think that ought to be subjected to a two-thirds vote?

Mr. COX. I am sorry?

Mr. HORN. Do you think if in order to get a waiver so you can legislate on an appropriations bill, should that be subjected to a two-thirds vote, not just a majority vote, which is what you have when you pass the rule?

Mr. COX. I have not given that thought, frankly.

Mr. HORN. See, that is transferred and we have seen it time and again on the floor this year where the authorization committees have just been thrown out and the appropriations subcommittees have authorized on appropriations bills and they get away with it on the rule, once we vote the rule. Some of us have voted against the rule when that has happened but once you get the rule, you are home free, nobody can raise a point of order on the floor. And that is a real area of conflict between appropriation subcommittees and the full committee and the authorizing committee.

Mr. COX. I will give that serious thought. I had not expected after working on this issue for 10 years that I would get such a central question that I had not considered before, but it is a very good one.

Mr. HORN. Well, think about it.

Mr. COX. I guess my inclination would be that that is the sort of thing that would fit right into this bill.

Mr. HORN. Right.

Mr. COX. The prevention of that end run, by the way, passing out a rule that waives the Budget Process Reform Act itself, is a central enforcement mechanism. No committee of either the House or the Senate under the bill will have jurisdiction to grant a rule or a procedure that would waive the requirement that the only end run is a two-thirds floor vote.

Mr. HORN. Well, thank you again.

Mr. Crapo, we promised you to be here at 10 and you have been faithfully here and Mr. Smith, you are both welcome to come to the table, and I know you have probably other commitments. What is your set-up between the two of you? Is anybody yielding to the other? I do not want 2,000 illegal immigrants coming over just because you cannot testify.

OK. The distinguished gentleman from Idaho. Welcome. I know you are the author of the basic lock box proposal and we admire you for getting something through the House that makes a little progress, so congratulations.

STATEMENT OF HON. MICHAEL D. CRAPO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IDAHO

Mr. CRAPO. Well, thank you, Mr. Chairman, and I appreciate the opportunity to come before the committee to address the lock box. Before I do, let me thank you and the committee for the effort you are undertaking because among all the things that we are doing in Washington today, budget reform is probably the most important in my book. It is the driver of the engine of what types of changes need to be made in Washington and, as I look over some of the proposed changes you are considering, not just the lock box, but many of the others that you are considering, they are the kind of changes that need to be made in our budgetary system.

As you know, the lock box has been around—our efforts to put a lock box into place have been around now for about 2 years or more and we have actually passed it through the House three times with very sizable majorities. I think the highest vote we got was 373 or something in that neighborhood, but vast majorities in the House each time we have passed it, only to see it stall in the Senate in one way or another, one subject to a bill that was filibustered. The most recent effort which was in the Omnibus Budget Act of 1996 that we are still working on, it is in conference today as we speak but I understand that, surprisingly, the Senate appropriators are insisting that it be dropped out. And we will probably see the conference committee come back without the lock box provisions in it.

And that is not surprising because, as you know, the lock box places control over reallocation of moneys that have been cut by spending on the floor of the House and I just want to go back and share with you how this came to my attention.

I was sitting on the floor of the House when we were debating, I think it was the superconducting supercollider about 2 years ago, or more now, about 3 or 4 years now. But in any event, one of the Members of Congress was telling the other Member of Congress, two of them were debating, and one was saying, well, you supported a cut in a previous bill and now you are not supporting this cut and that is not consistent.

And the other Member of Congress responded saying you know very well that if we vote to eliminate this fund that is not going to reduce Federal spending by a dollar and that this money will simply be shifted into other spending.

And I was sitting on the floor when this took place and my ears perked up because that was not my understanding and so I started looking into, and after literally months of digging through and talking to budget experts, I found out how it worked and, as a matter of fact, that is exactly how it works.

Once the general budget is set, as you know, the appropriating committees, the 13 committees spend their allocated piece of the budget dollars and if we cut, reduce or in any way modify the spending on any of those bills, all that happens is that when they go into conference those items that we have addressed or cut are simply not allocated. They have not left the budget. We did not cut them from the budget, we simply changed the allocation from being allocated to one particular project to not being allocated. And they are simply reallocated in the conference committee and spent somewhere else.

When we brought the proposal for the lock box, which is to say that when we debated it on the floor of the House, and we cut or reduce spending, that the money goes into the lock box and then pours into the deficit, we faced serious and strong and continued opposition to that from those who would prefer to see the ability to shift money around and keep the system fluid, if you will.

I suppose an argument can be made that once we set the major budget that we ought to live within the parameters of that budget and that then all that is allocated in that budget should be spent. But if we have such a system, it should be honest with the American people and then when we vote to cut spending on the superconducting supercollider or anything else we ought to tell the American people we are not cutting this money in order to save spending, we are not reducing the deficit and we are not addressing budgetary needs. Instead, we are simply saying this item does not have the priority to justify our spending and we are going to shift it to some other spending.

What the lock box does is take it one step further and say that consistent with our rhetoric when we debate these measures, the spending will actually go into deficit reduction.

I think you know how the mechanism works, I will tell you very quickly. As the bills work their way through the House and the Senate, various accounts are kept. You could do it any way you want. The way we do it is an average between the two levels of the Senate and the House versions, is what is used to be poured into the lock box. And then in conference the appropriators have the flexibility across their budget authority, across all 13 subcommittees, to find ways to find those savings but they are required to find those savings in the budget.

I would quit there and just——

Mr. HORN. On that point let me ask you, because that is the main objection they have, is that you are limiting their flexibility in negotiations with the Senate.

Now, you are saying in a way you do not limit that. The House by majority vote has set a target of what needs to be reduced from that bill and they have a right to negotiate within that target.

Mr. CRAPO. That is correct. As the lock box was first drafted, you would have to actually have the reductions within the specific appropriations bill in which the vote took place. And that did limit the ability to shift around and to negotiate with the Senate on various matters.

But as we have drafted it in a compromise with the appropriators, they now have the ability across appropriations bills to negotiate across all 13 of the discretionary spending bills. Now, they do not have the discretion to go into entitlements, although I would be glad to do that if we could get the votes to do that. But right now, the one item of their discretion that they do not have is that somewhere in the discretionary budget they have to find the savings that we voted for. And if they cannot do that, then we have limited their discretion because then the money does go into deficit reduction.

Mr. HORN. I now yield to the gentleman from Virginia.

No questions?

I yield to the ranking minority member. We are glad to see you here.

Mrs. MALONEY. I am delighted to be here. I flew in this morning.

Thank you very much for your testimony. I would like to have my opening testimony submitted to the record, if I could, please?

Mr. HORN. Yes. It will be placed at the beginning where my opening comments were submitted as if read without objection.

Mrs. MALONEY. Thank you.

Mr. HORN. Any other questions?

Mrs. MALONEY. No.

Mr. HORN. Thank you very much. We appreciate all you have done on this.

Mr. CRAPO. Thank you.

Mr. HORN. And we now have the distinguished gentleman from Texas, who has recovered from any wounds he suffered last week in a brilliant job of legislative management.

Welcome.

Lamar Smith of Texas.

STATEMENT OF HON. LAMAR S. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. SMITH OF TEXAS. Thank you, Mr. Chairman. And I have recovered, though it did take a couple of days, but we did have in the end a good week.

Mr. Chairman, I thank you and my other colleagues for inviting me to today's hearing on the budget process reform.

As a member of the Budget Committee, I am pleased that you have decided to focus on the need to reform the flawed budget process. Our deficit and growing debt are as much the result of a broken process as they are the product of an unwillingness to make choices and set priorities.

The budget process, a product of the era of big government, is the problem and now that the era of big government is over, we must fix the budget process.

One of the most serious flaws of the current budget process is that it focuses on the next election at the expense of the next generation. For the past 30 years, Washington has adopted spend-now, pay-later budgeting. The Federal deficit and debt are the most obvious results of spend-now, pay-later but they are just the tip of the iceberg. More serious are the growth in Federal entitlements and programs, whose costs will be borne largely by our children and future generations.

Using generational accounting, we can measure the size and breadth of the entire iceberg, not just the tip. Generational accounting measures current spending in Government programs from the perspective of what they will cost our children, grandchildren and future generations in taxes.

Every program approved by Congress must be paid for by taking money away from families. With the coming retirement of the baby boomers and today's huge national debt, our children and grandchildren will be saddled with massive bills to pay for the promises that politicians make today.

Generational accounting measures net lifetime tax rate, the amount of taxes paid by Americans of different generations over the course of their lifetimes minus Government benefits they receive. Using generational accounting, we can determine the true size of the economic iceberg toward which our ship of state is heading.

While politicians may talk about the end of the era of big government, the huge bill for big government is still yet to come due.

Most of that bill will have to be paid by our children and grandchildren and by future generations.

Americans born at the turn of the century paid taxes of about 24 cents on every dollar they earned. If current spending trends continue, Americans born in 1950 are likely to pay about 33 cents on every dollar earned. And taxes will consume 37 cents of every dollar earned by Americans born in 1992. That is a 50 percent increase.

What is worse, the 50 percent increase between what our parents paid in taxes and today's newborns are likely to pay is the good news. The bad news, if current trends were to continue the net lifetime tax rate for future generations would more than double.

As amazing as that statistic sounds, the bad news gets even worse. Even if we balance the budget by 2002, the net lifetime tax rate for future generations will nearly double.

These statistics may sound unbelievable, but they are all based on other government statistics. These figures are based upon information from the Office of Management and Budget, U.S. Census, Social Security Administration, Health Care Financing Administration and other agencies.

What generational accounting vividly demonstrates is that current spending and Government programs are unsustainable in the long term. Generational accounting is useful because it vividly depicts the promises that politicians make today from the perspective of whether they will be sustainable and what they will cost tomorrow. They focus the budget process beyond the next election and to the next generation in order to avoid this coming disaster.

The economic collision that I have warned about this morning is far from inevitable. We can avoid this catastrophe if we simply change course. I am pleased to have introduced the Children's Right to Know Act, legislation that improves the budget process by adding generational accounting to existing instruments of budget analysis. By focusing the budget on the long term, on our children, grandchildren and the next generation, these measures will aim our priorities beyond the next election. They will expose the economic folly of spend now, pay later.

Once we expose the generational consequences of political promises and their true threat to our children's prosperity, we can end spend-now, pay-later for good and choose a more responsible course. This year, Congress took a step in the right direction by passing the first balanced budget in 26 years. Unfortunately, President Clinton twice vetoed this balanced budget. But even if our balanced budget were signed into law, it would only have been a first step. To be balanced, our budget must do more than just eliminate red ink. A balanced budget also requires fairness for future generations, equity for our children and grandchildren.

Over the past 25 years, people the world over have learned that governments do not generate wealth, that Secretaries of Labor do not create jobs and that politicians do not produce prosperity. Unless we act to change our policies, and soon, future generations will face an era of big government and high taxes that suffocates their jobs, dreams and opportunities.

We can avoid this fate and prevent an economic collision that will make the Titanic disaster look petty if we face our problems head on. I am committed to a budget that is balanced for all generations and to an end of something for nothing, and I believe that the Children's Right to Know Act is that first step.

Mr. Chairman, again, I thank you for the opportunity to be before you today and for the opportunity you have afforded other colleagues as well.

Mr. HORN. Thank you for coming. That is a tremendously creative idea and what you are talking about is truth in advertising. Some time if you are adding other co-authors, put my name on that.

Mr. SMITH OF TEXAS. OK.

Mr. HORN. I do not know how that "Dear Colleague" escaped me, but it is very intriguing.

Mr. SMITH OF TEXAS. I appreciate that, Mr. Chairman.

Mr. HORN. And I commend you for doing this because no one should object to laying that record out of the potential impact on people by generation.

Mr. SMITH OF TEXAS. Thank you.

Mr. HORN. The gentleman from Virginia?

Mr. DAVIS. I also want to congratulate my colleague on, I think, a fair but innovative idea. In local government in Virginia, they used to keep the tax rate the same while assessments were rising and the bills would go up. A law came in the legislature that you had to advertise the true tax impact on the average household and it changed the way we did business because it was really truth, telling the truth about what the consequences are and it is so easy to mask with so many programs on autopilot today. I can tell you have been experienced in local and State government.

Mr. SMITH OF TEXAS. But it is, as you just said, truth in spending, truth in taxing, and we have a right to know what kind of a load, what kind of a burden we are putting on future generations.

Mr. DAVIS. When I go to groups and explain to them that nearly 20 cents, when you factor for Social Security and trust funds that are being used to balance the budget, nearly 20 cents of every tax dollar is going to pay interest on the debt, they are amazed. They are shocked. I mean, no wonder they are not getting value for their dollar when 20 cents goes off the top. And when they understand that, it just adds a new perspective and I think what you are talking about goes even further, so I would also, if you do anything else on that, add me to the list.

Thank you very much.

Mr. SMITH OF TEXAS. OK. Thank you. I appreciate it as well.

Mrs. MALONEY. Could I ask one question?

Mr. HORN. I just want to add one comment on that. I use the analogy that Lyndon Johnson ran the Great Society and the Vietnam War and he spent half of what we are now spending just for interest.

Mrs. MALONEY. I do not have a copy of your statement. I would like to see your statement and your bill, if it is possible. If the staff has a copy, I would like to look at it. And certainly what you are talking about is one of the things——

Thank you. The chairman has it so I have it right here.

One of the things that all of us or that Congress has been doing is really bringing more accountability and we now have a budget statement from CBO on every bill, an inflation statement. The Unfunded Mandates bill had to have an impact statement on what the funded costs would be for various States.

How exactly does your Children's Right to Know Act, how is that different from the accounting projections that we have to do now on expenditures in bills?

Mr. SMITH OF TEXAS. Well, there are two answers to that question. The first is we really do not do the projections that we should be doing in so many areas. Only in two areas do we really sort of entertain the ideas behind generational accounting and that is with Social Security and Medicare where we project as the various commissions have done what the cost is going to be in the future, but we do not do it with other parts of our budget.

And what this Children's Right to Know Act, Mr. Chairman, by the way, which I will be introducing next week, just to let you know, does, Mrs. Maloney, is to apply those principles to all aspects of our budget and right now we have only applied it to, as I say, Social Security and Medicare projections.

Mrs. MALONEY. Maybe I am misinformed but I thought for every spending bill we had to have a CBO budget statement on what the impact of that legislation would be.

Mr. SMITH OF TEXAS. We do, but that is a present impact. It is not an impact for 10 or 20 or 30 years from now. And that is what we are looking for with this generational accounting.

Mrs. MALONEY. So you would set up a whole accounting office that would then project on each bill with inflation and everything else how much this is going to cost in the future.

Mr. SMITH OF TEXAS. That is correct. What the future impact would be. In other words, the CBO just estimates what the current cost might be and I think it is frankly an obligation of our—you know, an obligation of our responsibility as legislators to know what the future cost is going to be 10 or 20 years from now, otherwise, we are really just passing on to future generations additional taxes.

Mrs. MALONEY. I find it very interesting. Do any States do this? Do you know? Do any States have generational impact statements?

Mr. SMITH OF TEXAS. Some States might and, frankly, the Federal Government has toyed with the idea and tried it periodically and it was tried for 1 year under the Bush administration and at the beginning of the Clinton administration but obviously in this case neither Republican nor Democratic Presidents like to confront the cost of the programs that they are proposing and I think that that is something that we do have to confront.

Mrs. MALONEY. I am interested in your bill. I look forward to reading it.

Mr. SMITH OF TEXAS. OK.

Mrs. MALONEY. Thank you very much.

Mr. SMITH OF TEXAS. Thank you, Mr. Chairman.

Mr. HORN. Thank you very much. We deeply appreciate your coming.

We now have one of my very distinguished colleagues from Arkansas who will soon become a member of the Supreme Court of Arkansas where he does not have to listen to the hurly burly of the Congress. He has many friends on both sides of the aisle.

We are delighted to have Ray Thornton, who is closing out a very distinguished congressional career here. A former university president, the only one to ever be president of both the University of Arkansas and Arkansas State University.

STATEMENT OF HON. RAY THORNTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARKANSAS

Mr. THORNTON. Yes, sir. There are people who wonder whether or not I can hold a job, but as a matter of fact, that was a very wonderful experience and one that I am glad that I had the opportunity of sharing with you, Mr. Chairman. University administration is perhaps even more complex than the Federal Government. I am not sure if it is close or not. But one thing that we did was to recognize the distinction between making investments that would last into the future as contrasted with the daily operating expenses of our institutions.

I appreciate very much your giving me the opportunity of coming today to talk about the importance of capital budgeting for the U.S. Government and I would like to ask that my prepared statement be made a part of the record.

Mr. HORN. It is a part of the record, without objection.

Mr. THORNTON. I would like to first just outline some of the reasons that we need this. A lot of people in Washington toss around the figure that every American citizen is $17,000 in debt. Well, that is a simplistic arithmetic using only the liabilities side of the balance sheet. I used to worry a lot about my friend Sam Walton until he died because during the course of his lifetime he owed millions of dollars but he owned billions of dollars and so I think it is important to recognize that there is a distinction between daily operating expenses and investments and assets which will enhance the productive capacity of this country into the future.

Using a very conservative mathematical valuation of the assets only of the Federal Government, not including those projects which have been built and turned over to the States, not including an appreciation in value of our forests or this building is on the books at $1 for example, with a very conservative valuation of our Nation's assets, a balance sheet will show that every American citizen rather than owing $17,000 is $1,000 in debt.

Well, that is serious, especially when you recognize that in 1980 that same balance sheet would have shown that every citizen had a net worth of $5,500. Over that short period of time, we have swung from having a balance sheet worth of $5,500 down to $1,000 of red ink and it is troublesome how we got into that situation.

We got there partly because we spent more money than we took in, and we have been addressing that, Mr. Chairman. We have been trying to cut back on our expenditures of funds. But an equally troubling thing to me is that over that same period the balance of our Federal assets declined. That is, we do not have the valuation of Federal assets today that we did in 1980. There has been a dis-investment in the future of America and one of the reasons for that is that we have not analyzed the distinction between operating expenses and investments in the future.

We hold a lot of assets, and some of them are not productive. Gold and foreign exchange holdings, for example, may not have much productive value, but our interstate highway system, federally owned buildings, land and federally financed infrastructure and even more important the role that we perform in developing capital in the private sector through investments in research and development, the funds that we expend in educating individuals by investing in their education, all of these spawn commercial activity and enhance the capability of our economy to do well.

People sometimes forget that our Nation's physical capital stock, educational capital and research and development capital are productive national assets that create wealth and improve the financial position of our citizens.

Let me give you two examples that are not included in my prepared statement. The first is at the end of World War II at the time that we owed 120 percent of our gross national product, the heaviest debt this country has ever assumed, at that time, Franklin Delano Roosevelt, shortly before he died at Warm Springs said when our service people return from the war, we are going to provide them with an opportunity for an education. Subsequent to that declaration, we passed the G.I. bill, which educated a generation of American citizens. That investment in education returned $7 to the U.S. Treasury for every dollar of investment.

Just a few years later, another great President, a Republican, Dwight David Eisenhower with the country still terribly in debt said we are going to build an interstate highway system to connect every corner of this great country to enhance commerce and to improve our prosperity. And we borrowed the money to build the interstate highway system which according to the administrators of the highway department now has a value of around three-quarters of a trillion dollars. It is on the books at nothing, but it is a very valuable asset.

And, Mr. Chairman, the thing that I am really concerned about is that our present way of accounting does not allow us to distinguish between consumption spending and investment spending. Families do this. Those who manage their finances would not borrow money for groceries, telephone bills or entertainment, but they would assume a mortgage to have a suitable place to live or borrow to buy a car or educate their children, recognizing that these are productive assets.

If this standard is reasonable for families and businesses, it ought to be reasonable and it ought to be used by the Federal Government.

The present presentation of our Federal budget obscures the distinctions between current operating expenses and long-term capital investments or expenditures of a developmental character.

Recognizing the need for a correction of this presentation, several colleagues and I have introduced legislation, mine is H.R. 1109, to clarify our choices of expenditures and to help us establish appropriate fiscal priorities. Capital budgeting would require a budget submission that presents the operating budget and an investment budget for each of the three major components of the budget, general funds, trust funds and enterprise funds; that investment budget would represent only the major activities which support the acquisition, construction and rehabilitation of productive physical capital, education and job training and investments in research and development.

All of these investments provide a vital foundation for commerce and the creation of wealth. All other activities, projects and programs would be presented in the operating budget.

Mr. Chairman, capital budgeting would provide better and more relevant information upon which to base both overall fiscal policy as well as program priorities within the Federal budget.

You have correctly pointed out, Mr. Chairman, that the Federal budget is the principal vehicle for making fiscal policy choices. And unless we make our budgeting process more rational, we are hindered in our ability to make the informed, responsible decisions which are needed to restore a healthy Federal balance sheet.

Mr. Chairman, let me congratulate you for your efforts to begin this process and ask that you give serious consideration and that you include a proposal for capital budgeting in your product.

[The prepared statement of Hon. Ray Thornton follows:]

STATEMENT BY REPRESENTATIVE RAY THORNTON (AR-2)
ON
CAPITAL BUDGETING
AS A MEANS FOR IMPROVING FEDERAL BUDGET INFORMATION
March 27, 1996

A lot of folks in Washington like to toss around the statistic that every man, woman, and child in this country owes $17,000 in government debt.

Because that figure is based on a simplistic rendering of statistics from only one side of the federal balance sheet -- the liability side -- it is, at best, a distortion of our nation's true financial picture.

Sam Walton owed millions of dollars at various stages of his life -- but no one worried about him, because he **owned** billions.

One cannot assess the financial health of an entity -- whether it is an individual, a business, or a government -- without looking at both liabilities **and** assets.

Using a conservative definition of assets, by 1993 federal liabilities exceeded federal assets by $1,000 per person -- a disturbing figure, but not nearly as alarming as the $17,000 liabilities-only distortion that we hear widely quoted.

That every American owes $1,000 in net government debt **is** alarming when it is contrasted with the federal balance sheet in 1980, when federal **assets** exceeded federal liabilities by $5,500 per person.

How did we get into such a position?

We have focused a great deal on the huge amount of debt that was accumulated during the 1980's.

What we have not focused on is the dramatic decrease in the balance of federal assets that occurred during the same period.

In short, a great deal of debt was amassed during this period, but this spending did not improve our base of productive assets.

The federal government holds abundant financial assets like gold, foreign exchange holdings, mortgages, and loans.

It is responsible for vast physical assets like buildings, land, mineral rights, and federally-owned infrastructure.

The federal government plays a significant role in capital formation by providing grants to states and local governments for public infrastructure improvements -- like roads and bridges -- that remain under the "ownership" of all U.S. citizens and provide a vital foundation for commerce.

Additionally, the federal government provides funds to individuals for investment in their education -- our nation's human capital -- and finances a major portion of our nation's research and development capabilities that spawn commercial activity.

It is important to remember that federal capital investment through grants exceeds direct federal capital investment by a factor of 2 to 1 -- without even taking into consideration capital formation made possible by federal tax policies.

Our nation's physical capital stock, educational capital, and R&D capital are productive national assets that create wealth and improve the financial position of our citizens.

Unfortunately, while we have begun the process of bringing the national debt into check, projections show that federal **assets** will continue to dwindle, which can only mean that the federal balance sheet will continue to worsen.

These circumstances remind me of a story that my grandfather used to tell about a family that fell upon hard times.

Papa said the family tried, but weren't able, to spend their way out of debt.

Nor were they able to starve their way out debt -- you can't cure a famine by eating your seed corn.

Rather, the only way they were able to improve their lot was to **work** their way out of debt -- to increase their productivity.

That is the fiscal situation the federal government finds itself in today.

But how do we establish proper budget priorities to tackle the federal debt problem if we do not effectively utilize, protect, and enhance our national assets?

For one, we need to be able to distinguish between consumption spending and investment spending.

Providing gasoline for a police cruiser is a current operating expense, but building a prison to restrain hardened criminals is an investment that provides value for many years.

The American people understand this distinction.

Families who prudently manage their finances would not borrow money for groceries, telephone bills, or entertainment, but they would certainly consider assuming a mortgage to buy a home or borrowing to buy an automobile or to educate their children.

They recognize that these are productive assets.

A successful business would not hesitate to assume debt in order to make a capital investment that increases the productivity of the business and provides a stream of increased earnings more than sufficient to amortize the debt.

If this standard is reasonable for families and businesses, it ought to be reasonable for the federal government.

However, the existing presentation of the federal budget obscures the distinctions between current operating expenses and long-term capital investments or expenditures of a developmental character.

At the beginning of the 104th Congress, I introduced H.R. 1109, the Capital Budgeting Act, to address the need for clarifying our choices of expenditure and establishing appropriate fiscal priorities in this era of austerity in federal spending.

Several of my colleagues have also proposed similar measures.

Capital budgeting would require that the budget submitted to Congress by the President be a unified budget comprising an operating budget and an investment budget for each of the three major components of the budget -- general funds, trust funds, and enterprise funds.

The investment budget would represent only the major activities and programs which support:

* the acquisition, construction, and rehabilitation of productive physical capital;

* education and job training; and

* investments in research and development.

All other activities, projects, and programs would be presented in the operating budget.

As Congress looks for ways to allocate federal funds more responsibly, a capital budget would ensure a continued focus on the government's total financial standing.

Capital budgeting would provide better and more relevant information upon which to base both overall fiscal policy as well as program priorities within the federal budget.

As you have correctly pointed out, Mr. Chairman, the federal budget is the principal vehicle for making fiscal policy choices, and until we make our budgeting process more rational, we are hindered in our ability to make the informed, responsible decisions needed to restore a healthy federal balance sheet.

I congratulate you on your efforts to begin that process and urge you to include capital budgeting in your budgetary reform efforts.

Mr. HORN. Well, we thank you. I know you have been a long-time advocate of this. You have a pretty good ally in the chairman of the Committee on Transportation and Infrastructure.

Mr. THORNTON. Yes, indeed.

Mr. HORN. And all of its members, the largest committee in the House. So as you know, we also have a few people lying in the bushes to shoot this proposal down, so hopefully we could get something up before you retire. We need your help.

Mr. THORNTON. I hope we can do it, sir. I would like to see it done this year. I think it is vital to the long-term well being of our economy that we have the needed tools to measure the differences and to set priorities between investments and consumption expenditures.

Mr. HORN. I did not know your—that is the first I had heard of your Roosevelt quote. I have cited the G.I. bill for 30 years as one of the great investments this country has made.

Mr. THORNTON. Yes, sir.

Mr. HORN. And I had heard, I have never checked the record, although the first speech I wrote for Senator Kuchel as an intern was on extending the G.I. bill, I had heard that they really considered it more of an unemployment act and trying to get them——

Mr. THORNTON. It was considered something to do.

Mr. HORN. And yet it turned out to be the greatest investment of the post-war period.

Mr. THORNTON. The thought was that these people were going to be coming home, there will not be jobs available for them immediately, what do we do, let us educate them.

Mr. HORN. Right.

Mr. THORNTON. And instead it turned into one of the greatest investments the country ever made.

Mr. HORN. Absolutely. Well, I am going to put in the chart to followup on your comment about the assets, a table we have here that was prepared by the Financial Management Service of the Department of the Treasury as of fiscal year 1993, major categories of assets as of September 30, 1993. It gives you an example from the Treasury that divides it into receivables at 15 percent, inventories at 11 percent, cash and other monetary assets at 14 percent, investment in other assets at 15 percent, and property and equipment at 45 percent. And it is essentially $1.3 trillion is the figure they have and that is very conservative. You know, the land has never really been appraised in some cases since 1872.

Mr. THORNTON. That is right.

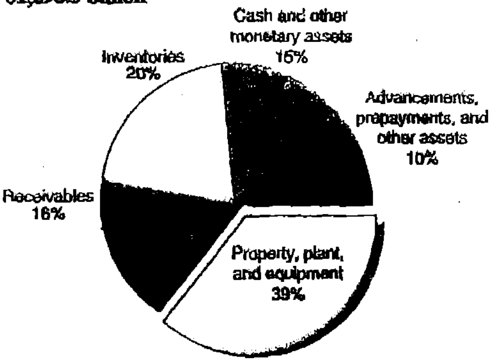
Mr. HORN. And they have 1872 rates.

[The information referred to follows:]

Major Categories of Assets as of September 30, 1995

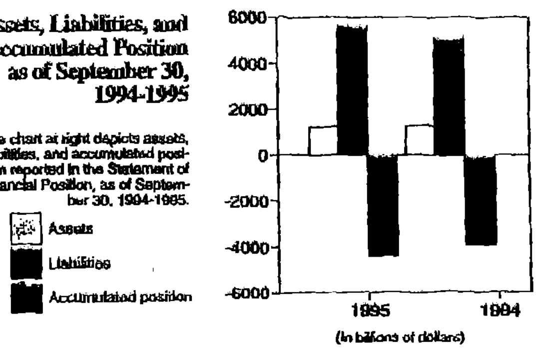
Assets are resources owned by or owed to the Federal Government that are available to pay liabilities or to provide future public services. The chart below is derived from the Statement of Financial Position (page 11). It depicts the major categories of assets as of September 30, 1995, as a percentage of total assets. The components for each of these categories are contained in Notes to Financial Statements.

Total Assets: $1,298.3 billion



Assets, Liabilities, and Accumulated Position as of September 30, 1994-1995

The chart at right depicts assets, liabilities, and accumulated position reported in the Statement of Financial Position, as of September 30, 1994-1995.



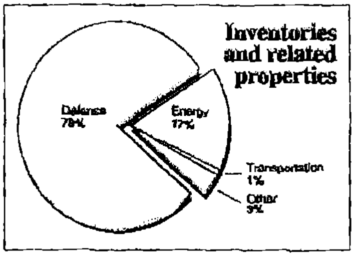
Agencies are required to submit those reports to the OMB and the Department of the Treasury. The Federal Government uses the data in these reports to improve the quality of its debt collection methods.

In 1990, the Credit Reform Act was enacted to improve the Government's budgeting and management of credit programs. The primary focus of the Act is to provide an accurate measure of the long-term costs of both direct loans and loan guarantees, and to include these costs at the time of loan origination. Most direct loans obligated and loan guarantees committed after September 30, 1991, are reported on present value basis.

5. Inventories and related properties

Inventories and related properties consist of several categories. Inventory held for sale is tangible personal property that is either (a) being held for sale, (b) in the process of production for sale, or (c) to be consumed in the production of goods for sale or in the provision of services for a fee. Operating materials and supplies are tangible personal property to be consumed in normal operation. Stockpiled materials are strategic and critical materials held due to statutory requirements or for use in national defense, conservation, or national emergencies. Other includes forfeited property, foreclosed property, commodities and other. For amounts see the table at right.

Agencies use a wide variety of methods to value inventories (e.g. first-in-first-out, last-in-first-out, latest acquisition cost, and weighted or moving averages). The Department of Defense uses the latest acquisition method to value its inventories. The Department of Energy uses the lower of cost or market to value its inventories.



Inventories and related properties as of September 30

(In billions of dollars)	1995[1]	1994[2]
Inventories held for sale	60.3	17.8
Operating supplies	57.0	90.9
Stockpiled materials	136.5	92.7
Other	5.3	21.4
Total inventories	269.1	222.8

[1] Some of the differences between inventory balances from 1994 to 1995 are due to Defense reclassifying inventories and recognizing previously unreported inventory items.
[2] Amounts are restated due to Defense audit adjustments.

6. Property, plant, and equipment

Property, plant, and equipment includes land, buildings, structures and facilities, ships and service craft, industrial equipment in plant, and construction-in-progress. It also includes automated data processing software, assets under capital lease, and other fixed assets that have been capitalized.

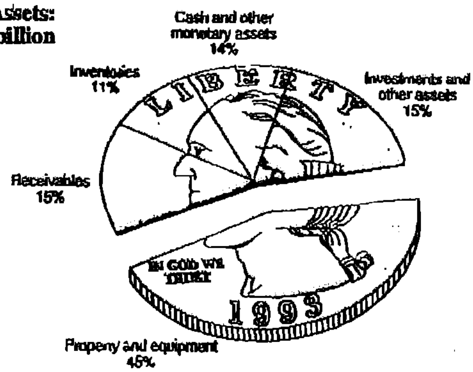
Land purchased by the Federal Government is valued at historical cost. The land acquired through donation, exchange, bequest, forfeiture, or judicial process is estimated at amounts the Government would have paid if purchased at the date of acquisition. No value has been assigned to the Outer Continental Shelf and other offshore lands. More than 651 million acres of public domain land have been assigned a minimal value of $1 per acre, and are included in the total land amount.

The accumulated depreciation reported by agencies in 1995 and 1994 was $76.5 billion and $66.8 billion, respectively. Most agencies use the straight-line method. Treasury estimates the depreciation for those agencies that do not report, using the straight-line method applied to the total of reported depreciable assets.

Major Categories of Assets, as of September 30, 1993

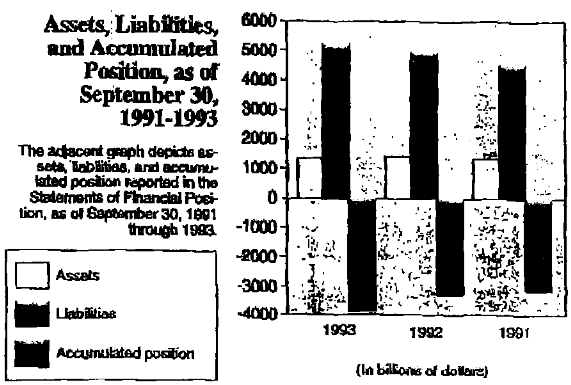
Assets are resources owned by or owed to the Federal Government that are available to pay liabilities or to provide future public services. The next chart is derived from the Statements of Financial Position (page 13). It depicts the major categories of assets as of September 30, 1993, as a percentage of total assets. The components for each of these categories are contained in Notes to the Financial Statements.

Total Assets: $1,362.4 billion



Assets, Liabilities, and Accumulated Position, as of September 30, 1991-1993

The adjacent graph depicts assets, liabilities, and accumulated position reported in the Statements of Financial Position, as of September 30, 1991 through 1993.



6. Property, plant, and equipment

Property, plant, and equipment includes land, buildings, structures and facilities, ships and service craft, industrial equipment in plant, and construction-in-progress. These assets include automated data processing software, assets under capital lease, and other fixed assets that have been capitalized.

Land purchased by the Federal Government is valued at historical cost. The land acquired through donation, exchange, bequest, forfeiture, or judicial process is estimated at amounts the Government would have paid if purchased at the date of acquisition.

No value has been assigned to the Outer Continental Shelf and other offshore lands. More than 662 million acres of public domain land have been assigned a minimal value of $1 per acre, and are included in the total land amount.

Most agencies use the straight-line method of depreciation. Depreciation is estimated by Treasury for those agencies that do not report depreciation expense. Treasury estimated depreciation using the straight-line method applied to the total of reported depreciable assets. Accumulated depreciation reported by business-type operations in 1993 and 1992 was $54.4 billion and $51.8 billion on assets of $174.8 billion and 179.9 billion respectively.

The useful lives for each classification of assets are as follows:

- Buildings . . . . 50 yrs.
- Structures and facilities . . . . 21 yrs.
- Ships and service craft . . . . 13 yrs.
- Industrial equipment in plant . 13 yrs.
- All other assets . . . . 13 yrs.

The largest ownership of Federal property, plant, and equipment remains within the domain of DOD, whose major equipment items and weapons systems are valued at the contract price. Fixed assets that may have been procured in different years are valued at the actual cost associated with respective year of acquisition. Real and personal property are recorded at acquisition cost. If the acquisition cost is unavailable, estimated cost at today's market price and remaining useful life are used. Capitalization policies varied, with minimum thresholds in the range of $200 to $5,000.

Property, plant, and equipment as of September 30

(In billions of dollars)	1993	1992
Military equipment	[1] 642.2	566.9
Buildings, structures, facilities, and lease-hold improvements	226.8	228.1
Construction-in-progress	128.8	134.8
Equipment (other)	59.2	57.1
Land	16.6	14.6
Other	26.3	19.8
Subtotal	1,097.2	1,045.3
Less accumulated depreciation	[illegible]	444.3
Total property, plant, and equipment	607.8	601.0

[1] Defense reclassified certain assets from "other assets" to property, plant, and equipment.

Mr. THORNTON. I appreciate that addition. I can provide for the record the citation to a recent study that was the basis for which my figures were taken.

Mr. HORN. Sure. And the record will remain open, if you would like to add some exhibits, we will be glad to put them in at this point in the record.

Mr. THORNTON. Thank you, sir.

Mr. HORN. Thank you. All right.

Mrs. MALONEY. Could I just ask one question?

Mr. HORN. Yes, please.

Mrs. MALONEY. I am a supporter of your bill and I am a supporter of capital budgeting and I appreciate your leadership on it.

As you know, Mr. Weiss has had a bill in for many years on this area. How is your bill different from Congressman Weiss'?

Mr. THORNTON. First of all, I think that Congressman Weiss has a bill that I would wholeheartedly support, and that is that we should develop a commission to tell us how to divide investments from expenditures. That is the one locking point on this, is how do you make the distinction. And Congressman Weiss has a bill in which I have joined that would call for the creation of that kind of study. I totally support that. His regular capital budgeting bill I also support but I do not think it fairly recognizes the importance of education and research and development. My bill includes an allocation for education and research and development that can be quantified as showing a productive consequence.

Mrs. MALONEY. Thank you very much.

Mr. HORN. OK. Well, thank you very much, Ray.

Mr. THORNTON. Thank you very much, Mr. Chairman.

Mr. HORN. We appreciate you coming.

Our next witness is a long-time colleague who has given a lot of thought to the budget process and various problems, the gentleman from Texas, Mr. Stenholm.

Welcome.

STATEMENT OF HON. CHARLES W. STENHOLM, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. STENHOLM. Thank you, Mr. Chairman, and members of the committee. It is indeed an honor and privilege for me to be here this morning and take just few minutes of your time and I intend just to take a few minutes. I would like to submit my entire statement for the record and summarize it.

Mr. HORN. Without objection, it will be inserted at this point.

Mr. STENHOLM. In it, we outline several specific areas that we think in process reform should be at least considered. We also acknowledge that several of our colleagues that will be testifying before you today such as John Kasich, Bill Orton, Joe Barton, Chris Cox, Peter Visclosky and others have done excellent work in this area and we have joined with them in co-sponsoring many of their ideas and proposals and commend those to you.

The one area that I want to specifically talk about is enforcement. Budget process reform is not a panacea. I know that, you know that, everyone knows that it does not replace the need of making tough decisions regarding budget. But that should not exclude us from considering ways to make the process work better and it has been my observation over the years and I have somewhat jokingly but somewhat seriously acknowledged that Gramm-Rudman I and Gramm-Rudman II were two of the worst pieces of legislation I have voted for in my 17 years in the Congress. And the reason I say that is it excluded about 62, 65 percent of the budget from being included in sequester.

And I think one of the better things that we could do as a Congress this year would be to set in place an enforcement mechanism so that whatever budget agreement that we eventually reach, and if we say that we are going to bring the deficit to zero in 2002 or whatever year we might agree, that it is important that we have enforcement year to year to bring us to that total and any year in which we miss it that automatically everything in the budget is included. And by everything, I include Social Security and taxes. Therefore, the question always comes what do you mean by everything? I do not know how to define everything than everything. And I think that in doing that we put a certain amount of discipline on us.

To those who believe that the answer to our budget and our economic and our growth needs in this country are the reduction of the tax rates, fine.

To those that believe that we need to cut spending in certain areas but not in other areas, fine.

When the wisdom of the Congress is put together, the best choices that it can do, and then we miss it for some economic reason or some other reason, the fact that we really did not do what we said we were going to do, I think that automatic cuts and rate of increase of taxes should occur.

You know, if your target is $100 billion in the year 1999 and the deficit is actually $110 billion, a small percentage reductio in COLA or a small percentage increase in taxes would not be noticed by anyone other than the financial markets and the Federal Reserve who would note that we are serious about maintaining our downward path for the deficit and that seems to be important.

I just came from a hearing of the Budget Committee with Chairman Greenspan again acknowledging that one of the best ways, if not the best way, to increase the national savings rate is to reduce the Federal deficit.

I believe that. I believe you believe that and therefore why not put a mechanism that can be as successful for all of the budget as a freeze on discretionary spending has been since 1990?

By that, not a freeze but a setting of a baseline and a cap and pay go for discretionary spending, I misspoke. It has been very successful in holding down the growth rate of discretionary. If only we had had the guts to do in 1990 what I am suggesting that we should do in 1996, our deficit would be in much better shape today and no one would have ever missed the changes that would have occurred because they would have been gradual.

And so in conclusion, I would say my formula has been on enforcement. In any year in which the deficit targets are not met, you would have $2 of automatic spending reductions, real, not fun and games, not postponed until after the next election, but real in the year in which it occurs, and $1 of real tax increases. And in most cases, that would be done by the CPI adjustment that would occur.

Therefore, it puts all of us into the same boat. Charlie Stenholm cannot go home and brag to my constituents that I voted for every spending cut that came down the pike but I just lost on every vote because my constituent would look me in the eye and say, well, Charlie, you voted right but my taxes still went up so obviously you did not in fact do that which you said you have done.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Charles W. Stenholm follows:]

Testimony of
CONGRESSMAN CHARLES STENHOLM
Hearing Before the
Subcommittee on Government Management, Information and Technology
March 27, 1996

Chairman Horn and subcommittee Members, I appreciate the opportunity to appear here today to discuss potential budget process reforms. I am delighted that you have taken up this subject, and I commend you for holding this hearing.

There are many who might argue that we should just leave the Budget Act alone and stop mucking-up the process of the budget just because we Members have difficulty dealing with the substance of the budget. They argue that those of us who feel the deficit is a problem should just cut spending by altering federal programs rather than through changing the process. My conclusion is that, of course, the tough choices always will have to be made. But the process by which we make decisions and the way that we talk about the choices we face have a tremendous impact on the outcome of policy.

The budget process also should hold Members more accountable. The fact that we even have spending categories which we call "uncontrollable" is a statement of our failure in the area of accountability. The federal government has run deficits for 26 years in a row -- obviously, for all of the years of the Budget Act of '74 -- and for 57 of the last 65 years. Obviously, no business could function with such a record. While the federal government has been able to avoid complete financial catastrophe, we are clearly feeling the pinch of fewer and fewer dollars to expend on programs because we must spend them on interest payments.

In that vein, I believe we should pursue several measures to make the budget process more fiscally responsible, including entitlement caps along the lines which I proposed on the House Floor last Congress or the caps in the Barton-Stenholm budget process reform bill, a 10-year window on PAYGO so that games cannot be played in the outyears, and setting enforceable deficit targets.

If Congress and the President can agree on a balanced budget plan -- and I remain hopeful that an agreement can be reached -- it is important that the agreement include an enforcement mechanism to lock in the deficit reduction. The public is justifiably cynical about promises of a balanced budget at some future date, having witness several false promises of balanced budgets in the past. The common flaw of balanced budget plans enacted in the past is that they allowed Congress and the President to avoid responsibility when the lower deficits they promised did not materialize. An enforcement mechanism that holds Congress and the President accountable for our promises of lower deficits is critical to gaining public credibility for a balanced budget plan.

Our effort to enforce a balanced budget plan and improve the budget process must be done with the goal of investing everyone equally -- every Member, every program, every constituent -- in seeing that the process work. In order to achieve this goal, everything must be on the table. When I say everything, I do not add any caveats to exempt sacred cows. Everything includes Social Security, and it includes taxes.

When Congress passed the Gramm-Rudman Act, members and special interests worked hard to add exemptions to a sequester mechanism to make sure that if a sequester occurred, their favored program was protected. By the time all of the compromises were made to ensure that the sequester was politically acceptable, it had lost much of its effectiveness because very few groups had a stake in ensuring that

Congress and the President act responsibly in order to avoid a sequester. The only way to prevent a repeat of this mistake is to avoid starting down the slippery slope of political accommodation for sacred cows and provide no exemptions. In order for an enforcement mechanism to be successful, the possibility of a sequester should be unacceptable to all parties involved. Once certain groups conclude that a sequester is an acceptable alternative, the ability to reach the compromises necessary to make the process work will be undercut.

At this point I would like to submit for the record a number of the suggestions I am hoping your subcommittees will consider. There may be nothing particularly novel in my list -- many Members such as Chairman Kasich, Bill Orton, Joe Barton, Chris Cox, Peter Visclosky, and others have done excellent work in developing ideas such as these. I believe each have merit and can contribute to improving our budget process.

In summation, budget process reforms will not solve our budget problems by themselves. However, by increasing the understandability, the credibility and accountability of the budget process, the reforms I have outlined here all would be useful tools in dealing with our budget problem.

BALANCED BUDGET AMENDMENT

It almost goes without saying that in my opinion, the best starting place for budget reform is a constitutional amendment requiring a balanced budget. Our Body certainly has done its part in that regard and, once again, I commend the current Leadership for doing so much to bring about passage of the BBA at the beginning of this year. I don't expect this Committee to act further in that regard, unless you have some magic to work on the other Body. I simply mention the BBA here because I do believe that if we were to have the larger context of a Constitutional requirement, much of the rest of what we need from our Budget process would follow more naturally.

That being said, I quickly follow with the assertion that a constitutional amendment is not a panacea. It is a first step. It must be followed by hard choices and priority making. It also must be followed with other procedures which will aid in the achievement of a balanced budget. That is what I would like to spend the rest of my time discussing.

BALANCED BUDGET ENFORCEMENT

The Coalition budget included a strong enforcement mechanism which establishes deficit reduction targets, a board of estimates, a requirement of the President and Congress to follow the targets, and tough enforcement mechanisms employing a potential sequestration of all programs. The Coalition budget would write into law the deficit reduction glide path that the budget projects and would require Congress and the President to take action if the deficit is projected to exceed the target in the upcoming year, or if the actual deficit in the preceding year exceeded the target. If Congress and the President did not take action to eliminate the excess deficit or increase the targets, there would be an across-the-board sequester without exception. We recognized that there might be circumstances such as an economic downturn or international crisis that may cause Congress and the President to conclude that adhering to the deficit targets would be unwise by allowing Congress to pass legislation increasing the targets. The critical point is that we as elected officials should be willing to go on record in favor of allowing higher deficits instead of simply allowing them to happen without taking responsibility. The enforcement language in the Coalition budget incorporated proposals introduced by Reps. Bill Orton, Pete Visclosky and other members.

ENTITLEMENT CAPS

One clear lesson of our experiences with the Budget Enforcement Act (BEA) is that placing restraints on the growth of entitlement programs is imperative to controlling federal spending. The discretionary caps of the BEA have served well to curb discretionary spending but left untouched entitlement spending. The failure of the BEA to deal with entitlements prevented it from effectively controlling total spending or significantly reducing deficits. Experience has taught us that Congress takes action to reduce entitlement spending only under extraordinary circumstances. It is critical that we take entitlement spending off of "automatic pilot" by imposing limits on entitlement spending that force Congress and the President to take action if entitlement spending grows faster than we can afford. Last Congress, I proposed an entitlement cap that limited the growth of all entitlements -- including Social Security -- to beneficiary growth plus inflation and an additional one percent cushion. Congress could set separate limits on entitlement spending by function so that programs that were under control were not penalized if other programs grew faster than allowed. This Congress, I have cosponsored legislation introduced by Rep. Joe Barton that would allow Congress to establish entitlement caps similar to my bill. Both bills share a few important principles that should be included in any entitlement cap legislation: establish fixed limits on entitlement spending; allow Congress to set priorities among entitlement programs and focus enforcement on programs that are growing faster than intended; and eliminate the exemptions for favored program (although the Barton-Stenholm bill exempts Social Security, I continue to believe that it should be included).

DISCRETIONARY CAPS

While the BEA's discretionary caps have worked reasonably well in controlling discretionary spending, the one weakness comes from OMB's ability to continually adjust the discretionary caps for inflation once they are set. I would recommend that the Budget Act be amended to remove the adjustment opportunity and have the caps remain intact as set by Congress. Both the Coalition budget and reconciliation bill passed by Congress included this reform.

FIREWALLS

Re-instating the firewalls between domestic and defense spending and adding a firewall between entitlements and discretionary would ensure that cuts in any area beyond those called for in the budget resolution be dedicated to deficit reduction. It would require that any new domestic initiatives beyond those called for in the budget resolution be paid for by cutting other domestic programs instead of by cutting defense further than the cuts in the budget resolution. This would force the choosing of priorities within each category by removing the temptation to "raid" one category for spending in another.

TRUTH-IN-LEGISLATING

Congress has been embarrassed on many occasions by provisions in tax and spending bills that the public justifiably felt benefitted "special interest," privileged narrow interests, and other Members' special constituencies. In past years I have introduced the Truth in Legislating Resolution in response to these concerns. This resolution would require committees to include in their reports the identity, sponsor and cost of each provision of a bill which benefits 10 or fewer beneficiaries.

Any Member who includes special benefits would have to be willing to experience any resulting publicity about those benefits Beyond being a simple, good policy of honesty in legislating, it would very likely have the secondary effect of reducing the number of this type of special interest provisions. This legislation is not intended to forbid such provisions, but simply assure that the House is not afraid to shed some sunshine on the laws it passes. By assuring the public that we in the House have nothing to hide, this resolution will enhance the public's confidence in Congress.

BASELINE REFORM

The previous baseline created a bias to increased spending. Eliminating the current services baseline as the House dealt with the budget this year began to restore common sense and honesty to our budgeting process, and I commend Chairman Kasich for following through on that idea which he, Tim Penny and I, along with others, were promoting last Congress. We must recognize increases in spending for what they are, and not talk about cutting spending when what we really mean is that we are not increasing spending as much as anticipated.

CONTINUING RESOLUTION REFORM

In past years, we have passed massive, omnibus continuing resolutions in which one huge bill made substantive changes in law and policy throughout the federal government without thorough debate and opportunity for review. While these problems have not resurfaced in the last few years, there is nothing in the rules to prevent similar abuses from re-occurring and, in fact, discussion about a "CR" this year has increased. Legislation I have supported in the past included provisions that would freeze continuing resolutions at current fiscal year's spending levels and would place strict limits on the inclusion of legislative language in the continuing resolutions.

LIMITATION ON WAIVING BUDGET RULES

We have waived the provisions of the Budget Act over 600 times since it was passed in 1974. The credibility of the budget process is undercut by the routine waivers of budget rules. Requiring that waivers of Budget Act rules be approved by a 3/5 vote would ensure that the rules are waived only in extreme circumstances. Alternatively, I would suggest providing for separate votes on each waiver under the Budget Act. Either change would do much to restore credibility to the Budget Act. At the same time, we should examine the Budget Act to identify the technical points of order that routinely require waivers to allow the legislative process to proceed but which are not essential to maintaining fiscal discipline. I believe that such a review of the Budget Act would increase respect for Act and improve the enforcement of the points of order that are truly important to maintaining fiscal discipline.

Mr. HORN. Thank you.

I yield to the distinguished ranking minority member for questions.

Mrs. MALONEY. Thank you, Charlie. I think you make a tremendous contribution to this body.

Do you have a bill in on this?

Mr. STENHOLM. Yes.

Mrs. MALONEY. You have a bill in on it?

Mr. STENHOLM. We have had the proposals in and we have joined with others and, in fact, this mechanism is in the coalition budget that we submitted and 72 Members of the House have already voted for this proposal or an enforcement mechanism because in our budget that we have put forward and intend to do again for fiscal 1997, we never got a budget for 1996, we think we ought to move on to 1997, and the enforcement mechanism is a key component of our budget or, as I said, of any budget, and that is why I commend you, Mrs. Maloney and Mr. Horn, the chairman and ranking member, for your interest in the process, because I think you can play a very key role in helping see that whatever we do on budget, we do have the correct amount and the right amount of process reform to see that we in fact live up to it.

Mrs. MALONEY. I believe you stated that your proposal was to limit mandatory spending growth to baseline plus 1 percent for 3 years? Is that correct? Is that what you said?

Mr. STENHOLM. That was in one of the proposals that we had and that which we submitted for the record.

Mrs. MALONEY. And thereafter, you said the absolute baseline thereafter. What is the absolute baseline and how is that different than the other possible baselines?

Mr. STENHOLM. Well, when I am referring to baseline——

Mrs. MALONEY. And, by the way, I do not have a copy of his testimony. Does the committee have his testimony and bill? We do not have it? OK.

Mr. STENHOLM. When I am referring to baseline, this has been a longstanding argument and that is to me baseline ought to be what you spent last year. Whatever it is, what you spent last year ought to be the baseline. Then if we are going to increase it—you know, if you get $100 this year and you get $99 next year, that is a cut; if you get $101, that is an increase. So when I refer to baseline and what we have been involved in over the many, many years of this suggestion for process reform, we have suggested that the baseline that we should start with on the budget committee every year is what you spent last year.

Mrs. MALONEY. And what is the absolute baseline?

Mr. STENHOLM. That is it.

Mrs. MALONEY. That is it. It is one and the same thing.

Mr. STENHOLM. That is one and the same.

Mrs. MALONEY. Now, what do we do in emergencies? We have a tremendous catastrophe in the country that the Federal Government has to bail out a State.

Mr. STENHOLM. You vote. You vote. The majority of the House or in the case of a constitutional amendment, 60 percent would be required to in fact break the budget. But we have never believed that you can have an absolute, irrefutable, take away the right of democracy to make a change, that is ridiculous. So we say—but we make it a little more difficult.

In our constitutional amendment that passed the House last year, one of the happier days of my legislative career was watching it pass and getting to be a small part of helping see that pass.

One of the saddest days was standing in the back of the Senate and watching it fail by one vote, but we did not have the votes.

But in that constitutional amendment, we recognize emergencies can happen. We specifically provide in the event of war it is automatically knocked out, but we also provide that 60 percent of the Congress can say there is an emergency that needs to have borrowed money in order to pay for it. And I believe if it is a true and legitimate emergency that cannot be paid for by cutting somewhere else that Congress would vote overwhelmingly to take care of the majority. But we suggest it ought to be more difficult to borrow money than it is or it ought to be more difficult to borrow it than just to automatically vote to do it, as we do year in and year out.

Mrs. MALONEY. Thank you very much. Like every debate in our caucus or on the floor, you add a great deal to the debate and I personally appreciate all your work in this area.

Mr. STENHOLM. Thank you.

Mr. HORN. Let me just ask you about one aspect of this. When you use the preceding fiscal year as a baseline, you run into the problem here of timing. Let us take an example. September 30, 1995, that is the end of fiscal year 1995. Now, we will have already acted on most of fiscal year 1996 at that point in time and the OMB and the President in November are recommending the numbers for fiscal year 1997. So technically, probably in terms of really knowing where all the pennies are, you need another year or so to close the books on fiscal year 1995. Now, you might get a ballpark estimate there out of OMB, but it will not be completely accurate.

Mr. STENHOLM. No. And I recognize that and whatever date we choose, there must be a certain amount of estimation but that estimation can be corrected by the process reform that I talk about. Eventually you can correct it.

Mr. HORN. Right.

Mr. STENHOLM. But for purposes of starting in the budget discussion, we have to agree on a date and use the best numbers but then eventually make sure they are real numbers and that can happen in the regular process of the budget year.

Mr. HORN. Yes. Very good. Thank you very much for coming.

Mr. STENHOLM. Thank you.

Mr. HORN. Now, the gentleman from Delaware I see is here, Mr. Castle, who has also given this a substantial amount of thought. And we are only 10 minutes behind at this point.

Welcome.

STATEMENT OF HON. MICHAEL N. CASTLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF DELAWARE

Mr. CASTLE. Thank you, Mr. Chairman. I will take that as a warning to speed things up a little bit.

I appreciate the opportunity to appear before the committee and that you and Mrs. Maloney are here. I am here only to discuss one very small aspect of the whole budgeting process but I appreciate what you are doing in putting together this omnibus bill which I have looked over enough to know it is truly omnibus at this point.

Mr. HORN. Ominous and omnibus.

Mr. CASTLE. Ominous and omnibus. And my aspect of it I think is significant although relatively small. I am going to talk about the budget reserve account which I have proposed and is in legislation now. It is H.R. 1245. It is Section 205 in your omnibus bill which you have before you. And I have a statement which has already been submitted for the record, so I will just speak briefly about some notes and then answer some questions.

First of all, a budget reserve account would require Congress to do what it does not do now, which frustrates me a great deal, and that is to budget for natural disasters and other emergencies. Appropriations would be set aside each year.

Each year the budget resolution would set aside an overall amount in the account and that would come within, and this is important, within the annual discretionary spending caps. When a disaster occurs, the Appropriations Committee would produce an emergency appropriations bill from the fund in the reserve account. And I might add, I am very dissatisfied with the way we process emergency claims now. I think the Federal Government probably has a lower standard for that than any other budgeting that we do in the course of the year.

The question obviously arises, well, look, if it is an emergency, how do you know how much money should be put in that account?

Well, there is no way you can absolutely define that, but we have gone back and depending on how you look at it, it ranges in the last 10 years at an average, you set aside the Gulf war and the special circumstances such as that, of $5.2 to $5.8 billion. And I believe that amount should be appropriated and these funds would be within the annual spending limits and would not add to the deficit.

The question arises what happens if there is an emergency that would exceed that and that is obviously a very legitimate question because of the unpredictability of the way things could go.

First, Congress could make the decision, as we do often now, I mean, that has been a good practice because we have been reducing expenditures on one side, at the same time we have been expending for emergencies in recent years, but we could make cuts in other programs to free up funds for disaster relief.

Second, if a disaster is severe, and usually that is going to be in time of war, and the Gulf war is the best example I can think of that, Desert Storm, there would surely be agreement in Congress to waive the budget reserve account and to pass special legislation in that circumstance.

Or, the Congress could adopt the provision of Congressman Sam Johnson, which I think is also included in your bill, which is a look-back provision which would be an offset in the next year. I think that is a good provision. I do not think it should be the only way we do this, but I think it is a good outlet in case there are some problems with respect to how we handle the budget reserve account, so I think they actually can work in conjunction with each other and not in opposition to each other.

But the key point is that in most circumstances the reserve account would allow us to make the expenditures which are necessary and give a process to all of this.

Then you get the other flip side of that, what happens if all the money is not used? Which opens up the minds of Members of Congress quite rapidly. And I believe in that case unexpended funds should be returned to the Treasury and should be used to reduce the deficit. I think we need some of the discipline that Congressman Stenholm and I am sure others who have appeared here have talked about.

The reserve funds should be spent on specific natural disasters and national security emergencies. No executive agency would be given any additional discretionary funds. We have had a problem in the past, as most of us are aware, of other nonemergency expenditures being made at the same time. We passed some emergency appropriation expenditures. I think that should be eliminated with a process such as this.

The monitoring, in my judgment, should be done by OMB, which will be required to report annually to Congress on how funds from the account are spent on each emergency. And we would have to change certain existing laws. We would have to amend the Congressional Budget Act of 1974 to create the reserve account and require the funds be included in the annual budget resolution in Section 202, allocations administered by the Appropriations Committee.

There is no perfect solution to this, Mr. Chairman. I wish I could stand here before you and say that, gee, if we do this, we will never have a problem again. And obviously the emergencies are uncertain as to whether they are going to happen and how expensive they are going to be. But of all the things we seem to do in our budget now, I have to tell you, I think this is the worst. I think this is the one we really have the least control over. It automatically adds to our deficit unless we offset it. The offsets become a political issue.

I have already stated in my judgment, and I think it is because the word emergency is used, that we do not have a very good process for reviewing the claims which are made and, quite frankly, even if we did, I think you have to look deeper than that. There are people who have probably claimed flood insurance three times in the last 10 years. And I just think we need to do a lot more in Congress on this entire issue.

So in broad brush strokes, that is why I am here, to present this to you. As I said, there is more detail in what I have already submitted and I will be glad to try to answer any questions you may have.

[The prepared statement of Hon. Michael N. Castle follows:]

STATEMENT OF CONGRESSMAN MICHAEL N. CASTLE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT

HEARING ON BUDGET REFORM

MARCH 27, 1996

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE THE SUBCOMMITTEE TODAY TO DISCUSS POSSIBLE IMPROVEMENTS TO THE FEDERAL BUDGET PROCESS, PARTICULARLY IN THE AREA OF EMERGENCY APPROPRIATIONS.

I BELIEVE WE NEED TO TAKE A VARIETY OF STEPS TO IMPROVE HOW OUR GOVERNMENT SPENDS THE PEOPLE'S MONEY. A STRENGTHENED BUDGET PROCESS WILL NOT ELIMINATE THE FEDERAL DEFICIT BY ITSELF, BUT IT WILL MAKE A REAL CONTRIBUTION TO THE EFFORT AND HELP RESTORE OUR CONSTITUENTS' FAITH IN HOW WE ARE MANAGING THEIR TAX DOLLARS. I STRONGLY SUPPORT YOUR EFFORT TO REVIEW ALL THE CURRENT BUDGET REFORM PROPOSALS AND PRODUCE COMPREHENSIVE BUDGET REFORM LEGISLATION.

IN AUGUST, 1994 I APPEARED BEFORE THE GOVERNMENT OPERATIONS COMMITTEE TO ARGUE THAT WE MUST CHANGE THE BUDGET RULES TO REQUIRE CONGRESS TO INCLUDE EMERGENCY SPENDING IN THE ANNUAL BUDGET PROCESS, PARTICULARLY OUR ANNUAL SPENDING LIMITS. IN 1994, THE HOUSE PASSED LEGISLATION TO PREVENT NON-EMERGENCY SPENDING FROM BEING ADDED TO EMERGENCY SPENDING BILLS. WHILE THAT PROPOSAL WAS A START, IT DID NOT FULLY ADDRESS THE PROBLEM OF HOW CONGRESS APPROPRIATES MONEY FOR DISASTERS AND OTHER EMERGENCIES. AS YOU MAY RECALL, THE SENATE FAILED TO ACT ON ANY BUDGET REFORM LEGISLATION IN THE LAST CONGRESS.

MY VIEW IS THAT WE MUST BUDGET FOR EMERGENCIES AND SET THOSE FUNDS ASIDE IN A RESERVE ACCOUNT.

AS YOU KNOW, UNDER CURRENT BUDGET LAW, EMERGENCY SPENDING IS NOT SUBJECT TO THE ANNUAL SPENDING LIMITS. THIS IS A CRITICAL SHORTCOMING IN OUR SYSTEM. IT PERMITS US TO AVOID PLANNING FOR EARTHQUAKES, HURRICANES, FLOODS AND OTHER DISASTERS. WE KNOW THAT THEY WILL ALMOST CERTAINLY OCCUR, YET WE FAIL TO PLAN FOR THEM. WHEN THEY HAVE HAPPENED, CONGRESS HAS EITHER DECLARED AN EMERGENCY AND APPROPRIATED BILLIONS OF DOLLARS TO RESPOND TO THE DISASTER ADDING TO THE DEFICIT, OR ENGAGED IN A NECESSARY, BUT

DIVISIVE DEBATE OVER CUTS IN OTHER PROGRAMS TO OFFSET THE NEEDED EMERGENCY SPENDING.

FROM A BUDGETING STANDPOINT, THE WORST PART OF THE CURRENT SYSTEM IS THAT EMERGENCY FUNDS DO NOT HAVE TO BE OFFSET BY OTHER SPENDING REDUCTIONS. WHILE THE CURRENT CONGRESS HAS ADMIRABLY MADE IT A POLICY TO FIND OFFSETS, A FUTURE CONGRESS COULD SIMPLY RETURN TO THE TRADITIONAL PRACTICE OF JUST ADDING EMERGENCY APPROPRIATIONS TO THE DEFICIT.

AS YOU KNOW, WHEN CONGRESS DOES CONSIDER OFFSETTING THE COST OF EMERGENCY SPENDING, THIS DEBATE OFTEN BECOMES DIVISIVE AND CAN ACTUALLY SLOW PROMPT ACTION TO HELP THE VICTIMS OF THE NATURAL DISASTER. THIS IS AN UNFAIR AND UNNECESSARY CONFLICT.

ANOTHER PROBLEM IN PREVIOUS CONGRESSES HAS BEEN THAT BECAUSE EMERGENCY APPROPRIATIONS ARE NOT SUBJECT TO ANNUAL SPENDING LIMITS IT HAS ENCOURAGED THE ADDITION OF FUNDS FOR PROJECTS WHICH ARE CLEARLY NOT PART OF THE EMERGENCY AT HAND.

MR. CHAIRMAN, WE CANNOT PREDICT THE EXACT TIME AND NATURE OF A DISASTER, BUT IT IS QUITE PROBABLE THAT THEY WILL OCCUR AND CONGRESS SHOULD MAKE AN ATTEMPT TO PLAN AND PAY FOR THESE EMERGENCIES -- **WITHIN EXISTING BUDGET LIMITS.**

MY PROPOSAL, H.R. 1245, WHICH IS TENTATIVELY SECTION 205 OF YOUR DRAFT BILL, WOULD CREATE A BUDGET RESERVE ACCOUNT INTO WHICH CONGRESS WOULD ANNUALLY APPROPRIATE FUNDS FOR EMERGENCIES. THE FUNDS IN THE RESERVE ACCOUNT WOULD BE INCLUDED IN THE ANNUAL DISCRETIONARY SPENDING CAPS SET BY THE BUDGET RESOLUTION AND ADMINISTERED BY THE APPROPRIATIONS COMMITTEE. THE FUNDS IN THE RESERVE ACCOUNT WOULD LOWER THE AMOUNT OF FUNDS AVAILABLE FOR OTHER PROGRAMS. THIS IS A KEY POINT AND IS THE ONLY RESPONSIBLE APPROACH TO SPENDING.

THE TEETH IN THIS PROPOSAL IS THAT IT WOULD ELIMINATE CONGRESS'S AUTHORITY TO SPEND MONEY OUTSIDE THE BUDGET LIMITS. THIS WOULD FORCE CONGRESS TO SET ASIDE AN ADEQUATE AMOUNT OF FUNDS IN THE RESERVE ACCOUNT.

WHAT IS AN ADEQUATE AMOUNT? I THINK CONGRESS AND THE PRESIDENT SHOULD TAKE A CAREFUL LOOK AT THE AMOUNT OF EMERGENCY FUNDS NEEDED IN PREVIOUS YEARS AND BASE THE RESERVE ACCOUNT ON THIS EXPERIENCE. FOR EXAMPLE, THE AVERAGE COST OF EMERGENCY APPROPRIATIONS BILLS FROM 1989 TO 1994 WAS $5.2 BILLION AND FROM 1991 THROUGH 1994 IT WAS $5.8 BILLION.. IF CONGRESS SET ASIDE

ROUGHLY THAT AMOUNT IT WOULD GIVE OUR GOVERNMENT ENOUGH FUNDS TO HANDLE MOST DISASTERS AND PROVIDE PROTECTION AGAINST UNNECESSARY DEFICIT SPENDING.

IF WE ARE FORTUNATE ENOUGH TO ESCAPE HURRICANES OR FLOODS IN A PARTICULAR YEAR AND THE RESERVE FUNDS ARE NOT USED, THEY WOULD REVERT TO THE TREASURY AND THEREFORE LOWER THE DEFICIT.

MR. CHAIRMAN, I HAVE BASED THIS LEGISLATION ON MY EXPERIENCE AS GOVERNOR OF DELAWARE. MOST STATES MUST OPERATE WITH A BALANCED BUDGET. THIS IS TRUE IN DELAWARE. WHEN THE STATE HAS A SURPLUS AT THE END OF ANY FISCAL YEAR, THESE FUNDS ARE PLACED IN A BUDGET RESERVE ACCOUNT WHICH IS NOT TO EXCEED 5% OF THE ESTIMATED STATE REVENUES. WHEN THERE IS AN EMERGENCY THE GENERAL ASSEMBLY CAN ALLOCATE THE RESERVE FUNDS BY A THREE-FIFTHS VOTE. I HAVE ADOPTED THIS CONCEPT TO THE FEDERAL BUDGET SYSTEM.

IN DELAWARE, THE RESERVE FUNDS ARE ROLLED-OVER FROM YEAR TO YEAR. I DID NOT ADOPT THAT FEATURE BECAUSE IN THE FEDERAL BUDGET AN ANNUAL APPROPRIATION IS STANDARD PRACTICE AND FRANKLY, BECAUSE ON THE FEDERAL LEVEL ACCOUNTS WITH MONEY IN THEM FROM YEAR TO YEAR TEND TO BE SPENT.

MR. CHAIRMAN, I BELIEVE MY PROPOSAL IS A SOUND ONE, BUT I WILL NOT INSIST THAT IT IS THE ONLY APPROACH WHICH SHOULD BE CONSIDERED. I THINK CONGRESSMAN SAM JOHNSON'S "LOOK BACK" PROPOSAL HAS MERIT. HIS LEGISLATION WOULD ALSO ADJUST THE BUDGET CAPS TO INCLUDE EMERGENCY APPROPRIATIONS.

THE CRITICAL CHANGE WHICH MUST BE MADE IS TO BRING EMERGENCY SPENDING WITHIN THE BUDGET LIMITS. IT IS NOT "FREE" MONEY AND SHOULD BE ACCOUNTED FOR JUST LIKE ANY OTHER EXPENDITURE.
I URGE THIS COMMITTEE TO APPROVE LEGISLATION THAT ACHIEVES THIS GOAL. THANK YOU.

CONGRESSMAN MICHAEL N. CASTLE
THE BUDGET RESERVE ACCOUNT

WHAT IS THE PURPOSE OF THE BUDGET RESERVE ACCOUNT?

- A BUDGET RESERVE ACCOUNT would require Congress to budget funds for natural disasters and other emergencies. Appropriations would be set aside each year to cover the costs of natural disasters and national security emergencies.

HOW WOULD THE RESERVE ACCOUNT WORK?

- The annual Budget Resolution would set an overall amount to be set aside in the account. The reserve funds would be within the annual discretionary spending caps. When a disaster occurs the Appropriations Committee would produce an Emergency Appropriations bill from the funds in the reserve account.

HOW MUCH MONEY WOULD BE PLACED IN THE ACCOUNT?

- Congress and the Administration would set the amount based on what was needed in previous years. The average cost of domestic discretionary emergency spending bills from 1991-1994 was roughly $5.8 billion. If we appropriated that amount we would have a significant amount of money available to respond immediately to natural disasters. **Most importantly, these funds would be within the annual spending limits and would not add to the deficit.**

WHY SHOULD CONGRESS APPROPRIATE FUNDS INTO THE ACCOUNT?

- This proposal would eliminate Congress's authority to appropriate emergency funds in excess of the annual spending caps. This would ensure that Congress would set aside a realistic amount of money to deal with the most likely emergencies. Under current law emergency spending is simply added to the deficit; this process must be changed.

WHAT HAPPENS IF A DISASTER EXHAUSTS THE RESERVE ACCOUNT?

- There is always the possibility that a disaster or series of disasters could require more emergency funds than is available in the reserve account. If such a situation occured there are several steps Congress can take: First, Congress could make cuts in other programs to free-up funds for disaster relief. This is often what we try to do under the curent rules. Second, if the disaster was so severe or there was a national security emergency like Desert Storm, there would surely be agreement in Congress to waive the Budget Reserve Account Law and pass special legislation to respond to the disaster. Or, Congress could add the proposal by Congressman Sam Johnson to establish a "look back" provision which would lower the discretionary spending level for the subsequent year by the amount spent on emergencies the previous year.

***** The Key point is that the Reserve Account would allow us to respond to most emergencies within our budget limits.**

WHAT HAPPENS IF THE RESERVE FUNDS ARE NOT USED?

- Unexpended funds would be returned to the Treasury. Obviously, this would help reduce the federal deficit.

WHAT COULD THE RESERVE FUNDS BE SPENT ON?

- Only on specific natural disasters and national security emergencies designated by acts of Congress. No executive agency would be given any additional discretionary funds.

HOW WILL WE MONITOR HOW EMERGENCY FUNDS ARE SPENT?

- The Office of Management and Budget (OMB) will be required to report annually to Congress on how funds from the Account are spent on each emergency.

EXISTING LAWS CHANGED BY THE CASTLE PROPOSAL:

* Amend the Congressional Budget Act of 1974 to create the Reserve Account and require that these funds be included in the Annual Budget Resolution and Section 602 allocations administered by the Appropriations Committee.

* Amend the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman Hollings) to repeal the authority for Congress to appropriate emergency funds not subject to budget limits.

***** There is no perfect solution to the problem of emergency spending, but the budget reserve account would bring emergency spending into the annual budget process and limit spending to real emergencies.**

Mr. HORN. Well, I think you have made an excellent suggestion. As you know, this Congress and my State of California, Florida, and others went through a whole series of natural disasters in the last 3 years: hurricanes, tornadoes, fire, flood, earthquake, that did bend the system quite a bit.

Now, FEMA gained a tremendous amount of experience, has become a very effective agency, I think, in handling these, but we were just fortunate at the time of the California disasters that in the pipeline there were several billion dollars because it took Congress in the Mississippi floods and other things quite a bit of time to deal with it and needless to say, when Members know the train is leaving the station and will get to the next station, a lot of things try to get tied onto that emergency relief.

Remember Governor Warren during the Second World War created the so-called rainy-day fund out of the budget to help handle this through some immediate post-war situations. He was the first Governor to do that. It made a lot of sense. The legislature agreed with it. But there were funds there that you could readily use as a Governor to deal with a situation.

And I think what you are suggesting here is just good common sense, frankly.

Mr. CASTLE. Well, if I may respond, Mr. Chairman, we do do this in Delaware, my State, and we have what we call a rainy day fund and we had budget problems, like everybody else, and back in the 1970's we started to make some of these decisions and one of the things we did is set aside 5 percent of our money. We are not as likely to have the kinds of emergencies we deal with here, although occasionally they arise, it might be just a financial emergency, which we are also allowed to go into this fund for.

We actually have two cushions. We have a 5 percent cushion and a 2 percent cushion. We have balanced our budget every year since, we have reduced taxes. It has been a tremendous fiscal incentive, particularly when the Members know—and ours can carry over, which I did not put into this legislation here. I think it is more appropriate to reduce the deficit in the circumstances in Washington. But I just think if we are really going to balance our budget, you need good practices such as this.

I wish it could be a little more exact because you are right, there has been a rash of emergencies of late, but I believe this would address the problem by and large and that is what we need to do, have a system to do that.

Mr. HORN. It seems to me it could be forward funded, just like the agricultural programs and student loans. We have operated on really a 2 or 3-year cycle with some of those programs and when you were Governor, I am sure the way you handled deficits that occurred was not only that rainy day fund but in essence a freeze of State expenditures or a call back based on the budget.

And I was citing earlier, I think, before you came in how Governors of California have handled that. Governor Deukmejian solved the $1 billion deficit left by Jerry Brown in 45 minutes. He took the oath, issued an Executive order and every State agency gave 2.5 percent of the budget for a year, we are halfway through the year, so it was really 5 percent of the rest of the year with 6 months. And we all contributed and the budget was balanced over overnight practically.

Mr. CASTLE. I do not think there is a Governor in the country who has not used that at one time or another and used it effectively. I have never understood, this is a little bit aside from the emergency reserve here, but I have never quite understood why the executive branch in Washington, regardless of who the President is or which political party they are, has not been able to more effectively use that. There seems to be a spend or else mentality. Part of it is entitlements, I understand that, spending. But the business of freezing or telling your Cabinet secretaries to return an amount of money is a highly effective way of impacting the budget at the margins.

And usually these deficits are in the 1, 2, 3 percent margin and those expenditures, even if you are dealing with the one-third of the budget that is discretionary, it can be significant. I do not think Congress has helped with that either, quite frankly. I think we have been reluctant to do that.

Mr. HORN. Well, I have put that bill in, I do not remember, in the 103d Congress, H.R. 1099. It had the strong support of the now-Speaker and the now-majority leader. It went to the Rules Committee three times to get it cleared for a floor vote. On the third turndown, a friend of mine who was then an elected Member of the Democratic leadership, puts his arm around me and says, "Steve, you know we cannot clear that for the floor. It would pass."

And I said, "Well, I thought we had come here to let the majority decide some of these things."

But with some of our budget people, the freeze is an anathema. Now, you know, when Governors have used this, as you suggest, you have used it as a Governor, to solve the problem, I must say it seems to me we are crippling both the legislative and the executive branch of this country not to deal with the fiscal responsibility that way.

I have mentioned it to the President, he was pretty intrigued. I gave him the authority to move money around within a certain firewall. He does not have that authority now. We grant reprogramming authority through the authorization and appropriations processes to some Cabinet departments, but we never have given them the tools to really balance the budget.

Mr. CASTLE. Well, then I am probably a minority right now for Republicans, but I agree with you that the President, this President, other Presidents, should have that authority within some bounds of accountability.

Mr. HORN. Yes. We would create a few firewalls so they cannot have all their pet projects. There has to be some balance. But there is—you know, I just cannot believe it, when you have a chief executive and you do not hold them to the responsibility of balancing the budget.

Well, any questions from the ranking minority member?

Mrs. MALONEY. Where would you set this fund up? In the OMB? This fund.

Mr. CASTLE. Yes.

Mrs. MALONEY. Just using existing personnel, et cetera? It would not cost more to set this up?

Mr. CASTLE. Well, obviously, that may have to be—if it is to be set up, it may have to be thought through more carefully, but it would have to be set up in some central agency such as OMB, probably using existing personnel to the extent one can. I am certainly not interested in running up extraordinary costs.

We do our emergency funding process right now without really a lot of added on personnel, so I do not see this as being—I would hate like heck to think that I am creating a bureaucracy. I might withdraw the whole thing immediately if I thought that. I think we could do it within the budget mechanisms we have today in this government.

Mrs. MALONEY. One thing that you testified, or maybe it was the chairman, that once you have these bailout bills, everything and the kitchen sink gets tied onto it. And as another budget idea, why can we not just have each bill address one subject? This sort of logrolling adds more to the deficit than anything.

Mr. CASTLE. I am so totally behind that concept that if you want to sponsor something to change it, I would be glad to help you with it. I think it is one of the great problems we have in this Congress is that extraneous matters get attached to appropriation bills or whatever. There are some rules which limit it, but I do not think it is limited enough.

I think we should be very tight with respect to those limitations. I mean, I am one who is opposed to the legislative riders on appropriation bills, too, as a first cousin to the other problem of these expenditures. And I think it is the worst, but you have rightfully stated in your question, the worst part of this by far is in these emergency appropriations. That is where you get all these—all of a sudden you have a museum being built or whatever it may be and that is just—to me, that is outrageous.

Mrs. MALONEY. Youth programs in one city and——

Mr. CASTLE. Yes. I mean, somebody ought to just raise political havoc with that one, but I think we should—if this bill could somehow legislate that out, we would be better served.

Mrs. MALONEY. Thank you very much.

Mr. CASTLE. Thank you.

Mr. HORN. Thanks very much.

Mr. CASTLE. Thank you, Mr. Chairman.

Mr. HORN. We appreciate your background and experience both.

Mr. CASTLE. I appreciate the opportunity very much.

Mr. HORN. That completes the Members' testimony. We will put the statements in the record prepared by Representatives Saxton of New Jersey; Campbell of California; Royce of California; and I believe Mr. Goss of Florida also has a statement. And Senator Brown cannot make it, so we will file all those statements for the record.

[The prepared statements of Hon. Porter J. Goss, Hon. Tom Campbell, and Hon. Gerald B.H. Solomon follow:]

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STATEMENT ON BUDGET PROCESS REFORM
CONGRESSMAN PORTER GOSS
CHAIRMAN, SUBCOMMITTEE ON LEGISLATIVE & BUDGET PROCESS
BEFORE THE
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION & TECHNOLOGY
MARCH 27, 1996

GOOD MORNING AND THANK YOU FOR ALLOWING ME TO OFFER THIS TESTIMONY. I COMMEND CHAIRMAN HORN AND THIS SUBCOMMITTEE FOR CONTINUING THE DISCUSSION ABOUT OUR BUDGET PROCESS AND OPPORTUNITIES FOR REFORM.

THE MOST IMPORTANT THING WE DO AROUND HERE IS TO MANAGE THE NATION'S FINANCES. THE BUDGET IS THE MEAT AND POTATOES OF THIS PLACE -- ALTHOUGH MANY PEOPLE HAVE CONCLUDED THAT SINCE THE ADOPTION OF THE 1974 BUDGET ACT WE HAVE INDULGED IN FAR TOO MUCH FAT ON THAT DIET!

EACH OF US HAS HORROR STORIES ABOUT THE COMPLEXITY OF OUR CURRENT PROCESS. ONE SIGNAL OF JUST HOW ELABORATE AND COMPLICATED THE PROCESS IS COMES FROM LOOKING AT THE BROAD JURISDICTIONS THAT EXIST AMONG COMMITTEES IN THIS HOUSE WHEN IT COMES TO BUDGET PROCESS. ANY EFFORT AT COMPREHENSIVE REFORM OF THAT PROCESS WILL REQUIRE COOPERATION AMONG SEVERAL MAJOR COMMITTEES OF THIS HOUSE -- AND I LOOK FORWARD TO WORKING WITH YOU TOWARD THAT GOAL.

AS YOU KNOW, THE RULES COMMITTEE HAS JURISDICTION OVER THE PROCEDURES PROSCRIBED FOR THE HOUSE IN ADDRESSING THE NATION'S BUDGET. UNDER HOUSE RULE X, CLAUSE 3, THE RULES COMMITTEE IS CHARGED WITH "REVIEWING AND STUDYING, ON A CONTINUING BASIS, THE CONGRESSIONAL BUDGET PROCESS."

CHAIRMAN SOLOMON -- AN UNDISPUTED LEADER IN THE CHARGE TO MAKE CONGRESS MORE FISCALLY RESPONSIBLE -- HAS MADE BUDGET PROCESS REFORM A MAJOR PRIORITY FOR OUR RULES COMMITTEE. AS SUCH, WE HAVE IN THIS 104TH CONGRESS HELD THREE JOINT SUBCOMMITTEE HEARINGS TO DISCUSS THE PROBLEMS WITH THE PROCESS AND PROBE WHETHER CONSENSUS CAN BE REACHED ABOUT HOW TO IMPROVE IT. THOSE GENERAL HEARINGS, HELD LAST JULY AND SEPTEMBER, LAUNCHED AN ONGOING OVERSIGHT PROJECT WHICH WE HOPE WILL CULMINATE IN MEANINGFUL PROPOSALS FOR REFORM.

WE ASKED OUR WITNESSES -- MEMBERS OF CONGRESS AND OUTSIDE EXPERTS -- THREE VERY BROAD QUESTIONS: 1) WHAT ARE THE OBJECTIVES OF THE 1974 CONGRESSIONAL BUDGET ACT?; 2) WHICH OF THOSE OBJECTIVES ARE RELEVANT IN TODAY'S FISCAL ENVIRONMENT?; AND 3) SHOULD THE BUDGET PROCESS BE RE-DESIGNED?. I WAS MOST PLEASED THAT YOU, CHAIRMAN HORN, WERE ABLE TO APPEAR AS A WITNESS AND PROVIDE US WITH YOUR EXPERTISE.

ALTHOUGH WE HEARD MANY DIVERGING VIEWS, ONE RATHER BASIC CONCLUSION THAT MUST BE DRAWN FROM THAT FIRST ROUND OF HEARINGS WAS THAT PROCESS CANNOT REPLACE POLICY SUBSTANCE BUT THAT WE CANNOT HAVE SUBSTANTIVE RESULTS WITHOUT A PROCESS THAT WORKS. NEARLY EVERY WITNESS SAID THAT THE PROCESS NEEDED TO BE IMPROVED.

WITH THIS YEAR'S HISTORIC ADOPTION OF A BUDGET BLUEPRINT FOR BRINGING OUR BUDGET INTO BALANCE, WE AGREE THAT IT'S CRUCIAL TO HAVE THE MOST EFFECTIVE PROCEDURES IN PLACE TO MEET AND MAINTAIN THAT GOAL. UNFORTUNATELY, TO MANY MEMBERS AND AMERICANS, LOOKING AT THE WORKINGS OF THE CURRENT CONGRESSIONAL BUDGET PROCESS IS LIKE LOOKING INTO A BLACK HOLE. CRITICS SAY IT'S TOO COMPLICATED, TOO CUMBERSOME AND TOO FREQUENTLY OUT OF OUR DIRECT CONTROL. THERE IS GENERAL FRUSTRATION.

THE PRINCIPLES MOST PEOPLE CITE AS IMPORTANT TO BUDGET PROCESS REFORM INCLUDE: ACCOUNTABILITY, SIMPLICITY AND CONTROL. THESE ARE PRINCIPLES THAT SHOULD GUIDE US AS WE REVIEW SUGGESTIONS FOR REFORM -- SUGGESTIONS THAT RANGE FROM MINOR TINKERING AROUND THE EDGES OF OUR CURRENT PROCESS TO DRAMATIC OVERHAUL.

I SHOULD POINT OUT THAT THIS CONGRESS HAS ALREADY PROVIDED SIGNIFICANT ACTION ON TWO INDIVIDUAL ITEMS OF BUDGET PROCESS REFORM. THE FIRST, THE LINE ITEM VETO, WAS A MAJOR PLANK IN OUR CONTRACT WITH AMERICA. AS YOU KNOW, WE HAVE JUST FILED AN HISTORIC CONFERENCE REPORT ON THE LINE ITEM VETO, WHICH THE PRESIDENT HAS PROMISED TO SIGN. AS A RESULT, WE ARE ONLY WEEKS AWAY FROM ENACTING A MAJOR CHANGE IN OUR NATION'S BUDGET PROCESS -- ONE THAT SHOULD PROVIDE THE PRESIDENT WITH A POWERFUL DEFICIT CUTTING TOOL WHILE ENCOURAGING GREATER FISCAL RESTRAINT AND RESPONSIBILITY IN THE CONGRESS. AS A HOUSE CONFEREE, I AM ENORMOUSLY PROUD OF OUR EFFORTS TO CRAFT AN EFFECTIVE AND WORKABLE LINE ITEM VETO.

THE SECOND ITEM OF BUDGET PROCESS REFORM WE'VE PROGRESSED ON IN THIS CONGRESS IS THE DEFICIT REDUCTION LOCKBOX, A PROCEDURAL DEVICE TO ENSURE THAT CUTTING AMENDMENTS PASSED DURING CONSIDERATION OF APPROPRIATIONS BILLS REALLY DO TRANSLATE IN SAVINGS FOR THE TAXPAYERS. I WAS MOST PLEASED THAT OUR SUBCOMMITTEES WERE ABLE TO WORK TOGETHER ON THIS MATTER, HOLDING A JOINT HEARING LAST YEAR AND BRINGING TO THE HOUSE FLOOR NOT ONCE, NOT TWICE, BUT THREE TIMES THIS IMPORTANT PROCEDURAL CHANGE. ALTHOUGH THE HOUSE HAS OVERWHELMINGLY SUPPORTED THE LOCKBOX CONCEPT, WE'VE RUN INTO A LESS ENTHUSIASTIC OTHER BODY. WE'LL KEEP WORKING ON THAT ONE.

MR. CHAIRMAN, ALTHOUGH WE REMAIN COMMITTED TO EXPLORING INDIVIDUAL CHANGES TO OUR PROCESS THAT CAN ACHIEVE SIGNIFICANT RESULTS IN PROMOTING FISCAL RESTRAINT, IT IS MY VIEW THAT, ULTIMATELY, WE SHOULD ATTEMPT A COMPREHENSIVE REWRITE OF THE ENTIRE BUDGET PROCESS. FRANKLY, I BELIEVE ONE OF THE BIGGEST SOURCES OF FRUSTRATION WITH CURRENT PROCESS IS THE MANY LAYERS THAT HAVE BEEN ADDED THROUGH INCREMENTAL REFORMS OVER THE YEARS. THE BUDGET ACT IS ENORMOUSLY DIFFICULT TO READ AND FOLLOW, IN PART BECAUSE IT HAS PERIODICALLY BEEN AMENDED, CROSS-REFERENCED, SUNSETTED AND PARTIALLY REWRITTEN TO REFLECT OUR DEFICIT REDUCTION GOALS OVER THE LAST 22 YEARS.

WE UNDERSTAND THAT THIS IS AN AMBITIOUS TASK. I APPLAUD YOUR EFFORTS TO TACKLE THIS DIFFICULT CHALLENGE AND I STAND READY TO WORK WITH YOU. THANK YOU AGAIN FOR THIS OPPORTUNITY TO SHARE MY THOUGHTS WITH YOUR SUBCOMMITTEE.

TESTIMONY OF THE HONORABLE TOM CAMPBELL, M.C.
"THE DYNAMIC WAY TO SCORE TAX POLICY"

THE FEDERAL BUDGET PROCESS HEARING
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY
WEDNESDAY, MARCH 27, 1996
ROOM 2154 RAYBURN

Thank you, Chairman Horn, for inviting me to testify before the Government Management Subcommittee on the issue of reforming the federal budget process, and how to make the federal budget process more manageable and responsive to the American people. It is a pleasure to take part in this important hearing.

Congress can gain valuable insight from the States in many key policy areas, and one important area is in the accurate estimation of the revenues available to provide government services in the first place. Through the sound application of an accounting device known as dynamic economic modeling, several state and local governments are providing clear and accurate insight into revenue patterns for future years. I am testifying today in support of the premise that dynamic economic modeling is a valuable means of estimating taxes and fiscal actions. In addition, this is a concept that Congress and the federal government should explore further.

At the heart of this discussion is whether we should encourage growth and opportunity in our tax policy. By implementing dynamic economic modeling, one can get a better idea of the revenue effects that changes in sensitive tax policy cause. The State of Massachusetts, for example, has been using dynamic economic methods successfully with the help of the accounting firm of Price Waterhouse. One example from Massachusetts cites significantly different revenue estimations resulting from a tripling of the Investment Tax Credit (from 1% to 3%). For 1997, static modeling estimates show a revenue loss of $29.2 million for the state. Dynamic Economic Modeling methods, by factoring in projected revenue offsets for corporate income tax (+$1.6 million), personal income tax (+$11 million), and sales tax (+$4 million), provide a more realistic estimate of a $12.6 million revenue decrease for the state.

Dr. Michael Boskin, former Bush Administration Economic Advisor and current Stanford University Economics professor, argued last year before Congress that dynamic economic modeling is not an attempt to "cook the books" as defenders of conventional models might suggest. As Dr. Boskin added, those who claim that this is an attempt to cook the books are starting with the erroneous proposition that the "books" are now in good shape. What he acknowledged is that there are serious problems in conventional accounting and in the current presentation of information.

Here's an example of how dynamic economic modeling may work. The House of Representatives Joint Economic Committee (JEC) cites a 1990 projection of Congressional Budget Office (CBO) realizations after capital gains tax rates were increased. Initial estimates of capital gains realizations showed significant gains even after a large increase in the capital gains tax rate after 1987. According to recent Internal Revenue Service data, however, actual realizations were less than half of what was projected by CBO for 1993. Instead of projected realizations of $295 billion in 1993, capital gains realizations remained stagnant at $141 billion -- an error of over 100%! In the words of the Joint Economic Committee, the higher capital gains tax rate has produced less annual real revenue in the 1990-1993 time period under the lower rate of 1985, despite a larger economy.

These are serious enough to justify exploration of policy changes in how we project revenue. At the very least, the idea of dynamic economic modeling could provide a range of revenue estimates around the number produced by the static mold.

It is time for Congress to take notice of dynamic economic modeling's implementation by States, and with the help of leading accounting firms, adopt it. Ignoring the debate on alternative revenue estimating will create a bias against tax policies to create growth which are now under consideration Good ideas which could enrich our future standard of living are at risk of outmoded economic calculations if we do not create this dialogue.

Thank you again for giving me the opportunity to testify today.

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TESTIMONY OF RULES COMMITTEE CHAIRMAN GERALD B.H. SOLOMON (R-NY) BEFORE THE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT'S SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY MARCH 27, 1996

Chairman Horn and Members of the Subcommittee:

It is a pleasure to appear before this distinguished panel this morning. At the outset let me commend the Subcommittee Chairman, Steve Horn, for his devoted work and untiring drive to give the American people a government that prudently manages and utilizes taxpayer dollars.

The issue before you today - that of budget process reform - is one that has been very important to myself and the Rules Committee for a long time. I welcome the subcommittee to this important debate. As you well know, the Republican Majority in the House has already brought about some key budget process reform measures in the 104th Congress. First, as promised in the Contract With America, we will place a Line Item Veto bill on the President's desk later this week. After the outstanding efforts of your own Committee Chairman, Bill Clinger, the Chairman of the Rules Subcommittee on the Legislative and Budget Process, Porter Goss and many other members on both sides of the aisle and in both chambers, a real line item veto applying to all areas of the federal budget will finally become law. I must say that after introducing this bill the day I came to Congress in 1979, I am pleased that it is finally reaching conclusion. With overwhelming public support for this budget process reform, majorities in both Houses were able to put together comprehensive legislation that I believe will go a long way toward aiding our fiscal discipline.

Secondly, the House has passed the "Deficit Reduction Lockbox Act" three times with large majorities of both parties supporting the reform. Again, the Rules Committee in consultation with the Budget Committee and this very Subcommittee was able to draft workable legislation to meet a flaw in the current budget process. Everyone of us should be proud of the bipartisan and cooperative manner in which both of these important budget process reform measures were adopted.

Despite these landmark successes, there is more to be done. When I think of our current federal budget process I am reminded of a very applicable statement by the French aristocrat, Alexis de Toqueville in 1833. He wrote "In its deal to do good works the federal government covers the surface of society with a network of small complicated rules, minute and uniform, through which the minds and most energetic characters cannot penetrate." Mr. Chairman, I know that you, like myself, desire to find our way through the maze of rules we affectionately call the Budget Act of 1974 in the hope that we may find a simpler

road - a road that not only us, as Members of Congress may follow, but one that the American taxpayer can travel as well.

Mr. Chairman, as you well know, the Rules Committee has also been pursuing the goal of budget process reform over the past year. Last session our two subcommittees, the Subcommittee on the Legislative and Budget Process and the Subcommittee on Rules and Organization of the House, under the dual and able leadership of Porter Goss and David Dreier, has held three hearings, hearing testimony from sixteen witnesses, including members of Congress and private sector experts on the budget process. While all of these hearings, such as the one this subcommittee is holding today, have focused generally on the entire budget process, we have found these hearings extremely informative. I am sure your similar efforts here today will produce similar useful results.

I look forward to working closely with this Committee and the Committee on the Budget in the coming months to address the weaknesses of the Budget Act. There are many Members of Congress, private sector and think tank policy analysts who possess many ideas as to the form this effort should take. I would hope we could proceed in a bipartisan and cooperative fashion relying on a truly deliberative process to produce a good legislative initiative.

Again, I thank the subcommittee for allowing me the opportunity to testify this morning and look forward to reviewing the product of this very useful exercise.

Mr. HORN. And we will now start with panel two. If you would come forward? The tradition of the Committee on Government Reform and Oversight and its subcommittees is that we swear in all witnesses but Members of Congress. Some of you are used to that.

If Mr. Zion, Mr. Martin, Mr. Monroney, Mr. Schatz would come forward and raise your right hand?

[Witnesses sworn.]

Mr. HORN. All four have affirmed. We welcome you.

Mr. Monroney, I believe you are the—was your father in Congress, Mr. Monroney? Michael Monroney of Oklahoma?

Mr. MONRONEY. Yes, Mr. Chairman.

Mr. HORN. Earlier when I mentioned the Legislative Reorganization Act of 1946, it was otherwise known as the LaFollette-Monroney Bill, so your father is the last one to get any significant reform through this chamber and that was 1946.

Mr. MONRONEY. Mr. Chairman, in Oklahoma, we call it the Monroney LaFollette bill.

Mr. HORN. Well, you are right. The House, we should call that, too. But those were the two that put the team together, along with one Everett Dirksen who was also the key to getting it through the House.

Well, let us start down the road here with Mr. Zion, the honorary chairman of the 60 Plus Association.

We are glad to have you, Mr. Zion. Welcome.

Mr. ZION. Thank you, Mr. Chairman.

Jim Martin, who is with me, and I have been on the Hill for 30 years in various capacities and I think I speak for both of us in saying that what your committee is trying to do is one of the most significant things we have seen in our 30 years and we certainly wish you well.

With your permission, I will ask Jim to make some preliminary remarks and then I will be a little more specific.

Mr. HORN. Welcome.

James L. Martin, president of the 60 Plus Association.

STATEMENTS OF JAMES L. MARTIN, PRESIDENT, THE 60 PLUS ASSOCIATION; ROGER H. ZION, HONORARY CHAIRMAN, THE 60 PLUS ASSOCIATION; MICHAEL MONRONEY, FORMER CHAIRMAN, COALITION FOR FISCAL RESTRAINT; AND THOMAS A. SCHATZ, PRESIDENT, COUNCIL FOR CITIZENS AGAINST GOVERNMENT WASTE

Mr. MARTIN. Thank you, Mr. Chairman. I am glad to be here. It is an honor to speak with you today.

I have submitted a detailed statement for the record, Mr. Chairman, and many of these distinguished Members of Congress have already covered these points. I would like to have that put in.

Mr. HORN. Without objection, it is in the record.

Each of your statements of all witnesses are automatically in the record once we introduce you for testimony.

Mr. MARTIN. Thank you. I just wanted to say whether it is Mr. Thornton, Mr. Smith, Mr. Stenholm, from either side of the aisle, they have made some really salient points here today. Mr. Cox of California. The more I hear Mr. Cox, I can see why he is on Senator Dole's short list as a possible Vice Presidential candidate from your State, Mr. Chairman.

What your subcommittee is doing should be front page news, but the heavy lifting you are performing on behalf of the American taxpayer I guess is not newsworthy. That is, it is not of a controversial nature, thus, it will probably be buried in the press, if reported at all, but you are saving today seniors, their children, their grandchildren billions of dollars by streamlining the governmental process.

You know, they say that ignorance is bliss and while Congress after Congress has blissfully authorized and appropriated billions of dollars, this subcommittee is looking long and hard at bringing the process into the 21st century.

You know, you are operating with a 75-year-old Model-T Ford. It has been overtaken and surpassed by modern technology, so it is time we implement this technology to reform the budget process.

Again, I have submitted a detailed statement covering the lock box provision, that such sums as may be necessary and all these arcane things, Mr. Chairman.

Let me just close by saying, again, our children and our grandchildren owe you a great deal for tackling this monumental problem. It is being done in a bipartisan spirit and both parties are to be congratulated for what I consider a thankless task.

Thank you.

[The prepared statement of Mr. Martin follows:]

Testimony by James L. Martin, President of the 60 Plus Association

Reform the Budget Process

Good morning Mr. Chairman and Members of the Committee, it is an honor to speak with you today.

My name is Jim Martin and I'm the President of the 60 Plus Association. 60 Plus is an anti-tax advocacy group that has dedicated itself to repealing the Federal Estate and Gift Tax, the most unfair and confiscatory of all taxes placed upon Senior Citizens and their heirs. Specifically, we're working with several Members of Congress as well as three dozen national organizations representing small family-owned businesses, grass roots social organizations, and many agricultural and farm groups and others concerned that the Estate Tax, also known as the "Death Tax," the "Grave Robber's tax" and the "Grim Reapers tax" is unfair, burdensome and a job killer.

Today 60 Plus is testifying before your committee and the American public about the great need for the Omnibus Budget Act of 1996. Buried somewhere in that lofty title are the words reform, common sense, accountability, and, would you believe, honesty.

What your Subcommittee is doing should be front page news but alas, the heavy lifting you are performing on behalf of the American taxpayers is not "newsworthy." That is, it's not of a controversial nature, thus it will be buried in the press, if reported at all.

But you are saving today's seniors, and their children and grandchildren, billions of dollars by streamlining the governmental process. They say ignorance is bliss and while Congress after Congress has blissfully authorized and appropriated billions of tax dollars, this Congress is looking long and hard at bringing the process into the 21st century. The 75 year old model T Ford has been overtaken and surpassed by modern technology, so it is time we implement this new technology to reform the budget process.

Again, our children and grandchildren owe you a great deal for tackling this monumental problem. It's being done in a bipartisan spirit and both parties are to be congratulated for a thankless task.

In his first State of the Union Address in 1982, President Ronald Reagan said, "All of us need to be reminded that the federal government did not create the states, the states created the federal government." Under Reagan's historic plan, he called for restoration of the Tenth Amendment, and called for transferring some 40 programs back to the states.

In short, I'm here, just as Ronald Reagan was, to advocate a New Federalism -- government run by the people, for the people.

This bill is a huge step forward to opening up Washington to the owners -- the American people. The citizens of the United States own this Capitol building. They own the monuments and all that are in them. From the light bill down to the chair I'm currently sitting in, they all are paid for and belong to the US taxpayers. This bill recognizes and appreciates the American Taxpayers, and restores dignity and respect to them that is long overdue.

I liken the current budget to a mythical phone bill that arrives in the mail saying "You Owe $100, send it in now." If every American suddenly got this sort of phone bill, with no itemization as to who they called, when they called them, the amount of time they spent on the phone, and what portion was long distance and what portion was local, there would be a lot of upset Americans. And furthermore, if this phone bill gave you no one to contact to question the bill, no contact to change any of the services, and listed "nobody" as accountable, many people, I suggest would probably just give up trying to figure it out and simply continue using the phone because trying to find out the needed information would be too time-consuming and fruitless.

What the new Omnibus Budget Reform Act of 1996 does to this fictional phone bill is make it real. The real phone bill itemizes phone calls. It tells the American people who they've talked to, for how long, whether the call is long distance or local. It figures in local, state and federal taxes. And if there are any question about billing, or new service, or if you find a service is no longer needed, phone numbers are clearly listed on the bill, and real live operators are standing by 24 hours a day to answer your questions.

This is what the new Omnibus Budget Reform Act does. It improves the budget process through new management accomplishing several things, which can be labeled no better than plain, old fashioned, long overdue, common sense. For example:

1. The bill encourages, rather than discourages, citizen involvement. The government in 21st century America will be the exact opposite of what George Orwell predicted would happen in his classic "1984." Instead of "big brother watching over each citizen," each citizen will not only have the "right to know" but will have the opportunity to access the details if they are so inclined. This is another common sense approach to the New Federalism, a federal government which belongs to the people. The people pay 81 percent of the Federal Taxes -- 81%! And like the newly elected Congressman, they don't know how many government programs there are, how each is performing, the legislative details, the program's mission, goals, objectives, what the benchmarks for the future are, how the program will increase or decrease liabilities. No one is happy having to make decisions with just a few of the facts, but considering we don't have any of the facts, a great change is called for, and this bill goes a great way to solving the problem here in Washington.

2. This bill allows for the dynamic view of economic analysis to be considered when estimating the fiscal impact of tax cuts and increases. Why is this so important? Up until now, the Congress has determined that if you cut, say, Federal Estate and Gift Taxes, which bring in approximately $15 billion to the Federal Treasury each year (only 1% of total receipts, certaintly not a revenue raiser), the static view has always been, "The

treasury is going to lose $15 billion." That's it. The dynamic view, however, examines the behavioral response of taxpayers. So instead of this tax cut costing the government revenue, it actually generates more revenue to the treasury through job creation, more taxes paid, more investments made, more capital bought, and an additional trillion dollars pumped into the economy, rather than into the pockets of accountants and lawyers who set up shop helping others find loopholes in current Estate and Gift Tax law.

3. It protects Social Security taxes from being used to reduce the deficit. This is another remarkable step, but only a first step. We would recommend that the Omnibus Budget Reform Act incorporate the Social Security Preservation Act of 1996 introduced by Congressman Mark Neumann (R-WI). This legislation restores and strengthens the Social Security Trust Fund by investing the current Social Security surplus revenues in REAL assets. Today's seniors, as well as tomorrow's, understand all too well that the Social Security Trust Fund is now full of IOU's, and that all of the money is invested in the $5 trillion national debt. Rep. Neumann's bill ensures that real assets are placed in the trust fund, insuring that Social Security benefits can be paid. So we hope the Committee would consider including H.R. 2928, the Social Security Preservation Act of 1996 in this bigger Budget Reform Act.

And 60 Plus will go a step further. We favor privatizing the Social Security system, 3 out of 4 Seniors -- 75% -- do too. We advocate giving today's senior's the choice to opt out or stay in the current system, and begin to gradually move the program out of the government's hands and into the hands of future retirees. Thus, by giving the citizens their own Private Retirement Account (PRA) and getting the government out of the retirement planning business, you create a win-win situation. First, the citizens win. Citizens have an actual retirement account, with real money in it, and no chance of it being taxed, and no chance of being penalized if they choose to work beyond the age of 65, or any other arbitrary number set up by the government. Secondly, the government wins. No longer does the government spend 50 percent of its annual budget on entitlement programs.

I would like to take a minute and make mention of several members of Congress who are getting out in front of the Social Security Reform process. Thanks to these Members, and many not mentioned, the so-called "Third rail of politics" has been disconnected. My friend Roger Zion has mentioned some of these Congressmen and Senators, and I will too.

Here in the House, Congressmen Jim Kolbe's (R-TX) bipartisan Public Pension Reform Caucus deserves to be recognized for the work it is doing to reform Social Security. The special efforts of the House Social Security Subcommittee must be noted, particularly Chairman Jim Bunning's (R-KY). On the Senate side, we commend efforts by Sen. Alan Simpson (R-WY) and Sen. Bob Kerrey (D-NE). Special thanks also goes to Rep. Mark Sanford (R-SC) for the legislation he has introduced to partially privatize Social Security. 60 Plus also recognizes Rep. Nick Smith's (R-MI) proposed Social Security Solvency Act which allows workers to invest any payroll tax dollars in excess of outlays into retirement savings accounts (RSAs). We also want to thank Congressman John Porter's (R-IL) Plan to move management of Social Security from the public to the private sector.

I must also mention that these Members of Congress are doing the so-called Generation X'ers a big favor. Generation X, the 25 to 35 year olds, believe more in UFOs than they do in future Social Security benefits I would also suggest that the Committee is doing seniors a big favor. Seniors are just as likely to believe in the second coming of Elvis than the likelihood of receiving their continued Social Security benefits.

4. All spending cuts go directly to deficit reduction, with a 30 year plan to eliminate, ELIMINATE, the national debt. The "lock box" concept is simple and good for all Americans. The Congress cannot spend the money saved through spending cuts ever again.

5. The reform bill "mandates," (a scary word I know, but not in this context), that revenues coming in to the government are more than expenses going out. Imagine that, the government spending less than it takes in each year. Anybody around here remember the word "Revolutionary?"

6. It gives the American people and Members of Congress a national balance sheet. Why is this so remarkable? Well, it isn't to Mr. and Mrs. Senior Citizen who have lived by this basic principal all their lives, but Congress has never done this before. The politicians really have no idea what the government is liable for. Nobody really has a handle on what our long term promises are, nor do we really know what our unpaid bills are. Every family in this country must know this in order to survive. Is it any wonder we have a $5 trillion debt?

7. It prevents government shutdowns, which everyone now agrees hurt innocent people. Why should a budget *process* be responsible for throwing people out of work? This does not make sense. Budget *cuts* are one thing, but *process*?

8. It ends appropriation bills that have open ended spending language that stipulate "such sums as may be necessary," basically giving government agencies a carte blanc to spend, spend, and continue spending. The excesses of government spending must come to a halt, and this reform bill reigns in government spending.

9. It ends "baseline" terminology. Never again will a spending increase be called a cut. This is a long overdue honest change.

10. It gives the President the line item veto to cut spending. Enough said.

In conclusion, you may be asking yourselves, "Why does a seniors' group care about the budget process? Seniors are leaders, always have been, always will. They own more of our government because of the simple fact that they have paid more in taxes than the rest of us. And, thank heaven, they live longer. Senior citizens are the true landlords, the true Federalists, and as such, they rightfully deserve to know where and how their money is being spent. James Madison said "Knowledge will forever govern ignorance, and a people who mean to be their own Governors, must arm themselves with the power knowledge gives." The Omnibus Budget Act of 1996 does just that, it gives to the people knowledge, and the power to be their own governors, as it were.

Gentlemen, let's face it, forty years of Federalism have failed. It's time to give the power back to the people. It's time to resurrect Reagan's New Federalism. This is good for seniors, and it's good for America.

Thank you gentlemen.

Mr. HORN. Well, thank you very much.

Do you want to add anything, Mr. Zion?

Mr. ZION. Yes, Mr. Chairman.

Mr. ZION. I believe the greatest single contribution toward budget simplification would be to tackle this 50 percent problem, the entitlements, specifically Social Security.

Now, the Budget Reform Act, through a national balance sheet, showing Congress and the taxpayers what our assets and liabilities are, will expose the current Social Security trust fund problem and the looming Social Security crisis to the U.S. taxpayers.

I have written a book, "The Republican Challenge," and in it I have examined the current trust fund crisis. Basically, if you are working, you are being robbed of your retirement funds. If you are contributing to Social Security, the thousands of dollars which are supposed to be put away each year for your retirement are not really being put away at all. However, if a private retirement company were to handle your money the same way that Congress is currently managing Social Security funds, they would face felony charges, huge fines and jail sentences.

Unless the funds are dealt with now, the baby boom population which has already started to retire will not have enough working Americans to support them. Unless the diversion of surplus funds is stopped, either future retirees' benefits will have to be dramatically reduced or the Nation will face a tremendous new tax, a tax on Social Security benefits.

If the American people find out what Social Security tax money is really being used for, I believe we are going to have a revolution.

I would like to point out Congressman Jim Kolbe's and Charlie Stenholm's bipartisan Public Pension Reform Caucus and the tremendous work it is doing of looking at ways to prevent the oncoming train wreck of Social Security. I thank Senator Simpson and Senator Kerrey for their massive efforts in the Senate to bring to the attention of the America people the need to reform Social Security. The House Social Security Subcommittee members cannot go overlooked, particularly Jim Bunning. Special thanks also go to Mark Sanford, legislation he has introduced to partially privatize Social Security. Several others. Nick Smith who was here.

I have to confess, though, as a former Member of Congress, I know how difficult it is to tackle Social Security. That is why I admire so much what you folks are willing to do.

The provision in the Budget Reform Act that protects Social Security benefits from being used to reduce the deficit is a real good thing, especially Mark Neumann's efforts on behalf of saving Social Security, and recommend that the committee include his bill, the Social Security Preservation Act of 1996, in the overall Budget Reform Act. What Representative Neumann's bill does is restore people's faith in Social Security. By investing these surpluses, which is spent on government programs and replaced with IOUs, the real assets, namely treasury bills and CDs, the trust fund is sound again. So I think this is a great idea.

But what is the long-term problem of Social Security? Some time ago, our organization, 60 Plus, went to our members and asked them what they thought about privatizing this program and by three to one they said it was a good idea.

60 Plus has come out in favor of privatizing. That resembles the Chilean model that has been successful for 14 years. What is really remarkable is that the 60 Plus organization is the only senior citizens organization that really wants to tackle this subject because it is so sensitive.

As we know, Social Security is on a collision course with mathematics. The demographics tell the story. For example, this is frightening, in 1945, there were 42 workers paying each Social Security recipient. In 1950, 16 workers. Today, 3.3 workers for each Social Security beneficiary. And you can see the trend.

In our forthcoming report on Social Security privatization, 60 Plus looked at Social Security's board of trustee's report, which trustees were appointed by President Clinton. We found that the pessimistic or high cost assumptions are the most accurate forecasts when we start talking about insolvency.

When payroll taxes will fall behind benefit requirements, if the pessimistic numbers are right, our rendezvous with insolvency is set for 1999, 30 years earlier than some people are talking about, so this Social Security squeeze is coming on us very fast.

Well, how does the transition take place? In 1994, $323 billion was paid to retired and disabled workers. Additionally, most older workers will depend on Social Security when they retire. Well, you cannot just abandon these people, but how can we make this transition from a creaky Social Security system that currently supports 42.9 million people to the more secure privatization system?

When the Chilean Government privatized its system, it issued General Recognition Bonds that recognized the liabilities of the old Social Security system. In Chile, workers had a choice. They could either stay in the old system or shift to the new and 90 percent of them took the new privatized system over the old. And those who shifted to the new system were granted a recognition bond for the money they had already contributed. Bonds were added to the workers' private retirement account redeemable when each worker retires.

Now, unfortunately in the United States, it seems unlikely that the government could issue trillions of bonds. The U.S. economy with a GDP of approximately $7 trillion could not withstand such a massive Federal plunge into the capital markets. The government could not support the interest payments and principal payments which would amount to more than $700 billion a year. The Chilean economy withstood the transition because their debts were not astronomical and its economy was growing very rapidly.

Although the full details of this transition are beyond the scope of this hearing, we do have some ideas, none set in concrete. We are striving only to make relevant suggestions as a contributor to the Social Security debate.

We advocate a radical change in course in order to avoid this disaster. By privatizing the system, Congress can assure all Americans a retirement with dignity and comfort. Replacing the current system with private personal retirement accounts not only will secure pension benefits, dramatically encourage and increase savings and investment, stimulate economic growth and heighten the standards of living for all Americans.

Finally, debate on Social Security reform must focus on this pivotal date of 1999, not 2029. The Social Security crisis will arrive much sooner than most people expect, not only affecting today's workers, but today's retirees.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Zion follows:]

Testimony by The Honorable Roger H. Zion, (R-IN, 1967-'75)
Honorary Chairman of the 60 Plus Association

Reform the Budget Process
STABILIZE, THEN PRIVATIZE, SOCIAL SECURITY

Mr. Chairman, Members of the Committee, my name is Roger Zion -- I represent 60 Plus, a senior citizen group that strongly believes that by eliminating double taxes on senior citizens and their heirs, specifically the Federal Estate and Gift tax. We can free up millions of dollars and restore freedom and dignity to the people by repealing this onerous tax.

Today I'm here before you to talk about the Budget Process Reform bill. I am wholeheartedly in favor of the objectives of this bill. 60 Plus President Jim Martin has already gone into some detail about the specific objectives the new Omnibus Budget Reform Act accomplishes. I believe the greatest single contribution toward budget simplification would be to tackle the 50% problem, entitlements, specifically Social Security. And the Budget Reform Act, through a National Balance Sheet (Showing Congress and the taxpayer what our assets and liabilities are) will expose the current Social Security Trust Fund problem and the looming Social Security crisis to the US taxpayers.

In my new book, "The Republican Challenge," I've examined the current Trust Fund Crisis. Basically, if you are working, you're being robbed of your retirement funds. If you are contributing to Social Security, the thousands of dollars which are supposed to be put away each year for your retirement aren't being put away at all. If a private retirement company were to handle your money in the same way Congress is currently managing our Social Security funds now, they would face felony charges, huge fines and long jail sentences. Unless the funds are dealt with now, the baby boom population, which has already started to retire, won't have enough working Americans to support them. And unless this diversion of surplus funds is stopped, either future retirees' benefits will have to be dramatically reduced or the nation will face a tremendous new tax, a tax which could very well be a tax placed on all Social Security benefits.

If the American people find out what their Social Security tax money is really being used for then I believe we are truly going to have a revolution.

The rumblings of a real revolution are taking place right now. And I'd like to take a minute and recognize several patriots who are serving their Country well.

I'd like to point out Congressmen Jim Kolbe's (R-TX) and Charlie Stenholm's (D-TX) bipartisan Public Pension Reform Caucus and the tremendous work it is doing looking at ways to prevent the on-coming train wreck that is Social Security. I'd like to recognize Sens. Simpson's (R-WY) and Kerrey's (D-NE) massive efforts in the Senate to bring to the attention of the American people the need to reform Social Security. The efforts of the House Social Security Subcommittee members cannot go overlooked, particularly Chairman Jim Bunning's (R-KY) efforts. Special thanks also go to Rep. Mark

Sanford (R-SC) for the legislation he has introduced to partially privatize Social Security. And we salute Rep. Nick Smith's (R-MI) proposed Social Security Solvency Act which allows workers to invest any payroll tax dollars in excess of outlays into retirement savings accounts (RSAs). Also we recognize Congressman John Porter's (R-IL) Plan to move management of Social Security from the heavy hands of the government to the invisible hand of the free market. This is clearly another good start, but even Porter says this is "not a...solution to the larger, long-term financial ills of Social Security." Thanks to these Members, and many not mentioned, the so-called "Third rail of politics" has been disconnected.

I must confess, as a former Member of Congress, I know how difficult it is to tackle Social Security. That's why I admire so much those members in this Congress who are putting their re-election campaigns on the line for the good of the country.

The provision in the Budget Reform Act that protects Social Security benefits from being used to reduce the deficit is a good thing. However, I'd like to especially recognize Rep. Mark Neumann's (R-WI) efforts on behalf of saving Social Security and recommend that the Committee include his bill, the Social Security Preservation Act of 1996, in the overall Budget Reform Act. What Rep. Neumann's bill does is restore the people's faith in the Social Security Trust Fund. By investing the Social Security surplus, which is spent on government programs and replaced with IOUs, in REAL assets, namely, treasury bills and CDs, the trust fund is made sound again. So we cannot stress enough our recommendation that this Committee add the Neumann legislation.

I also want to address the long term problem of Social Security.

Some time ago 60 Plus went to our members and asked them about Social Security privatization and we found that seniors favored privatization 3 to 1. Times have changed indeed. And if that wasn't enough, *Time* magazine, almost one year ago to the day, ironically enough, did a cover story on the Social Security crises. After that I knew personally that I had better take a closer look at Privatization.

60 Plus has come out in favor of privatization that resembles the Chilean model that now has a successful 14 year track record. What is really remarkable is that the 60 Plus Association is the only senior citizens group to endorse and promote the privatization of Social Security. Last May, 60 Plus submitted an essay on Social Security Privatization to *Insight* magazine where we took on the AARP. The AARP said basically that taxation is the key to saving the Social Security system. It is a very interesting article and I would like to submit it for the record along with my testimony.

Social Security as we know it is on a collision course with mathematics. The demographics tell the story. For example, in 1945 there were 42 workers paying each Social Security recipient. By 1950, there were only 16 workers per beneficiary. Today there are only 3.3 workers per beneficiary.

In our upcoming Report on Social Security Privatization, 60 Plus examined the Social Security's Board of Trustees report, (Trustees appointed by President Clinton) and we found that the pessimistic or High Cost Assumptions are the most accurate forecast as to when we can expect insolvency, i.e. when payroll taxes will fall behind benefit requirements. And if pessimistic numbers are right, then our rendezvous with insolvency is set for 1999, 30 years earlier than what most politicians and journalists report. By saying that there will be no financial problems until the trust fund goes broke, usually, politicians say in 2029, they are patently misleading the US taxpayers. By talking as if the Trust Fund contained hard cash, politicians have not been straight with the American public. Their claim that our problems are a generation away -- and thus not worth talking about, is false. The Social Security squeeze starts before this decade ends.

How does the transition take place? In 1994, $323 billion was paid to retired and disabled workers. Additionally, most older workers will depend on Social Security when they retire, The government just cannot abandon these payments. How can America make the transition from a creaky Social Security system that currently supports 42.9 million people to a more secure privatized system?

When the Chilean government privatized its system, it issued General Recognition Bonds that recognized the liabilities in the old Social Security system. In Chile, workers had a choice either to stay in the old system or shift to the new (over 90 percent took the new private system over the old system). Those who shifted to the new system were granted a recognition bond for the money they already had contributed. The bonds were added to the workers Private Retirement account and redeemable when each worker retires. Unfortunately, in the US, it seems unlikely that the government could issue trillions of bonds. The US economy (with a GDP of approximately $7 trillion) could not withstand such a massive federal plunge into the capital markets. The government could not support the interest payments and principal payments (which should amount to more than $700 billion per year). The Chilean economy withstood the transition because such debts were not astronomical and its economy was growing very quickly. Furthermore, the government busily privatized numerous industries generating additional cash to support the transition.

Although the full details of a transition are beyond the scope of this hearing, we at 60 Plus do have some ideas, none of which are set in concrete.* We are striving only to make relevant suggestions as a contributor to the Social Security debate.

60 Plus advocates a radical change in course in order to avoid this disaster. By privatizing the system now, Congress can assure all Americans a retirement with dignity and comfort. Replacing the current system with private personal Retirement Accounts not only will secure pension benefits, but will dramatically encourage and increase savings and investment, stimulating economic growth and heightening the standard of living for all Americans. Putting control of their retirements back in the hands of individual workers also will help the United States accumulate the capital it needs to compete in the global marketplace in the coming century.

Finally, debate on Social Security Reform must focus on this pivotal date of 1999, not 2029. The Social Security crisis will arrive much sooner than most people expect. It will affect not only today's workers, but today's retirees.

Thank you very much.

* 60 Plus' ideas generally include educating the population, raising the retirement age, eliminating double taxation on Social Security, revising sources of future benefits, i.e. starting in 2000 workers will no longer pay Social Security taxes, but the government will mandate that all workers put a minimum of 8% of their wages into a new PRA system.

Mr. HORN. Thank you.

Mr. Monroney, if you would summarize your statement, that is in the record, we would appreciate it.

Mr. MONRONEY. Thank you, Mr. Chairman.

As background, the reason I am interested in this, is for 7 years I served as chairman of the Coalition for Fiscal Restraint, a group which took up the issue of budget process reform repeatedly over a period of 5 or 6 years. And, as you indicated earlier, I have had a longstanding interest that goes back 50 years to the Congressional Reorganization Act of 1946 because budget process reform was one of the objectives, unfortunately unrealized, of that particular piece of legislation.

While that act did modernize the procedures of Congress in many ways, it was unsuccessful in reforming a budget process which was much less flawed then than it was today.

The national debt then, primarily as a result of deficit spending during World War II, was $270 billion. It is 18 times that much today. Even the annual deficits have exceeded that total 1946 national debt several times in recent years, as well as today's national debt, one that is likely to top $6 trillion before under the best of circumstances we can balance the budget. It is that debt which underscores the importance of getting the Nation's fiscal house back in order and the importance of your hearings here today.

The road to a balanced budget, to national fiscal responsibility is there for the Congress to travel. You need only to find the will and political courage to make the journey, but in the meantime, that road is filled with potholes represented by the lack of discipline and accountability in the congressional budget process. Each of these potholes in turn represents an inherent bias for more spending and less spending restraint.

To fill these potholes, most of which are separate and distinct from one another, I would urge the following steps.

First, you should discontinue current services budgeting. It is a disingenuous process or practice which misleads the American people into believing that Federal programs which are in reality being increased in costs from 1 year to the next are being cut.

Second, you should extend some form of enhanced rescission authority to the President. I believe the House has taken that issue up today and I would congratulate the Congress if that occurs. As a matter of fact, Congressman Cox who testified earlier has pointed out in the past that prior to the 1974 Budget Impoundment and Control Act, before the White House lost the authority to impound funds, from 1959 to 1972, Presidents rescinded or impounded nearly 6 percent of all Federal spending and that in today's dollars is equivalent to saving about $90 billion in today's budget.

If Presidents had retained that recision authority over the past 24 years and exercised it in the same fashion, it is interesting to speculate how much less our national debt would be today.

Third, you should enact the so-called lock box proposal to ensure that funds cut from appropriations bills on the floor of the House are not spent without starting again from scratch in the process and receiving proper authorization.

Fourth, and importantly, I would urge the Federal budget be in the form of a binding joint resolution rather than the nonbinding, concurrent resolution as is the case today. This has been a proposal in several measures proposed by Congressman Cox in the past. Such a joint resolution which requires executive branch approval would bring the President into the budget process at an earlier time.

Recognizing the possibility of disagreements with the President, but to avoid future shutdowns, I would urge, as Congressman Cox testified earlier, that the process include an automatic trigger of a continuing resolution to continue government spending at a fixed percentage of the previous year's level. I believe 95 percent has been suggested.

Fifth, I would strongly urge acceptance of last year's recommendation by the Bipartisan Commission on Entitlement Reform to ensure that the so-called entitlement programs are brought within budget control. That proposal would require Congress to set in advance the desired level of spending for every Federal program and it would exclude Social Security and interest on the national debt.

Frankly, Mr. Chairman, I would go one step further and I would include Social Security under the discipline described.

Some day, as has been stated by Mr. Zion and Mr. Martin earlier, you will have to address the problem of our Social Security system, which is headed toward bankruptcy shortly after the turn of the century, with some form of means testing, lowering the COLA adjustments each year to something below the Consumer Price Index or perhaps some form of privatization or a combination of the first two.

Now, I might add just parenthetically, Mr. Chairman, that I was invited originally to speak here as a representative of the Concord Coalition. The Concord Coalition has not taken a position on budget process reform, but the recommendation I just made would certainly be endorsed by the Concord Coalition.

Six, I would urge stricter budgetary controls for costs relating to emergencies.

Seventh, I would urge an end to the abuse of waivers which permit the Congress to ignore the budget.

And, eighth, I would strongly oppose one proposed change in the budget process, one which would take certain programs, such as the transportation trust fund or the Superfund cleanup off budget. Such an action would leave these programs subject to the same form of excessive abuse and undisciplined spending which has led to the problem we have today.

These are my recommendations. There may be other areas of this process which could use overhaul or fine tuning, but you have an opportunity this year to move quickly in the spirit of bipartisanship on these proposals and I urge you to do so. These reforms would fill many of the potholes in the road that Congress must travel and in so doing would provide you with the disciplines necessary to make the hard choices which could sooner bring the Federal budget into balance and as a result help to lessen the massive and growing burden of debt which is already the legacy of our generation to Americans in the future.

Thank you.

[The prepared statement of Mr. Monroney follows:]

STATEMENT OF MICHAEL MONRONEY ON BUDGET PROCESS REFORM BEFORE THE SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY OF THE HOUSE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

March 27, 1996

Good morning. My name is Michael Monroney. I appreciate the opportunity to speak before this Subcommittee today on the importance of resolving a number of problems in the Congressional budget process which stand in the way of sound fiscal management of the federal budget.

For seven years I served as chairman of the Coalition for Fiscal Restraint (COFIRE), a group of more than 130 trade associations, corporations and citizens' groups which was organized in 1988 to promote reductions in the growth of federal spending so that we might minimize the long-term economic impact of massive annual deficits which have now driven the national debt over $5 trillion.

Recognizing that a seriously defective budget process is and has been a major obstacle to responsible Congressional budgeting, COFIRE consistently urged reforms in that process, beginning in 1989 with support for the Boschwitz-Frenzel proposal (H. R. 1613) which would have eliminated "current services" budgeting. COFIRE also supported every proposal which would have given line item veto authority to the President.

In April of 1991 sixty-six of our member-organizations signed a letter to members of the House, urging passage of the Budget Process Reform Act of 1991 (H. R. 298), sponsored by Mr. Cox of California.

Again in January of 1992 eighty-five of our member-organizations signed a letter to all House members, again urging hearings on H. R. 298 and on H. R. 1889 co-sponsored by Mrs. Patterson of South Carolina and Mr. Stenholm of Texas.

In July of 1994 more than eighty of our member-organizations signed an open letter to the House of Representatives, urging passage of H. R. 2929, the then-current version of Congressman Cox's earlier budget process reform proposal, and of H. R. 3444, the Common Cents Budget Reform Act, co-sponsored by Mr. Stenholm of Texas, Mr. Penny of Minnesota, and Mr. Kasich of Ohio.

In January of 1995 copies of a COFIRE letter to Chairman John Kasich, urging elimination of "current services" budgeting and passage of line item veto authority for the President, were sent to each member of the House

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My personal interest in the budget process, however, dates back to fifty years ago when such process reform was a goal, unfortunately unrealized, of the Congressional Reorganization Act of 1946 (sometimes referred to as the Monroney-LaFollette Act) of which my father, then a member of this body, was the chief sponsor in the House.

While that 1946 act did modernize the procedures of the Congress in many ways, it was unsuccessful in reforming a budget process which was much less flawed then than it is today. The national debt then -- primarily as a result of deficit spending during World War II -- was $270 billion. It is eighteen times that much today. Even the annual deficits have exceeded that total 1946 national debt several times in recent years.

It is today's national debt -- one that is likely to top $6 trillion before the federal budget can be balanced under the most optimistic of circumstance -- which underscores the importance of getting the nation's fiscal house in order and which makes the subject of this hearing so important, specifically to future generations of Americans upon whose shoulders this debt will fall.

The road to national fiscal sanity is there for the Congress to travel. You need only to find the will and political courage to make the journey, but, in the meantime, that road is filled with potholes represented by the lack of discipline and accountability in the Congressional budget process. Each of these potholes, in turn, represents an inherent bias for more spending and less spending restraint.

To fill these potholes, most of which are separate and distinct from the others, I would urge the following steps (and not necessarily in the order of their importance):

First, you should discontinue "current services" budgeting. It is a disingenuous practice, deliberately misleading the American public into believing that federal programs which are, in reality, being increased in cost from one year to the next are being cut.

The budget process is complicated enough for in-siders to understand without providing such dishonest misconceptions to the public about the way in which their tax dollars are being spent.

Second, you should extend some form of "enhanced rescission" authority to the President. The consequences of the Budget Impoundment and Control Act of 1974 have made the President a virtual eunuch when it comes to fiscal policy, technically being able to spend not one cent more nor one cent less than Congress permits.

The President has never had and should never have spending authority beyond that which Congress allows, but he or she should have the ability to veto specific spending with the constitutional allowance for a two-thirds vote to over-ride such vetoes remaining as a protection for the Legislative Branch.

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As Congressman Cox has pointed out, prior to the 1974 Act and before the White House lost such authority, from 1959 to 1972 presidents rescinded nearly six percent of all federal spending ... and that, in today's dollars, is equivalent to saving about $90 billion in today's budget. If presidents had retained that rescission authority over the past 24 years and exercised it in that same fashion, it would be interesting to speculate how much less our national debt would be today.

Third, you should enact the so-called "Lock Box" proposal to insure that funds cut from appropriation bills on the floor of the House are not spent without starting again from scratch in the process and receiving proper authorization.

It is inconceivable to me that such funds, having been eliminated from an appropriation bill, can simply be allocated elsewhere and spent at the discretion of the Appropriations Committee -- and most often on some member's favorite porkbarrel project -- with little or no debate. It is irresponsible fiscal management.

Fourth, to restore public confidence and avoid the embarrassment of future shutdowns in federal programs and services, I would urge that the federal budget be in the form of a binding joint resolution -- rather than a non-binding concurrent resolution as is the case today.

Such a joint resolution -- which requires Executive Branch approval -- would bring the President into the budget process at an earlier time. Recognizing the possibility of disagreements with the President but to avoid future shutdowns, I would urge that the process include the automatic trigger of a Continuing Resolution to continue government spending at a fixed percentage of the previous year's level. I believe 95 percent has been suggested.

Fifth, I would strongly urge acceptance of last year's recommendation by the Bipartisan Commission on Entitlement Reform to insure that the so-called "entitlement" programs are brought within budget control. That proposal would require Congress to set in advance -- as, presumably, would the Joint Resolution suggested in my previous recommendation -- the desired level of spending for every federal program, and it would exclude Social Security and interest on the national debt ... as presumably would the Joint Resolution.

Both would eliminate the undisciplined practice of blank-check appropriations for what currently comes under the definition of "such sums as may be necessary" which, in itself, is an open-ended invitation to fiscal mismanagement.

Frankly, I would go one big step further and include Social Security under the discipline described. Someday you will have to address the problem of our Social Security system -- which is headed toward bankruptcy shortly after the turn of the century -- with either means-testing, lowering the COLA adjustments each year to something below the Consumer Price Index, as has been suggested by Senator Moynihan, or some form of privatization, perhaps a combination of these remedies.

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Sixth, I would urge stricter budgetary controls for costs relating to emergencies requiring federal funding. I believe one proposal which has been suggested is a so-called "rainy day" fund consisting of monies set aside in each budget to be used only for specified and genuine emergencies and for only one such "emergency" at a time.

Seventh, I would urge an end to the abuse of "waivers" which permit the Congress to ignore the budget. I would urge that, in such instances, waivers could only be obtained by requiring a two-third recorded vote in both houses rather than the current majority or "by unanimous consent."

Eighth, I would strongly oppose one proposed change in the budget process ... one which would take certain programs, such as the transportation trust fund and the Superfund cleanup, off budget. Such an action would leave those programs subject to the same form of excessive and undisciplined spending which has created our rapidly escalating national debt.

These are my recommendations. There may be other areas of this process which could use overhaul or fine-tuning, but you have an opportunity to move quickly this year in a spirit of bipartisanship on these proposals, and I urge you to do so.

These reforms would fill many of the potholes in the road Congress must travel ... and, in so doing, will provide you with the disciplines necessary to make the hard choices which could sooner bring the federal budget into balance and, as a result, help to lessen the massive and growing burden of debt which is already the legacy of our generation to Americans in the next century.

Thank you for the opportunity to present these views.

Mr. HORN. Let me just ask you a question on point eight. You mentioned the Transportation Trust Fund and the Superfund cleanup off budget. Ones that are of particular interest to the House are the Highway Trust Fund and the Aviation Trust Fund and the concern there is that people when they roll up to the gasoline station are paying a percent of that particular gallon into the Trust Fund. And when people get a ticket on an airline, a certain amount goes into the Aviation Trust Fund. And we have Presidents, both Republican and Democratic, who use those as budget balancers. The desire would be obviously to have the authorization committees control what projects are authorized out of that fund, rather than the appropriations committees because they are not really available to the appropriations committees when the Presidents are sitting on them. We could force it out of them, I am sure, by an act of Congress, but at this point, we have not. So I wondered, it is not giving up congressional control, it is just an argument over who is controlling what, I think, to sum it up.

Mr. MONRONEY. Well, I agree with that, Mr. Chairman.

Mr. HORN. All right.

We have one of our regular witnesses and we are delighted to see Thomas Schatz, president of the Council for Citizens Against Government Waste.

Mr. SCHATZ. Thank you very much, Mr. Chairman.

And let me apologize for not having the written statement. I know that it left my office last night, but I do not know what happened once it got here. Maybe it is that new privatized post office we have. I understand a number of the Members have complained about it.

Mr. HORN. You might be right.

Mr. SCHATZ. I know it got out of there.

First of all, I also want to add my congratulations to many of the Members that have appeared here this morning. Congressman Cox and Congressman Largent have been working very hard on a coalition to put together a budget reform bill. Congressman Stenholm as well has been working for many years.

And I congratulate you, Mr. Chairman. This is a bill that comprises many of the issues that we have been working on for many years. I know your able counsel, Harrison Fox, as well has been very involved. You and I talked about this a few years ago.

Mr. HORN. Right.

Mr. SCHATZ. And I am glad to see you in the right position to really get something done.

Many cite the beginnings of our current budget chaos to the 1974 Budget and Impoundment Act. That act changed the fiscal year, established the current budget process and interestingly required Federal agencies to submit a 5-year plan to Congress.

That stimulated some planning interest within the Office of Management and Budget, but the focus on 1-year spending cycles really negated any potential success of that long-term planning.

Since the 1974 act, spending is out of control. The national debt has exploded and these chronic deficits are sapping our Nation of the resources it needs to create a higher standard of living for the next generation. Efforts to reduce spending have, for the most part, failed. The Gramm-Rudman-Hollings Act was revised enough times to basically make it totally ineffective.

Since 1974, Presidents Ford, Carter, Reagan, Bush and Clinton have sent Congress 1084 recision requests. These requests for spending cuts could have saved $72.8 billion. Congress enacted only 399 of these spending cut requests. Total savings from those cuts are $22.9 billion. That leaves taxpayers with $50 billion in unanswered requests.

Mr. Monroney mentioned these other efforts over the years that would have saved really what in today's dollars would have been $90 billion, in essence cutting the deficit in half.

The term budget process is misleading. Congress does not budget in any meaningful sense of the term. A real budget is a financial plan that controls how much money may be spent overall in each expenditure category prior to any specific act of spending. The Federal Government operates without this financial plan to discipline its spending decisions.

Total spending emerges from the multitude of separate spending decisions Congress makes during a fiscal year. Unlike the private sector, Federal spending decisions are made without reference to revenues. The current budget process is therefore heavily biased in favor of spending more, taxing more and borrowing more.

This bias could be substantially reduced by establishing, as suggested in your draft legislation and by the Grace Commission, an Office of Federal Management inside the Executive Office of the President.

You may be aware, Mr. Chairman, that Leon Panetta himself made such a proposal back in 1991.

Mr. HORN. I am aware of that.

Mr. SCHATZ. I imagine if you went to him today and said let us do it, I do not know if you would get the same response. But it is something that is very significant because it would really make budget a function of management and right now the problem is that budget controls everything that goes on over there. No matter how much they talk about putting the M back into OMB, you have to take the whole thing and start over again in a lot of ways.

Mr. HORN. And, as you know, this is why this subcommittee has recommended we create a separate Office of Management and get serious about the problem.

Mr. SCHATZ. That is exactly what needs to be done.

Mr. HORN. I tried for years to think that with budget clout you would get something done with management. Finally I became convinced it was not happening. And when the Presidents come in, they choose somebody that is either an economist or an accountant, depending on administration, and their concerns are with the budget, which is overwhelming and you can understand that. Their concerns are not with management.

Mr. SCHATZ. That is exactly right. Maybe some of the people that have made the management changes, people that get called in to rescue drowning companies might be the kind of person you would want in that type of position.

Mr. HORN. Right.

Mr. SCHATZ. We would just recommend those decisions. If you have to fire somebody, fire them. We need to save money.

In terms of the process inside of Congress, we recommend biennial budgeting and appropriations, which is not all that popular with some of the leadership, but nonetheless should be strongly considered.

A taxpayer debt buy-down proposal is proposed by Congressman Walker of Pennsylvania.

And a spending cuts commission proposed by Congressman Miller and Senator Mack as a backup should Congress fail to agree on the numbers. And I know that you do have that as well in your legislation.

The two-thirds requirement for spending over the budget ceiling is a good idea, particularly because it would affect all appropriations in a certain category, even if only one piece fell over the limit.

The "such sums as may be necessary" has been used for many years to basically overspend. That should be eliminated.

Even entitlement laws should have a fixed dollar amount except for Social Security and interest on the debt.

The rainy day fund recommended by Congressman Castle we have long supported. It works very well, as you note in the States, and in other areas and that should be done as well.

Deficit reduction lock box has already been through the House. It needs to get through the Senate. It needs to be enacted.

The joint resolution being passed by both Houses, signed by the President, would get this process in gear a lot faster during the year. Members might actually be able to get home for Thanksgiving and Christmas under these circumstances. There has been a lot of talk about a family friendly atmosphere here. This would go a long way toward ensuring that would occur.

Baseline budgeting, the current services has been changed by House rules but not by statute. That needs to be fixed. In addition, the line item veto must be done. We have obviously—we are moving in that direction.

Mr. Chairman, these reform bills have been around for many years. It has been noted by several of the witnesses this is not an exciting topic, even your own subcommittee does not appear terribly excited by it based on the lack of attendance here today, nothing personal to the Members, but it is in many ways arcane but it is very fundamental.

We fought for many years to get Chief Financial Officers into the Federal Government, which is something else that needs to be worked on, obviously.

Mr. HORN. That was a great contribution.

Mr. SCHATZ. Thank you, but——

Mr. HORN. And I think it is going to result in 1997, and hopefully with all but Defense, we will have a budget sheet like the modern corporation and the modern university and practically every Government in America but the U.S. Government.

Mr. SCHATZ. That is true. And the fact is that when you say to people that for the first 230 years or 220 years, whatever it was, that we did not have something like this, they look at you as if you are from another planet, but the fact is that it did not happen.

Mr. HORN. Right.

Mr. SCHATZ. We did not know what the numbers were. Congress in many ways operates blindly when it comes to spending money.

This whole budget process reform that you are talking about would be an incredible enhancement to the ability of Members to look at numbers, understand them, know what they are doing and see what actually is working and not working.

The performance standards you have in here as well are critical. It is one thing to plan, it is another thing to not have a measurement of whether or not that plan has been achieved.

Mr. HORN. Right.

Mr. SCHATZ. And that has been talked about by everyone from Peter Drucker down to the labor/management committees in various companies these days. It is very significant.

I have really no other statement to add orally. I would be happy to answer any questions. And I really do congratulate you and the members of the subcommittee and the others that have been pushing to move this forward and I certainly pledge the efforts of all of our members and our staff to get this moving and hopefully get it enacted this year.

[The prepared statement of Mr. Schatz follows:]

Testimony of
Thomas A. Schatz,
President,
Council for Citizens Against Government Waste before the
Government Management, Information and Technology Subcommittee of the
House Government Reform and Oversight Committee
March 27, 1996

Good morning, Mr. Chairman. Thank you for the opportunity to testify today before the Subcommittee on Government Management, Information, and Technology. My name is Tom Schatz and I represent the 600,000 members of the Council for Citizens Against Government Waste (CCAGW).

CCAGW was created 12 years ago after the late Peter Grace presented to President Ronald Reagan 2,478 findings and recommendations of the Grace Commission (formally known as the President's Private Sector Survey on Cost Control). These recommendations provided a blueprint for a more efficient, effective, less wasteful, and smaller government.

Since 1984, the implementation of Grace Commission recommendations and CCAGW have helped save taxpayers more than $433 billion. With the national debt of more than $5 trillion our work is far from done.

Mr. Chairman, you and the members of this subcommittee face one of the most daunting tasks confronting this Congress -- reforming Washington's wasteful ways.

This 104th Congress *could* remake the federal government into a much smaller and frugal institution. The new majority has wisely taken on the entrenched bureaucracy and status-quo special interests by serving up a seven-year balanced budget act. In our view, Mr. Chairman, Democrats and Republicans alike now have a chance to build a blueprint for fiscal soundness and tilt the balance of power back to America's working families. Many citizens are fed up with inside-the-beltway budget jargon and policies that have created a mountain of debt for our generation and future generations.

CCAGW believes the congressional budget process is broken. One way to address this broken system may be to try biennial budgeting. Many in Congress believe this budget style is not possible, especially when the Congress and the President cannot agree on spending requirements for the current fiscal year budget cycle.

In 1984, the Grace Commission found that the Executive Branch was in dire need of planning and budgeting reform. The task force that examined Federal Management Systems recommended that administration goals and activities be met over five-year periods. This long-term budgeting was an attempt to improve agency planning. The most recent attempt to increase long-term planning within the federal government came with the passage of the Congressional Budget Control and Impoundment Act of 1974. It is ironic that the words "budget" and "control" are included in the title, when, in reality, "uncontrollable budgets" have followed since its enactment.

The 1974 Budget Act changed the fiscal year, established the current chaotic budget process, and required federal agencies to submit a five-year plan to Congress. The five-year projection requirement stimulated planning interest within the Office of Management and Budget, but the focus on one-year spending cycles has negated any potential success of long-term planning.

Very briefly this morning, I want to address reasons why our national debt has soared so far out of control. During the line-item veto debate -- and let me acknowledge how encouraging it is to see that "enhanced rescissions" will be in effect on January 1, 1997, no matter which party is in the White House -- Senator McCain of Arizona spoke about the 1974 Budget Impoundment and Control Act. On March 20, 1995, he said "In 1974, the deficit was $6.1 billion; the total debt was $483 billion." He added, "Repeating that, the deficit was $6.1 billion; it is estimated in 1994 to be $203 billion (1995 - $163.9 billion deficit) And as I mentioned, the debt was $483 billion in 1974. In 1994, it was $4.6 trillion - trillion dollars. We are now carrying an annual deficit that is about half of what the national debt was, the entire national debt. We have gone from $483 billion in 1974 to $5.2 trillion estimated in 1996."

Mr. Chairman, that is why groups like CCAGW exist. We, as a country, will not succeed by sapping our gross domestic product and future economic growth with annual deficits and outrageous debt. The process is broken and the people know that it needs to be fixed now.

What has happened since the 1974 Budget Act was enacted? Spending is out of control because of the process. The 22 year-old Budget Act has heaped trillions of future taxpayer dollars onto the national debt. It has limited the discretion of the executive branch and the way federal monies are spent or saved. The Budget Act of 1974 did grant the President the power to request rescissions from the budget. However, in order for those rescissions to take effect, Congress must enact the recommended spending cuts within 45 days. Under this Act, Congress is not even required to **vote** on the rescission recommendations. It is virtually ignored by the Congress.

Since 1974, Presidents Ford, Carter, Reagan, Bush and Clinton have sent Congress 1,084 rescission requests. These requests for spending cuts could have saved taxpayers $72.8 billion. However, Congress enacted only 399 of these spending cut requests. The total savings from these 399 spending cuts are $22.9 billion. But that leaves taxpayers with nearly $50 billion in unanswered rescission requests.

The 104th Congress has been locked in very serious fiscal year (FY) 1996 budget negotiations for months. Currently, we are about to start the seventh month of FY 1996.

Whenever monumental decisions about balancing the budget are debated, time is crucial to ensure that Congress and the Administration do the right thing and guide our country toward fiscal prosperity. Unfortunately, this seemingly never-ending debate on the budget occurs every year. Year after year, more and more time is consumed by budget debates. Year after year, deficits run rampant and spending is not brought under control.

The federal budget was last balanced in 1969, and the 25 annual budget deficits since then raise serious questions about the ability of the president and the Congress to restore fiscal soundness to the nation.

The budget process is clearly broken. Indeed the term "budget process" is misleading because Congress does not budget in any meaningful sense of the term. A real budget is a financial plan; it controls how much money may be spent overall and for each expenditure category, prior to any specific act of spending. The federal government operates without such a financial plan to discipline its spending decisions. Total spending emerges from the multitude of separate spending decisions Congress makes during the fiscal year. Unlike the private sector, federal spending decisions are made without reference to revenues. The current budget process is therefore heavily biased in favor of spending more, taxing more, and borrowing more.

Mandatory spending, outside the "direct control" of Congress, accounts for more than 47.3 percent of the federal budget, and is further proof of how the current budget process fails to control spending. Mandatory spending is governed by eligibility and benefit or payment rules and not the appropriations process. Consequently, these so-called entitlement programs have been allowed to grow as if on automatic pilot. Mandatory spending has grown 51 percent since 1989 and is expected to grow 39.5 percent during the 1994-99 period.

In this Congress, there are nearly 20 bills that reform the budget process or attempt to better organize the structure of the budget process, including the Capital Budget Commission Act and the Omnibus Budget Act of 1996.

Budget process reform process must include biennial budgeting and appropriations and taxpayer debt buy-down. In addition, the final version must contain the following:

o A two-thirds requirement (supermajority) on spending over the budget ceiling. This supermajority vote would create a strong incentive for both the President and Congress to reach agreement on the budget. For example, if Congress wished to enact an appropriation that, together with other appropriations in a certain budget category, exceeds the ceiling for that category, would be subject to all appropriations in that category to a two-thirds vote.

o The ubiquitous term "such sums as may be necessary" must be replaced in all entitlement laws with a fixed dollar amount for all accounts except Social

Security and interest on the debt. This will help end "uncontrollable spending."

o There must be a "rainy day" fund that sets aside a prudent amount for emergencies and provides procedures insuring that the funds will only be used for specified purposes and for only one "emergency" at a time. No longer can emergency spending bills be the vehicle used for pork-barreling a bill that is certain of a presidential signature.

o All spending cuts must be captured for deficit reduction (lock-box).

o The budget must be a joint resolution that must be passed by both Houses of Congress and signed by the President. If no agreement can be reached, then an automatic Continuing Resolution would kick in that funds the government at 75 percent of the previous year's level and contract authority would continue under the previous year's terms and conditions.

o End baseline budgeting. The fraudulent use of baselines will end the deceptive spending "cuts" game that actually increases spending.

o PAYGO guidelines in supplemental spending must be met so that spending increases are offset with cuts in other programs.

o No authorization or spending bill can be considered until a binding overall budget resolution (signed by the President) is in place.

o Enhanced rescissions (line-item veto authority for the President) must be in place.

Budget negotiations need to start earlier, not at the end of the year when budget negotiators are forced to compete with a tight House calendar and the holiday season. Instead of cooperation, taxpayers outside the beltway only see confrontation. If budget guidelines are binding between both ends of Pennsylvania Avenue, political games would be diminished and real spending reductions could begin.

Budget reform bills in the 103rd and 104th Congresses have had bipartisan support, but have had a difficult time reaching the floor for a vote. CCAGW hopes this session will be different.

Reps. Christopher Cox (R-Calif.), Joe Barton (R-Texas), Charlie Stenholm (D-Texas), and Steve Largent (R-Okla.) should be praised for taking the lead on budget process reform. And, Mr. Chairman, you deserve our thanks as well for focusing on this vital issue. We understand that more senior members are not fully embracing the idea of budget reform. They understand the current system and its complicated rules, but this is a hollow argument for continuing a broken system.

The momentum is on the side of reformers. With enhanced rescissions nearly signed into law, the next step is producing a simple and understandable budget process. Rep. Cox wrote last year that "Congress has missed its budget deadlines every year since 1974. And in recent years, as many as half of all spending bills have automatically waived the budget law -- end running its spending restrictions in order to spend willy-nilly."

This is a bipartisan effort. More than 200 co-sponsors from both sides of the aisle signed onto budget process reform in the 103rd Congress. CCAGW is committed to fighting for the elimination of wasteful spending. But balancing the budget without fixing the process will not be enough.

Mr. Chairman, in 1960, President Eisenhower decided not to spend eight percent of the entire federal budget. He believed that the government shouldn't overspend the people's money. In fact, between 1959 and 1972, Presidents Kennedy, Johnson, and Nixon rescinded nearly six percent of all federal spending. Today, that would compute to $90 billion in **annual** savings to the taxpayers -- enough to wipe out half the FY 1996 deficit. Budget reform efforts would not restore that kind of power, nor should it, but it will tip the scales toward the taxpayers and away from Washington.

That concludes my testimony. I would be pleased to answer any questions your subcommittee may have.

Mr. HORN. Your help and the help of the other Members here and the groups they represent are absolutely essential if we are going to get something done. You have to help us educate all our colleagues in this area because, as you suggest, it is not known as the most visceral, exciting hearings we hold around here but, frankly, billions of dollars are at stake if we get this done right. And so thank you for coming and thank you for your testimony. Those are excellent suggestions and we appreciate it.

Thanks.

The next panel and the last one, panel three, is Mr. Dave Mason, Mr. Stephen Moore, Mr. Joseph White, Mr. Richard Kogan. If they will come forward.

[Witnesses sworn.]

Mr. HORN. We will just go down the line that is in the agenda. Dave Mason is not here. He is going to join us in about 15 minutes.

We will start, then, with Mr. Moore. Stephen Moore is director of fiscal policy studies at the CATO Institute.

Welcome.

STATEMENTS OF STEPHEN MOORE, DIRECTOR OF FISCAL POLICY STUDIES, THE CATO INSTITUTE; JOSEPH WHITE, SENIOR FELLOW, GOVERNMENT AFFAIRS, THE BROOKINGS INSTITUTION; RICHARD KOGAN, BUDGET DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES; AND DAVE M. MASON, VICE PRESIDENT, GOVERNMENT RELATIONS, THE HERITAGE FOUNDATION

Mr. MOORE. Thank you, Mr. Chairman. It is a pleasure and a privilege to testify before this committee and I want to add to the comments of the previous panelists in congratulating you on your leadership on this important issue of budget process reform.

Let me make four or five quick points that are in summary of the statement that I submitted to the committee.

The first is that I believe that the current budget process does have a pro-spending bias in it and if you look at my testimony, in the last couple of pages I added some graphs, but if you look at the table, what we have seen since 1955 when we adjust for inflation with respect to Federal spending has been about a fourfold increase in spending. That is adjusting for inflation. Even if we adjust for the increase in population, we spend about three times more per household today than we did in 1955.

The interesting thing about this table is it shows that almost all the growth and the spending has, not surprisingly, been in the income redistribution programs, health care, income security, Social Security and so forth. So I do think that we have a big problem with respect to the bias that we have with respect to the pro-spending in the budget.

And I would add one more point and that is that I believe if you look at the 1974 Budget Act, the 1974 Budget Act was designed to actually add fiscal discipline and reduce deficits, but if you look at the data on this, it shows that in fact whereas in the 20 years before we put into place the 1974 Budget Act, we had an average budget deficit of about 1 percent of GDP and average deficits of about $30 billion.

In the 20 years since enactment of the 1974 act, we have had average budget deficits of $170 billion and 3.5 percent of GDP. Clearly what we are doing now is not working, Mr. Chairman.

The second point that I would make is that we are not on the right track right now with respect to dealing with our budget deficit. When President Clinton released his budget, it was all good news, it was saying that we are on the right track in terms of getting spending under control, that the era of big government is over and in fact the deficit is going down.

What I would like to show you is then the second graph in my testimony, the average annual real budget deficit for every major presidency.

Now, I linked together the Bush and Clinton policies because they were essentially the same but the major point about this is that if you look at these statistics, what you see is that in the 1990's under Bush and Clinton, the deficits have even been higher in real terms than under Reagan. And, of course, Reagan's high deficits were the major stain on his record.

But the more important point is that if you look at the most recent Congressional Budget Office numbers with respect to their baseline forecast of where we are headed with the budget deficit, they predict that by the year 2005 our deficit will, although going down in 1996, after 1996 go up to about $350 billion.

So what we are doing right now, let me understate this point, is not working.

Third, I do believe that process does affect substance. It does affect the outcomes. The rules of the game are important. And I think one good example of this is the Gramm-Rudman era where when we put into place the Gramm-Rudman policies, especially the sequestration process, although Gramm-Rudman did not work as well as it was intended to do, there is no question that that was an era of substantial budget deficit reduction.

In fact, if you look at the era 1985 to 1989 when we had Gramm-Rudman in effect, we did see a substantial reduction in the growth rate of spending. We also saw a reduction in terms of cutting the deficit in half. The deficit went from about 6 percent of GDP prior to having Gramm-Rudman in place down to about 3 percent. Now, of course, we would have liked to bring it to zero, but that was substantial progress.

And, finally, we got rid of Gramm-Rudman, not because it was not working but precisely because it was working. It was increasingly putting constraints on spending, especially entitlement programs, which is not very well understood.

Because we had the Gramm-Rudman cap on the nonentitlement programs, what was happening, it was forcing Congress to constrain entitlements because if they did not cut entitlement programs it would have eviscerated virtually all of the nondiscretionary programs.

And so what you saw during the Gramm-Rudman era was a reduction in the entitlement spending rate of growth. It had been growing at about 8 percent. Entitlements only grew at about 4 percent during the Gramm-Rudman era.

Fourth, let me just go over some of the major points that I think we need deal with respect to fixing the budget process.

I think the single most important thing we need to do, quite obviously, is a balanced budget amendment. We should do it with a tax limitation, but if we do not have the votes to pass a balanced budget amendment with a tax limitation, then we ought to do it without a tax limitation.

Those people who say that the balanced budget amendment is a gimmick, in my opinion, Congressmen, if the balanced budget amendment were a gimmick, we would have done this a long time ago in Washington.

Second of all, we ought to do a supermajority to raise taxes. We are not a majoritarian country. Our entire constitution is about protecting the rights of the minority. We have had 20 tax increases since 1970. I believe it is time to put a stop to this and I think the idea of a supermajority would be a very effective constraint.

And, by the way, Mr. Chairman, there are about 10 States now that have through the initiative and referendum process put in place the supermajority requirements. And we did a study at CATO which I would be happy to provide the committee with——

Mr. HORN. I would like it at this point in the record, of which States and what the supermajority is.

Mr. MOORE. Sure.

[The information referred to follows:]

States Requiring a Supermajority of State Legislators or Approval of Voters for New or Increased Taxes

State	Year First Adopted	Super-majority of Legislature	Voter Approval
Arizona	1992	2/3	
Arkansas	1934	3/4*	
California	1979	2/3	
Colorado	1992	2/3	✓
Delaware	1980	3/5	
Florida	1971**	3/5*	2/3
Louisiana	1966	2/3	
Mississippi	1970	3/5	
Missouri	1996		✓
Nevada	1996	2/3	
Oklahoma	1992	3/4	
Oregon	1996	3/5	
South Dakota	1978**	2/3	✓
Washington	1993	2/3	✓
Number of states		13	5

Source: Cato Institute.
*In Arkansas, applies to all taxes except sales and alcohol. In Florida, applies only to corporate income tax.
**New stricter measure was passed in November 1996.

Mr. HORN. Are they all generally two-thirds or are some 60 percent, some are 65?

Mr. MOORE. Some are 60 percent. Most are actually 60 percent. Some are two-thirds. And what our study showed was that these have been a fairly effective constraint on reducing taxes. In fact, in Arizona where they put this in place, the legislators say that they do not even bother to propose tax increases any more because they know because of this constraint they cannot get tax increases through the legislature.

We also compared, by the way, Mr. Chairman, the States that do have these supermajority requirements versus those that do not and you do see a very different rate of growth of taxes in the States that do have these in place versus those that do not.

I also believe that we ought to take the suggestion of Minority Leader Richard Gephardt who came up with, I think, one of the best proposals of all which would be to have a national referendum on any tax increases.

Again, this is something that is happening around the States. There are now six States that require a State referendum of voters to raise taxes and Mr. Gephardt suggested this as part of his tax reform proposal. I think it makes a lot of sense. It essentially gives voters a veto power over any tax increase legislated by the Congress.

And let me make one final point and that is the point about moving toward something that has been dear to my heart since I came to Washington and that is the question of dynamic versus static revenue analysis that we use.

We know that we are getting the wrong results from Joint Tax Committee and Congressional Budget Office from the way that we are doing it now.

Now, there is a lot of dispute about what is the best way to change the system, but if you look at what happened, my favorite example of this is what happened with the capital gains tax revenues after we raised the rate in 1986.

The Congressional Budget Office and the Joint Tax Committee, after we raised that rate from 20 to 28 percent, predicted that by the year 1992 we would have realizations of capital gains of somewhere in the neighborhood of $300 billion.

Actual realizations in 1992 were about $130 billion. Both Joint Tax and Congressional Budget Office were off by about a factor of two. We lost about a $50 billion in revenues from 1990 to 1994 simply because we were overestimating how much revenues would have come in with the increase in the capital gains rate.

So this was a fantastic rate of error. We are talking about a 250 percent rate of error in terms of how much realizations would have been.

Why did they make this mistake? Because they did not assume that people would change their behavior when we raised the rate from 20 to 28 percent.

I believe actually that we have lost revenue. We have lost revenue from 1990 to 1995 because we raised the capital gains rate and yet CBO and Joint Tax both told us that it would be a large revenue gainer. It is a good example of how wrong revenue analysis leads us to bad policy results.

And I will end with that. Thank you, Mr. Chairman.

[The prepared statement of Mr. Moore follows:]

STEPHEN MOORE

DIRECTOR OF FISCAL POLICY STUDIES

THE CATO INSTITUTE

Mr. Chairman, thank you for the opportunity to offer my views on the imperative of budget process reform in the 104th Congress. I want to especially commend Rep. Horn for his commitment to fixing our archaic and fiscally inept budget rules.

Over the past fifty years Congress has lost complete control of federal spending. I attach a copy of a table that shows the real growth rate of federal spending since 1955. Even after adjusting for inflation, the federal government spends four times more today than it did forty years ago. As the chart shows, entitlement spending has been the largest area of expansion. My overall conclusion from this data is that government today is America's Number 1 Growth Industry.

A top priority for this Congress should be the enactment of a new budget act. The 1974 Budget Reform and Impoundment Control Act has been a monumental failure. One of the purposes of the 1974 Budget Act was to eliminate deficit spending. But here is the actual legacy of that legislation: in the twenty years prior to the Budget Act, the budget deficit averaged just 1 percent of GDP and $30 billion in 1994 dollars. In the twenty years since the enactment of the 1974 Act, the average budget deficit has been $170 billion per year, and 3.5 percent of GDP. We have accumulated more than $4 trillion of debt since 1976. By any objective standard, the budget process has not worked better under the 1974 act--it has worked much worse.

Figure 1 shows the size of the budget deficit by President since the Truman Administration. Bush and Clinton have amassed larger deficits than Reagan in the 1980s, even after adjusting for inflation. We are not on the right track. In fact, the CBO predicts that if we stick with the Clinton budget plan, the deficit will begin rising after 1996 back up to a record high of $350 billion within ten years.

The 1974 Budget Act cannot be fixed. Tinkering won't do the job. The 104th Congress ought to repeal the act before it does more damage to our national economy.

What should be the key components of a new budget act?

The centerpiece of any budget reform quite clearly is an amendment to the Constitution outlawing deficit spending. Most everyone on this Committee is keenly aware of the need for a balanced budget requirement, so I will not long dwell on the subject. Deficit spending is an unconscionable form of fiscal child abuse.

There are hundreds of groups in Washington that pretend to speak for the interests of children. But who in Washington, among the thousands of powerful special interest lobbyists and self-proclaimed do-gooders, speaks for the children who are going to have to pay off our irresponsible debts today? The single most pro-child policy that any of us can pursue in Washington today is to reduce the crushing burden of debt our government is now preparing to place on the next generation's backs.

I sincerely wish that we did not need a constitutional amendment to solve Washington's addiction to red ink. Unfortunately, the destruction of our nation's once firmly held moral rule against deficit spending requires us to amend out Constitution and command Congress to do what it used to feel honor-bound to do--that is, balance the budget.

The argument is made by tax and spend opponents of the BBA that a constitutional requirement is just "a gimmick." No one really believes this. If the amendment were a gimmick, Congress would have approved it long ago. The reason that defense contractors, corporate lobbyists, federal workers, teachers unions, the welfare industry and other powerful special interests groups ferociously attacked the BBA is not because they think it won't work, but because they shudder at the thought that it will. What frightens the predator economy in Washington is that gift-bearing politicians may have the federal credit card taken away from them.

The U.S. House of Representatives last year wisely approved the BBA. The matter now lies outside of your hands. The real issue is: What can be done in the meantime to make the budget process work better and to end deficit spending?

Last year the House passed a courageous budget crafted by Budget Committee Chairman John Kasich which promised a balanced budget by 2002. But one thing is a virtual certainty: no matter how sincere your intentions of balancing the budget, the deficit will not be eliminated by 2002 unless new budget enforcement rules are implemented to ensure that this admirable goal is honored.

Here are the components of a new budget act that I would urge in order of priority:

1) **An Enforceable Legislative Balanced Budget Requirement**

Don't wait for a balanced budget amendment. Act now. The most urgent reform for this Congress is to pass a legislative balanced budget law that enforces the deficit targets established in the House Budget Resolution.

What I have in mind is a new Gramm-Rudman formula that establishes iron-clad enforceable deficit targets. One of the great myths in Washington is that Gramm-Rudman was repealed because it wasn't working. Gramm-Rudman was repealed by the pro-spending constituencies in Congress precisely because it was working too well.

Gramm Rudman was enacted in 1985, when Congress was under intense public pressure to immediately reform the budget and reduce the $200 billion budget deficit. The controversial law required Congress to balance the budget by 1991 by meeting a series of annual deficit reduction targets. If Congress missed these targets, the law would trigger automatic spending cuts--a process called "sequestration"--to reduce the deficit to the mandated level.

Critics charge that the act was a blunderous failure because Congress continually veered off the GRH balanced budget track. It is true that Congress routinely missed the deficit targets. Actual deficits under GRH were on average about $30 billion per year above maximum deficit targets.

Still, Gramm Rudman had a positive effect on the federal budget. The best way to measure this impact is to compare the actual deficits recorded under the five years of GRH with what the deficit was projected to be by the Congressional Budget Office (CBO) without the law. The 1989 deficit was about $100 billion lower than it was expected to be in 1985 without Gramm Rudman. In fact, the Gramm-Rudman era, 1986-1989, was the only period of genuine deficit reduction in nearly twenty years. The deficit fell from 6 to 3 percent of GDP over this period.

The most dramatic effect of Gramm-Rudman was to curb government expenditures. Government spending in the five years prior to GRH grew at a rate of 8.7 percent, but slowed to only 3.2 percent in the five years it was in effect. Even entitlement spending was curtailed under GRH to a 5 percent growth rate, because Congress realized that if they allowed programs like Medicare and Medicaid to rise uncontrollably, they would eat up the rest of the budget and cause painful automatic cuts in discretionary spending.

Senator Gramm and Majority Leader Dick Armey have introduced legislation to restore many of the features of the old Gramm-Rudman. The most vital reform is a series of deficit reduction targets, that if missed invoke automatic across the board spending cuts-- a sequester. I would urge that any new sequester process include all federal outlays except interest payments and Social Security benefits.

This will impose a much-needed dose of discipline into the budget process.

2) **A Supermajority Requirement to Raise Taxes**

Americans have been hit with twelve tax hikes in the past twenty years: each one has succeeded in further expanding the size of government, rather than reducing the debt. Requiring a three-fifths or two-thirds majority in both the House and Senate to pass a tax increase would allow Congress to pass tax hikes in cases of national emergency, but would make it very difficult for Uncle Sam to continue its annual ritual of peacetime tax hikes. Several states, including Arizona, California, and Oklahoma, have enacted such measures; they have stopped tax increases dead in their tracks. As one Arizona taxpayer advocate of the supermajority requirement recently told me: "Now the legislature doesn't even bother to propose new taxes."

The Contract with America established new rules requiring a 60 percent vote to raise income taxes. This was a good start. But now this hurdle should be made to apply to all revenue raising bills.

3) **National Referendum on all tax increases.**

Another populist budget reform that is sweeping through the states is the requirement that any tax increase must be ratified by a popular vote of the people in the next election. This gives the taxpayers veto power over the state legislature's efforts to raise taxes. Congress should be forced to take its case to the people, when it wants to take more dollars out of our paychecks. It is a virtual certainty that George Bush and Bill Clinton's wildly unpopular record tax increases would have been blocked if this rule had been in effect.

Minority leader Dick Gephardt deserves hearty congratulations for suggesting this reform as part of his 10 percent tax plan. Perhaps a bipartisan consensus could emerge on this issue.

4) **Dynamic scoring of tax law changes**

The 1986 capital gains tax rate increase has raised roughly $100 billion of less revenue than the Joint Tax Committee estimated when the law was enacted. Capital gains realizations are less than half the level expected. See Figure 2. Why these gigantic forecasting errors? Congress still uses static analysis to score tax rate changes--a scoring technique that assumes little change in behavior to tax changes and almost no overall economic impact of new tax laws. The assumptions have been shown time and again to be wrong. We know the procedures are wrong. But we still use them.

The capital gains tax cut in the Contract with America will almost certainly raise revenues for the government--and the cap gains cut may raise substantial new revenues. The rich will pay more taxes with the rate cut. But the Joint Tax Committee refuses to score these dynamic effects. The Cato Institute has long endorsed a zero capital gains tax. But the static revenue estimators say this will reduce revenues by $150 billion over five years. Dynamic estimates indicate that a zero capital gains tax will so energize our economy that total tax revenues may actually increase if the capital gains tax is eliminated. But as long as we are slaves to static scoring, pro-growth tax initiatives will be torpedoed by faulty computers.

Dynamic scoring will yield more accurate tax revenue estimates, and thus encourage better policy.

5) **Line item veto authority for the President.**

This provision is obvious. The President should have the power to cut out the waste that Congress won't. A recent Cato Institute survey of current and former governors finds that more than 80 percent believe the President should be given this authority. One of most negative consequences of the 1974 Budget Act was to strip the President of his legitimate impoundment powers--a power that had been exercised by every President from Thomas Jefferson to Richard Nixon. Line item veto would be a partial restoration of the presidency's legitimate powers over the purse strings.

6) **An end to baseline budgeting.**

When the School Lunch Program is going to increase by 4.5 percent per year, that is a budget increase, not a budget "cut." Baseline budgeting is a fraud. Lee Iaccoca once stated that if business used baseline budgeting the way Congress does, "they'd throw us in jail."

It's time to end the false and misleading advertizing in the budget. Congress should be required to use this year's actual spending total as the baseline for the next year's budget. If we spend more than the current year, we are increasing the budget, if we spend less, we are cutting it.

7) **A statute of limitation on all spending programs**

It has been said that the closest thing to immortality on this earth is a federal government program. Congress doesn't know how to end programs--even years and years after their mission has been accomplished. (Hopefully, this Congress will prove this statement wrong!) A five-year sunset provision should apply to every spending program in the budget--entitlements and discretionary programs. This would require the true "reinvention" of programs by forcing the re-examination of every program including entitlements, every five years.

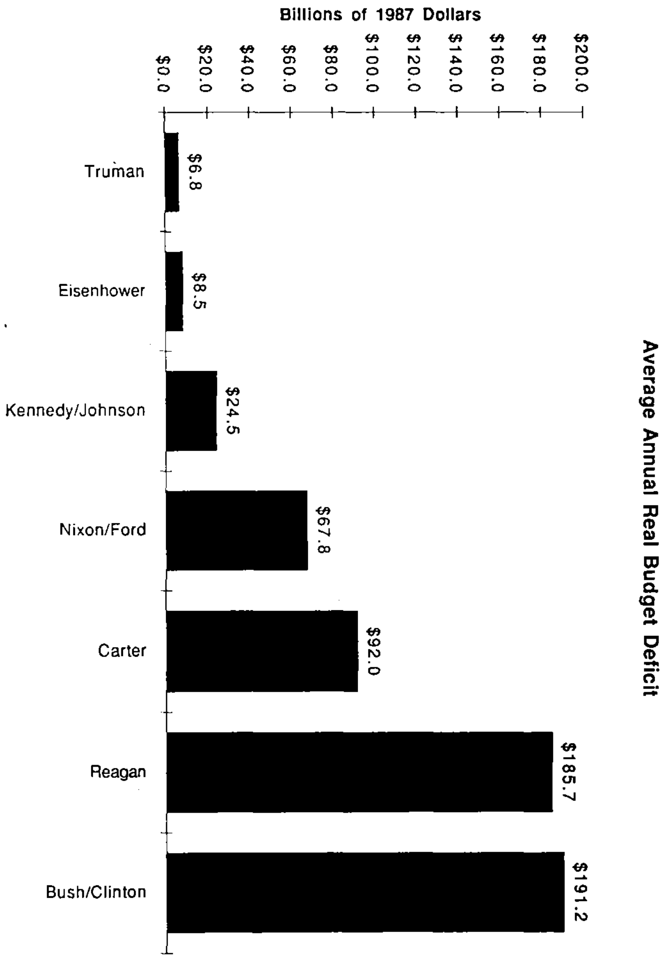
8) **Debt-buy down provision**

This is Rep.Bob Walker's idea of empowering taxpayers to dedicate up to 10 percent of their income tax payments to retirement of the national debt. Politicians earmark spending all the time. Taxpayers should have that same right.

Why are these budget process reforms so vitally important to the balanced budget exercise? Because the rules of the game matter. The rules dictate outcomes. For more than twenty years, forces that favor spending have consistently prevailed over forces that favor fiscal restraint. This pro-spending bias in Washington threatens to cripple our nation's economic future.

Let me conclude by retelling a story about the late great Washington Redskins football coach George Allen. Allen lived by the motto "the future is now." He traded all the Redskins draft picks for over-the-hill veterans. He spent millions of dollars of owner Jack Kent Cooke's money to purchase expensive free agents. After several years of this, Jack Kent Cooke finally fired Allen. When asked why, Cooke responded: "When George Allen came to Washington I gave him an unlimited budget. But George managed to exceed it." That's the way taxpayers now feel about our politicians in Washington.

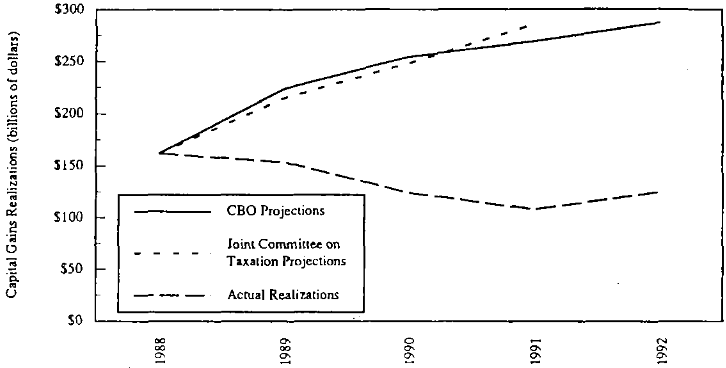
We are in desperate need of budget process reform and I again applaud Rep. Steve Horn for his leadership on this issue.



BC/fig/deficit

Figure 2

Estimated and Actual Capital Gains Realizations



Source: Joint Economic Committee, 1993.

	Billions of 1995 Dollars		Real Growth
	1955	1995	1955–95
National Defense	$242.8	$271.6	11.9%
Health	1.7	272.4	16,374.2
Income Security	28.8	223.0	674.0
Social Security	25.2	336.1	1,236.4
Education & Social Services	2.5	56.1	2,117.4
Veterans' Benefits	26.6	38.4	44.5
Community Development	0.7	12.6	1,618.8
Interest	27.6	234.2	750.0
International Affairs	12.6	18.7	48.2
Science & Technology	0.4	17.0	3,937.8
Agriculture	20.0	14.4	−27.9
Justice/General Government	5.2	32.1	523.4
Transportation	7.1	39.2	453.1
Energy/Natural Resources	7.2	26.5	268.4
Offsetting Receipts	−19.8	−41.4	108.6
Total Outlays	$388.9	$1,538.9	2,957

Source: Budget of the U.S. Government, Fiscal Year 1996, Historical Tables.

Mr. HORN. I think you are absolutely right and I think we are going to solve that problem in this Congress if we do nothing else.

Very well. Let us get to the next witness, Mr. White.

We are glad to see you here. I think I have a copy of your testimony in front of me. Let me just get it. Well, I do not see it right now. Why do you not go ahead?

You are senior fellow in government affairs at the Brookings Institution. I once held that position myself, so it is nice to see somebody from Brookings here.

Mr. WHITE. It is probably even more nice to see somebody who was once at Brookings up there.

Mr. Chairman and distinguished members of this committee, I very much appreciate the opportunity to appear today and contribute to deliberation about your effort to create a useful package of budget process reforms. And I should note that your own book on the Senate Appropriations Committee is something I enjoyed reading and use as a reference for my own work.

I hope you and anybody else here appreciates the difficulty of analyzing materials that are not yet anything representing a bill; that include something like 20 different bills or portions of bills by reference, a bunch of OMB circulars, and various things to be drafted later, and so I hope you are viewing this hearing as an opportunity to gather some general responses to the general trend of ideas here, but I also hope that once there is a more coherent bill drafted that you will be holding further hearings so that people can respond more coherently than I will manage to do today.

I will divide my comments into three basic questions: first, the theory of what is wrong with the budget process that has been expressed here in testimony and also in the bill, on the portions of bills proposed; second, some contradictions within the bill as proposed; and, third, what I see as the major difficulties with the general approaches that are being suggested here.

I refer to a number of things in my written testimony, but I would like to emphasize a few here.

One is that in this set of proposals one of the main reasons presumed for the failure to balance the budget is the existence of entitlements, entitlements being programs that promise benefits to persons or firms so long as they meet certain conditions such as being unemployed after a period of work, or sick and age 65 or over.

Now, the purpose of entitlements is to protect people from certain risks and this bill proposes to eliminate all but the entitlements for Social Security and interest on the debt. All other entitlement programs—Medicare, Medicaid, unemployment insurance, military pensions, civil service pensions, food stamps, veterans benefits, and so on—would be turned into annually appropriated programs, at the mercy of a series of further procedures that are designed to discourage annual appropriations.

In short, this bill says that in case of economic downturns or other bad luck, the risk to the budget from those economic downturns is far more important than the consequences for individual citizens.

The second major theoretical idea here is a critique of "baselines," so-called. The bill would require that all formal comparisons within the budget process focus on nominal dollars, the difference between 1 year's spending and the next year's proposal. "Baselines" in this context, means estimates of what it would cost to provide the same services as offered under current law next year as this. Because of inflation and population growth, the baseline is on average higher than the previous year's spending.

Clearly if the public knew that, that it would cost more money to provide the same services, it would be more likely to support higher spending. So the purpose of abolishing baselines is to focus attention on spending, rather than what the spending buys.

And that is a third distinction that I think is fundamental here. This bill essentially says that too much attention is currently paid to the details of budgeting, to what we buy rather than how much we spend.

Now, budget processes exist to resolve a difference within our own preferences, between our preferences about a total, how much money we spend, and the details, what we get for that money. Usually, we want to buy more but spend less. And a good budget process is normally designed to have a series of iterations. You say, well, OK, we want to spend this much, would we buy it for that, well, no, that is—we really want to end up with more than that, but, OK, so—gee, but if we do not want to spend what all that adds up to so you go through a series of iterations.

And in many, many ways, this bill makes the premise, no, we do not want to know what we are going to buy with the money, we just want to set a total and then force things to fit into the total. And if it turns out that there is a lot you do not get for that amount, well, in many cases what this bill says is we will not really decide what will be given up instead, instead, we will give that authority to somebody else. We will give it to a State Governor, in the case of a State-administered program, or we will give it to the President in some of the procedures or we will give it to the director of an agency in some situations.

Now, again as a way of cutting the budget and not paying attention to what you get for the money, it is a perfectly reasonable theory, but you have to realize what you are doing.

Obviously this bill in many points presumes that majority rule is a bad idea, a majority rule leads to bad results. The bill also includes a number of different procedures to improve the budget schedule to make budgeting more timely.

Now, in general, the presumptions within this package are not contradictory. I think that elimination of entitlements, distrust of majorities, accounting changes, spending cuts, et cetera, all fit an ideology that says government is an inherently corrupt violation of the free market and should be limited in all ways. But I am not sure that is what many members of the public would think they were supporting in budget reform. I am not sure that that is what this committee would be supporting, and so I think it is important that the committee think about, as it makes choices within the ideas in this package, some of the contradictions that are here.

Now, some are rather subtle. For instance, if the public has more information, if you do a lot to make the public more informed, then it may seem inappropriate to have all these two-thirds majority requirements. A public that is more informed and paying more attention, may object more to being thwarted by two-thirds majority requirements.

How do you do generational accounting? What does it mean to do generational accounting for programs that are all annually appropriated where there are no commitments beyond 1 year?

There are some very direct contradictions.

Mr. HORN. I think I should say at this point that the bill you are referring to is simply a compilation of everybody's ideas.

Mr. WHITE. Right.

Mr. HORN. At this point, neither the chairman nor the subcommittee nor the full committee, let alone the House, have acted on any portions of it. Some of the ideas people are committed to. One of them happens to be generational accounting, which you are now talking about. But in terms of removing entitlements, nobody has made a decision on removing one entitlement, but it is a problem that the committee has to discuss and we will discuss in terms of what do we mean by an entitlement and what kind of automatic ratchet upward does that mean in the budget and why does Congress not face up to a few of these areas one way or the other.

Mr. WHITE. Well, Mr. Chairman, I assume my job here is to comment on the set of ideas in the package——

Mr. HORN. That is right.

Mr. WHITE [continuing]. Not on guesses about what come out in the end, right?

Mr. HORN. I appreciate your comments because that is exactly what we want and no one says any of this is consistent, as you would expect when you have roughly, I think, 15 to 20 different people really have designed parts of what is in this bill.

Mr. WHITE. Right.

Mr. HORN. None of whom particularly agree on ideology, they are all over the spectrum.

Mr. WHITE. I do think that anybody who wants could look at the written testimony for some of the other specific contradictions, but there is obviously an overarching contradiction that you have to think about in general between any efforts to constrain budget decisions to force deficit reduction on the one hand and your general goal of making the budget schedule easier and more timely on the other.

Generally, the way to ease decisions and make them more timely is to facilitate compromise, and even that may not be enough.

A number of the procedures here at least greatly favor one side: require supermajorities which generally makes things harder to do, not easier, and create a wide variety of opportunities for hostage taking and brinkmanship.

So there is a tradeoff and my guess is that one legitimate conclusion from the experience of the last 20 years is that the more procedures and obstacles you set up the harder it is to get anything done on time, so this would actually make it harder, not easier. But, again, you just have to think about the tradeoff there.

Overall, I would like to emphasize a couple of difficulties with the sweep of ideas in the package.

First of all, the case for the balanced budget is far weaker than its proponents imagine and the case for achieving it solely by spending cuts is even weaker.

Every responsible estimate of the effect of deficits in the economy finds that balancing the budget, though helpful, does not provide markedly positive returns. The Congressional Budget Office's estimate of the effects of the balanced budget resolution from last year was that the GDP would be half a percent bigger in the year 2002.

Now, we can talk about whether one can justify what works out as a 2.8 percent of GDP cut in various programs for a half a percent increase in the size of the economy. We can argue about that. But it seems perfectly reasonable to suspect that the main reason the budget has not been balanced is that the benefits are not so obvious that the voters, when it is put to them in terms of specific cuts or tax increases, actually support that.

It is one thing to say that voters are all for the balanced budget, or mostly for the balanced budget, and also mostly for not cutting Medicare. And you can assume that, perhaps, if they were forced to choose the balanced budget. But maybe they would not and maybe that is reasonable.

The second thing is that most entitlements are entitlements for good reasons. Medicare that had to be funded by an annual vote each year would be a much worse guarantee of coverage. Imagine what would happen if appropriations were delayed and the Secretary of HHS made decisions that could be traced to somebody dying.

Remember also that many of the entitlements are specifically designed to be automatic stabilizers of the economy and under the logic of this package if unemployment increased, a two-thirds majority would be needed to pay extra benefits. That is not a very good idea.

Also, we can argue all we want about baselines, but the fact remains of how much it will cost to buy what we bought last year is a fundamental question that anybody in any budget process asks.

Now, the fact is also if you look at the appropriations process, everything they do compares to last year's spending, if you look at every one of their tables. You want to look at both sets of numbers, both what it would take to buy what you bought last year and what you would spend compared to last year. It is not that one is right or one is wrong, but you cannot say you should never look at what it would cost to buy last year's product.

I also think that overall we really have to worry that many of the provisions here, particularly those for allocating funds in the Cox proposal for annually appropriated former entitlements, cede huge amounts of discretion. This essentially means that law will no longer be law, that a law that says these are your benefits under certain conditions will no longer be true. That is not the law. It will be law if Congress appropriates enough money. And I think it is very dangerous to make law that vague and imprecise.

My final comment is that in the context of all of this, we have to remember you can talk a lot about estimates, but we have to remember how much the economy affects us.

I was listening to Mr. Moore's testimony, listening to comments about the drift of the deficit after the Budget Act, which also happens to be after 1973 when the economy since then was much worse on average; talking about the entitlement spending, supposedly due to Gramm-Rudman-Hollings. Well, there were virtually no laws changing entitlements after Gramm-Rudman-Hollings was passed in 1985. Much more legislative action was taken before 1985, in the 1982 to 1984 period, than in the 1985 to 1989 period.

Gramm-Rudman-Hollings did not work. The economy was better from 1985 to 1989 than it was from 1982 to 1984. With lower inflation, the increases in entitlements were not as great. The demographics were better because of just the way that worked through the system.

You can look at how you judge capital gains spending but generally realizations in a recession year like 1992 are not a good comparison.

On the whole, we heard a lot today about various ways of saving maybe half a billion here or there in terms of item vetos or whatever and the general course of the economy is just so much more important than that and you really want to think about if whether given the relatively small benefits of deficit reduction and the very definite effects of whatever cuts or tax increases one would choose and the great uncertainty in terms of overall results due to economic fluctuations, if changes in what is already a very complex process that is very hard to follow really are a good idea.

Thank you.

[The prepared statement of Mr. White follows:]

Joseph White

The Brookings Institution

Mr. Chairman and distinguished members of this committee: I very much appreciate the opportunity to appear today and contribute to deliberation about your effort to create a useful package of budget process reforms. Given the wide array of proposals that have been floating around Capitol Hill, bringing them together to create some order and hopefully some analysis is a fine idea.

I hope you appreciate the difficulty of analyzing materials that are not yet anything resembling a bill, that contradict each other in numerous ways, and that refer to a vast array of processes, ranging from congressional procedures to internal management of agencies. I think it is important that the participants today, reporters and the public recognize what kind of materials we are discussing. We have here a draft outline of a bill. It includes references to language that exists in a total of twenty (by my count) other bills that have been introduced in the House or Senate, drafted for either body, or passed with such language as amendments. It also refers to four different Office of Management and Budget Circulars, an array of materials produced by an organization called "Citizens for Budget Reform," and in a number of cases says the necessary language still has to be drafted. I urge you to view this hearing as an opportunity to gather some general responses to the general trend of ideas here, but to plan on holding further hearings on a more coherently drafted and carefully pruned document once you have produced one.

At this stage, I believe it makes most sense to divide my comments into three parts. First, I will discuss how the materials here seem to define "what's wrong" with the budget process. Second, I will point out some major contradictions among the measures proposed here. Last, I will describe what is right with current budgeting, what some of the proposals here ignore about how budgeting works, and therefore why I would advise against passing legislation that included such measures.

The Evils This Bill Proposes to Fix

I must emphasize here that I am looking for a logic in the texts that should not be associated, in all cases, with individual sponsors. Nevertheless, the following themes seem evident.

1) The budget must be balanced by cutting spending. The bill provides a wide variety of measures to balance the budget. The most direct is taken from H.R. 1131, and is in essence a new version of the Gramm-Rudman system of targets and sequesters that failed miserably in the 1980s. The difference between H.R. 1131 and Gramm-Rudman is that the former demands explicitly that the deficit be diminished solely by cutting spending. I believe the assumption that deficits should only be reduced by spending cuts also fits other proposals here, though it is not always so explicit.

Second, the proposals here assume that the budget is not balanced for a series of reasons. The most prominent are:

2A) The existence of entitlements. Entitlements are programs that promise benefits to persons or firms so long as they meet certain conditions, such as being unemployed after a period of work, or sick and age 65 or over. The purpose of entitlements is to protect people from certain risks. This bill proposes to eliminate all but the entitlements for Social Security and interest on the public debt. All other entitlement programs -- Medicare, Medicaid, unemployment Insurance, Military pensions, civil service pensions, food stamps, and so on -- would be turned into annually appropriated programs, at the mercy of a series of further procedures that are designed to discourage appropriations. In short, this bill says that in case of economic downturns or other bad luck, the risk to the budget is far more important than the consequences for individual citizens.

2B) "Baselines". The bill would require that all formal comparisons within the budget process focus on nominal dollars, the difference between one year's spending and the next year's proposal. Baselines, in this context, means estimates of what it would cost to provide the same services as offered under current law next year as this. Because of inflation and population growth, the baseline is on average higher than the previous year's spending. Clearly if the public knew that, it would be more likely to support higher spending; so the purpose of abolishing "baselines" is to focus attention on spending rather than what the spending buys.

2C) Too much attention to the details of budgeting. Budget processes exist to resolve a difference between preferences about a total (how much we spend) and the details (what we buy). Usually we want to buy more but spend less. Most systems go through a series of iterations: there are suggestions for spending, suggestions for a total, the details are cut to fit the total but not enough, the total may be raised slightly but not enough to include all that's left, the details are cut again, and so on. The point here is that you don't really know how much you want to spend until you know what you would have to give up; or what you want to buy until you know what it will add up to. But allowing the total to be affected by attention to the details is likely to lead to more spending than just setting the total arbitrarily. Therefore this bill tries to strengthen the current trend towards setting totals with as little attention to their programmatic consequences as possible.

That trend is already dominant in the appropriations process, for which all parties in Congress as well as the administration have proposed shrinking "caps" through 2002 and nobody has specified what programs would be cut to meet those targets. This bill follows that logic in the Gramm-Rudman-Redux proposals of HR1131, the caps in HR2599, and the transformation of Budget Resolutions into laws with binding caps by budget function each year before Congress considers specific legislation to meet those totals.

2D) "Pork". This bill provides the President with an item veto so he can reduce spending to meet budget targets. But I should emphasize that at least it is limited to that purpose, so it is a far more moderate proposal than what Congress appears to be set to pass momentarily.

2E) Majority rule. Many provisions in these proposals assume that majorities cannot be trusted. It goes beyond the current requirements for 3/5 of the Senate to overturn a point of order against measures that would increase the deficit. Instead, some parts of the bill use extraordinary majorities of 3/5 in both chambers and some of 2/3 in both chambers. Sometimes these are applied not only against measures that would increase the deficit compared to current law but against legislation that fails to meet a target for deficit reduction.

Third, this bill seeks to respond to public and probably internal disgust with the failure to pass budget legislation on time. At the same time, it seeks to enforce budget controls by preventing action on some items before action on others. So, in general, it includes an array of actions about the budget schedule. The problems and responses include:

3A) Adopting budget-related legislation without previous agreement on an overall budget plan. This package includes a requirement that overall budget total laws be adopted each year before any other action.

3B) Too much time spent on budgeting. So this package includes a change from annual to biennial budget resolutions.

3C) Government shutdowns due to failure to enact appropriations. So this package includes procedures for automatic continuing resolutions at the previous year's exact level of spending if appropriations have not been enacted. In the case of former entitlements that have been transformed into annually appropriated programs, this requires further provisions allowing agency heads or state governments to make all necessary cuts to account for the fact that normally one year's spending will not provide the same services the next year.

3D) Government shutdowns due to failure to raise the debt ceiling. Actually the package is ambivalent about this. It provides a one-time debt-ceiling increase, but also includes measures to ensure that if the next increase is not passed, the Secretary of the Treasury will not be able to avoid a shutdown.

Fourth, this bill seeks to increase cooperation between the President and Congress, by making cooperation necessary early in the process. It defines the problem in two ways.

4A) Presidents making proposals that do not explain how to balance the budget. So it includes provisions to require presidents to make such proposals.

4B) Presidents not having to agree to Congressional budget targets early in the year. So the budget resolution would be converted into a law. Of course, that means if they cannot agree on a budget resolution they cannot do anything, since 2/3 majorities are required to do anything without a resolution, and 2/3 majorities could have overrided the president's veto of a resolution.

The fifth and last category of presumptions is that the deficit could be reduced and government's presumably negative effect on the economy limited by technical changes to government management to make it more efficient. The package therefore includes a huge hodgepodge of management reforms, ranging from separation of an Office of Management from an Office of Budget, to requiring many more forms of accounting, to drastic changes in regulatory procedures. We may group these into:

5A) The government runs on automatic pilot. So programs must sunset, there must be zero-based budgeting, and of course there should be no entitlements except the two that it would be suicide to eliminate, interest and Social Security.

5B) Citizens aren't aware enough of the terrible deficit, so government must provide a wide array of documents to tell them how bad it is.

5C) The true costs of government are hidden. So government must do much more cost-benefit analysis, emphasize accrued long-term obligations, etc.

5D) The government does not pay enough attention in budgeting to performance. So this bill joins the recent round of efforts to cut spending by having "performance budgeting."

Contradictions Within the Package

In general, the presumptions within this package are not contradictory. Elimination of entitlements, distrust of majorities, accounting changes, spending cuts, etc. all fit an ideology that says government is an inherently corrupt violation of the free market, to be limited in all ways.

Yet some legislators, and many members of the public, may not distrust government quite so much, while being attracted to parts of these proposals. And there remain a number of contradictions that will require choices by you in putting together the final package.

Some are rather subtle. If the public has more information, does it make sense to require 2/3 majorities? A relatively more informed and attentive public may be more likely to be incensed by being thwarted by supermajority requirements.

Others are much more direct. You can't have both a binding annual budget resolution and a biennial resolution process. The deficit reduction targets with 3/5 requirements fit awkwardly with the new binding budget resolution system with 2/3 requirements. How does an automatic CR (to prevent gridlock) fit with measures to make the debt ceiling even more of a roadblock? There would be no contradiction if the budget were already balanced, but it is not. How does an automatic CR fit with the Armey provisions that forbid appropriations without reauthorizations, and require sunsetting of authorizations? Where does the HR822 outlay reduction commission fit with either of the three new budgeting schedules -- the biennial process, the move of the fiscal year to match the calendar year, or the schedule provided with the binding resolution in HR2929? How can caps be based on the "most recently published current law baseline" (HR2599) if current law baselines have been abolished (HR2929)?

Finally, there is an overarching contradiction between the effort to constrain budget decisions to force deficit reduction, and the claimed interest in ensuring that government not be shut down by conflict. Budgeting involves fundamental conflicts over the size and purposes of government. The only way to ease decisions and make them more timely is to facilitate compromise -- and even that may not be enough. Yet this bill greatly favors one side, requires supermajorities and creates a wide variety of opportunities for hostage-taking and brinksmanship. On balance, I have to expect that the goal of making the process more timely will be obliterated by the other measures in this package.

Major Difficulties With This Package

The most obvious objection to the non-bill before us is that it is so contradictory and incoherent. Once it were cleaned up, however, it would still represent some combination of the assumptions that I described in the first section, so I will direct my attention here to those basic assumptions.

First of all, the case for a balanced budget is far weaker than its proponents imagine, and the case for achieving it solely by spending cuts is even weaker. I do not expect most members of this committee to agree, of course. But I wish you would consider two points.

1A) Every responsible estimate of the effects of deficits on the economy finds that balancing the budget, though perhaps helpful, does not provide markedly positive returns. Thus in its update on the Economic and Budget Outlook in August of last year, CBO reported that the effect of enacting the policies in the Congressional Budget Resolution for FY 1996, which would balance the budget by 2002, would be to increase GDP by a tenth of a percent per year, and a total of half a percent by 2002. That was the payoff for the cuts in Medicare, Medicaid, discretionary spending and other programs that were proposed. It is very small -- easily wiped out by all sorts of unpredictable economic fluctuations. Ultimately the real reason this Congress has had so much trouble convincing the American public to support those policies is that it does not have strong evidence that they are worth the cost.

1B) Current rhetoric emphasizes that total spending will increase because of "entitlements," basically those that serve the elderly: Social Security, Medicare, and Medicaid. This is true. But the causes are crucial. When the population ages and a larger proportion is retired, one of three things MUST happen. Either the elderly will get less per capita. Or their share of the national wealth will increase due to government transfer programs. Or their share will increase due to earnings from investments, which means wages will be lower compared to the return to capital. The third option takes just as much from workers as the second. The difference is, the third is much more likely to favor people who had money to invest, and the second is much more secure for all citizens. We can argue about the proper balance of effects, but surely we should expect part of the result to be larger transfer payments to the larger number of elderly. We can argue about how much other programs could be cut from the current base, but at some point you hit bottom, and then the effects of an aging population must cause spending to increase. So policy that focuses only on spending either denies demography, or simply chooses that the people who rely most on Social Security and Medicare will lose most from the aging of the population. I doubt that is wise.

Second, focusing entirely on numbers and ignoring program effects is not good government. In particular:

2A) Most entitlements are entitlements for good reasons. Medicare that had to be funded by an annual vote each year would be a much worse guarantee of coverage. Imagine what would happen if the appropriations were delayed and the Secretary of HHS issued regulations that caused some person to die from being unable to get care! Remember also that some of the entitlements are specifically designed to respond immediately to economic downturns, as "automatic stabilizers." Under the logic of this package, if unemployment increased, 2/3 majorities would be needed to pay extra benefits. That's an awful idea.

2B) We can argue all we want about "baselines," but the fact remains that how much it will cost to buy what we bought last year is a fundamental question that anybody, in any budget process, asks. Amid a raft of proposals to get agencies to direct their budgeting towards outputs, it is ludicrous to say that Congress should not ask how much it would cost to maintain the existing level of output.

Third, this bill is fundamentally antidemocratic, in two senses.

3A) **The supermajorities in this bill bias policymaking dramatically, against what often will be majority will.** They are justified, I suppose, by the assumption that the unbalanced budget is such a disaster that it must be prevented by any means. But the fact is, the deficit is no such disaster. If it were, the benefits of balance would be much greater. That does not mean there is no place for some systemic bias towards fiscal conservatism. Within a system that makes any action difficult, measures that provide further obstacles to policy changes that increase the deficit, as exist under current law, might be justified. But this package goes far beyond that point.

3B) **The procedures in this bill are designed to inhibit rational debate on the budget.** As I stated earlier, budgeting in any situation is a process by which preferences about details are made to confront preferences about totals, so that each can affect the other and differences be resolved. This bill would foreclose that process in many ways. At some points it sets into law arbitrary preferences about totals -- with no attention, at this point, to what the effects would be. At other points it requires that, in any given year, totals be set before any serious debate about how to achieve them. At other points it encourages government shutdowns, or gives the advantage in shutdowns to people who want to cut entitlements. This is, at best, arrogant: based on a belief that if the public seems conflicted between balancing the budget and the cuts needed to achieve balance, the authors of this bill know how the public "really" wants to resolve the conflict. I think Democracy means making it possible for the public to decide for itself.

Also, some of the measures in this bill are simply unpractical. That is especially true of the government management proposals.

4A) Nobody has ever been able to make performance budgeting work, because the outputs of federal programs are exceedingly difficult to measure, and could not be compared to each other even if they were measured. Every decade or so somebody comes up with the same idea under a new name -- Program Budgeting, PPBS, ZBB, MBO, "Reinvention" -- and it's always bogus.

4B) An Office of Federal Management will never do much good, for two reasons. First, if there are serious inefficiencies in government, they are almost always due to policy choices: whether to have a supercollider or space shuttle or third submarine; or to create a housing program for the poor in a way that involves private sector developers. And there are always plenty of people with (often plausible) arguments as to why these are not such bad choices. Second, no central agency can ever know more than a smidge about managing specific programs. Management requires detailed knowledge of the law, of policy environments, of practical difficulties, of human resources within an agency, and many other matters. It's not a matter of the kind of simple rules that could be imposed by an office with one staffer for every $3 billion or $5billion or $10 billion of spending.

Last, and related especially to the concerns about democracy, some of the proposals come very close to abolishing the rule of law and substituting arbitrary allocation of federal funds. Most evidently,

5) **The provisions for allocating funds for annually appropriated former-entitlements cede huge amounts of discretion.** Some of it goes to the heads of federal agencies. The rest goes to state governments. But in either case, the votes of Congress and signature of the President will no longer determine how programs operate. Law about program benefits would no longer be law: it would be law-if-Congress-appropriates-enough-money. It is not at all clear from the available materials what would happen if the courts objected to these terms.

Conclusion

Some of the ideas within this text deserve further consideration. Many of the accounting presentations would be useful, so long as they do not replace the basic current documents and one does not expect revolutionary results. The item veto provisions are a far less extreme change in our basic institutions than the version that is expected to be enacted soon. There is always room for debate about whether specific programs should be entitlements, though I would probably disagree with the authors in most cases. Measures to encourage the President to submit more thorough budget proposals are a reasonable idea, though he should also be expected to say when and why he objects to a total mandated in advance. There is a case to be made for a fallback Continuing Resolution position, legislated in advance -- especially if it applies only to the current discretionary programs.

Overall, however, much of the basic ideas in this package are bad budgeting. Ultimately they are united by two things. One is a notion of the merits of a balanced budget that is unsupported by the evidence. The other is a refusal to acknowledge that the public's moderation on the issue could be appropriate, and deserves respect from politicians.

The public wants a balanced budget. It also wants a set of programs and level of taxes that would not create a balanced budget. This is not a flaw of democracy. It is normal. Contradictory desires are the reason for politics and government. We want peace in Bosnia but not to be the world's policeman. We want to get rid of Castro but not to invade. We want to guarantee health care to everybody but not to pay the price. We want a clean environment but a decent business climate. So we compromise.

In the battle of the budget we could compromise on smaller deficits, rather than either the level that would result from current law or a truly balanced budget. This Congress has an opportunity to enact such a compromise. President Clinton's proposals are not what the majority of Congress wants, but they are a far cry from his proposals a year ago, and would substantially reduce the deficit. If it really cares about both the deficit and democracy, this Congress will compromise on the substance, instead of messing around with the process.

Mr. HORN. I thank you very much. That is very helpful in pointing out the number of contradictions which you will find in any legislative document and I am sure we will find some more before we are done.

Mr. Kogan, you are the budget director, Center on Budget and Policy Priorities. Welcome and please summarize your statement. It automatically goes in the record, the full statement.

Mr. KOGAN. Mr. Chairman, thank you very much for inviting me. My statement is rather lengthy. I will try to summarize it and I will try to keep my summary short.

Mr. HORN. Yes. Please do because we are going to be running late and I am going to have to recess soon on this, so go ahead.

Mr. KOGAN. Most of my comments are directed toward H.R. 2929, a bill introduced by Mr. Cox. I find that bill takes the bad ideas that underlie some, but not all, of the other bills to an extreme and therefore it is easiest for me to address. But the principles are principles that can apply more generally.

I have three points that I would like to make. The first is that the budget process generally works, in that it allows majorities to coalesce around an overall budget plan and then pass through Congress legislation to implement that budget plan. It is a different matter about whether the President signs it or not, but nobody suggested getting rid of the Presidential veto. So the congressional budget process, as I see it, works as it is intended to work. Whether the plan is a plan to increase deficits or decrease deficits is a congressional choice.

So therefore, the two issues that arise from this that are emblematic in H.R. 2929, I think, are in both cases wrong. That bill in a number of different ways sets fixed targets. Some bills set fixed targets for the deficit, others set fixed targets on total spending, or on some subcategories of spending, such as discretionary or entitlements or on some individual entitlement programs. That bill would go all the way down to the creation of targets for individual programs, that is to say appropriations targets, and would de-entitle entitlements.

The second theme, which is particularly prevalent in H.R. 2929 but also exists to a greater or lesser extent in other bills is that the rules, generally, these caps, these fixed dollar caps, must be enforced by supermajority waivers, that is to say it takes more than a majority to change your mind.

My fundamental point is that supermajorities are basically undemocratic, basically unfair, and that they really should have no place in the House of Representatives or the Congress as a whole.

Let us talk about fixed deficit targets as the starting point. Fixed deficit targets are wrong because the size of the deficit or surplus in any given year should depend on what the net national savings rate is. If we have very high net national savings, as some countries do, we can afford a much bigger deficit than the United States is now running and still have plenty of capital available for capital formation. Given the very low rate in the United States of personal savings right now, we should probably be running a surplus, not a balanced budget.

Since the net national savings rate varies all over the place over time, it follows logically that an economically appropriate deficit or surplus would vary all over the place. Setting a fixed target for it would therefore almost by definition be the wrong target.

Further, whether the target that is set is economically right or wrong, it is simply a public policy tradeoff between present consumption and future consumption. If we save more now, then we will be able to spend more later. This is a perfectly good argument for saving more now and is why I would like to reduce the deficit. But that is just a public policy tradeoff, and public policy choices almost by definition should not be preordained by targets that were set in place in some prior year and are immutable.

Third, fixed deficit targets are procyclical. That is to say, when the economy goes into a downturn, revenues fall off and unemployment compensation increases. Then to reach your fixed deficit target all of a sudden you will have to raise taxes and cut spending or both, which will kick the economy when it is down and if you do this hard enough you can turn a recession into the Great Depression. Certainly that is what the Government tried to do from 1929 to 1933 with great success. It created a Great Depression.

And, finally, because fixed deficit targets are such bad policy, people who know better try to evade them and often succeed. This is what has happened to a certain extent during the Gramm-Rudman II years. And that sort of evasion creates a form of institutional lying in which OMB feels, for better or worse, that it has to make rosy scenarios and Congress feels, for better or worse, at least so it is not disadvantaged vis-a-vis the President, that it has to adopt the rosy scenarios.

It is significant in this respect that from 1980 to 1995, over the 15-year period, the first 11 of those years the actual deficit ended up higher than the deficit in the budget resolution. But for the last 4 years, since Gramm-Rudman II was repealed, honest estimates of where the economy is can come out of the White House and it turns out that the actual deficit has been lower than the deficit in the budget resolution because things have improved in the economy a little bit faster than people thought they would.

I think honest numbers over a long period of time are what we need for the public to begin to regain trust in the institution of Government generally.

OK. So fixed deficit targets are bad. It follows by the same token that spending caps are equally unwise policy. Prior entitlement cap bills, for example of the sort that Mr. Stenholm suggested were not as bad as the entitlement cap bills that were submitted to you and formed some of the pieces of what you are looking at.

For example, prior entitlement cap bills submitted by Senator Dole, Senator Domenici, Mr. Armey, Senator Gramm, and Mr. Stenholm, all set entitlement caps which would automatically change if caseload changed and would automatically change if inflation was different from what had been originally projected. They were flexible caps, basically trying to say that the cyclical portions of the economy they would allow to operate. It was really the underlying structure of the entitlement that they were looking at.

I do not like spending caps, but at least if you have to do them, do them in that way. Set them in real dollar, real benefit terms per beneficiary.

The spending caps in H.R. 2929, however, do not do this. Those are fixed numbers with automatic sequestrations if the numbers are violated. As Mr. White said, that means that the numbers are important and the policy is not. Those caps would be pro-cyclical and destructive in the same way that a balanced budget constitutional amendment would be. And the two simplest examples of this are to imagine what a fixed spending cap on unemployment insurance, as H.R. 2929 would do, or a fixed spending cap on deposit insurance would mean.

It would mean in the case of unemployment insurance, which generally doubles when there is a recession, that the average length of benefits of an unemployed person would be cut in half. Or the average dollar amounts of benefits would be cut in half.

In the case of deposit insurance, which generally runs at zero or negative in good times and when there is a banking crisis can run up to $5, $10, $15 or even $80 billion a year, it would mean that actually deposits are not insured. And the sort of banking crisis that happened in 1929, 1930 and led to the collapse of the system and the creation of deposit insurance in 1933, could then play itself out again.

Basically, these are insurance programs and the whole purpose of insurance is to be there if you need it. The whole purpose of immutable spending caps is to say, "If you really need it, it is not there."

You might as well just repeal unemployment compensation and deposit insurance and, to a lesser extent, similar programs that are meant to be responsive to problems if you enact H.R. 2929.

The background, however, to this discussion of the problem with entitlements, is the general perception that in some way or other entitlements are out of control. And, of course, if you look at numbers and numbers alone, you will see what the Entitlement Commission saw 2 years ago, which is that entitlements are eating up the rest of the budget and gradually, and particularly as the baby boomers retire, eat up everything. And so you could reasonably say that, yes, entitlements are out of control.

A closer look, however, shows that Medicare and Medicaid are out of control, that Social Security remains in control until I retire and that everything else, everything else, welfare, AFDC, the earned income tax credit, veterans' pensions, military and civil service retirement, everything else, are projected to shrink as a share of GDP for the foreseeable future.

The problem is not entitlements or entitlement caps, it is Medicare and Medicaid. And the issue with Medicare and Medicaid is that those are entitlements of a different nature. They are not ones like Civil Service Retirement, for example, where we have an understanding of the beneficiary population and we have an understanding of the benefits and we can decide whether they are or are not too generous, but there is not a control problem.

In Medicare and Medicaid, we have entitlements which are truly blank checks where the doctors decide, in essence, how much money the Government spends. It is not the number of beneficiaries per se, it is not whether inflation is higher or lower, though those have an important role in it, it is that we have granted a blank check to a person.

By analogy, a fixed entitlement cap is saying to a person, "Here is $95, go buy this week's groceries." A well-designed entitlement says, "Here is a shopping list, buy exactly what is on this shopping list and nothing else," and Medicare and Medicaid say, "Here is my credit card, do what you want."

So there is a real reason to reform Medicare and Medicaid. There is not a real reason to attach entitlement caps even to Medicare and Medicaid, but rather to reform them, to make them more like other entitlements in the way that benefits are delivered.

This is my discussion of the budgetary portion. Like Mr. White, I am really appalled at the idea that supermajorities would be contemplated by any elected official. The framers of the Constitution specifically rejected supermajorities as a way of deciding public policy questions. There are some procedural supermajorities and ways of determining relative power between the President and Congress, but there are none for deciding public policy issues.

The Continental Congress operated through supermajorities and the framers of the Constitution, who had lived through that experience, knew what they were rejecting.

Supermajorities are inherently unfair. Freedom is not just the Bill of Rights, which protects me as an individual citizen, but is also my right, your right, to have an equal voice in Government. Supermajorities say no, we do not all have equal voices, some are more equal than others. Some people get one and a half votes for everybody else's one vote.

What happens is that some public policy choices, and the citizens and representatives who advocate them, would not be equal and by that token would not be fully free.

My basic answer to this question is that it is better to let a majority do the wrong then than to have rules that force minority will upon the majority—in part because the wrong things that happen are not so wrong, are not so disastrous that the country cannot live through them. We lived through the 1980's, the first time in history in which we had nonrecession, peacetime, large deficits and we are headed back in the other direction. Mistakes get corrected over time without the country collapsing. Take away the right to equal representation and I do not know what we have left.

Moving to the more prosaic, I would like to wrap up my testimony by suggesting just a few things that I think are good about the budget process and that should be protected, and that in some cases can be improved.

As I said right at the beginning, the reason the budget process works, in my view, is that it allows a majority to coalesce around a budget plan and then actually enact the implementing legislation that makes that plan work.

The reconciliation process is the single most important part of the budget process. It should be kept and, if possible, strengthened.

What you should avoid are proposals that allow other forces to help pick apart governing majorities, that help other people divide and conquer. So to my mind, lock boxes, line item vetos, and automatic continuing resolutions all weaken various tools that governing majorities have, sometimes to get themselves together, sometimes vis-a-vis the President. They do not weaken them very much but they weaken them somewhat and therefore weaken the budget process in its ability to keep a majority together to try to implement legislation.

I just do not think you need to do them. I do not think lock boxes, line item vetoes, or automatic CRs gain you enough for what they give up.

I do have seven possible reforms that I would like to suggest.

The first is that the accounting of contractual insurance programs, such as flood insurance, perhaps deposit insurance and pension insurance, through the Pension Benefit Guarantee Corporation is not done right now. And while I am definitely not endorsing the balance sheet budgeting that was a portion of one item of the proposal, it is in fact right that balance sheets when applied to contractual insurance programs do give a better answer than current cash-flow accounting does, and would allow better budget decisions to be made at the margin.

What should we do with pension insurance? Is pension insurance reform a good idea or a bad idea? Or deposit insurance reform?

It would allow that to be accounted correctly so that an action which increases risk would show up as a cost and an action which decreases risk would show up as a savings, as it should be, rather than the way it is now where random cash-flows determine CBO scoring.

Second, I would like to suggest that perhaps you might call upon CBO and OMB to put their heads together and fix the scoring of asset sales. There are a couple of ways to do it wrong. We tried one wrong way before. This Congress has tried a different wrong way to make up for the last mistake. It is not easy to figure out what the right way is, but I think that it is worth addressing just so that the public understands that we are not budgeting through gimmicks.

Third, with respect to the reconciliation process, I would suggest that the Rules Committee be asked to always give a free vote to any Member who wanted to make entitlement savings or tax increases in a reconciliation bill permanent rather than temporary. Too often reconciliation bills make the savings for the years they were told to and then the committees of jurisdiction, who did not really want to do what they were asked to do, say, oh, the minute the budget window closes I am bouncing right back up to where I would have been anyhow.

Since the deficit problem we have is not a short-run deficit problem but is a long-run deficit problem, it seems that permanent savings, a little bit of bending of the rules to favor those people who favor permanent savings, might be a wise idea.

Next, I would suggest having the Byrd rule apply only to the Senate rather than to conference reports. The Byrd rule has the unfortunate side effect of making it harder to keep governing coalitions together because things that were important to some members of the coalition have got stricken out and, second, it makes some things which are clearly budgetary but not technical savers such as civil service pay restraint not in order and therefore pulled out of the package.

I would suggest from my experience on the House Budget Committee that what worked well for the House Budget Committee, rotating membership, be carried over to all of the committees of Congress. The House Budget Committee has had one series of really highly qualified chairmen after another and highly qualified ranking members. Likewise the House Budget Committee, both the Republicans on it and the Democrats on it, have done a good job of representing their party caucuses, not straying off in different directions just because of their committee assignment. And I think all committees could be brought into closer conformity with what the majority wants if rotating membership were a part of the regular feature of the game.

Finally, for my two most controversial recommendations: To the extent that there is a perception that pork is a problem, a reality which I do not think is matched by the perception, it seems to me that more logical than the line item veto, which cedes power to the President and gives him a greater ability to divide and conquer, more logical than that would be public financing of congressional campaigns to diminish at least somewhat the influence of campaign contributions on public policy decisions.

And last but not least, since so much of the deficit discussion is couched, both in economic terms and rhetorical terms, about saving for our children's future, I would suggest that if you do want to do any constitutional amendments at all, you lower the voting age to zero and allow parents or legal guardians to vote on behalf of their children, so that children would have a greater representation in this Congress.

[The prepared statement of Mr. Kogan follows:]

The Federal Budget Process Already Works

Testimony before the Committee on Government Reform and Oversight,
Subcommittee on Government Management, Information, & Technology
United States House of Representatives,
by Richard Kogan,
Senior Fellow, Center on Budget and Policy Priorities.
March 27, 1996

The budget process has largely worked as intended, allowing majorities to construct budget plans and pass implementing legislation. Yet it is now under attack in two fundamental ways. First, many Members are suggesting that budget making be done by establishing multiyear, fixed, unbending, automatically enforced, numerical ceilings. These ceilings may be applied to individual spending programs such as Medicaid. They may be applied to broad categories of spending, such as all entitlement programs or all discretionary programs. They may be applied to annual spending totals, or even to the deficit. But such fixed ceilings are bad economics, unwise public policy, and unnecessary toward achieving prudent budgets.

Second, a large number of Members seem eager to abandon majority rule, which is the underpinning of our democratic republic and goes hand in hand with a free citizenry. So-called "supermajority waivers" are now being proposed with depressing regularity. Their effect is to allow one side of a debate to prevail with less than half the votes while the other side needs more. It means partially or completely disenfranchising some of your fellow citizens — potentially a majority of them.

It is ironic that any Member, owing his election to the voice of the majority, would contemplate subverting majority rule. It is doubly ironic that Members who profess a deep respect for the workings of a free marketplace of goods, services, capital, and labor would attack the free marketplace of ideas.

And in some cases, Members propose budget process "reforms" that combine the worst of these two sins: fixed multiyear spending or deficit ceilings, combined with rules that would prevent a majority from increasing them. What would justify such a restrictive approach?

I have heard an answer — that the deficit is too big; that it is Congress' fault; that Congress is incapable of solving the deficit problem by majority rule; therefore, impose fixed ceilings on the deficit (such as zero) and create rules to hamstring a majority that may think 1 is a better number than 0.

Let's examine these propositions one at a time.

Big Deficits?

Adjectives such as "big" don't tell us much about the deficit. In fact, the best way to measure any economic factor — and the deficit is an important one — is relative to the size of the nation's economy. Graph 1 includes a thick line depicting the deficit as a percent of the economy for the last 40 years. One striking aspect of this graph is that, as a share of the economy (gross domestic product, or GDP), the deficit is lower today than it has been in almost fourteen years.

But is the current deficit, about 2 percent of GDP, big? One way to address this question is by comparing the deficit as a percent of GDP to the real growth of GDP, shown by the thinner dotted line. Two important facts are revealed by this comparison.

- First, particularly in the 1960s, the deficit was often lower than the economy's real growth. This means that the debt grew more slowly than the economy.

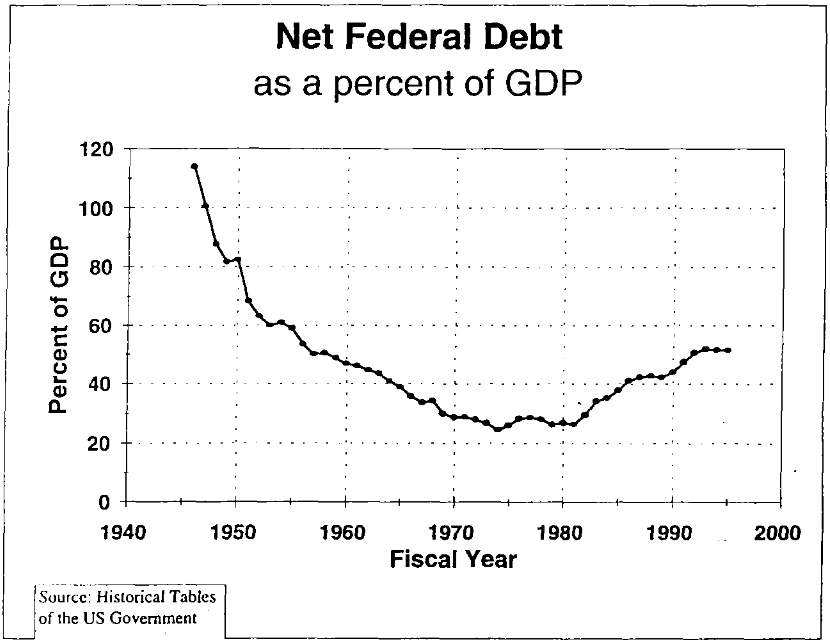
Of course, the deficit in any given year is the amount our government's debt *grows* in that year. When the thick line (the deficit) is below the thin line (the economy's growth), the debt is growing more slowly than the economy. This means the *burden* of our debt is shrinking. Stated differently, the debt as a percent of GDP is shrinking. And it generally means that the share of our budget devoted to interest payments is shrinking as well.

True, in this situation we still have deficits and the debt still grows, but if the economy grows faster, the debt hurts less. This allows us to attach a possible meaning to the concept of a "big" deficit: a deficit is big if it causes our government's debt burden to rise.

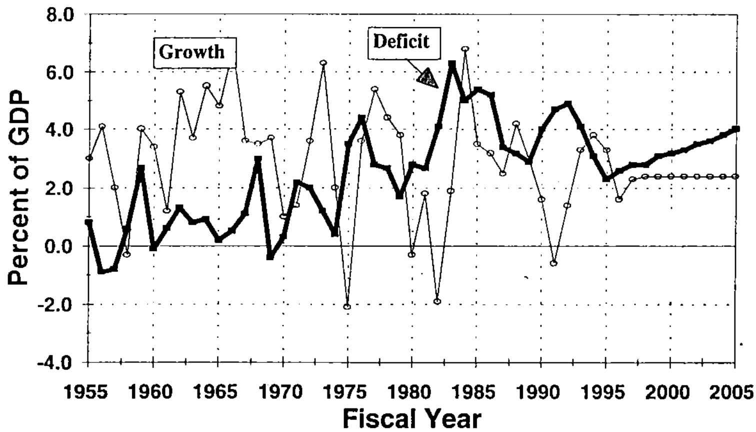
- This definition of "big" leads to the second important fact: except during the 1980s, our government has run big deficits *only* during times of war or recession. This generalization appears to be true back to the beginning of this century, and probably back to the beginning of the Republic.

Graph 2 shows that our government's debt as a share of the economy shrank significantly from 1946 through the 1970s (notwithstanding regular deficits), rose significantly during the 1980s, and has now leveled off. What is the conclusion? In the early 1980s our government made the mistake of cutting taxes significantly more than it cut spending. Starting in the mid-1980s we took a number of steps to reverse that mistake, and now (another decade older and deeper in debt) we have finally stopped digging ourselves into a hole.

From my point of view, these two graphs refute the propositions discussed earlier:


Net Federal Debt
as a percent of GDP
120
100
80
60
40
20
0
Percent of GDP
1940
1950
1960
1970
1980
1990
2000
Fiscal Year
Source: Historical Tables of the US Government

Graph 1: Deficits as Percent of GDP and Real Economic Growth



Source: Historical Tables Budget of the United States Government, Fiscal Year 1996
CBO: An Economic and Budget Outlook Update August 1995.

- "The deficit is too big." Not now.

- "It is Congress' fault." Not for at least 10 years, and even when it was, Congress' sin was agreeing with the popularly elected President to a budget plan that itself seemed popular.

- "Congress is incapable of solving the problem by majority rule." Demonstrated to be false by the evidence of the last ten years.

The "Right" Deficit

So much for the good news. After all, Graph 1 doesn't stop at 1996, this fiscal year, but continues for another decade. It shows the estimate made by the Congressional Budget Office (CBO) of the likely course of the deficit if the laws and policies of the previous Congress were to remain in place. It shows a deficit that slowly rises as a share of the economy. True, the deficit does not reach the levels of the mid-1980s, but it is clear that those deficits, occurring in times of peace and prosperity, were an aberration and unjustifiably high. "Not the worst," is an uninspiring slogan, ranking right up there with "never been indicted."

But there are two additional reason's to substantially reduce the deficit below CBO's path. The first is that, within the decade after the graph ends, I and my demographic cohort will retire and break the bank. It would be well for the nation to save some capital for the baby boomers' retirement; we squirrels are going to need a lot of acorns to last through the winter.

The second reason is related to the first, and gets to the fundamental economic reason for deficit reduction. Earlier I referred to the "debt burden." But why is it a burden? What is wrong with a national debt, anyway? After all, about four-fifths of Treasury securities are owned by Americans; paying off the debt (or even reducing its rate of growth) means paying money from some Americans to other Americans. Leaving aside distributional questions, how would that make the nation as a whole richer? In addition, Treasury securities provide Americans with a completely ironclad, risk-free location for their savings; why should that opportunity by limited?

Why Should the Deficit be Reduced?

Most simply, why do both you and I want lower deficits? The principal reason to reduce or eliminate the deficit is to increase the net national savings rate. The personal and corporate savings rate is lower now than it was in the 1950s, 1960s, and 1970s. At the same time, federal deficits have grown as a share of the economy, further reducing national savings. The resulting very low net national savings rate means slower long-term growth in both the nation's capital stock and the economy.

Thus, the purpose of deficit reduction is to increase net national savings and private capital formation, which should in turn increase productivity and real economic growth over the long run. (The issue of who benefits from increased economic growth is extremely significant, but nonetheless separate from the overall rate of growth.) The idea is for the nation to consume somewhat less now so it can consume more later.

And this isn't a simple tradeoff of now vs. later; economic history and an overwhelmingly large number of economists agree with the axiom that savings equals investment, and agree that history shows a real rate of return on investment of about 3 percent per year. Thus, Ben Franklin understated the value of thrift; over a decade, $1.00 saved is $1.30 earned.

This somewhat simplistic distillation of mainstream macroeconomic thought, has two ramifications. The first is that, in choosing a higher or lower deficit, our government is making a tradeoff between present consumption and future consumption.

People will differ about the relative values of present and future consumption. It is easy to understand that some will not be thrilled by trading lower consumption now for higher consumption (with a bonus) later.

- To begin with, some people doubt all economists, and are skeptical that there will be a positive rate of return. To them, deficit reduction is not compelling — why tighten your belt now if there isn't much reward later?

- Some might worry that they won't live to see the fruits of current scrimping. Those who do not intend to have children may not be mollified that future generations, at least, will benefit.

- And some will focus on distributional issues; conceding that future decades will be wealthier *as a whole* if we reduce the deficit now, they may expect that none of those benefits will go to them, their children, any of their friends, or any of their friends' children. The last two decades have been pretty dispiriting for the bottom half of our population, since virtually all the nation's real economic growth has accrued to the top half.

Notwithstanding these arguments, I am in the nest with other deficit hawks. I deeply hope that some future Congress will help distribute the economic pie more evenly. And I believe it is easier to redistribute a larger pie than a smaller one.

So what is the "right" deficit? The foregoing discussion suggests three answers to that question, all correct. The first answer is, "the lower, the better." Since the question is one of saving for the future and since a positive rate of return on savings and investment is extremely likely, the more savings now, the richer we will be later. From this macroeconomic perspective, reducing the expected deficit in 2002 by $100 billion is good, by $200 billion is better, and by $400 billion is better still. Of course, by now I am positing a *surplus*. But that is what saving for the future is all about.

Stated differently, answer to the optimal level of the deficit or surplus depends on a national value judgment that weighs current consumption against future consumption. Since the personal savings rate has been falling steadily, I infer that most Americans place a higher value on current consumption than did their predecessors. Thus, it appears consistent that they should also tolerate higher deficits.

Second, I just said that the bigger the surplus, the better. Arguably, the higher the net national savings rate, the better. Of course, this result cannot be taken to an absurd limit. That is, we cannot reduce current consumption — with a goal of increasing future consumption — to the point that we don't eat, or that we starve our kids, or fail to educate them, and so on. It is possible to save too much. Further, it is also possible to starve necessary public investment in an attempt to reduce the deficit; for reasons discussed more below, this would be a very unwise approach. Finally, the law of diminishing returns applies to national savings as it does to all other investments.

But the point of this analysis is more fundamental; it is the *net national savings rate*, not the deficit or surplus, that matters. A net national savings rate of 8 percent has generally been considered decent. We could achieve that by a private savings rate of 6 percent and a government surplus equal to 2 percent of GDP. Or we could achieve it by a private savings rate of 11 percent and a deficit equal to 3 percent of GDP. It doesn't matter how, and the results will be equally good for the future. Because the deficit or surplus does not operate in a vacuum, a reasonable economic target for a deficit or surplus depends entirely on circumstances.

How Fast Should the Deficit be Reduced?

One question is how quickly we should reduce the deficit. According to standard theory, if economic conditions remain unchanged from year to year, then the increase or decrease in the deficit from year to year represents the degree of economic stimulus or drag (respectively) that federal fiscal policy imposes on the economy. Too much fiscal drag — too rapid deficit reduction — could cause a recession. The evidence of the past few decades seems to suggest that reducing the deficit by an amount equal to ½ percent of GDP per year would not place too much drag on an otherwise healthy economy, although this experiment has only been tried one or two years at a time. Generally, that

Public Investment and Capital Budgeting

The economic rationale for deficit reduction, as discussed, is to increase net national savings and therefore total investment, leading to a greater capital stock, greater productivity, and greater real economic growth.

However, national investment actually has two components, private and public. Public investment is necessary where the private sector will not or cannot undertake investments important to future productivity. Examples of necessary public investment are education, infrastructure for transportation and distribution, and certain types of scientific research. There are also areas where private markets fail — areas for which there is no theoretical impediment to private sector investment but nonetheless private sector investment is inadequate. Examples of market failures include credit crunches, in which small businesses cannot get correctly priced credit; the general nonexistence of a market for small business equity capital; and the inadequate markets for disaster insurance.

The point is that public investment can have the same salutary effect as private investment. Therefore, in theory, increasing government spending for public investment will increase total national saving directly. Simultaneously, it will decrease net national savings by increasing the federal deficit. The increase and decrease in national savings will net to zero. This is the theoretical argument in favor of capital budget accounting, in which investment spending is *not* counted as an outlay at the time it is made.

There are four corollaries to this theory. First, since investment spending would not be counted as an outlay when made, it must be counted as an outlay later, as the investment depreciates. Thus, over a long period, capital budget accounting will not reduce the measured budget so much as change the rules at the margin to favor investment spending over consumption spending.

Second, we don't have any acceptable method to depreciate such investments as education, scientific research, or federal disaster insurance. Thus, capital accounting for these items would probably be done wrong; we just don't know whether costs would be stated too early or too late. And limiting capital budget accounting to physical infrastructure (for which reasonable depreciation schedules exist) would bias the rules in favor of one type of investment and against other types that may have higher rates of return.

Third, if investment outlays were measured on a depreciation rather than cash basis, changes in the federal budget deficit would no longer measure fiscal stimulus or contraction. This would impede an intelligent discussion of federal fiscal policy. Thus, capital budget accounting probably substitutes badly measured changes in national savings for well measured savings in fiscal policy.

Finally, the entire theory of capital budget accounting rests upon the assumption that the typical public investment is about as wise as the typical private investment. A road from nowhere to nowhere is not a wise investment; neither is teaching that the world is flat; and neither is investing so much in one field of scientific research that the nation's stock of scientists is diverted from more productive fields of enquiry.

Thus, in debating capital budget accounting, Congress should consider whether either the accounting or the investments will be done correctly. Simply keeping our spending priorities focussed on wise public investment may be the better approach to this issue.

amount of fiscal drag has been offset by monetary stimulus; the Federal Reserve and private credit markets have lowered interest rates.

Thus, all other things being equal, reducing the deficit by $35 billion per year, and by more as the economy grows, should not pose an economic problem. Given the current deficit of about $160 billion, one may be able to balance the budget in five years without causing a recession. However, if an economic slowdown occurs for other reasons during that period, as it might, we should accept the fact that the budgetary effects of the slowdown would postpone numerical balance by a year or more.

The issue of five vs. seven vs. ten years for balancing the budget is not one of macroeconomics at all. The problem is that with so much off the table — Social Security, defense, revenue increases — the resulting spending cuts are focussed much too narrowly. Some programs, and the people who rely on them, are hit too hard. This is particularly unfair since those are the people who are least likely to benefit from deficit reduction. I have a hard time asking somebody already worse off than I am to reduce *his* current consumption so that *my* future will be better.

The Fallacy of Fixed Targets: Deficit Targets and the BBA

As explained previously, from an economic perspective a balanced budget is simply a number somewhere along the spectrum between deficit and surplus; it has no magic to it. From an economic perspective, it is a purely arbitrary target.

A fixed deficit target of zero — a balanced budget requirement — is inappropriate because the net national savings rate, which is the real issue, is a combination of our government's deficit or surplus and the private savings rate, and the private savings rate may vary considerably over time. What is an adequate deficit or surplus given one private savings rate may be totally inadequate given another. It follows that a constitutional fixed deficit target (such as a balanced budget) sets in place a figure that could be far too high or far too low in future decades.

I currently want lower deficits, but in a democratic republic the size of the deficit or surplus — a trade-off between present and future consumption — should be made by the representatives of the electorate. I accept the fact that democracy is more important than my personal preferences about current vs. future consumption. Most simply, the fact that a balanced budget is just one possible answer to a judgment call about public policy tradeoffs is an additional reason to oppose a constitutional balanced budget amendment (BBA). Since the issue of the deficit or surplus and the net national savings rate boils down to a judgment call between current and future consumption, there is every reason to let the majority make that call and no reason to let the minority make it.

Fixed deficit targets are unwise for reasons that go beyond the fact that there is no "right" deficit or surplus, either in an economic sense or a public policy sense. They are unwise economics because, if followed, they would increase the likelihood of more frequent, deeper recessions, and perhaps depressions as well. Further, they are unwise because they are likely to be evaded (for good reason), but the evasions involve substantial deceit and therefore foster public cynicism.

The Business Cycle

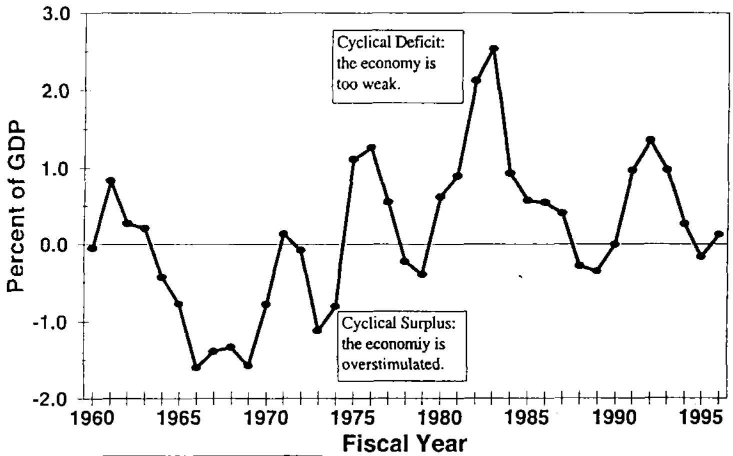
The previous section concluded that, all other things being equal, reducing the nominal deficit $35 billion per year would not be a macroeconomic problem. Of course, all other things are never equal. Specifically, the economy goes through cycles of growth and contraction, oscillating somewhat irregularly around a line that represents underlying real growth. In other words, we have recessions from time to time, and also periods of overstimulation that may threaten to create an inflationary spiral. During periods of recession, the deficit increases, as Graph 1 illustrated. The major reason is that revenues automatically fall, but an important secondary reason is that spending on such programs as unemployment compensation and food stamps automatically increases.

Note that I described the business cycle as an oscillation around an underlying trend. If one ignores the oscillations and concentrates on the underlying trend, one can see what economists call the "structural" deficit. That is, one can estimate what the deficit would be in any year if the economy were following its normal path, rather than being temporarily affected by a period of recession or overstimulation. Clearly, it makes good economic sense for our government to reduce the structural deficit — the underlying trend line — while ignoring the cyclical deficit or surplus.

Almost all economists agree that the so-called "automatic stabilizers" are very useful to the economy. Graph 3 shows the portion of the deficit that is attributable to the automatic stabilizers. That is, it shows the effect that economic deviations from the underlying economic trend have had on revenues and some spending programs. As can be seen, this "cyclical" deficit or surplus can be quite large; the cyclical deficit in 1983 was 2.5 percent of the economy. In contrast, the 1996 budget resolution called for spending cuts in 1996 of about .55 percent of GDP, about the amount that is generally considered safe. What this means is that the policy actions needed to counteract cyclical deficits can be so large that they are beyond even the most dedicated and ambitious Congress.

If we insisted on hitting a fixed deficit or surplus target, then during a recession we would have to raise taxes or cut spending; in 1983, the amount would have been 2.5 percent of GDP even if the underlying budget would have been balanced absent the recession. Note that 2.5 percent of GDP is five times as much as the ½ percent of GDP that is considered a safe amount of deficit reduction. (Further, it is safe only in non-recessionary period, because the Federal Reserve can create economic stimulus by

Graph 3: Budgetary Effects of the Economy



Source: Historical Tables of the United States; CBO Economic Update reducing interest rates. During a recession, interest rates sometimes fall so low that they cannot be further reduced.) The fiscal drag of cutting spending or raising taxes during a recession amounts to stomping on the economy when it is down, and is a good way to turn a recession into a depression.

Of course, this means that cutting the deficit by 2.5 percent of GDP in 1993 would *not* have lead to balance in that year; the economy would have gotten still worse as a result of the attempted deficit reduction; revenues would have fallen still further; unemployment compensation would have cost still more; and still more deficit reduction would have been attempted. After "Black Tuesday," our government spent form 1929 to 1933 struggling mightily to balance the budget, enacting heroic spending cuts and tax increases. That policy was an economic disaster.

Gramm-Rudman-Hollings and Budgetary Deceit

The Balanced Budget and Emergency Deficit Control Act of 1985, better known as Gramm-Rudman-Hollings I and II (GRH)[1], was a statutory version of a balanced budget constitutional amendment. GRH set fixed deficit targets, declining to zero. It enforced those targets through sequestration, automatic across-the-board cuts in many spending programs (although some key ones were exempt).

This means that GRH II had all the macroeconomic flaws discussed above. Specifically, if followed faithfully, it would force our government to raise taxes or cut spending by huge amounts in the event of a deep recession, very possibly triggering a depression. It was largely because of the unpalatable economic and budgetary consequences of meeting fixed deficit targets that the executive and legislative branches conspired to evade GRH II for as long as they could, and ditch it when they could no longer evade it. Here's how the evasion worked.

The official estimator, the Director of OMB, would make an estimate of the deficit for the *coming* fiscal year in September, and again in October, based on laws in place and OMB's economic and technical estimating assumptions. Here is the key: OMB could choose sufficiently rosy economic assumptions, and sufficiently unrealistic technical spending assumptions, that the fixed deficit target would appear to be met. (One year in the midst of the savings and loan crisis, for example, the administration estimated that net deposit insurance outlays would be zero.) Congress, in its budget resolution, did not want to give itself an impossible burden that the administration was unwilling to share, so

[1] GRH I was unconstitutional because the wrong person — the Comptroller General — was ultimately responsible for the budget estimates the drove sequestration. The Supreme Court, in Synar v. Bowsher, ruled that only the President or an executive branch official responsible to him could be delegated the authority to make the estimates. This is important because it helps explain what was wrong with GRH II and with other bills modeled on it.

Congress regularly voted to accept the administration's estimating assumptions, though often after considerable public angst. Thus, the amount of deficit reduction actually needed in a budget plan was set at an achievable level simply by OMB's manipulation of the estimating assumptions. There was no look-back to force sequestration based on after-the-fact actual deficits; if there had been, GRH II would have self-destructed even sooner.

In 1993 CBO reviewed GRH and the BEA and came to the following conclusions about the budget process:[2]

- First, budget enforcement procedures are much better at enforcing agreements than at forcing such agreements to be reached.
- Second, participants in the budget process should be held accountable for results that are under their *direct* control. [Emphasis added]
- Third, the enforcement process must be credible.
- Fourth, the process must include a certain amount of flexibility to allow reasonable responses to unexpected events.

It seems to me that GRH failed all four of these tests, though arguably it achieved flexibility through the use of creative evasions.

One can see the sad effects of GRH II. Rather than produce bad macroeconomic results, GRH II institutionalized the art of smoke and mirrors, timing shifts, and the rosy scenario. It created a situation in which institutional lying was the norm. Reporters spent more time exposing the little and big deceits than they did talking about the actual contents of and policy issues related to our government's budget. My belief is that GRH II added to the ongoing erosion in public trust of our government and its elected officials, and that it will take many years of candor for that trust to be reestablished. It is noteworthy that, from 1980 to 1995, the actual deficit was higher than the budget resolution's deficit in every year except 1992, 1993, 1994, and 1995. Note that these are the four years after GRH II collapsed. It can reasonably be expected that any attempt to reimpose fixed deficit targets will also thrust our government back into the dark days of institutional lying. It is probable that fixed spending caps or fixed entitlement caps will produce the same result.

The fixed deficit targets produced other reactions that were not conducive to honest budgetary debate. To begin with, when the rosy scenarios proved chimerical, as they regularly did, recriminations flowed in both directions. Second, hitting budget-year

[2] *The Economic and Budget Outlook: Fiscal Years 1994-1998*, p. 86.

targets became the alpha and omega of budgeting. Instead of looking down the road with an unbiased forecast to see where the long-term structural deficit was headed, our government focussed obsessively on the next year's deficit ceiling. It took actions that were unwise in the long run in order to meet short-run targets; it avoided short-run costs even if they were likely to produce significant, permanent, long-run gain; and it patted itself on the back for escaping artificial short-run crises, producing unwarranted complacency.

In contrast to budgetary debates during the GRH era, the budget debate last year was of a noticeably higher quality. Of course, that is a pretty poor standard of comparison, and objective observers might argue that even last year's debate was too focussed on numerical questions such as nominal growth rates and too oblivious to questions about the underlying policy and economic tradeoffs. Still, last year's debate deserves decent grades. Both the Congress and the President used estimating assumptions that were in the ballpark. Both the Congress and the President debated whether the spending cuts were too harsh. Both the Congress and the President focussed on long-term figures; they were not distracted by little, short-term ups and downs. And to a reasonable extent, where specific programmatic priorities or specific design features of the cuts were at issue, these were mentioned in public debate and the public, if it cared to, could know where each side stood.

Most important, both the Congress and the President wasted only a little time on badly designed, inherently wrong-headed budget process proposals; they debated the substance of the budget, and seemed satisfied to use the existing process to implement whatever agreement could be reached.

The Fallacy of Fixed Targets: Spending Caps and Caseload

As noted, automatic stabilizers exist on the spending side of the budget, as well as on the tax side. Unemployment insurance is the most significant of these, but Food Stamps, the Earned Income Tax Credit, Medicaid, and Aid to Families with Dependent Children (AFDC) each respond to the business cycle. The reason is that each responds to caseload and caseload is partially a function of the economy. In this respect, it is bad macroeconomic policy to put a fixed cap, unresponsive to changes in caseload, on entitlements as a whole or any individual means-tested entitlement.

Further, as shown by Graph 3, the business cycle and the attendant deficit increases are in fact temporary. They have little or no effect on the long-term deficit. Therefore, there is no special need for immutable entitlement caps. In summary, fixed entitlement caps are no better than flexible caps in addressing the long-term, underlying causes of rising deficits; they are bad macroeconomics, as noted; and they are especially harmful for the persons served by the programs. It makes no sense to cut unemployment benefits, food stamps, or any similar program just when it is most needed. Yet that is exactly would an immutable entitlement cap would do.

Recognizing this logic, earlier bills to cap entitlements have always provided that the cap shall automatically increase or decrease to reflect changes in caseload. For example, in the last few years, the Bush Administration and a number of leading Republican Members of Congress have proposed to cap the total cost of all entitlement programs except Social Security. If the cost of entitlements under existing law would breach the cap for the coming fiscal year, Congress would have to reduce entitlement costs. If Congress failed to take such action, the President would have to order "sequestration" — across-the-board cuts in entitlements — to meet the cap.

In every one of these bills, the formula used to establish the entitlement cap included an adjustment in the cap to reflect changes in the number of beneficiaries. Examples of these bills include:

- President Bush's proposed cap in 1992 and the Dole/Domenici bill of 1992 to implement the President's proposal;
- The Domenici/Nunn entitlement cap amendment to the 1995 budget resolution, based on the report of the "Strengthening of America Commission;"
- The Armey flat tax/entitlement cap bill of 1994;
- The Gramm entitlement cap bill of 1995; and
- The Stenholm entitlement cap amendment of 1994.

This does not mean that I am endorsing entitlement cap bills with caseload-adjusted cap. I don't like even the best-designed entitlement cap because it seriously diminishes accountability in three ways.

- Our government should decide to cut, increase, or leave unchanged a given entitlement law based on a number of factors (of which price is quite important), rather than forcing automatic cuts if an inherently arbitrary cap is breached.
- If automatic cuts occur, no one has to claim responsibility and defend why they happened, even if the defense would have been sound. Members and the President can say, "It was out of my hands."

- A more subtle problem is that arbitrary caps take on a life of their own; if the cap is *not* breached, that fact becomes an excuse to avoid examining either the merits or the costs of the programs it covers.

So I am not enamored of any arbitrary caps (including discretionary caps). The purpose of the foregoing economic discussion was to show that a cap that does not adjust for the effects of the business cycle on caseload is significantly worse than a cap that does.

The budget process bill that Mr. Cox introduced in 1993, HR 2929, is an example of the most unwise form of an entitlement cap. In effect, it would turn all entitlement programs except Social Security into discretionary programs. Each would be subject to its own fixed-dollar, immutable cap, established annually through the appropriations process. If economic conditions produced a higher caseload than contemplated at the time of the appropriation, the administration would be required and empowered to make program changes as needed to keep within the fixed dollar cap on each program. These could include across-the-board or selective benefit cuts or waiting lists. What good is unemployment insurance if a recession requires the administration to set up long waiting lists? A laid-off worker needs unemployment insurance starting when he is laid off, not starting 6 months later, when someone else leaves the rolls.

The fallacy of fixed caps has also started to appear on individual means-tested entitlement programs. Fixed dollar block grants in programs that are inherently subject to caseload, such as the Medicaid and AFDC programs, are bad economic policy. It is one thing to cut Medicaid 30 percent below what it would otherwise cost under existing law, as the 1996 budget resolution called for. It is quite another thing to cap the program so that it no longer fluctuates with the business cycle. The issue of the size of the cuts is independent of the question of programmatic responsiveness to economic-driven caseload changes.

Although the Food Stamp bill that passed the House last year was not a block grant, it also incorporated the fallacy of fixed caps. A formulaic cap would have been established by the bill, based on CBO's multiyear, steady-state economic forecast. The economy will inevitably oscillate around that steady-state forecast, but the Food Stamp cap will not. Thus, Food Stamp benefits will be automatically cut whenever the economy is in a recession.

Spending Caps and Inflation

Future inflation is even less predictable than future caseload. There are two key points with respect to inflation. The first is that inflation has very little effect on the level of the deficit. The second is that inflation can vary markedly, and for a long period of time, from forecasts. Therefore, the issue of inflation is especially relevant to questions of overall entitlement caps or fixed caps on individual entitlement programs.

And it is noteworthy that the entitlement cap bills listed above all included automatic adjustments to the caps if inflation deviated from expected paths.

To begin with, many years of CBO analysis show that general inflation has almost no effect on the federal budget deficit. If inflation is higher than expected, federal outlays increase but so do federal revenues, and by almost the same amount.[3] This analysis is based on existing law, in which almost every entitlement is directly indexed or indirectly responsive to changes in prices. Therefore, the conclusion is that there is no budgetary need to set fixed caps on entitlements, or on Medicare and Medicaid. Yes, there is a great need to cut them relative to existing law. But after that cut is made, the new, slimmer health programs should continue to provide benefits that respond to changes in inflation. The deficit targets will likely still be achieved.

Second, if a fixed rather than an inflation-adjusted cap is placed on entitlements as a whole or on health entitlements, that cap may have very unexpected programmatic results if inflation turns out to be very different from forecast. Fixed ceilings could lead to a significant *unintended* erosion of entitlement benefits or to a significant *unintended* liberalization of real benefits, depending on the unpredictable course of inflation. (The same is true of a fixed, rather than an inflation-adjusted, discretionary cap.) Although any fixed cap would presumably be designed to accommodate *projected* inflation, the projection is certain to be wrong, and perhaps by a substantial degree. For example, if Medicare were capped but then inflation turned out to be one percent per year higher than expected, the amount of extra spending needed to keep Medicare whole would total $76 billion over 1996-2002.

The possibility that inflation will surpass current expectations should not be ignored. CBO is currently projecting that general inflation will average around 2½ percent per year for the foreseeable future. Yet in the 1980s general inflation averaged 4.5 percent per year, and in the 1970s, 7.0 percent per year.[4] Further, CBO's record on economic forecasting, though as good or better than others', is hardly perfect. For example, in early 1988 CBO overestimated inflation for the year already in progress by 1.0 percentage points; in 1990 CBO underestimated inflation for the year in progress by 0.5 percentage points.

Over a longer period of time, the projections are even more speculative, by necessity. For example, CBO's baseline economic assumptions published in January 1995 imply prices in 2002 that are 4.3 percent higher than implied by CBO's January 1993

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[3] See *The Economic and Budget Outlook: Fiscal Years 1996-2000*, Congressional Budget Office, January 1995, pages 78-79.

[4] These figures reflect the average annual percent change in the GDP chain-type price index on a calendar-year basis. Note, however, that low inflation is not unprecedented. For example, in the 1960s general inflation averaged 2.7 percent per year.

assumptions. In contrast, CBO's economic assumptions of January 1985 implied prices that, seven years later, actually turned out to be 4.5 percent lower. The conclusion is that high-quality, unbiased seven-year price assumptions can be off as much as 5 percent in either direction during an era of relative economic stability. For Medicare, for example, this means that total program costs in 2002 might be $16 billion higher or lower than CBO expects solely because of uncertainty about inflation.

All the above arguments apply to aggregate discretionary caps. In 1990, when the Budget Enforcement Act established caps on discretionary appropriations, those caps were set at a level that produced the level of *real* (inflation-adjusted) spending that the negotiators agreed to. The caps were made adjustable, so that if actual inflation differed from the forecast made in 1990, the caps would increase or decrease accordingly. Because inflation has generally been lower than forecast in 1990, those caps have automatically been adjusted downward in each subsequent year but one.

Spending Caps and Federal Insurance Programs

Generally, federal insurance programs exist because the private market does not provide the type of insurance the public wants. Unemployment compensation is such a program; it should be obvious that a fixed-dollar cap on unemployment compensation, as would be established by the Cox bill or the Barton bill, is profoundly antithetical to the essence of the program.

Other types of federal insurance are equally important to the orderly functioning of the nation's economy. Deposit insurance, for example, keeps the problems of a few individual banks or thrift institutions from turning into destabilizing panics. The Price-Anderson Act allows the nuclear power industry to exist; the private sector would not provide liability insurance to the industry, so our government did. In general, federal insurance programs of this sort run at virtually no cost until there is a major problem; at that time, they cost whatever is needed to indemnify depositors, etc., for their losses.

Of course, that is what insurance is all about, and illustrates still another flaw with the balanced budget constitutional amendment; it means that potentially expensive commitments of our government, such as deposit insurance or the Price-Anderson Act may not be legally binding on those few occasions when they might really be needed.

Similarly, the Cox and Barton bills would allow such programs to work as intended only when they weren't needed, but would halt them in their tracks when they were. For all practical purposes, such proposals are tantamount to repealing deposit insurance, crop insurance, expropriation insurance, nuclear accident insurance, and the like.

Automatic Stabilizers and Tax Policy

It is instructive to note that advocates of fixed deficit ceilings or spending caps do not advocate fixed revenue floors. That is, they do not propose to reform the budget process so that, if revenues fall as a natural response to a business slowdown, taxes are automatically raised. Apparently there is a consensus that, on the revenue side at least, the automatic stabilizers should be allowed to work.

This raises two issues. First, should our government rely exclusively on automatic stabilizers to respond to the business cycle? Or should it supplement the automatic stabilizers by enacting, say, temporary tax cuts and spending increases during a recession? Among economists the debate is inconclusive. The standard argument against Congressional supplementation is that it usually comes too late to counteract the recession, and may provide stimulus during the economic boom that often follows a recession; it may risk overstimulation, doing more harm than good.

Assume you accept this reasonable argument. Note here that the "pay-as-you-go" rules in the Budget Enforcement Act of 1990 (BEA) are consistent with this economic theory. Nothing automatically happens if taxes fall or entitlement costs rise under current law, but Congress may not cut taxes or liberalize entitlements by statute, even temporarily, without enacting a corresponding offset. Thus, the pay-as-you-go rules allow the automatic stabilizers to work, but prohibit congressional supplementation. The rules tend to enforce the structural deficit path agreed to in a prior budget plan, and allow cyclical deficits or surpluses to fluctuate as they may.

If Congress imposes budgetary rules, such as the pay-as-you-go rule, that rely exclusively on automatic stabilizers to counteract the business cycle, then it becomes doubly important for the automatic stabilizers to be robust enough to work. Currently, automatic stabilizers are fairly robust, as Graph 3 indicates. Specifically, under existing law, federal revenues are highly sensitive to changes in national income. Measured in percentages, if national income drops, federal revenues will drop by almost twice as much. The economic results seem favorable; comparing the last 50 years with the prior 150, recessions have become noticeably milder and somewhat less frequent.

However, recent tax proposals threaten to weaken the automatic stabilizers. Specifically, proposals for a flat tax would make federal revenues less sensitive to the economy. Under a flat tax, as individuals lose real income, they would tend to be subject to the same tax rate (though they would pay a lower amount) rather than be subject to the lower tax rates that would apply under the current progressive income tax structure. Even more troubling are proposals to shift from an income tax to a consumption tax; under some consumption tax plans, the highly sensitive corporate profits tax would be repealed. In a recession, as national income falls, federal revenues would fall by about the same percentage, rather than by twice as much. As a result, automatic stabilizers would be only half as effective as they are now. A case can be made to strengthen the existing automatic stabilizers; certainly they should not be weakened.

The Fallacy of Fixed Targets: Capping vs Reforming Health Care Entitlements

The previous discussion has attacked fixed deficit targets and fixed entitlement caps, in aggregate or program-by-program, as being bad macroeconomic and programmatic policy. Why have they become such a fad? As far as I can tell, the underlying reason is expressed by those who point to the fairly rapid increase in entitlement spending over the past few decades, in nominal terms, in real terms, and as a percent of the budget. It is sometimes said that, "entitlement spending is out of control."

From my point of view, it is both necessary and proper to worry about the growth of entitlement programs, and to enact legislation to restrain that growth. However, it is both unnecessary and unwise to do so by means of fixed caps. To explain why, I need to back up a bit.

Assuming that current laws and policies are left in place, the entire budgetary problem of the next decade hinges around Medicare and Medicaid. If they remained flat as a percent of GDP — if they grew in real terms only as fast as Social Security — then total spending would be shrinking, interest on the debt would be declining, and the deficit would be shrinking. Thus, a statement such as "entitlements are out of control" is much too imprecise. It would be far more accurate to say that Medicare and Medicaid are out of control.

Given this reality, three conclusions seem to follow. First, overall entitlement caps are inappropriate because they subject programs with relatively better cost control features to sanction based on Medicare and Medicaid growth. Likewise, fixed caps on other programs, such as Food Stamps and AFDC, are unnecessary as budget control mechanisms. The design, the costs, and the effects of such programs can certainly be debated, but there is no budgetary reason to impose fixed caps on them.

Second, it is perfectly reasonable that the 1996 Congressional budget targeted 72 percent of its seven-year entitlement cuts to Medicare and Medicaid. Likewise, the President's 1997 budget targets 66 percent of his seven-year entitlement cuts to those two programs. Basically, the President and Congress agree on the shape of the entitlement package but disagree on its total size; the congressional entitlement package was larger because Congress proposed much deeper tax cuts.

Third, it is desirable that the Medicare and Medicaid cuts our government ultimately agrees upon be made permanent. Too often in the past, a portion or all of the cost-saving measures in entitlement bills were designed to expire immediately outside the budget window. This may be a possible area for budget process reform; perhaps the reconciliation process can be designed to give a clean amendment to those who want to make all entitlement savings in a reconciliation bill permanent.

Three Types of Entitlements

Broadly speaking, entitlement programs can be designed in three fundamental ways. First, they can have rigidly controlled costs, as with capped entitlements such as Title XX social service grants. Second, they can have tightly designed eligibility and benefit features, but be open-ended with regard to enrollment and nominal per-capita costs. Social Security, Food Stamps, and veterans benefits are examples of this type of program. Finally, they can be open-ended with regard to real benefits, program eligibility criteria, or both. Medicare and Medicaid fall in this category.

Let me use an analogy to illustrate the three types. Imagine that the budget-maker in your family sends you out for the groceries: there are three different types of instructions you might receive.

- **Capped.** "Here is $95. Go buy enough food to last a week."
- **Tightly designed.** "Here's a detailed shopping list for this week. Go buy the items on it, but nothing more."
- **Blank Check.** "Here's my credit card. Go buy food."

Medicare and Medicaid fall into the latter category. Those programs pay for whatever procedures and tests the doctor orders, without limit.[7] In the case of Medicaid, states can choose to cover considerably more services than the basic federal package, and can raise the income threshold for eligibility for children, AFDC adults, and the "medically needy" to very high levels. The federal government pays most of the costs. Given a blank check, I'm surprised that costs haven't risen even faster.

One key conclusion follows from this analysis. This Congress attempted to turn Medicare and Medicaid into capped entitlements as a way of making savings. This may be a serious over-reaction. The drawbacks of capped entitlements go beyond the fact that they are unresponsive to the business cycle, and therefore weaken the automatic stabilizers, as previously discussed. In addition, capped entitlements are unresponsive to changes in prices; that is, the caps do not adjust if inflation turns out to be different from CBO's forecast. And they are unresponsive to changes in caseload.

It follows that a better approach would be to make Medicare and Medicaid more like those entitlement programs that are not out of control. In Medicare, for example, the essential reform could be to turn the entire program into a voucher system. The insurance market would have to be reformed to guarantee community rating and prohibit exclusion based on medical conditions; access to competing health insurance plans would have to be organized; and risk-pooling mechanisms for insurance companies would be needed. This task requires a lot of careful thought and some time to implement, but it would also create a system in which every elderly person would be guaranteed a voucher adequate to buy health insurance and the annual inflation-adjusted rate of increase in vouchers would be controlled by statute. Such a system would no longer be a blank check, and Medicare would no longer be out of control.

A related approach could be taken for Medicaid. The key point here is that the entitlement to Medicaid benefits and the scope and nature of services covered by those benefits would become clearly spelled out by federal statute. States could not choose the expansions of eligibility, services, and fiscal manipulations that they have in the past. Notice that this approach is the exact opposite of a block grant; instead of giving states a fixed amount of money and letting them do whatever they want, for good or ill, the federal government would tighten eligibility, benefits, and payment rates and define them more clearly as a way of cutting costs and cost growth.

Conclusion

In principle, I do not think it is necessary or appropriate to establish multiyear ceilings on the deficit, on spending as a whole, on categories of spending such as entitlements or discretionary programs, or on individual programs such as Medicare and Medicaid. Rather, Congress should (and in fact does) use the annual budget resolution to set dollar limits on discretionary appropriations for the budget year, and should (and often does) use the reconciliation process to make significant budgetary reforms in entitlements and taxes. Likewise, one does not need the pay-as-you-go rule to prevent entitlement liberalizations or tax cuts; budget resolution multiyear allocations are adequate to achieve that result.

In other words, the Budget Enforcement Act (BEA), with its discretionary caps and its pay-as-you-go rule for tax and entitlement proposals, is not necessary. But I would hasten to add that the BEA works as intended, and avoids the major sins of fixed ceilings. The pay-as-you-go rule prohibits our government from deliberately passing legislation that would increase the structural deficit, while allowing the temporary effects of business cycles to run their course — it allows the automatic stabilizers to work. It does not require institutional lying in the form of a rosy scenario; it allows both the President and Congress to use reasonable estimates about the effect of their budgetary policies. And the discretionary caps, being adjustable for unanticipated changes in prices, guarantees that the real level of resources agreed to in 1990 has been an effective ceiling on discretionary appropriations.

In short, avoid fixed targets in any form. Use the budget-making tools our government already has; they work. If you decide to set multiyear targets, however, follow the model in the BEA: inflation-adjusted discretionary targets, and pay-as-you-go rules that allow automatic stabilizers to work and accommodate changes in caseload and inflation.

The real challenge for our government is not the budget process at all. Rather, it is to end the blank-check features of Medicaid and Medicare. This will involve resolving a set of knotty programmatic issues, but it is possible to make those two health programs much more like the other entitlements, which are not out of control, and in fact are growing no faster than our economy as a whole.

Majority Rule in a Democratic Republic

So far, I have focussed on the unfortunate economic, policy, and institutional effects of fixed deficit or spending ceilings. I would like to turn now to issues of majority rule. I have already said that majority rule is more important than any particular public policy outcome. I think this principle is the glue that holds our country together. The vast majority of Americans can accept, perhaps grudgingly, that they will sometimes lose a fair fight. Many can accept that their public policy views will *never* be shared by a majority of their fellow citizens. But very few Americans can accept losing an unfair fight, and at least some have the decency to feel that if they can't win fairly, they shouldn't win unfairly.

It is simply unfair for public policy issues to be decided by supermajority rules.

I contend that it is also unconstitutional for public policy issues to be decided by supermajority rules. (Admittedly, the existence of the United States Senate, which does not represent people but rather certain arbitrary jurisdictions of primarily historical interest, means that our government as a whole is not fully majoritarian. Still, the existence of the Senate is no excuse to make the situation less fair than it currently is.)

I am convinced that the constitutional convention had it right when it voted against supermajority requirements. Supermajority rules applied in the Continental Congress; the framers of the Constitution had experience with them and understood exactly what they were rejecting.

Both James Madison and Alexander Hamilton, the key figures in drafting the Constitution and the authors of the Federalist papers (along with John Jay), explained why the Constitution rejected supermajority rule:

> [Madison] It has been said that more than a majority ought to have been required for a quorum, and in particular cases, if not in all, more than a majority of a quorum

> for a decision. ... [But that would mean] ... [i]n all cases where justice or the general good might require new laws to be passed, or active measures to be pursued, the fundamental principle of free government would be reversed. It would be no longer the majority that would rule; the power would be transferred to the minority. Were the defense privilege limited to particular cases, an interested minority might take advantage of it to screen themselves from equitable sacrifices to the general weal, or in particular emergencies to extort unreasonable indulgences.
>
> [Hamilton] [M]uch ill may be produced by the power of hindering that which is necessary from being done, and of keeping affairs in the same unfavorable posture in which they happen to stand at a particular period.

It is equally telling that, in key areas of public policy, the Constitution does not tell future Congresses what must be done; rather, it relies on majority rule to enact such legislation as may be necessary. The framers of the Constitution were willing to accept the idea that future Congresses were free to make very poor public policy decisions by majority vote. Specifically, the Constitution grants the authority to, *but does not mandate that*, future Congresses may "lay and collect taxes, ... borrow money ... coin money ... fix the standards of weights and measures ... declare war ... raise and support armies ... provide and maintain a Navy ..." Clearly, the constitutional convention was giving the majority the right to unilaterally disarm by choosing not to raise armies or maintain a Navy. Clearly, Alexander Hamilton (later the first Secretary of the Treasury) felt that principles of majority rule were so important that Congress could decide to destroy both government and commerce by choosing not to raise taxes, coin money, or borrow money.

Finally, it is significant that Madison equated majority rule with "free government." I think he was right. Freedom consists not just in the Bill of Rights, which protect individuals from the powers of government, but also in the right to have an equal voice in our nation's government. A person who cannot vote, or whose vote is diluted by supermajority rules, is not an equal citizen and so is not fully free.

In this context, most of the budget process bills submitted to this Committee, such a Rep. Cox's bill, diminish our freedom by placing particular public policy outcomes above majority rule.

Protecting the Tools of Majorities

I believe that the most effective features of the congressional budget process and the legislative process generally are those that allow a majority to find itself, make a plan, and execute that plan. The Congressional Budget Act has a number of features that strengthen majority rule.

The first is the existence of a budget resolution itself. While budget resolutions have often proven difficult to pass, this simply reflects the difficulty of putting together any overall legislative plan that a majority can commit to. The problem is that most public policy issues, and particularly budgets, do not have two sides but three or more. Therefore, it is often the case that no single budget plan is affirmatively supported by a majority. Yet the process of passing a budget resolution focusses a majority of each chamber — usually but not always on a strictly partisan basis — on creating a plan that its members can live with. Absent a budget resolution, it seems very clear that the President's budget would be the only standard against which discretionary appropriations could be measured, and that either the status quo or the special interests of the narrowly based committees would govern entitlement questions.

Most simply, budget resolutions strengthen the power of the majority party to govern, and that is a virtue; parties should be strong enough to govern.

Second, the reconciliation process is a wonderful tool for enacting a comprehensive budget plan. Without reconciliation, individual narrowly based committees could stop the reform of their entitlements simply by not reporting any legislation. This is exactly what happened to the first four budget resolutions (fiscal years 1977-1980), which called for specific entitlement savings and got almost none. When the reconciliation process was first used in 1981, that type of stonewalling ceased. Probably the most significant vote in the history of the budget process occurred in 1981, when 20 committee chairman signed a "Dear Colleague" letter calling for the House to strip the reconciliation directive from the 1982 budget resolution. On a close vote, the Budget Committee prevailed and the reconciliation directive was retained.

The fact that a reconciliation bill is a single bill that must ultimately be voted up or down allows the majority to stay together in implementing its plan. If it were, say, 10 separate bills rather than one bill with 10 titles, one or more of the bills might not survive, as the minority and some members of the majority who disliked that particular policy prevailed. Yet if some key aspect of a deal is defeated in this way, then the entire coalition might break apart. The budget resolution and the reconciliation process thus allow a majority to make a plan and see that it is implemented, even over the objections of more narrowly based interests.

And the broader point is that this Committee should resist any budget process changes that impede a majority from forming a plan to begin with, or allow it to be nibbled to death later. In Congress, a deal is a deal. An honest politician is one who keeps the agreements he makes, no matter how reluctantly he made them.

Among budget process changes that would weaken a governing coalition and facilitate deal-breaking are the lock-box proposal, the line-item veto, and "automatic" continuing appropriations. The lock-box proposal allows a temporary majority, voting on one specific item in an appropriations bill, to automatically reduce the appropriations allocation and discretionary caps. This is wrong; people who voted for the budget resolution should not turn around and vote to lower the allocation they just agreed to. Yet, under the lock-box procedure, they have very little choice if they oppose a particular funding item in an appropriations bill. Most generally, the lock-box concept violates the fundamental precept that a deal is a deal.

The line-item veto has similar flaws. It can allow a minority of one chamber (consisting perhaps of Members opposed to the previously agreed-upon budget resolution) to side with the President and knock items out of an appropriation bill after the fact, even if those items were entirely consistent with budget resolution assumptions and of critical importance to the majority coalition.

Let's put this in a different context: in a dispute with Congress, a president has as his major weapon the veto. Congress has as its major weapon the ability to package items together, giving the president an all-or-nothing choice. By giving the president a line-item veto, the Congress unilaterally disarms itself in the contest between the branches, fundamentally upsetting the balance of powers carefully arranged in the Constitution. Unless you think that the problem with the legislative process is that Congress is too powerful and the President is too weak, don't hand away Congress' single best weapon.

Taking this logic one step farther, many Members of both parties have argued over the years for an automatic "continuing appropriation" as a way of curbing perceived congressional abuses and precluding government shut-downs. The automatic continuing appropriation would maintain spending programs at some formula level, such as the prior year's level or 95 percent of the prior year's level.
But, again, this proposal would hand over Congress' best weapon; the power to package. Suppose Congress is intent on eliminating some item that the President wants very much to keep. (I am thinking of the military assistance program, which Congress eliminated in 1973 over strenuous objections from President Nixon.) Or suppose Congress is intent on reducing an agency by some larger figure, say 20 percent. Under an automatic continuing resolution, the president can get his way by vetoing the regular appropriation, with the unwanted cut, as often as he is sustained. But if Congress keeps control of the text of a continuing resolution, the sides are more evenly matched.

Possible Reforms to the Budget/Legislative Process

As you can see, I think the most important role of this Committee is to safeguard the ability of a majority to govern (Minority rights are important because we can never be quite sure who the majority is And they are important because no majority should ever go unchallenged. Thus, the right of the minority to offer a motion to recommit with instructions should be jealously preserved, and the Rules of the House should not get so cluttered with impossible, contradictory provisions that every plausible instruction would trigger some point of order.)

In general, I have suggested leaving the current process alone. It works. I do, however, have seven suggestions that might improve budget products, would help majorities govern, and would be consistent with the principles of a democratic republic.

1) Accounting for insurance programs. The budgetary accounting of federal non-credit insurance programs should be reformed. Programs such as flood insurance and expropriation insurance allow citizens to purchase binding, multiyear insurance contracts from the government. The future costs of such a contract cannot be avoided once the contract is issued, not even by a change in law. Thus, the economic effect of the transaction (usually a subsidy) occurs when the contract is signed, not when the (possible) claim is subsequently paid. That economic effect should be recognized as a cost up front. Failing to do so may mean that legislation expanding insurance risks and costs is paradoxically scored as deficit reduction, simply because the short-term cash flow favors the government. This produces a perverse incentive for Members of Congress.

Deposit insurance and pension insurance are similar to legally binding contracts, and arguably should also be accounted for on an up-front basis.

2) Accounting for asset sales. Similar conceptual weaknesses occur in the budgetary accounting for the sale of non-financial assets. Under prior rules, asset sales were not scored as deficit reduction because the attendant cash flow was generally just a timing shift, not deficit reduction at all. But this approach could lead to the unhappy result that selling an asset was scored the same as giving it away. The new rules imposed on Congress by the 1996 budget resolution solve this problem, but at the price of making asset sales that may increase long-term deficits attractive because of their short-term cash effects. OMB and CBO should be requested to devise a solution that addresses both problems.

NOTE: Neither of the first two recommendations is an endorsement of "balance-sheet budgeting," a concept that is fatally flawed when applied to the government as a whole. But the analytical tools that are appropriate for business balance sheets are also appropriate for those government programs that have a business-type contractual relationship with the public, and may be appropriate for handling the disposition of income-producing federal assets.

3) Outyear entitlement costs. It is worth exploring whether the reconciliation process can be designed to guarantee a clean amendment to those who want to make all entitlement savings or tax increases in a reconciliation bill permanent.

4) A more flexible reconciliation process. I suggest that the House negotiate with the Senate on limiting the Byrd rule so that it applies only to Senate consideration, not to

conference reports. In return, allowable time for Senate debate might be increased somewhat.

The Byrd Rule was undoubtedly well-intentioned, but it has the effect of making it harder to maintain governing coalitions on reconciliation bills in both the House and the Senate, it knocks out of reconciliation bills various provisions that are surely relevant to budgeting in a general sense (such as civil service pay restraint), and it eliminates non-budgetary provisions that would allow the policy in various entitlement reforms to be implemented more effectively. For example, the Byrd Rule would prevent the inclusion in reconciliation of an authorization for a temporary study commission to compare the effects of the welfare changes made by various states under flexibility newly granted in the reconciliation bill. Why?

5) Committee responsiveness. I suggest that each Committee of the House be constituted on the same basic lines as the Budget Committee, with one-third (or one-quarter) of the membership rotating off each Congress, and with the resulting Chairmanship vacancies filled by vote of the party caucus without regard to seniority. This has produced a succession of highly qualified Budget Committee chairmen and ranking minority members, and has kept the Committee membership in very close policy alignment with each party caucus. Further, this procedure will directly or indirectly strengthen the role of the party leadership, which is important in creating parties strong enough to govern.

6) Public financing of congressional campaigns. I suggest that this Congress enact public financing of campaigns. If there is any single factor that makes legislation reflect something other than the honest convictions of the Members and the policy preferences of the voters, it is the influence of campaign contributions. Campaign finance reform may well be more effective than the line-item veto in reducing what is commonly known as pork. And it won't turn over political leverage to the President, as the line-item veto would.

7) On behalf of future generations... Much of this paper made arguments against a balanced budget constitutional amendment, notwithstanding the economic advantages that a large deficit reduction package would bring. Both the economic arguments and the rhetorical arguments for a balanced budget proposal involve sacrificing now so that the future will be better for our children. An argument can be made that the interests of children are not adequately represented in Congress.

I have a modest proposal to address that concern, which is nonetheless consistent with the principles of majority rule and democratic republicanism that underlie our Constitution and this paper: I suggest that the Constitution be amended to lower the voting age to zero, and that parents or legal guardians have the right to vote on behalf of their children. One citizen, one vote. What could be fairer?

Mr. HORN. Well, we have quirky ideas occasionally presented——

Mr. KOGAN. I am dead serious.

Mr. HORN. I know you are dead serious. But I will give you my experience with the Signal Hill Elementary School 3 weeks ago where the third, fourth and fifth graders met with me. They had studied Washington. And one fourth grader raised his hand and said, "Do you think we kids should vote for President?"

And I said, "Well, let us ask the fifth graders how they feel about that." And I asked the fifth graders, "Do you think the fourth graders should vote for President of the United States?"

Unanimously said no, they were not up to it.

And then knowing the third graders were next in line, I suggested that the fourth graders might want to vote on that and they agreed, third graders are not up to doing that.

So it is an intriguing idea.

Mr. Mason has come in. We had better get Mr. Mason's testimony on the record.

We have had your testimony. We do put it in.

Mr. MASON. You do not want me to read it all.

Mr. HORN. Please summarize it. Please summarize it and do not read it to us.

I have said that in other panels and they look at me and read their whole testimony.

Mr. MASON. I appreciate that, Mr. Chairman, and I want to commend you for the time that you are taking for this important subject that others do not.

I would like to thank Mr. Kogan for his last suggestion. As the father of six, I would have a kind of automatic supermajority in certain circumstances.

Mr. KOGAN. No problem.

Mr. MASON. I guess first of all, I want to say you are obviously targeted on a critical area and I would start out with the premise that in fact the budget process does not work, has not worked very well since 1974. Spending has gone up, deficits have gone up, and I do not think it is unreasonable for us to look and say, well, the Budget Act was passed in 1974, we have had pretty continual deficits since then, there must be a relationship and we need to look at reforms to the budget process to address this issue.

Obviously in the past year, you have had some very difficult times with the President. I know some other witnesses have referred to the Kerrey-Danforth Commission and I have covered some areas in there where I do think the spending and entitlement trends absolutely need to be acted on and, in fact, it is possible for Congress to kind of stumble through and take these things a year at a time and fix this and fix that and fix another thing, but I think in the long run that will leave us with a very unsatisfactory result where you will have a series of crises, which in fact we have had over the past several years, you had a 1987 budget deal, a 1990 budget deal, we had Gramm-Rudman I, Gramm-Rudman II. We try to adjust these things as we go along and I think you need to look at it in a broader context.

I do think that H.R. 2929 from the last Congress was a wonderful place to start and, in fact, I have been a little bit puzzled as to why there has not been more push behind that as the majority changed in Congress. And I would encourage you to look at that. I know you have looked at parts of that as the basis for further reforms.

And a couple of things in particular, I think, are critical. One is to get a mechanism for regular review of entitlement programs. You do not have that now; 37 percent of the budget and declining is discretionary expenditures and, in fact, you have pretty good control over that now between the budget resolution and the appropriations committee. That is not where the problem is. You have 63 percent of the budget and increasing that is fundamentally uncontrollable through the annual process and you absolutely have to have a way to get a hold of that.

I agree entitlement caps are the wrong way to do that because then you leave the fundamental structure of the entitlement programs in place and you just put something on top and you are just going to have a crash or a problem at some point.

I think you need rather to look at fundamental reforms in the programs which should not be budget driven in the first instance. I think the concept of entitlement, the idea that we are going to pass these general laws and particularly in these two programs mentioned that open up the checkbooks, is what needs to be reexamined with budget being one of the limitations.

The second critical piece of H.R. 2929, I think if you did one thing that might be as close to a silver bullet in the process as you can get, is to have a binding budget resolution and put it first in the process. We have just been through a year, and we have been through years like this before, where the President had a budget which was dead on arrival and Congress had a budget resolution which was crafted without reference to the President and you went through 6 or 8 months of crafting bills and so on and you got to the fall and you had this big crisis. And sometimes it was solved through summits and this year it was not solved at all, but we need a way to get Congress and the President to grapple earlier in the process with some of the big decisions about what the overall spending levels will be.

And I think that binding budget resolution is a good way of doing that and would allow you to go on and make some of the subsidiary decisions which now get put first in the process in a more rational fashion. And, as I say, if there is one thing you would do, I would pick that first.

Last, just following up on a couple of the other witnesses, on supermajorities, there is nothing in fact inherently conflicting with democratic theory and supermajorities. Supermajorities have been with us as a part of democratic structure since we have had democracies. And, in fact, they operate as kind of constitutional limitations on the Government.

There may in one particular case be good or bad reasons or good or bad times and ways to impose supermajority requirements, but the idea that we would do away with the Senate filibuster, we would do away with the Byrd rule all together, for instance, and not merely in reference to conference reports, that we would do away with or substantially alter the procedures for constitutional amendments, which, of course, are in the constitution itself which require extraordinary supermajorities.

And I do not think there is any particular reason why you should not use supermajority requirements to build in preferred outcomes in the budget process. And certainly one of those preferred outcomes from my perspective ought to be a limitation on tax increases.

I think it is a legitimate thing for the voters, for the citizens to say we want a prejudice against tax increases built into the process and for Congress to do that or to make other judgments of that sort along the way.

So I will conclude there and be happy for your questions.

Thank you, Mr. Chairman and Mrs. Maloney.

[The prepared statement of Mr. Mason follows:]

David M. Mason

Vice President, Government Relations

The Heritage Foundation

The Federal Budget Process: Needed Reforms

Chairman Horn, and Members of the committee, I would like to thank you for this opportunity to present testimony on the critical question of reforming the federal budget process.[1] You are to be commended for addressing this issue, and, as I will outline, this Congress has already taken numerous productive steps to begin the many reforms needed to institute a sensible federal budget process.

Taxpayers sent a clear message to Washington in 1994 that they do not want useless and obsolete programs to waste their money more efficiently. They want the budget to be balanced in a timely fashion, and they want the result of this effort to be a smaller, less costly government.

Unfortunately, the Clinton Administration managed to cast the 1995 budget debate more as a struggle over the process of how to balance the federal budget on paper, without making any hard decisions, than as a serious attempt to define what the government should look like once the budget is put in balance, and what was needed to reach that result. The Balanced Budget Act of 1995, which passed Congress only to be vetoed by President Clinton, did contain many substantive policy changes to slow federal spending growth and turn some federal programs back to the states. But in an effort to force the President to compromise, even this did too little to alter the basic structure of government.

Lawmakers thus face many important challenges in the 1996 election period.

First, they must make the case for continuing to cut spending -- especially discretionary spending if a budget deal significantly reforms entitlement programs -- to keep the budget on target for balance in FY 2002;

Second, they must engage in a serious debate about what the federal government should look like once the budget is in balance and how it should be restructured to meet the needs of the next generation of Americans;

Third, they must change the underlying structure of entitlement programs to prevent these programs from consuming ever more tax dollars and ever greater shares of the federal budget; and

Fourth, and critical to achieving the first three goals, legislators must reform the budget process itself to reign in spending and bring accountability to how tax dollars are spent. The current budget process is a disaster and badly needs reform. The President is often a mere bystander, unable to exercise much control of the nation's purse strings except through the veto once Congress has passed a budget. On the other hand, spending authority within Congress is highly diffuse across many committees. As a result, most Members of Congress are on one or more committees with the authority to spend money, but no one Member is responsible for how the money is spent. In order to reign in the government spending machine, conservatives must make the case for reforming the budget process.

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[1] This testimony is adapted from the forthcoming Heritage Foundation Study, *Issues '96*. Large portions were prepared by Scott Hodge, Charles Griffin, and other Heritage analysts.

Balancing the federal budget is not a panacea for what ails the federal government or the national economy. It is simply one step in returning fiscal health to a decrepit institution and one element in boosting economic growth. To transform the federal government from a relic of the past into a modern institution, much more needs to be done to slow the growth of federal spending, especially the uncontrollable portions of the budget known as entitlements, or mandatory spending. Also, the budget must be stripped of programs that have become outmoded, obsolete, broken beyond repair, candidates for privatization, or transfer to state or local authority. And the process of crafting the budget itself, which now takes over a year from the time the White House begins its work to the time Congress puts the finishing touches on it, must be fixed or the first two priorities cannot be accomplished.

Moreover, balancing the budget and cutting taxes, as the Balanced Budget Act of 1995 (BBA) proposed to do, are not competing ends. Cutting taxes is central to boosting long-term economic growth as spending is curbed to bring the budget into balance. To be sure, balancing the budget without tax cuts, as some in Congress have proposed, will produce higher economic growth over the long term than not balancing the budget would. But more robust economic growth is generated by a balanced budget plan that includes tax cuts. Key to this superior growth potential are tax cuts to stimulate new investment and tax cuts for families.

Spending Is the Problem

The Clinton Administration proudly claims that the 1993 Omnibus Budget Reconciliation Act (OBRA 1993), which instituted the largest tax increase in U.S. history, produced three years of continuous decline in the federal deficit for the first time since the 1950s. While the causal relationship between the Clinton tax increase and slightly falling deficits is questionable, one fact is certain: Tax increases do not lead to long-term deficit reduction. As the budget deals of 1982, 1984, 1987 and 1990 showed clearly, tax increases lead to higher federal spending, slower than expected economic growth, and, not surprisingly, higher deficits.

* Recent Congressional Budget Office (CBO) figures show that while the deficit did decline from $255 billion in FY 1993 to $161 billion in FY 1995, it is now estimated that it will soar to nearly $300 billion in ten years, or 83 percent higher than today.

Deficits are a symptom of a disease, and the disease is spending. Thus, the 1995 budget debate was unlike every other effort to eliminate the federal deficit because it focused solely on how much to slow the growth of spending. There was no discussion at all, even from liberals, of the "need" for additional tax revenues to close the deficit.

Recent CBO spending projections reveal how daunting the task of controlling spending really is.

* From FY 1995 to FY 2002, if no changes are made in current law, federal spending will balloon by $582 billion, a 38 percent rise. On average, CBO projects that total federal spending will grow by 4.8 percent per year through 2002. While discretionary, or appropriated, programs are projected to grow by some 14 percent over

the next se ·en years, and net interest payments on the national debt by 16 percent, the reason for the explosion in federal spending is entitlement, or mandatory, spending.

The Need to Control Entitlements

While the short-term projections of entitlement growth should demand lawmakers' attention, the long-term growth projections should demand every taxpayer's attention. If left uncontrolled, entitlements will consume a greater share of budgetary resources, leaving less money for defense, education, housing, national parks, and other areas. But these areas also will continue to consume a larger share of the nation's resources. The result will be stifled economic growth, higher taxes on tomorrow's workers, and reduced living standards for every American.

However, the impact of growing entitlements extends well beyond the federal budget. Unrestricted entitlements distort individual behavior in many ways -- for example, by discouraging self-help or even encouraging some beneficiaries to choose leisure over work. And growing entitlements distort political behavior as more and more Americans become members of an "entitled class." Until recently, politicians have been more than willing to accept deficit spending to avoid making politically painful choices on tax increases or benefit cuts.

How many entitlement programs are there? While there are "about 400 entitlement and mandatory spending accounts," it is difficult to answer this question because there is "no clear definition of what constitutes a 'program'."[2]

• According to the 1994 report of the Bipartisan Commission on Entitlement and Tax Reform, headed by Senators Robert Kerry (D-NE) and John Danforth (R-MO, now retired), since the early 1960s, entitlement spending has consumed an increasing share of total federal spending, rising from 22.7 percent of all spending in FY 1963 to over 47 percent in FY 1993.

• In the short term, CBO projects that if nothing is done to slow the growth of entitlement programs, they will grow in aggregate by $465 billion over the next seven years, a 63 percent increase. Worse yet, CBO expects entitlements to consume 57 cents of every dollar spent by the federal government in 2002 -- over 8 cents more than is spent today.

The long-term forecasts reported by the Kerry-Danforth Commission are even more troubling. These projections suggest that entitlements will become a liability that cannot be sustained by the federal government, by the economy, or by taxpayers.

• "The gap between Federal spending and revenues is growing rapidly. Absent policy changes, entitlement spending and interest on the national debt will consume almost all Federal revenues in 2010. In 2030, Federal revenues will not even cover entitlement spending."[3]

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[2] Ibid.

[3] "Bipartisan Commission on Entitlement and Tax Reform: Final Report," January 1995, p. 4.

* "By 2030, unless appropriate policy changes are made in the interim, projected spending for Medicare, Medicaid, Social Security, and Federal employee retirement programs alone will consume all tax revenues....If all other Federal programs (except interest on the national debt) grow no faster than the economy, total Federal outlays would exceed 37 percent of the economy. Today, outlays are 22 percent of the economy...."[4]

* "By 2003, unless appropriate policy changes are made, fewer than 15 cents of every dollar will be available for nondefense discretionary programs...."[5]

* "The share of Medicare Part B cost paid by enrollees as monthly premiums has been shrinking since the program began. When the program started, the enrollee and the Federal government had a 50-50 partnership -- each paid 50 percent of the cost. Today, the Federal government pays 70 percent of Part B costs; by 2030 the government's share is projected to increase to 92 percent."[6]

* As of 1991, the federal government (in reality, the taxpayers) had over $14 trillion in unfunded benefit liabilities: $5.7 trillion for Medicare, $7.3 trillion for Social Security, and $1.4 trillion for federal retiree health and pension programs.[7]

*** Entitlement programs defy good budgeting practices.**

The principles of sound budgeting and fiscal responsibility require that spending decisions be based on available resources. The way current entitlement programs are designed, with their open-ended claim on the economy's resources, violates this principle.

Sound budget measures would require that the eligibility criteria of these programs be driven by priorities and limits set by Congress in the budget. But today, the federal budget is being driven by the eligibility criteria of federal entitlements. The entitlement tail wags the budget dog. The automatic growth of these programs forces higher taxes on American workers.

Deficit reduction should not be the primary goal of entitlement reform. It should be the result. These programs should be reformed because there needs to be a real decision about their scale, their objectives, and how best to achieve their goals.

Simple "fixes" are not the way to reform entitlements. Sweeping cuts without reforms, for instance, are akin to using wage and price controls to curb inflation. As history shows, price controls and spending caps produce the budgetary effects of clamping a lid on a boiling pot. Nor is means-testing itself a sound way to curb the growth of mandatory programs, especially if tax increases are used as the primary tool for "taking benefits" away from upper-income recipients. Means-testing does nothing to change the fundamental problems with the program. The result is a broken program with

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[4] Ibid., p. 8.
[5] Ibid., p. 10.
[6] Ibid., p. 18.
[7] Ibid., p. 79.

fewer beneficiaries. If means-testing is to be employed, it should be as an explicit reform with a program.

Current entitlement programs also should be authorized and funded on at least a biannual basis. If necessary, a commission should be created to balance program eligibility and available budgetary resources. Congress would vote on such recommendations at the beginning of every two-year cycle. Further, the government should have a mechanism for monitoring who is receiving federal assistance from all sources. For able-bodied individuals, there should be a lifetime limit on government assistance.

*** Entitlement programs violate the American principle of federalism.**

The principle of federalism suggests that programs should be funded and managed by the most effective level of government. Many federal entitlement programs, such as Medicaid and welfare, have become expensive mandates to state and local governments. The long-term result of such mandates is an irrational balance of funding for programs that distort state government decision-making. Moreover, since states depend on federal dollars, they have less incentive to manage programs in the most efficient and cost-effective manner.

*** Entitlement programs undermine responsible behavior.**

Entitlement programs undermine individual behavior in various ways. While the disastrous incentive effects of welfare on the behavior of the poor are well known, entitlement programs also encourage the middle class to change their behavior in ways that are neither fiscally healthy nor socially desirable. The fastest growing portion of the Medicaid program, for example, is made up of the long-term costs of nursing care for the elderly "poor." However, many middle-class seniors are simply divesting themselves of their assets and technically impoverishing themselves to become eligible for Medicaid's generous nursing home payments. Such a scam may work to the benefit of a senior's children -- absolving children of the cost of caring for their parents -- but society is much worse off as a result.

The perverse behavioral effects of entitlements are many and varied:

- Middle-class entitlements encourage adults to live well by passing the tab to their children.
- Recipients need not face the consequences of their actions.
- Entitlements discourage self-help.
- Agriculture subsidies force farmers to grow to satisfy the dictates of bureaucrats, not the market.
- In programs such as Medicare and food stamps, providers become the real beneficiaries, not users.
- When benefits get high enough, some recipients will choose leisure over work.

*** Entitlement programs distort congressional behavior.**

Over time, politicians become more responsive to entitled groups than to taxpayers. Members of Congress thus lose control over the budgetary process and their own political decision-making.

* Entitlements have altered the proper balance of power between Congress and the President.
* "Uncontrollable" programs force consideration of tax increases based on the decisions of a previous Congress rather than on the spending priorities of current Members.
* Entitlement programs encourage deficit spending to avoid politically painful choices on tax increases or benefit cuts.
* Entitlements crowd out discretionary spending.
* Congress has a long history of designing entitlement programs poorly and misjudging their future costs. The most relevant example today is Medicare.
* Because of poor design and mistakes leading to surges in spending, Congress is constantly faced with painful political decisions -- which it usually flinches from taking.

A Government in Shambles

The federal government has become a monument to the needs and priorities of the 19th century, the Great Depression, World War II, and the Great Society. No amount of "reinventing," as Vice President Al Gore's National Performance Review proposes, can turn institutions created to address problems the nation faced 30, 50, or even 100 years ago into agencies capable of meeting the needs of Americans in the 21st century.

Most taxpayers would be stunned to learn how old many federal programs and agencies really are. Large segments of the federal bureaucracy were created decades ago for purposes long since forgotten. It is time, for instance, to strip out of the budget such pre-World War II programs as the Rural Electrification Administration, the National Helium Reserves, Impact Aid, and the Agricultural Extension Service.

Many relatively new programs also have seen their missions made obsolete by technological and social changes. The Corporation for Public Broadcasting, international broadcasting programs such as the Voice of America, Low-Income Home Energy Assistance, and the Department of Energy, for example, all are outmoded or irrelevant because of technological and market changes.

Because outmoded, obsolete, or inefficient programs almost never die, bureaus, agencies, and programs that duplicate each other's functions have sprung up all over the government. The National Performance Review identified a staggering degree of duplication throughout the federal bureaucracy. For example:

* Some 14 separate government departments and agencies spend $24 billion a year on 150 employment and training programs.[8]

* Washington spends "about $60 billion a year on the well-being of children. But we have created at least 340 separate programs for families and children administered by 11 different federal agencies and departments."[9]

The U.S. General Accounting Office also has documented massive duplication throughout the federal government. Entire Cabinet agencies are duplicated by other federal departments. Among the GAO's findings:

* "The Department of Commerce shares its mission with at least 71 federal departments, agencies, and offices."[10]

* Export promotion programs are fragmented among 19 agencies. "The U.S. Department of Agriculture, not Commerce, receives about 74 percent of total funding for these programs, although it accounts for only about 10 percent of U.S. exports."[11]

Moreover, since World War II, Washington has assumed hundreds of functions once exclusively within the jurisdiction of state and local governments. Many others must be undertaken by state and local officials in ways prescribed by Washington as a condition for receiving federal funds. According to Vice President Gore's National Performance Review, "much of Washington's domestic agenda, $226 billion, to be precise," is allocated to state and local governments "through an array of more than 600 different grant programs."[12]

* Before the current Congress initiated welfare reform, the federal government operated 11 major programs providing food assistance to low-income persons. Total food aid to beneficiaries equaled $35 billion in FY 1993.

* There are at least 14 major federal housing programs for low-income persons. Many state governments also operate independent public housing programs. Total housing aid for these beneficiaries equaled $23.5 billion in FY 1993.

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[8] The National Performance Review: Creating a Government That Works Better and Costs Less (Washington, D.C.: U.S. Government Printing Office, September 7, 1993), p. 49.

[9] Ibid., p. 51.

[10] U.S. General Accounting Office, Transition Series, Commerce Issues, GAO/OCG-93-12TR, December 1992, p. 9.

[11] Ibid.

[12] The National Performance Review, p. 51.

* There are at least 240 programs targeted to "at-risk youth." The 1994 crime bill created a dozen more.

* The Department of Education alone manages over 240 programs. Yet federal spending comprises about 6 percent of all education spending.

* There are at least 62 federal economic development programs under the jurisdiction of 18 different departments and agencies.

* The federal government has spent nearly $100 billion on mass transit over the past 30 years, and ridership is lower today than before Washington began this investment.

* Over the past 20 years, Washington has given state and local governments nearly $60 billion to build gold-plated wastewater treatment facilities that they no longer can afford to operate.

* EPA regulations have been the source of this problem. The General Accounting Office reports that the cost to local governments just to meet federal water standards will grow from $19 billion to $32 billion a year by 2000.

Washington also has a very poor record of managing the nation's assets. Consider the problems in just five programs, as documented by the GAO:

* Many of the 337 dams built by the Bureau of Reclamation are over a half-century old and in desperate need of repair.[13]

* The Forest Service now needs $644 million to maintain and reconstruct trails and recreation sites.[14]

* Within a few years, much of the Army Corps of Engineers' $125 billion inventory of water resources projects will have reached the end of its design life.[15]

* Ongoing Federal Aviation Administration modernization projects are years behind schedule, with the Air Traffic Control System dependent on obsolete equipment. "Of the more than 200 projects in FAA's modernization effort, only 36 are completed, accounting

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[13] U.S. General Accounting Office, Transition Series, Natural Resource Management Issues, GAO/OCG-93-17TR, December 1992.

[14] Ibid., p. 9.

[15] Ibid.

for just 3 percent of the $32 billion" FAA will have to spend to upgrade the Air Traffic Control System between 1982 and 2000.[16]

* The National Weather Service modernization program "has exceeded its expected cost and is far behind schedule. The initial cost estimate of nearly $2 billion has risen to $4.6 billion," and the projected completion date has slipped from 1994 to 1998.[17]

"Reinventing" programs as broken as these will not save them from eventual collapse. Every federal program is in need of a top-to-bottom review and, where necessary, should be dramatically overhauled, terminated, privatized, or transferred to state or local governments.

The Need for Budget Process Reform

While there are many reasons why federal spending is out of control, and why the political process seems helpless to stop it, the process of making a budget is a significant factor. The modern explosion in federal spending began shortly after the 1974 Budget Act was passed in the "wake of the Watergate scandal, when regard for the institution of the presidency had reached its lowest ebb."[18] The 1974 Act stripped the President of his authority to impound funds -- that is, to refuse to spend excessive program funding appropriated by Congress -- and directed greater spending authority to Congress.

However, spending authority within Congress is highly diffuse: Many committees have the power to spend taxpayers' money, but no one committee or member is accountable for how it is spent. Thus, the budget process is biased toward increasing spending, rather than toward setting priorities. The key to bringing accountability to the budget process is therefore to shift greater authority back to the President through such measures as the line-item veto and the Balanced Budget Amendment and to tighten the rules under which Congress goes about crafting the budget and spending money.

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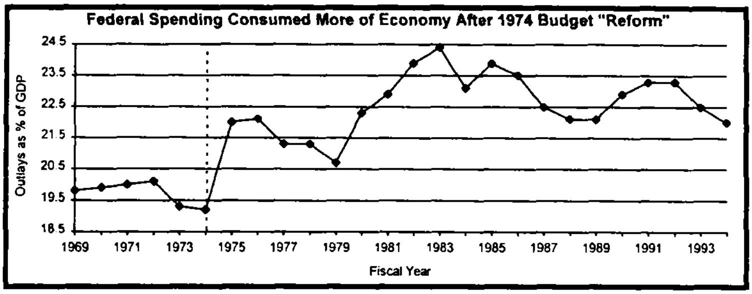
[16] U.S. General Accounting Office, Transition Series, Transportation Issues, GAO/OCG-93-14TR, December 1992, p. 13.

[17] GAO Transition Series, Commerce Issues, p. 14.

[18] Stephen Moore, "Managing the Federal Budget," Mandate for Leadership III (Washington, D.C.: The Heritage Foundation, 1989), p. 68.



Contrary to popular belief, the federal budget is not a single document. Even the President's proposed budget, transmitted to Congress each year, usually incorporates four or five separate volumes totaling thousands of pages. The House and Senate must digest the proposal and then generate their own documents -- at least 15 separate pieces of legislation -- that outline their proposal. This ponderous process repeats itself each year.

The annual workload for Congress and the President includes the initial proposals from each side (the President's budget submission and the Congressional Budget Resolution), the 13 appropriations bills, and, when necessary, a reconciliation bill to deal with changes in tax and entitlement policy. Often, "emergency" or "supplemental" appropriations bills are added mid-year.

* The 13 (or more) appropriations bills cover only 37 percent of federal spending. Remaining "mandatory" or entitlement spending is addressed, if at all, in a single reconciliation bill.

This messy process must be married with "authorizing" legislation that may determine how a program spends money over two years, five years, or indefinitely. The numerous steps in the budget process make it difficult to cut spending. Real spending cuts can be derailed at any of several steps.

When considering the federal budget process, it is often best to examine it thematically. The key steps in the current process are:

1. Vision: formulating a framework for the budget through the President's submitted budget and the congressional budget resolution;

2. Authorization: approving program details and maximum spending levels;

3. Appropriation: approving specific amounts of discretionary spending; and

4. Reconciliation: changing permanent tax and entitlement law to meet the requirements of the budget resolution.

Congress vs. President. Unfortunately, Congress and the President act independently in the most important step in the whole process: establishing their own vision and framework for the budget details. The President submits his budget proposal to Congress at the start of each year to establish his vision. Following the President's submission in early February, Congress outlines its vision by March of each year through what is known as the budget resolution. This sets Congress's spending priorities.

At this stage in the process, neither branch's proposal needs be approved by the other branch. In most recent years, as was the case in 1995, the visions of the President and Congress differed significantly. Under the existing process, however, negotiations between the two branches do not occur until the end of the process -- typically just before (or even after) the new budget year begins -- when a serious impasse often occurs. This happened late in 1995 for the FY 1996 budget.

The budget resolution is not signed by the President, so does not have the force of law. Congress then proceeds with the authorization and appropriations process. It is not until a reconciliation bill is adopted by the House and Senate, usually in the fall, that the two branches even begin to discuss their policy differences. This often leads to a "train wreck," as was the case in 1995, in which parts of the government shut down or operate under stopgap funding while Congress and the President try to work out their differences.

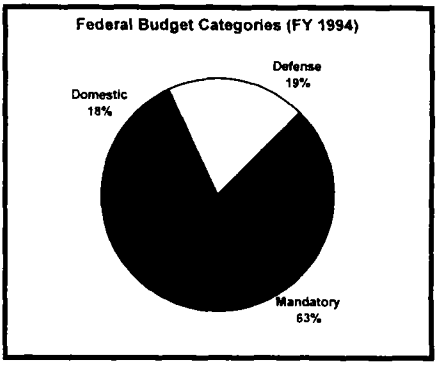
Authorizers vs. appropriators. It would be incorrect to assume that the only disputes in the budget process are those between the executive and legislative branches. In fact, a significant logjam can occur because of policy differences among the budget committee, authorizing committees, and appropriations committees. The budget committee drafts a blueprint based on certain policy assumptions. Authorizing committees then are required to craft legislation setting out the responsibilities and maximum funding levels for a program with that framework. It is then the responsibility of the appropriating committees to decide how much to spend.

This three-tiered process means that the people who decide how much to spend cannot decide how that money should be spent. Similarly, the politicians who set the policies for the program have no meaningful control over its funding. With policy decisions divorced from spending decisions in Congress, the likelihood of ever-higher spending is increased.

• For example, the effort to eliminate the Commerce Department in 1995 required action by 11 committees and 9 subcommittees, including the House and Senate Appropriations Committees, the House and Senate Commerce Committees, and the House Government Reform and Oversight and Senate Governmental Affairs Committees.

With a strong consensus among all these parties needed to end government programs, there is a clear bias against cutting spending.

Entitlements vs. nobody. While discretionary spending programs are subject to multiple hurdles each year, entitlements -- which are mandatory spending programs -- operate on complete auto-pilot. If Congress and the President never passed another budget bill, entitlement spending -- which includes Social Security, Medicare, Medicaid, and welfare -- would continue unchecked.



* Two-thirds of the federal budget is consumed by mandatory spending that need not be approved annually by Congress or the President.

Leaving entitlements without annual approval has contributed to the dramatic increase in mandatory spending as a percentage of the federal budget.

* The portion of the budget consumed by mandatory spending has doubled since 1968. Mandatory federal spending also represents a significant force in the American economy. More than one-tenth of the nation's economy (10.7 percent of gross domestic product) is consumed by mandatory programs.

Entitlements can be addressed in the budget process, but when they are, it is done in a single bill called a reconciliation bill, which often incorporates permanent changes in tax law, pitting entitlement reforms against tax policy.

Despite the major fiscal impact of entitlement spending, there is no established process for Congress and the President to review these expenditures regularly. The Congress spends more than half the year focusing on how to spend one-third of the federal budget, with far less attention paid to the other two-thirds.

Previous Reforms. Budget crises in 1986, 1988, and 1990 were met by specific spending agreements coupled with budget process reforms. Because reforms left the flawed budget process largely intact, however, the agreements held only for a couple of years, to be followed by new crises when economic or political conditions changed.

The most significant of these reforms, the Gramm-Rudman-Hollings Act, required automatic, across-the-board spending cuts (called a sequester) if Congress failed to meet the deficit targets prescribed in law. Gramm-Rudman was successful in reducing small differences between projected and prescribed deficit targets, but it broke down when the deficit became so large in 1990 that Members of Congress refused to allow an automatic spending cut to take effect.

The 1990 budget deal scrapped Gramm-Rudman and instituted statutory caps on discretionary spending. But these have been adjusted numerous times, so they have served as little more than "speed limits" on the spending expressway, since they were set far above anticipated spending growth rates. Moreover, since they focused only on discretionary spending totals, ignoring fast-growing entitlement spending, these caps have had limited effect in bringing down the deficit.

THE 104TH CONGRESS' RECORD ON THE BUDGET PROCESS

The new Congress came in with an ambitious budget reform agenda that included passing constitutional amendments to balance the budget and provide the President with a line-item veto. In addition, the new Congress promised to bring honesty to the budget process by eliminating typical congressional tricks such as "baseline budgeting," in which increases in spending are called "cuts" because they fall below the spending levels projected by the Congressional Budget Office.

Although often stymied by the White House and old guard lawmakers, the new Congress had a good year trying to bring needed reform to the budget process. The Balanced Budget Amendment to the Constitution received overwhelming support in the House, only to lose by one vote in the Senate. Congress also advanced legislation to provided the President with a line-item veto and enacted rule changes to remove some of the trickery from the budget process.

Some of the more important budget process issues addressed by the 104th Congress include:

The Balanced Budget Amendment. In 1995, both the House and the Senate considered constitutional amendments that would provide for a balanced budget by the year 2002. While the House overwhelmingly achieved the two-thirds majority needed to send the proposal to the states for ratification, the Senate fell one vote short of the 67 votes needed when liberal Senators who previously had supported the Balanced Budget Amendment reversed their position under heavy lobbying from the Clinton Administration.

Senate Majority Leader Bob Dole reserved the right to bring the amendment back up for a vote in 1996, should one of the dissenting Senators switch positions.

Fiscal conservatives in the House and Senate attempted to include a tax limitation provision in the Balanced Budget Amendment requiring a supermajority (three-fifths) vote in both houses to increase taxes. Unfortunately, that effort fell short in both chambers. Such a safeguard is justified because, as shown in Chart 1 in this section, the deficits of the last 25 years have been caused by spending increases rather than by taxes that are too low. Without a tax limitation provision, a balanced budget requirement could be used as a justification for tax increases.

Thr Line-Item Veto. The Line-Item Veto Act (H.R. 2, part of the Contract With America) was approved by the House and Senate, but the two versions differed widely. After a lengthy conference, this legislation is now ready to be sent to the President.

Used conscientiously, a line-item veto could cut wasteful spending without jeopardizing necessary programs. State experience shows, however, that the line-item veto alone is not likely to result in huge budget reductions, although states have found it to be a fairly effective curb on spending growth over time. Moreover, it serves as a check on the usual tendency of legislators to lard appropriations bills with pork-barrel spending designed to garner additional votes--both for the majority party in Congress and the individual Member back home.

The Byrd Rule. Section 313 of the Budget Act is the so-called Byrd Rule, which prevents "extraneous" provisions from being included in the reconciliation bill. The rule was proposed by Senator Robert Byrd (D-WV) a decade ago to prevent adoption of a particular provision with which he was unhappy. Unfortunately, it has resulted in a long-standing problem in the Senate. A provision deemed out of order under the Byrd Rule must face a three-fifths vote (60 votes) to survive intact. In 1995, more than 45 provisions were ruled extraneous and summarily removed from bills. Among the lost items were:

* Reforms in the peanut subsidy program;
* Rescission of highway demonstration spending (pork);
* Creation of Medical Savings Accounts; and
* Welfare reforms, including measures to reduce illegitimacy

Tax Limitations. The House did adopt a supermajority provision regarding tax increases as a House rule. Since this House rule would not have the same standing as a constitutional amendment, it would not apply to the Senate and could easily be changed if a new Congress decided it no longer wanted to live under it. A House vote on a constitutional amendment to require a two-thirds supermajority for tax increases is now scheduled for April 15. It is significant that the vote on the House rule change received significant support from both sides of the political aisle. The vote was 279-152, or 65 percent in favor -- just short of the two-thirds needed for a constitutional amendment -- with 52 Democrats voting for the rule.

Scoring Rules. One of the most significant disputes in the confrontation between the President and Congress over the Balanced Budget Act of 1995 was the question of "scoring." The President argued for the use of Office of Management and Budget (OMB) spending and revenue estimates to judge whether the budget deal met the requirement of balance by 2002, while the Congress stood by the more conservative predictions of the Congressional Budget Office (CBO). Using the President's OMB numbers would have permitted hundreds of billions in additional spending over seven years. If Congress and the President are serious about achieving a balanced budget, it makes sense to use the numbers that produce the most spending cuts; this leaves the greatest likelihood that the budget will be in balance when the plan predicts.

Lock Box. Another concept which could help reduce spending, the "lock box," was approved in preliminary form by the House in 1995. Currently, if the House or Senate adopts a specific spending cut, the savings can be diverted to spending increases on other programs. This becomes particularly troublesome in conference committees where back-room deals are cut. The lock box bill establishes congressional and Treasury procedures to ensure that votes in Congress to cut specific spending programs translate into overall deficit reduction. Under this plan, internal congressional spending caps applying to the 13 appropriations bills would be lowered whenever the House and Senate vote to cut a particular program. The savings would be totaled by the Treasury Department, which then would reduce overall spending caps for both Congress and the executive branch. Even if fully implemented, however, this plan, like the line-item veto, is unlikely to produce major spending cuts, though it would discourage hypocrisy.

Truth in Budgeting. The Contract With America contained a provision that required House committees to compare new spending recommendations to how much was spent on a program in the previous year. Under the old system, tax-and-spend liberals had the upper hand because spending increases were judged not against actual spending for the previous year, but against projected spending for the next year. With these rules, even a spending increase could be called a cut, as happened frequently during the Medicare reform debate in 1995. The House rules change applies only to House committee reports, however, and not to all government budget documents.

On the basis of this already good record, Congress should now take the next logical steps in budget reform, including:

* Finishing the job, begun in 1995, of enacting a balanced budget plan with tax cuts for families and economic growth.

* Making real reforms in entitlement and other programs, both to improve the operation of those programs and to balance the budget.

* Beginning a national debate on what the federal government should look like in the year 2000: What is the proper role of the federal government? What should it do and what should it not do? What programs and functions should be returned to the states, to the private sector, or to individuals themselves?

* Using visible oversight hearings to showcase the need to overhaul the federal government. Washington is a government in shambles because it has become a monument to the 19th century, the Great Depression, and the Great Society, and no amount of "reinventing" can fix it.

* Bringing sound business principles to government. Washington poorly manages hundreds of billions of dollars in assets and commercial enterprises that should be sold to raise cash to reduce the government's liabilities.

* Reforming the budget process so that the process itself does not become an impediment to change.

Measures to Fix the Budget Process

Congress should move quickly to overhaul the budget process before the process itself stymies the major restructuring the government needs to move into the next century. Conservatives should focus on restoring the balance of spending power between Congress and the President by passing such measures as the Balanced Budget Amendment and the line-item veto. Congress also needs to clean its own house. Conservatives should centralize spending authority within a few accountable committees and enact other rule changes to safeguard taxpayer dollars.

Specifically, Congress should:

Send a balanced budget/tax limitation amendment to the states. Congress should promptly consider a constitutional amendment that provides for a balanced budget by the year 2002 with a requirement for a supermajority (three-fifths) vote to raise taxes. Unless these requirements are specified in the Constitution, the nation is doomed to an endless string of broken promises and accounting gimmicks that permit politicians to say "just wait five more years"-- over and over again

Pass a Balanced Budget Enforcement Act. Congress should enact and the President should approve a new budget process designed to implement the requirement for a balanced federal budget. The package under discussion by the House's Cox-Largent task force is an excellent starting point. Among the important features of that proposal is a budget resolution, signed by the President, that sets out overall spending, revenue, and deficit figures for the year. This resolution would have to be adopted before any other spending or budget legislation.

Other essential features of budget process reform include elimination of the current services baseline, an annual review of entitlements, a mechanism to review regulatory costs, and a sequester or other device to ensure that spending and deficits stay within established limits.

Each of the following reforms could be adopted either as part of such a reform package or separately.

Abolish the appropriations committees. The 105th Congress should find the political courage to reorganize the committee structure to rationalize spending powers and build in accountability. The current three-layered congressional budgeting system is both complex and diffuse. Many committees of Congress have the authority to spend tax dollars, but no one is accountable if such spending results in higher deficits. Studies show that when spending authority is limited to a few committees, Members are more accountable for their decisions, which result in minimal deficit spending and occasional budget surpluses. For example, the Hoover Institution's John Cogan found that congressional spending decreased sharply in the 1920s after spending power was centralized.[19] Combining authorizing and appropriations functions would eliminate one of the three layers in the budget process and strengthen the Budget Committee's ability to limit spending by permitting it, rather than the spending-oriented appropriations committees, to guide budget decisions.

Uniting policymaking and spending decisions in the same committees would eliminate a severe bias in the appropriations process. The fact that the House and Senate Appropriations Committees exist solely to spend tax dollars provides a perverse disincentive against cutting spending. Every dollar cut from the budget represents a corresponding cut in the power of the appropriators, particularly the so-called Cardinals (subcommittee chairmen).

Establish a lock box. The 105th Congress should adopt rules to ensure that when Members vote for spending cuts, the savings are not secretly recycled into new spending. This reform would make it much more difficult for appropriations committees to insert pork-barrel or controversial spending in conference reports. In addition, the direct tie to deficit reduction might encourage members to offer and support more amendments for specific spending cuts.

Revise the Byrd Rule. The Byrd rule should be modified to permit reasonable spending policy decisions to be included in the reconciliation bill. While the limited debate time in the Senate for consideration of reconciliation bills does help prevent legislation from becoming a Christmas tree bearing all sorts of extraneous provisions, the current structure of the rule prevents Congress and the President from adopting important reforms that directly affect how the taxpayers' money is spent.

Introduce truth in budgeting. The practice of baseline budgeting should be eliminated, and all government budget documents should indicate the change in actual spending from one fiscal year to the next. As discussed in the chapter on government reform, the House and Senate also should adopt rules requiring witnesses to disclose any federal funding they receive.

Conduct an entitlement review. Congress and the President should be required to reexamine entitlement spending at the same time they consider the appropriations bills. It is fiscally irresponsible to spend months feuding over one-third of the federal budget while scarcely noticing the major drain on federal resources: entitlement programs that consume most of the annual budget. The regular review should include a careful study by the appropriate committees of the programs within

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[19] John F. Cogan, "The Dispersion of Spending Authority and Federal Budget Deficits," in John F. Cogan, Timothy J. Muris, and Allen Schick, The Budget Puzzle: Understanding Federal Spending (Stanford, Cal.: Stanford University Press, 1994).

their jurisdiction and should result in roll-call votes in the House and Senate that, at the very least, force Congress and the President to acknowledge the current and future levels of these programs. Annual budget resolutions should establish spending ceilings for all mandatory spending programs, except for interest on the national debt, as is now done for discretionary (appropriated) spending. Committees with responsibility for mandatory programs would be required to revise these programs to limit spending accordingly. The nation no longer can afford to confer benefits on classes of people with no regard for the cost to the American taxpayers.

Introduce biennial budgeting. If the congressional budget process were expanded from an annual to a biennial process, much time would be freed to permit a more careful analysis of policy revisions. A two-year budget would permit Congress and the President to spend much more time debating the fundamental role of government and how to revise and improve existing federal programs. While biennial budgeting may be a useful reform, however, it must not be adopted without the other urgent reforms noted in this section. Two-year budgeting on its own would merely create a higher-stakes "train wreck" and cause more harm than good.

Conclusion

The package of reforms this committee has laid out is commendable in scope and intent. Their range demonstrates the depth and breadth of the problems we face in bringing the federal budget under control. To solve our budget problems we need both a commitment to do so from the public and lawmakers, and the right process to allow that commitment and determination to be carried through. It was not the commitment as much as the process that failed us this year, and revisions along the lines that the committee is exploring are long overdue.

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Mr. HORN. I yield to the ranking minority member to question the witnesses.

Mrs. MALONEY. First of all, on the supermajority, Mr. White and Mr. Kogan, you had very differing opinions on it.

I believe, Mr. Kogan, you called it undemocratic, majority should rule, the Constitution has certain areas where we had a supermajority for treaties and constitutional amendments and other areas.

Why do you think we should have an exception to standard policy, Mr. White, on the supermajority? In requiring supermajority for the tax increases?

Mr. WHITE. I am a little——

Mrs. MALONEY. Excuse me. I was not here for your testimony. I came in at the end. I guess I should say then someone who is opposed to—I guess Mr. Mason or Mr. Moore. I did hear Mr. Kogan's statements that he thought it was undemocratic.

Mr. HORN. No, Mr. White and Mr. Kogan are opposed to the supermajority. Mr. Moore and Mr. Mason favor the supermajority.

Mrs. MALONEY. OK. So instead—I thought Mr. White was opposed to it but I was not here for your testimony. You did state that Gramm-Rudman did not work.

Mr. WHITE. Can I comment anyway?

Mrs. MALONEY. Yes.

Mr. WHITE. OK. I would take a somewhat less hard line than Mr. Kogan. I think that in general where supermajorities exist within the constitutional design, it is without an obvious policy bias, for instance, that it is for treaties per se. And by the way, that was, of course, in a time when we were not going to have many treaties because we were a heck of a long way from anybody else.

Now, for constitutional amendments per se, the principle of requiring supermajorities for certain specific policy choices is somewhat different. I also think that you have to distinguish between the consequences of providing obstacles to action as opposed to attempts to use supermajorities to provoke action.

After all, in many cases in budget proposals what people are really doing is saying we will cause some terrible effect to happen unless you create a supermajority to take some other action. Now, it is very hard to make people act.

In the case of Gramm-Rudman, what happened was both sides thought that the consequences were going to be so terrible that the other side would have to give in, so nothing happened.

I worry in a situation of greatly polarized political forces where the purpose of the package of provisions is in fact to force change in policy. For instance, in this bill, a supermajority for raising taxes, combined with a supermajority for not balancing the budget, means you will have to cut certain programs and so it is actually an action-forcing set of proposals. I think that does not work and it is bad policy. But I do think that, for instance, if carefully crafted to inhibit legislative changes such as in some cases the pay-go rules, then I do not have as many—I do not object to supermajorities against legislation to increase the deficit, such as the pay go rules. That is a very different kind of thing.

Mrs. MALONEY. Would you like to comment, Mr. Moore?

Mr. MOORE. Well, I guess my view on this is that we are—I guess I stated this in my remarks, but let me restate it. We are not a majoritarian country. I mean, the entire—this Congress is not run on majoritarian rules. We have all sorts of rules as such that Dave mentioned that restrain majority rule.

It is also true that our constitution is based on——

Mrs. MALONEY. We do not use majority rule in all policy, though.

Mr. MOORE. Well, I am talking about things like what Dave was talking about with respect to——

Mr. HORN. May I interject? As a student of the Senate, there is such a term as unanimous consent over there. And, as we always kid, there are two rules in the Senate: exhaustion and unanimous consent, exhaustion being the filibuster. And I was part of a team that staffed 1 year to fight a filibuster on the Civil Rights Act of 1964. We finally won getting, I believe, the 66, 67 votes we needed. But it took 1 year.

So that was public policy, folks, and it still is and the threat of a filibuster does completely change legislative behavior.

Mr. MOORE. But the point I am trying to make is that what our Constitution is, virtually every element of what our Constitution is is a limitation on the powers of majority rule and the powers of government. And if you look at what has happened over the last—especially 60 years, those constitutional restraints on Government have been eroded away, through pervasion of the general welfare clause of the Constitution, interstate commerce, things of that nature.

I do not think that this is at all inconsistent with what the founders envisioned when they envisioned a Government of very restricted government power.

Mr. HORN. Do you want to add anything, Mr. Mason?

Mr. MASON. No, I agree with Stephen, that limitations on what the Government can do, and I would place in there deficit spending and increasing taxes are appropriate sorts of constitutional constraints to put on the legislature and to require supermajorities to do things of that nature is a valid and I think good public policy.

Mr. MOORE. Let me just make one more point about this majoritarian issue though, and that is that I would be in favor of one majoritarian issue which would be to require that any tax increase passed by the Congress be approved through a referendum of the voters. A majority of the voters would have to approve through the referendum process this kind of tax increase.

Again, this is what a lot of States are doing and I would add that if the 1990 and 1993 tax increases had had to be approved by a majority of the voters, then we would have had neither of those.

Mr. HORN. Mr. White.

Mr. WHITE. I was wondering if I might ask the chairman if he thought having to spend a year trying to overcome a filibuster to pass the Civil Rights Act of 1964 was a good idea. I mean, the fact that we have supermajorities in the Senate in many ways has not always been considered a good thing.

Mr. HORN. Well, let me just cite you the comment of my counterpart, the assistant to the Democratic whip when I was assistant to the Republican whip. John Stewart said when it was all over and we had worked every day together for a year, "You know, maybe it was wise that we had to take a year and get those 67 votes because at that point, the Nation knew we meant business, that we had an overwhelming consensus of the Senate and their votes were on the record."

It did not seem too wise as we did not get much sleep during that year, but that is true. That is on anybody's list of what are the five major historic bills of this century.

But let me raise another point that the ranking minority member is really raising in getting this discussion out. It seems to me there is a very serious constitutional question as to whether the Congress can impose a two-thirds vote if the Constitution does not impose the two-thirds vote.

Does Congress, especially the House, which was mentioned by both of you, have the right to impose a two-thirds rule, shall we say, when it has not been specified in the Constitution? And the feeling could be that if the framers thought that was a wise idea, they would have put it in the Constitution and since they did not put it in the Constitution, do we really have the power to do anything but have a majority vote on the House side?

That is not an illegitimate question. It is a legitimate question. And it might well be settled in the courts, whoever is on the winning or losing side.

Mrs. MALONEY. And may I add to your question?

Mr. HORN. Certainly.

Mrs. MALONEY. Mr. Chairman, may I add to your question?

As you pointed out in your questioning, the filibuster, you needed two-thirds to break it and then it goes back to a majority vote, so what you have is really a procedural vote, not a majority vote.

Mr. HORN. Well, everybody—no one was kidded. Everybody knows that the filibuster deals with substance and you can call it procedure just like a hold which is the silent filibuster on which nobody has ever done any research on. I probably should have been keeping notes on that one. But Senators for years, decades, have gone to either of their leaders and said, gee, Bob or whoever is the leader, I cannot make it in town this week and I really want to be here for that bill. That is the innocent part of the hold, it is when the hold that goes on and on and on and as Senator Baker told his troops over there when he was majority leader under the Reagan years, he said, look, folks, all holds are off the last 2 weeks, we are going to bring up those items, we have tried to accommodate everybody. And, as you know, they accommodate on a bipartisan basis over there, which we do not do here. We are strictly a majoritarian institution and the majority rules. The majority wants the rule and votes that rule prior to a particular substantive bill.

Mr. MOORE. Well at the very least, Mr. Chairman, we ought to have symmetry in the rules between raising taxes and cutting them. And right now, we do not. In fact, if you wanted to have a bill to cut taxes because of the pay-as-you-go rule, you have all sorts of supermajority hurdles you have to exceed, both in the House and the Senate. I believe there are three-fifths rules—is it three-fifths for the pay-as-you-go? I think it is three-fifths.

Mr. KOGAN. That is not correct. In the House there are no supermajorities for cutting taxes, all you need is a majority waiver of the point of order.

Mr. MOORE. In the Senate, you have a three-fifths rule under the pay-as-you-go. If we have three-fifths to raise——

Mr. HORN. Well, that is the new filibuster level, the 60 instead of 67.

Mr. MOORE. Right. And so if we have a three-fifths rule against cutting taxes, then we should certainly have a three-fifths rule for raising them.

Mr. HORN. Well, we are going to let everybody argue that one out.

Mr. WHITE. May I comment on one thing there?

Mr. HORN. Sure.

Mr. WHITE. What that makes clear is that the people who maintain that position are saying they care far less about the deficit than they do about the level of taxes and the level of spending. And we have to be clear about what the problem is that we are supposedly trying to solve.

There is a lot of testimony to the effect that tax hikes do not reduce deficits, but that is a quite remarkable theory because it means that all sorts of politicians over hundreds of years who have paid all sorts of political prices for raising taxes have all been doing something unnecessary. They were just all idiots who did not happen to listen to the research of the 1980's that claims that just because deficits persisted even though there were some tax hikes, those tax hikes did not have anything to do with reducing the deficits from what they would have been otherwise.

Mr. HORN. Well, I am sure that is true, very frankly. Because when they thought they were reducing the deficit, the majority came along and spent it. It is as simple as that, as Ross Perot would say.

Mr. WHITE. He would, Mr. Chairman, but it is very hard to find the bills with which they did that. If, for instance, you look at the 1980's, you have to find the legislation and it is not there.

Mr. KOGAN. Spending as a percentage of GDP is down fairly substantially over the last 3 years and revenues are up and the combination has reduced the deficit fairly substantially. Part of that is the good performance of the economy. It is easy to have a good performance coming off a deep recession. And part of that is the tax increases and spending restraint that were enacted first in 1990, which hardly showed up because of the recession and then again in 1993. But it seems to me that Perot's answer is not vindicated by the facts.

Mr. HORN. Well, it seems to a lot of people that whether you did anything or nothing, the economy would recover and millions of jobs would be added to the economy. Every President, no matter who is in office, Republican or Democrat, liberal or conservative, always takes credit for jobs in the economy. Those are being generated when the economy eventually gets well from a recession, depression, whatever you want to call it.

Mr. KOGAN. CBO regularly does an analysis, not only of the deficit but also of the structural deficit, in which they try to wipe out the effects of budget cycles and just look at what the deficit would have been if it had operated at what used to be called a "full-employment" level. And CBO's analysis has also shown that the structural deficit has come down in recent years, which is why I said what I said, which is a part of it is the economy, but part of it also is, comparatively speaking, spending restraint and tax increases. And therefore Mr. Perot is simply wrong in his cynical assertion that tax increases do not reduce the deficit.

Mr. MOORE. Well, we do have regression analysis that shows that every dollar of tax increases over the last 40 years has led to about a $1.50 increase in spending, so there is a statistical relationship.

One point about this reduction of the deficit. It is almost—it has nothing to do with the 1990 or the 1993 budget deal. It is almost entirely accounted for by the very large reductions in defense spending that we have had. We have seen a $100 billion reduction in real defense spending since Reagan won the cold war and the fact of the matter is that if you take out defense spending from the budget, spending as a percentage of GDP, nondefense spending is at an all-time high right now. So we have not cut anything except defense from the budget.

Mr. MASON. And further in these long-term trends you are talking about, yes, we have done fine over the last 3 years, but if you fail to do something about entitlements, then that problem is going to start growing again in 3, 4, 5 years out to a point where you will not be able to control it easily.

Mr. HORN. Mrs. Maloney had a question.

Mrs. MALONEY. Some of you commented in your statement that Gramm-Rudman did not work. And I would just like to ask all of you or anyone who would like to comment further why did it not work?

Mr. HORN. Mr. White.

Mr. WHITE. I have written a couple of fairly long chapters in a fairly long book on this subject.

Basically, Gramm-Rudman was a hostage game.

Mr. HORN. Was what?

Mr. WHITE. Was a hostage game. The theory of the hostage game was that unless cuts were made in entitlements and increases made in taxes in order to reduce the deficit to targets that were set in advance, then there would be a series of cuts made in discretionary programs.

In order to make the threat particularly frightening, the cuts in discretionary programs were designed to be as idiotic and mindless as possible. I mean, it was explicitly designed for that purpose.

The problem was that it is actually much easier to devise automatic reductions in entitlements or automatic increases in taxes, you just have a surcharge or a COLA cut or whatever, and the reason that they had done it in discretionary programs was because nobody wanted to cut entitlements or raise taxes. Therefore, it was equivalent to saying, "I will take your least favorite child hostage and then unless you let me shoot your more favorite child, I will shoot your least favorite child."

Worse than that, it was designed so each side had to shoot—each side's children would be shot. The President's defense would be shot and the congressional Democrats' domestic spending would be shot.

Now, since both alternatives were clearly unacceptable—either letting the sequester occur or making the entitlements cuts or tax increases that would be necessary to appropriately avoid the sequester—there were only two other possibilities. One was to lie about the estimates and so when the estimates were close enough that you could lie about it, say within 50 billion or so, they did.

The other alternative was to change the targets and so when the estimates were not close enough to lie about it, they changed the targets.

Between 1985 and 1990, it is true the only serious deficit reduction was from the winding down of the cold war, and that would have happened in defense anyway both because of the fact that the Reagan buildup was so large and there had been some scandals and nobody was quite sure why we needed quite that much money, and then also because the cold war was won in 1988 and 1989.

But it was a hostage game. It was never a serious policy proposal. It was never a situation where those cuts were supposed to occur. They were designed to be so stupid that nobody would ever let them occur.

Mr. MOORE. Well, it is my view that Gramm-Rudman was generally a success, if you judge success by the fact that the deficit came down, that was what the purpose of Gramm-Rudman was.

If you look at what the deficit was in 1985, it hit an all-time peak, it was nearly 6 percent of GDP. After the end of the Gramm-Rudman era, 1989, it was down to less than 3 percent. Now, that is still too high, but we had cut the deficit.

Mr. HORN. And was it not down to about $110 billion?

Mr. MOORE. $150 is what it was.

Mr. HORN. What was it?

Mr. MOORE. $150 billion.

Mr. HORN. $150?

Mr. MOORE. Right.

Mr. HORN. I thought they got down to $110.

Mr. MOORE. No. But the point is—I mean, I think I agree with Joe on one point, and that is that the mistake we made with Gramm-Rudman is when we had the across-the-board spending cuts, it should have applied to entitlements as well. We should have—and if we re-do Gramm-Rudman, as I think we ought to, we ought to have that sequestration process not just apply to the discretionary programs in defense and nondefense but also entitlements, even Social Security.

Mr. HORN. In essence, it is a freeze.

Mr. MOORE. Well, it basically says, look, we are going to push down the overall spending level on an across-the-board level unless Congress makes the rational choices and chooses.

So, no, it did not lead us to a balanced budget but it was a period of budget reduction. And if you talked to Members of Congress in the 1980's, they would readily admit that the reason we got rid of things like revenue sharing, the reason we got rid of things like UDAGs was precisely because they were facing the sledgehammer of Gramm-Rudman cuts.

So I think it did not work nearly as well as we intended but I think generally that kind of restraint is exactly what we need right now.

Mr. HORN. Mr. White disagrees.

Mr. WHITE. Well, if you take—Gramm-Rudman did produce the system of binding 602A allocations or 302A allocations as they were called them.

The reason UDAG and revenue sharing were eliminated is because they could not be fit within the binding allocations from the budget resolution. Gramm-Rudman per se, the thought of sequesters, had nothing to do with that.

There may be Members who believe that it operated as an effective threat, but if you look at the 1982 to 1984 period, in 1982 you had TEFRA. In 1983 you have the Social Security fix. In 1984, you had DEFRA. All of which were serious and substantial deficit reduction legislation.

If you look at the period from 1985 to 1989, you have nothing comparable. So if the idea of Gramm-Rudman was that it was going to cause legislative action to reduce the deficit, it simply failed.

Yes, the deficit came down because of the economy, but until somebody can point to legislation that reduced the deficit, the argument that Gramm-Rudman caused deficit reduction just cannot be supported.

Mr. KOGAN. May I comment a little bit about this Gramm-Rudman history? There are two points I would like to make. The first is that it applied to fiscal years 1986 through 1990. The deficit went back up noticeably in 1990, a Gramm-Rudman year, as compared to 1989.

The second is evident from the graph I included just after page 8 of my testimony. This is a graph of the cyclical, as opposed to the underlying structural, portion of the deficit or surplus. And so it merely shows what component of any given deficit is caused by the economy.

One of the things you see is that from fiscal year 1986 through fiscal year 1989, we went from having a cyclical deficit to having a cyclical surplus. We were in a period of economic expansion. And the amount of that difference from half a percent of GDP positive to half a percent of GDP negative, that is to say from a positive deficit to a positive surplus, corresponds to the amount of supposed improvement attributed to Gramm-Rudman, but actually caused by the economy.

And then in 1990 when we jumped back to neutrality, when we were not in a period of cyclical over-stimulation but simply at a normal period, sure enough, the deficit was back up again to where it had been before.

So I think that basically the history of Gramm-Rudman cited through these numbers, it more supports what Mr. White has been saying than the other panelists.

Mr. HORN. Do the other panelists want to have the last word?

Mr. MASON. I would point out that over time you will see the performance of the economy is the biggest single factor affecting the deficit and that is one of the reasons I am so skeptical about turning to tax increases which are bad for the economy as a way to remedy the deficit problem. You may get some short-term gains as a result of that, but I think the long-term change in the performance of the economy is going to hurt you more than anything you make in the first year or two.

Mr. HORN. Mr. Moore.

Mr. MOORE. Well, just one last thing about Gramm-Rudman and that is, you know, you can listen to what I am saying about it or Mr. White and Mr. Kogan. We obviously disagree. I think the best evidence is listen to what the special interest groups were saying. They loathed Gramm-Rudman. Every interest group, whether you are talking about defense contractors, the NEA, to the Children's Defense Fund, this was the worst instrument we had ever put into being and that is why there was such heavy lobbying to get rid of it in 1990 because it was putting—if you look at the growth of spending, in that period we had Gramm-Rudman, there was a reduction. In fact, in 1987, we actually had spending grow less than the rate of inflation. So again, I am not saying it worked perfectly. I think if we do it again, we should learn lessons from where it went wrong, but we need that kind of legislative balanced budget amendment until we change the Constitution, in my opinion.

Mr. HORN. Yes, the special interests never liked revenue sharing, either. They never agreed with it and once the majority was very clear, they could go back and kill it with a Republican President's help, the Democratic majority killed it. And that was probably one of the few things that really helped communities because they could make decisions based on that money. But anyhow, maybe we will get back to that one of these days and simplify life a little.

Any other questions from the ranking minority member?

Mrs. MALONEY. No.

Mr. HORN. Any other questions the staff thinks are pertinent that we ought to raise here?

If not, we might send them to you and you can respond, if you do not mind. That is our usual practice.

Let me just thank you as witnesses for being patient and staying long. We have enjoyed the dialog.

Let me thank the staff that prepared this hearing, the majority staff headed by J. Russell George, he is two over from me on my left, staff director and counsel. And the detail work done by the gentleman on my immediate left, Harrison Fox, professional staff member and Anna Miller, professional staff member, particularly on the fiscal side, and Andrew Richardson as our clerk. And on the minority staff, Matt Pincus and Mark Stephenson, professional staff members. And we thank the official reporter, Jan del Monte.

We hope we can all get a rest now, right? We have been at it. Thank you very much.

[Whereupon, at 1:10 p.m., the subcommittee was adjourned.]

FEDERAL BUDGET AND FINANCIAL MANAGEMENT REFORM

TUESDAY, APRIL 23, 1996

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 311, Cannon House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn and Bass.

Staff present: J. Russell George, staff director and counsel; Harrison Fox, professional staff member; Andrew G. Richardson, clerk; Matt Pinkus, and Mark Stephenson, minority professional staff members.

Mr. HORN. A quorum being present, the Subcommittee on Government Management, Information, and Technology will come to order.

This morning we examine the proposals for the Federal budget law in the process reform, as well as various financial management reform proposals.

This hearing is the second of a three-part examination of the Federal budget, financial management accounting activities, practices of the legislative and executive branches.

Over the last 75 years, at least 15 major acts and dozens of supplementary legislative provisions have structured the legislative and executive branches budget process. Even though these bills, taken by themselves, represent major steps forward, together they are a collective mix. As a result, Congresses and Presidents have had to patch together budgeting, accounting, financial information, procedures, rules, and practice.

The current Federal approach must change. A comprehensive bipartisan effort to reform the Federal budget process and law and to support financial management reform is warranted.

Federal budget and management reforms are possibly grouped in six broad areas: Helping Congress make better decisions; controlling mandatory spending; expanding budget information; managing Federal fiscal and debt policy; improving financial management and accounting; and implementing performance budgeting.

The first four topics will be the focus of today's hearing. The final two categories, improving financial management and accounting and implementing performance budgeting, will be the major focus of the third day of our Federal budget financial management and accounting hearings that will be held this Thursday, April 25th.

Today's hearing includes several witnesses commenting on Federal financial management and budget reform proposals. The witnesses will present their highest priorities for budget process and law as well as financial management reforms.

Appearing today will be U.S. Representatives Bob Wise and Jim Saxton, and an overview will be presented by the representatives of the two legislative branch agencies: namely, James Blum, Deputy Director, Congressional Budget Office; and the Honorable Charles A. Bowsher, the Comptroller General of the United States, who heads the General Accounting Office.

From the executive branch, we will hear from G. Edward DeSeve, Controller, Office of Federal Financial Management, Office of Management and Budget; Assistant Secretary for Management and Chief Financial Officer George Muñoz of the Department of Treasury.

A financial management expert panel will include the following: Donald R. Wurtz, Chief Financial Officer, U.S. Department of Education and Dr. Herbert Jasper, who will be presenting testimony for David S.C. Chu, fellow of the National Academy of Public Administration.

Our last witness is Ted Sheridan of the Financial Executives Institute.

We thank you all for joining us and look forward to your testimony.

The subcommittees, as you know, swear in all witnesses but Members of Congress, and when you come up, I will have you take the oath, and we obviously will include in the hearing record the statement that you formally have submitted. We would appreciate it if you would orally summarize that written statement in 5 minutes so we can then get the questions.

We will certainly add Members' statements later. We will be submitting other questions following this hearing, and then we would have time for questioning, each round, each Member, 5 minutes at a time.

Mr. HORN. So let us start with the Members of Congress who are here. Mr. Saxton, I believe, was here first.

Welcome, Jim. We are glad to have you here.

STATEMENT OF HON. JIM SAXTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. SAXTON. Thank you very much, Mr. Chairman. Might I ask unanimous consent that my statement, my prepared statement, be submitted for the record?

Mr. HORN. Without objection, it will be so ordered.

Mr. SAXTON. Mr. Chairman, I wanted to bring to your attention an issue this morning which I think is of great importance in terms of the methods that we use to put the budget together and to determine what effect the changes, particularly in tax policy, have from time to time on the revenue that we are able to collect as a result of taxes which are in place and changes which occur.

As you probably know, Mr. Chairman, the method that is used to compute the flow of Federal revenue that is used by our scorers is today described as a static model, which means in essence that that model takes into consideration no change in the rate of economic growth, which might affect our revenues.

I am pleased to tell you this morning, Mr. Chairman, that Congressman Campbell from California has prepared a bill, or actually a resolution, which would take into consideration this subject and provide for a new model for scoring, known to some as a dynamic model, which in essence means that there are a variety of things that Congress may do from time to time, particularly with regard to tax policy, that would have an effect on economic growth and, hence, on Federal revenue.

The current method of official analysis of tax changes has a number of severe deficiencies, in my opinion. For example, in the evaluating of a tax bill designed to boost economic growth, the first assumption made in official revenue analysis is that the proposal will have no effect on economic growth. In this respect, the current method can be described as a static revenue analysis, as I said before.

Now there are a number of us here who recognize that there are certain actions that are taken by the Congress or by certain Federal agencies which do have an effect on economic growth. In the current situation, for example, there are many who believe that the Fed's actions recently in expanding the money supply, which had the effect of reducing interest rates, have provided for the current boost in the economy.

I heard numbers this morning on employment rates and who is able to get jobs—and about people who are able to get jobs easier and more quickly and at a higher level than a few months ago, and so, for example, in terms of things that the Federal Government can do to effect economic growth, perhaps interest rates are one of them.

Also, there are some of us who believe very strongly that the Congress plays a major role in determining effects in economic growth in terms of the kinds of tax policy that we adopt from time to time, and the assumption, therefore, that there is no effect on economic growth because of changes in the Tax Code biases, the entire system and the entire debate against the ability of the Members of Congress and the members of the voting public to understand what the potential is with regard to changes in the Tax Code.

If the effects of a proposal are reasonably debatable, perhaps the budget rules should permit the Representatives here in Congress, as well as the American people, to debate these issues, knowing full well that we will effect some kinds of changes.

I think the best example of where this went wrong, at least in my memory, occurred as a result of changes which took place in the Tax Code in 1986. As we all well remember with regard to those changes, one of the major changes was a significant increase in the capital gains tax. At the time, our scoring here in Congress—in other words, trying to determine what the effect of Federal revenue would be—certain assumptions were made which did not come true in any way, shape, or form.

I have a chart here to my right, which is in full color, which I have seen only in black and white, so, being a Member of Congress, I get confused, probably. But essentially what happened was, in 1982 we had some tax cuts, and, of course, the red line, I believe, indicates what happened in terms of realizations from some changes that took place from time to time.

In 1982 we can see that with the Reagan tax cuts and the adjustments in lowering the capital gain tax rates, realizations from capital gains tax began to grow, and in 1982 through 1985 there was quite a significant growth, as demonstrated here by the red line.

Then in 1986, Congress passed a bill known as Tax Reform, where we were trying to flatten rates, and the capital gains tax, of course, was one of those that was affected. The immediate effect was that we encouraged people to sell off capital or liquidate capital, and as a result of that, there was a huge blip in the amount of revenue that we received at that time because of those changes.

Now that is where we began to run into difficulty in determining what was going to happen, because CBO projections and other projections which occurred in 1988 and 1989 indicated that we would continue to see growth in the capital gains realizations in our Federal revenue flow, and, in fact, because the tax rates were increased and because it had a negative effect on realizations, we actually ended up with a much lower rate of realization than was projected.

Now this is because, once again, nobody took into account the effect of that tax change through 1988, 1989, and 1990 on economic growth and, hence, revenue flow.

So what Mr. Campbell is suggesting in his bill is that we encourage CBO and the Joint Tax Committee to use dynamic scoring in order to take into consideration a full account, or as full as possible account, of the effect of tax rate changes of various kinds on economic growth, on wages, and on Federal revenue. So I support Mr. Campbell fully.

Mr. Armey, of course, has made this point over and over again. As a matter of fact, Mr. Chairman, I might ask to be made part of the record a short joint economic report that we did in September 1995 on this subject.

Mr. HORN. Without objection, it will be put in the record.

[The report referred to follows:]

01-28-97 05:31PM FROM JOINT ECONOMIC CTE. TO 52373 P002/003

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

ECONOMIC UPDATE

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September, 1995

CAPITAL GAINS AND THE REVENUE ESTIMATION PROCESS

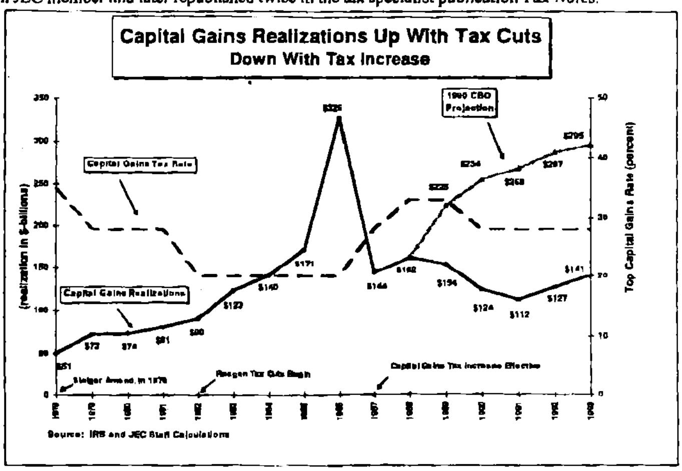
Over the last decade some of the most controversial issues of tax policy have revolved around the treatment of capital gains. These issues include proposed changes in scoring capital gains tax rate cuts, the impact of capital gains rate changes on federal revenues, and related issues regarding the effect of changing capital gains rates on behavior and economic activity. A review of estimation problems in the prior capital gains debate provides an interesting perspective from which to view the revenue estimation process with respect to capital gains.

CBO's Capital Gains Fiasco

In 1990, the then-Democratic controlled Congressional Budget Office (CBO) made a projection of capital gains realizations for the years 1989-1995. This projection was used for constructing the CBO revenue baseline and was also provided to the Joint Committee on Taxation (JCT) as the starting point for estimating the revenue effects of capital gains tax cuts. Early in 1991, JEC Republicans examined these CBO projections and concluded that they were grossly erroneous. The first public disclosure of these huge errors came in a study issued by the ranking Republican JEC member and later republished twice in the tax specialist publication *Tax Notes.*[1]

A follow up JEC investigation in 1992 using more recent tax data found that the CBO estimates were off by over 100 percent in most cases.[2]

The graph nearby shows the projected CBO realizations relative to actual realizations. According to newly released IRS data, the amount of the error grew to a level of $154 billion by 1993.



In the 1994 JEC annual report, it was estimated that the annual revenue losses from the CBO mistake had grown to about $40 billion. Over the years 1989-93 capital gains realizations had been overstated by nearly 700 billion dollars, implying a revenue loss of about $150 billion over this period. After a transition period following the 40 percent increase in the capital gains tax rate effective in 1987, real capital gains revenues stabilized at a level lower than that of 1985, before the announcement effects of the tax change became apparent. In other words, the higher capital gains tax rate has produced less annual real revenue in the 1990-1993 time period than under the lower rate of 1985, despite a significantly larger economy.

In other words, the official scoring of the capital gains tax cut, and its portrayal as a huge tax benefit to the rich, was derived from an analysis of CBO baseline realizations that were over 100 percent inaccurate. Moreover, despite the intensely partisan use of this misinformation, and the eventual knowledge by the estimators involved that this was wrong, CBO and others failed to correct the record and acknowledge the mistake.

These mistakes have been serious enough to cause problems even in the projection of the revenue baseline with no policy changes assumed. In 1991, a Republican JEC report warned[3] in publicly disclosing the capital gains baseline problem for the first time, that large revenue losses in coming years would result. Then-CBO director Robert Reischauer flatly denied this, acknowledging the mistake but contending it had been fixed; however, CBO later was forced to make huge "technical reestimates," i.e. corrections, to its revenue projections.[4]

Conclusion

Three main conclusions follow from the data. First, capital gains realizations and revenues are highly responsive to changes in the tax rate. When this sensitivity is ignored or understated by official revenue analysis, huge errors have resulted, as in the previous capital gains debate. Second, there is no evidence from the actual historical data demonstrating that capital gains tax rate reduction would reduce revenues. Third, on the basis of the historical data on capital gains realizations and revenues, it would be reasonable to expect higher revenues to follow a reduction of the capital gains tax rate.

Official analysis of capital gains tax legislation has experienced a number of problems in the past, leading to extremely inaccurate results. Clearly economic and behavioral factors have not been adequately accounted for in evaluation of previous capital gains legislation. Instead of reliance on artificially precise revenue and distribution estimates which are unlikely to be accurate and assume no macroeconomic effects, it would make more sense to provide a range of revenue estimates based on a variety of reasonable economic and behavioral assumptions.

Christopher Frenze
Chief Economist to the Vice-Chairman

Endnotes

1 Armey, Richard, Ph.D., and JEC Republican Staff, Distorting the Data Base: CBO and the Politics of Income Redistribution, Washington, DC, 1991, and Tax Notes, May 20, 1991.
2 JEC Republican staff, Massive Errors in Capital Gains Projections, Washington DC, 1992.
3 Armey, op.cit.
4 *The Washington Times*, May 1, 1991.

Mr. SAXTON. And I guess I would just say in concluding that these effects are obviously not limited to the capital gains rate. I just used this as an example of how we can go so wrong in using these static assumptions and this static model.

As a matter of fact, I guess it is safe to say that the CBO and the Joint Tax Committee, were off by a full 100 percent in this case. But the same is true with regard to the personal income tax. The same holds true with regard to other business taxes, which have an effect on economic growth.

And I thank you for giving me the opportunity to bring this to your attention this morning.

[The prepared statement of Hon. Jim Saxton follows:]

Statement of JEC Vice Chairman Jim Saxton
before the
Subcommittee on Government Management, Information, and Technology
of the
Committee on Government Reform and Oversight

"Budget Process Reform"

Tuesday, April 23, 1996

Mr. Chairman, and Members of the Subcommittee, thank you for the opportunity to appear before you today. There are a variety of important budget reform ideas before the Subcommittee that will be addressed by others, but I would like to focus on one issue of special interest to the Joint Economic Committee (JEC). This is the issue of dynamic revenue analysis, on which the JEC has worked for several years.

This week I plan to join Congressman Campbell and several others as cosponsors of a dynamic revenue measure developed by Congressman Campbell. At this time, I would like to complement Congressman Campbell for his hard work on this issue, and convey my continued support as we move forward.

The current method of official revenue analysis of tax changes has a number of severe deficiencies. For example, in evaluating a tax bill designed to boost economic growth, the first assumption made in official revenue analysis is that the proposal will have no effect on economic growth. In this respect, the current method can be described as static revenue analysis.

Is this a neutral or objective assumption to make about pro-growth tax legislation -- that it will fail to have any effect on growth? While the extent of resulting growth may be a debatable proposition about which reasonable people can disagree, does objectivity really require a loaded assumption that this kind of legislation will have no effect? This kind of assumption is not objectivity, but an institutionalized prejudice against pro-growth tax policy that is ingrained in official revenue analysis. This institutional bias makes the adoption of pro-growth tax changes much harder to enact.

If the effects of a proposal are reasonably debatable, perhaps the budget rules should permit the representatives of the American people, instead of congressional staff bureaucrats guided by arbitrary rules, to debate and consider these issues. If an elected Member of Congress wishes to offer a bill to promote economic growth, should this proposal not be debated on its merits? Why should an elected Member of Congress with a reasonable proposal be at the mercy of a congressional staff opinion based on biased rules?

Current revenue analysis is too unrealistic, arbitrary, and static. This does not mean that it should be replaced by revenue analysis that is excessively unrealistic in the opposite direction. Tax changes can produce economic effects between the extremes of zero on the one hand and infinity on the other. In any specific case a reasonable range of likely effects could be identified by empirical research and debated by Members of Congress.

What we need is a revenue estimation process that is realistic and neutral, without biased assumptions about the effects of pending tax proposals. The Campbell resolution is an improvement in the process that would encourage more dynamic analysis.

Probably the most striking example of bias in official revenue analysis was uncovered by the JEC in 1991. In analyzing some CBO capital gains projections in estimates of family income, a JEC economist noticed some anomalies. Further investigation established that CBO had grossly overestimated 1989-95 capital gains realizations by ignoring the effect of the higher capital gains tax rate after 1986.

In other words, in the face of higher tax rates, CBO projected robust growth in capital gains realizations. These CBO projections were off by over 100 percent in most cases. These defective data were central to some very important issues then under consideration.

For example, in scoring the Archer proposal for capital gains tax reduction in 1989, revenue analysts used a level of capital gains income that was overstated by over 100 percent. This skewed the estimate of projected static revenue losses and the distributional analysis. The defective CBO forecast was also incorporated into the CBO baseline revenue projections in official CBO budget estimates. In addition, the faulty data were also used in the defective CBO family income data fueling the class warfare debate.

The point is that the CBO error was fed into three different sets of statistics at the center of the most controversial issues of the time. The CBO error was over 100 percent in most years. What did the CBO staff do when they realized that the data splashed over the front pages of newspapers all over the country were grossly erroneous?

This is the most amazing of all: they did nothing. CBO staff did not inform the Members that the scoring of their legislation had been botched by bad CBO numbers. They did not inform the press that the numbers they had been fed for months were based on a massive CBO error. Those on both sides of the class warfare debate were never informed about the mistake by CBO. The massive errors were allowed to stand.

The CBO error was not publicly corrected until then ranking JEC Republican Dick Armey exposed it. JEC research on a related issue had uncovered the CBO error in examining anomalies in CBO income data. Mr. Armey released a series of JEC studies and reports on this subject starting in 1991. However, if not for the JEC minority, no one outside of the CBO and the revenue estimators would have ever found out about the CBO mistake.

After JEC member Senator Roth raised this issue on the Senate floor, Senate Finance Committee Chairman Bentsen privately asked him for an explanation of what he was talking about. In other words, not even the chairman of the Senate Finance Committee was informed about the problem. Incidentally, CBO has never indicated that any sanctions regarding those staff who failed to disclose this mistake to Members and the press have ever been taken.

This whole episode demonstrates some of the shortcomings of official revenue analysis. It can generate huge projection errors and produce grossly unrealistic and inaccurate results. Moreover, the degree of secrecy in the process is unhealthy and raises the possibility that huge mistakes will never be properly disclosed, as has happened at least once. The Campbell bill includes sunshine provisions to discourage this kind of problem and encourage more openness and disclosure.

I urge the Subcommittee to favorably consider the dynamic revenue analysis reform.

Mr. HORN. Well, we appreciate it.

As vice chairman of the Joint Economic Committee, no one can say you have not tried to educate your colleagues on our side of the aisle. You have been prolific in putting out very fascinating economic data while you have been vice chairman and as the ranking member now.

Let me ask you a couple of questions. It seems to me that with our current budget process, where we have tried to get integration of revenue with expenditure, which was the whole purpose of the 1974 act, that we need to get into the bloodstream when the various congressional groups consider these aspects, the economic picture.

Now, obviously one way to do this is to have the Appropriations Committee sitting as a whole, as well as Ways and Means, or maybe even jointly, but perhaps we ought to just have them do it separately, and have the key economic actors in the Federal Government testify before them and the key members of the Joint Economic Committee to get some agreement on the economic assumptions used.

To your knowledge, to what extent does, say, the chairman of the Federal Reserve Board, the Comptroller General of the United States, and the Director of the Office of Management and Budget come together as a group to share their projections, their analysis of other projections, and try to merge a little bit of monetary policy with fiscal policy, when these various players in the congressional process are about to consider the details of the President's budget recommendations?

Have you seen that integration of economic knowledge with the appropriations budget process, the revenue process? And if so, what do you suggest that we might do to get it in the bloodstream?

Mr. SAXTON. I think the best example of where we went wrong in not integrating our thought process happened in the last decade when we saw the Reagan tax cuts go into place and subsequently saw great economic growth and a great increase in the amount of Federal revenue that we had available to us.

In other words, in the 1980's, in the early 1980's, the tax writers did a good job of producing a tax program that accomplished what I believe a good tax program can do.

At the same time, those of us who are all involved in the process of appropriating recognize that we had that additional revenue, but we were tied into a different system in continuing to spend significant sums in excess of what we were collecting, even though our revenue stream was going up.

So it seems to me that the real gap in the past has been a gap between the thought processes involved in writing good tax policy and at the same time all of us, collectively—and I don't point fingers because I was here and I was part of the second part of this process that was wrong, too—we simply didn't connect the spending program with the tax program. If we had, we would have been out of trouble with regard to deficit and national debt long before this.

Mr. HORN. Well, do you have a feeling that, let's say, your colleagues on the Budget Committee, the Ways and Means Committee, and Appropriations, take into account the economic assumptions? Or do they just say, "Phooey, let's get down to detail; we have got this, this, and this to do"?

Mr. SAXTON. I think the problem with the system that we have is endemic. Within it, a model by which we forecast the results, the economic and fiscal results, of tax policy, has endemic in it a system with certain assumptions which prevent us from doing good short-term and long-term analysis.

In other words, if we use assumptions which assume no economic change because of change in tax policy, then it seems to me that we are doomed to be unable to come up with any kind of logical explanation of what might happen.

Our current system says it is so unscientific to figure out what is going to happen 2 or 3 or 4 or 5 years from now because of tax changes, it is so difficult to do that, and we have had a history of being inaccurate in doing that; therefore, we won't try to do that, we will just say there will be no change.

What happens when we assume there will be no change is that when we debate tax policy, and if we believe that reducing the capital gains tax promotes economic growth, and if we at the same time must assume or believe that there will be no growth in the economy because of changes, then there will be an automatic assumption that there will be a revenue loss, and that is unrealistic, from my point of view.

In order for us to proceed to do tax policy that does promote economic growth and have a logical debate about it, we must correct this assumption that says there will be no growth in revenue.

Mr. HORN. Well, how do you see—do you see a process and a way to get that into the bloodstream? How would you set up a part of our budget process to get those parties together?

And obviously I should name the chairman of the Council of Economic Advisors, and now we have got a somewhat politicized, to say the least, economic advisor.

Mr. SAXTON. I think that is a very good question, and, as a matter of fact, Tom Campbell's resolution will set up such a mechanism.

I am not familiar with all of the details of the mechanism that he sets up, but he does set up a committee, or a panel, which brings together these individuals and permits them the flexibility to put together the type of model that they believe will be the most accurate in predicting the outcome of changes that we make, particularly in the Tax Code.

Mr. HORN. The other thing that bothers me is that we can never seem to get agreement on CBO assumptions and OMB assumptions. Has the Joint Economic Committee looked at that and seen if there is a process by which we could get agreement on some of these assumptions?

I mean, the Congress looks at the executive branch, regardless of party, and feels they change their assumptions to meet their political aim. Now, does that mean there isn't an honest economist around the executive branch? What do we do to hammer out how we approach things and they approach things?

Mr. SAXTON. Well, I am not sure that we are ever going to get total agreement between the Congressional Budget Office and the Office of Management and Budget. I think, you know, if you want to look at today's situation, I think it is fair to say that when the Office of Management and Budget folks came to be appointed, that there was at least at that time a significant difference in the outlook of the administration as compared to the outlook of the new Congress.

When economists or analysts are appointed, while certainly they all try to be objective, all of their objectivity is based on certain assumptions that they begin to work with, and the assumptions at the Office of Management and Budget, regardless of who the President is, are oftentimes different than the Congressional Budget Office.

So as long as we are going to have an administration with a forecasting group and a Congress with a forecasting group, I suspect we will have significant differences in outcomes. But that should be perhaps part of the process, and that reflects different attitudes and different philosophies of people who serve in the two branches.

And that may not be bad, but what I think is bad is when our House and the Senate begin to debate tax policy with a bias toward loss of revenue on any tax with regard to any tax that you want to reduce.

It prevents us internally in the Congress from having a logical discussion about it, because the first thing that happens on the floor is that somebody says, well, you are cutting taxes on this group or that group and it reduces revenue when, in fact, our intent is to increase revenue, and it, therefore, leads to illogical discussions, and I will not point to some of them, but some of them are in recent memory.

Mr. HORN. Well, let me move to one last question because I know you are pressed for time.

The one thing that fascinates me are the new year's projections of the various private and sometimes governmental economic resource groups. Has the Joint Economic Committee ever looked back 1, 2, 3 years to see what may be the top 20 or 30 projectors in this country and said, including government, and then what actually happened?

I think it would be a worthy service, if you haven't done it, to just take, in our neck of the woods, southern California. You have got the UCLA projection that comes out like clockwork every new year, and nobody ever thinks back the next year to say, are they all wet or aren't they?

It just seems to me a useful public service and a useful service to your congressional colleagues would be, here is what some of these key groups, east, west, midwest, said last year, and here is how the economy came out.

Have they thought of doing that?

Mr. SAXTON. I don't know that we have done that specifically. It is a good idea.

I think perhaps we could compile a success rate of some kind or a ratio of success for some of the economic forecasters and see which ones are doing the best job over a historic window that we might look at. That is a good idea, but I think the bigger issue for us is to try to get our house in order so that we can have logical discussions based on something other than the static model that we use here in the Congress today.

Mr. HORN. Well, as I suggested earlier, the one way I can think of to get our house in order is to at least get the information out and have it questioned by these different economic actors, the legislative branch and the executive branch, and do that at the beginning of the session.

We are looking for things to do usually in January anyhow, as people warm up, and the committees warm up. It seems to me we could get some of these people in the room. It would be good education for the public. C–SPAN would carry it, I am sure, and you would have the Comptroller General, the chairman of the Federal Reserve, the head of the Council of Economic Advisors, and so on right down the line, the Director of OMB, and also the Director of the Congressional Budget Office, as the professional groups.

Mr. SAXTON. We would certainly intend to do that kind of thing as the Joint Economic Committee next year.

I would also say you will be pleased to have this discussion a little later in the week. I understand you are going to be hearing from Mr. Campbell about his bill.

Mr. HORN. We are.

Mr. SAXTON. You may want to pursue these matters specifically with him, because he spent the last several months putting this bill together, and I believe he does have a panel of some kind in the bill, and, again, I am not familiar with the details of what the panel looks like.

Mr. HORN. Good. Thank you very much, Jim. I appreciate your coming down here.

Mr. HORN. Is Mr. Wise here?

All right. I believe Senator Brown is not going to be able to join us. He will be here Thursday.

Let us start then with panel two, Mr. James Blum, the Deputy Director of the Congressional Budget Office.

Mr. Blum, if you will just raise your right hand.

[Witness sworn.]

Mr. HORN. The clerk will note that the witness has affirmed.

I guess it is an experience for an economist to start taking oaths, but proceed.

STATEMENT OF JAMES L. BLUM, DEPUTY DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. BLUM. Well, we will do our best, Mr. Chairman.

I appreciate the opportunity today to discuss various proposals for reforming the Federal budget process. As you directed, Mr. Chairman, I will submit my prepared statement for the record and limit my oral remarks to a very brief summary.

Mr. HORN. All right.

Mr. BLUM. The Congressional Budget Office is, by its nonpartisan nature, a cautious institution, so it should come as no surprise that the Office is cautious about supporting proposals to reform the budget process.

Mr. HORN. Excuse me a minute, Mr. Blum, if I might. I see Congressman Wise has come in. If we could just let him testify, because you are probably on a tight schedule, too.

STATEMENT OF HON. ROBERT E. WISE, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WEST VIRGINIA

Mr. WISE. Stay right where you are, sir.

I appreciate it, Mr. Chairman. It is very gracious of you. I simply want to join with the others who testified, and particularly Chairman Clinger, who has been the tireless soldier in this fight for many years, supporting capital budgeting.

Earlier this year I sponsored an amendment to balance the Federal budget using a capital budget, because I think if people are going to require, as rightfully they should, that the Federal budget be the same as the family budget, the business budget, the State or county budget, that it ought to be set up the same way that those budgets are set up.

With this week's passage of H.R. 842, this Congress reaffirmed the importance of investment and fiscal infrastructure. The interesting thing is, for those who complain that taking the trust funds off budget is too Draconian a step, the reason that we have to look at something like that is because they refuse to consider capital budgeting, which would actually include the capital costs of infrastructure in the Federal budget.

I am going to ask that my statement be made a part of the record. I am going to cut out incredible parts of it. But I simply want to say that there is a problem that both parties have, Republican and Democrat, in their budget assumptions, and that is that their budget assumptions, whether you are looking at the White House, you are looking at CBO, or you are looking at the Republicans' assumptions, the growth component is woefully inadequate; 2.3 percent growth doesn't get us anywhere.

Only when we recognize that we need a higher rate of growth, only when we recognize the infrastructure needs, and only when we recognize that the present budget system that we have, a Federal unified budget, is a disincentive to infrastructure investment, will we begin to grapple with the real problem of growth and declining wages, and in that case then I think the capital budget becomes important, because that permits you to make the long-term, tangible investments in infrastructure and achieve sensible budgeting practices as well as a balanced budget.

Now, I appreciate the Chair's indulgence. Mr. Blum, I appreciate your indulgence. And I would ask that the balance of my statement be made a part of the record.

Mr. HORN. Sure. Without objection, that will be done. Thank you very much.

[The prepared statement of Hon. Robert E. Wise, Jr., follows:]

BOB WISE
2D DISTRICT, WEST VIRGINIA

COMMITTEES:
COMMITTEE ON TRANSPORTATION & INFRASTRUCTURE
COMMITTEE ON GOVERNMENT REFORM & OVERSIGHT

Congress of the United States
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STATEMENT OF CONGRESSMAN BOB WISE OF WEST VIRGINIA

BEFORE THE SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY GOVERNMENT REFORM AND OVERSIGHT COMMITTEE

APRIL 23, 1996

Mr Chairman, Members of the Committee, I would like to thank you for holding these hearings

As you know, I have long been a supporter of capital budgeting. Earlier this Congress I sponsored an amendment to balance the federal budget using a capital budget and for several years Chairman Clinger and I have worked on legislation to establish a capital budget which highlights investment over consumption spending.

With last week's passage of HR 842, this Congress reaffirmed the importance of investment in physical infrastructure. The effort to take the Transportation Trust Funds off-budget highlighted many of the issues that the Chairman and I have addressed for years. This is not just an issue of using taxpayer dollars for their intended use, but our responsibility to future generations -- not to leave a legacy of crumbling roads and decaying bridges.

WE NEED CHANGES IN THE CURRENT BUDGET PROCESS

This week the Congress attempts to finish work on the budget for FY 1996 and begin work on FY 1997. It is apparent that we need to get our fiscal house in order and the major issues facing Congress boil down to prioritizing spending for the next decade and beyond. While there are 435 different answers to that question, almost everyone agrees that we need to invest in programs and projects that are lasting and will benefit future generations. That is why I am here today, to discuss the concept of Capital Budgeting.

At home in West Virginia, I am often asked, "Why doesn't the Federal Government balance its budget like my family?" As a veteran of six years of service on the House Budget Committee, I have come to believe that many of the budget problems facing this Congress, particularly the shift in recent years from public investment toward consumption spending, have as much to do with the budget process as with decisions made -- or not made -- by the Congress.

Perhaps the greatest, and to me the most mystifying, problem with the current system is the fact that the federal government's unified budget makes no distinction between money spent on investments and money spent for consumption. Highways, federal salaries, health benefits and foreign aid, which are all examples of federal programs that are paid for through taxes and borrowing, are all accounted for in basically the same way. But all borrowing is not created equal Borrowing for physical infrastructure can be justified if it pays for itself in the long-run by increasing the nation's wealth and capacity for future economic expansion. Borrowing to meet the day-to-day expenses of government cannot.

Both Chairman Clinger and I have introduced legislation that would divide the federal unified budget into an operating budget and a capital budget. Under our bills the operating budget would include all programs that meet the immediate obligations of running the government. The capital budget would include long-term, tangible investments in infrastructure. This legislation would direct the operating budget to be balanced but would allow the federal government to borrow money for certain investments in infrastructure that increase the national wealth and contribute to economic growth. Money borrowed for those infrastructure investments would be paid back over the life of the road, bridge, sewer system or other infrastructure investment.

IS A CAPITAL BUDGET FEASIBLE?

The concept of a federal capital budget is not new. The budget was expanded in the 1950s to include information on investment spending. Reform in the 1980s required even more investment information in the unified budget. In fact since the Federal Capital Investment Program Information Act of 1984 Presidents Reagan, Bush and Clinton, have submitted budgets that include projections of Federal physical capital spending and information regarding recent assessments of public civilian physical capital needs.

Many other industrialized countries employ a capital budget, and businesses and most state and local governments have investment budgets that separate long-term capital investments from year-to-year operating costs. Individuals and groups as diverse as former OMB Director Richard Darman, the General Accounting Office and the Progressive Policy Institute have endorsed distinguishing between investment and consumption spending in the budget. As a recent GAO report on the harmful effects of the deficit points out, "a new [budget] decision-making framework is needed, one in which the choice between consumption and investment spending is highlighted throughout the decision process, rather than being displayed for information purposes after the fact."

Businesses know the difference between borrowing to consume and borrowing to invest. Borrowing is a smart move when the money is used to finance productive investments that help a business modernize its equipment, expand and become more profitable. But borrowing money to pay salaries or executive bonuses or to send employees to expensive conferences rather than to modernize would be foolish.

BUDGETING FOR THE FUTURE

I believe the federal government should make this same distinction in its budget. By borrowing for current expenses the government is asking future generations of taxpayers to pay for the cost of running the government today. But borrowing to invest is different. If the government passes part of the cost of building a road to future taxpayers, it also gives them something in return -- a new highway that will encourage economic development, facilitate commerce and increase economic growth for years to come.

Instituting a capital budget would force policy makers to decide whether or not each investment is worth borrowing money to finance. In addition, the public would benefit from knowing that the government's current costs are being paid for and that any borrowing is for investments in the future rather than paying for the present and saddling future generations with bad debt.

All of us agree that the U.S. must make investments that are critical to future economic growth but that the budget deficit must also be reduced. Rather than going from crisis to crisis, the federal government should have an institutionalized system of long-term investment planning. Adopting a federal capital budget would provide such a mechanism.

Mr. Chairman, Members of the Committee, this is a time of fundamental change in the way government serves the people. In order to be more responsive to taxpayers' needs and more responsible with taxpayers' money, I believe the federal government should reform its budgeting to distinguish between consumption and investment. Adopting a capital budget would begin to effect this critical change and I hope you will seriously examine and ultimately endorse this important budget reform.

Mr. HORN. Mr. Blum's testimony will begin here then to get it all together in one place, without objection.

Mr. Wise will follow Mr. Saxton.

Go ahead, Mr. Blum. Sorry for the interruption.

Mr. BLUM. Not at all, Mr. Chairman.

I started out with the observation that the Congressional Budget Office is, by its nonpartisan nature, a cautious institution, so that it should come as no surprise that we are also cautious about supporting proposals to reform the budget process. Our general view is that the budget process is working reasonably well and does not need major reform at this time.

Most of the complaints about the budget process, I believe, are actually a product of political disagreements between the President and the Congress over budget policy, not procedure.

In our opinion, the budget process is not and cannot be designed to force particular outcomes in the absence of broad political agreement or to obstruct those outcomes when agreement has been reached.

The budget process has evolved over time and changes have been made incrementally, just as budget decisions tend to be incremental in nature. Some reforms do not work well. For example, the fixed deficit targets of the Gramm-Rudman-Hollings Act did not work as designed, largely because of the absence of political support for the actions that would have been necessary to achieve them.

Other recent reforms have worked, such as the limits on discretionary appropriations and the pay-as-you-go requirements for new direct spending and revenue measures. These were put into place in 1990 as part of the Budget Enforcement Act and worked as designed in order to enforce a budget agreement that had been reached at that time.

The subcommittee is now considering a large number of possible changes in the budget process, some comprehensive, others that are quite narrow in scope.

My prepared statement discusses a few of the major proposals that have been on the table for a number of years, such as converting the concurrent budget resolution into a joint resolution in order to get early agreement between the President and the Congress on an overall budget plan, converting the annual budget cycle into a biennial cycle so as to free up legislative time for other matters, and imposing caps on mandatory spending programs so as to control our annual growth.

While these proposals, on the surface, have some attractive features, they also have potential drawbacks that could present serious problems.

For example, joint budget resolutions could be the cause for further delays in making budget decisions; biennial budgets could raise the stakes higher and also lead to delays; and mandatory spending caps, by themselves, are not likely to be effective without political consensus.

My prepared statement also suggests a few general considerations about budget process reforms, such as avoiding unintended consequences and trying to accomplish too much in a single reform package.

In particular, in evaluating various reform proposals, especially omnibus proposals, it is important, we believe, to be cognizant of the implementation costs in terms of time and resources need to carry out the reforms.

In conclusion, Mr. Chairman, the budget process generally is intended to allow a consensus to work its will in setting budget policy. Over the years, we believe it has performed that task quite well. When the process has been modified to force policy outcomes in the absence of an underlying political consensus, the changes have failed. The budget process, in our view, cannot force political consensus on budget policy when it does not exist.

Mr. Chairman, that concludes my statement. I would be happy to answer any questions that you might have.

[The prepared statement of Mr. Blum follows:]

Statement of
James L. Blum
Deputy Director
Congressional Budget Office

Chairman Horn and Members of the Subcommittee, I am pleased to be here today to discuss the issue of reforming the federal budget process. The basic theme of my testimony is that the budget process is working. It achieves the functions it is designed to perform. Evidence often cited as proof of the failure of the budget process actually reflects political disagreement over basic budget policies that the process cannot--and probably should not--control. Accordingly, I believe the Subcommittee should proceed cautiously as it considers an omnibus reform measure.

THE BUDGET PROCESS WORKS

Fundamentally, the budget process works well. Although the record of Presidential vetoes of major budget measures over the past year and continued conflict over fiscal year 1996 appropriations would seem ample cause for a less enthusiastic endorsement, those difficulties and other evidence of the failure of the budget process involve matters beyond the control of the process. In recent years, the budget process has not only accomplished the basic purposes for which it was created, it has also displayed certain virtues that should be preserved in any reform effort.

Last year, the Congress adopted a historic budget resolution recommending a balanced budget by fiscal year 2002. It then proceeded, without inordinate delay, to develop and approve reconciliation legislation, appropriation measures, welfare reform legislation, and other landmark measures that were consistent with the resolution and that CBO projected would achieve the resolution's balanced budget goal. Thus, using existing procedures, the Congress was able to accomplish the most fundamental and perhaps the most important function of the budget process--to establish and enforce a comprehensive budget plan for the federal government.

Critics of the budget process point to different evidence. Last winter, the President vetoed the reconciliation and welfare reform measures that included most of the policy changes necessary to follow through on the budget resolution's balanced budget recommendation. The Congress and the President continue to disagree over funding levels for major federal programs for the current fiscal year, a year that is already half over. That disagreement has led to two partial shutdowns of the federal government and has required the Congress to enact a record number of continuing appropriation acts. Moreover, only recently has essential legislation increasing the limit on the public debt been enacted into law.

Yet, much of the apparent failure of the budget process is actually a product of political disagreement between the President and the Congress over budget policy. That disagreement is not the result of inherent flaws in the budget process. The budget process is not designed to force certain outcomes in the absence of broad political agreement or to obstruct those outcomes when agreement has been reached.

Rather, the budget process provides a framework of rules and procedures that generally serves as a conduit for majority rule. The process establishes a structure in both the executive and legislative branches for disseminating information on the budget and for developing and enforcing budget plans for the federal government. In the Congress, it also provides a means of coordinating the actions of committees. More expansive, policy-oriented goals for the budget process, without political agreement on how to reach those goals, ask more of any budget process than can be delivered.

How an Adaptable Budget Process Evolved

The modern budget process is an amalgam of procedures and practices set forth in various statutes and in Congressional rules of procedure. Principally, however, the modern budget process is established in two laws--the Budget and Accounting Act of 1921 and the Congressional Budget and Impoundment Control Act of 1974. The former provides for an executive budget process centered around the annual submission of a budget proposal by the President. The latter provides for a Congressional budget process centered around adopting and enforcing a concurrent resolution on the budget by the Congress.

The basic purposes of each of those statutes correspond to the constitutional roles and responsibilities of the respective branches of government to which they apply. The Budget and Accounting Act of 1921 requires the President to submit an annual budget setting forth his proposals in detail for the upcoming fiscal year. Because the President under the Constitution heads the executive branch, the act establishes procedures to ensure that the President's priorities prevail in his annual budgetary proposals.

The Congressional Budget Act of 1974 establishes a Congressional budget process for the Congress to set forth its own budget. However, because power in the Congress is dispersed, the Congressional Budget Act establishes a procedural framework for bringing majorities in the House and Senate into agreement on the budget. It does so by providing for the Congress to adopt annually a broad, nonspecific concurrent resolution. The resolution is not signed into law; it serves only as a guideline for Congressional action on actual legislation on spending, revenues, or the debt limit.

Because Congressional majorities control the Congressional budget process, different majorities have used it for different policy goals. Budget resolutions have recommended both tax cuts and increases, entitlement cuts and expansions, and annual appropriation cuts and increases. Moreover, majorities in the Congress have also modified the process--sometimes by an informal change in practice--to accomplish their policy objectives. For example, a change in budget resolution practices in 1981 converted the reconciliation process from a limited, seldom-used procedure to a potent new tool for conforming permanent spending and revenue law to the priorities established in the budget resolution.

Changes Made in the Budget Process to Reduce the Deficit

The most significant recent changes in the budget process have been made over the last decade or so to reduce and control the deficit. Initially, those changes met with mixed success, in part because they may have asked more of the budget process than it could reasonably deliver. More recent revisions to those procedures have put in place deficit control procedures that the budget process can more realistically accommodate.

In 1985, the Balanced Budget and Emergency Deficit Control Act was enacted into law. Known as the Gramm-Rudman-Hollings Act, or GRH, it established a firm schedule of declining deficit targets that called for eliminating the deficit by fiscal year 1991. It established a procedure--known as sequestration--to make uniform percentage reductions in spending that would be triggered if the targets were not met. Moreover, it amended the Congressional Budget Act of 1974 to ensure that Congressional action on the budget resolution would be consistent with the new statutory deficit targets.

Even though budget resolutions were adopted that met the targets, and spending and revenue legislation was enacted that was projected to meet the targets, actual deficits generally failed to reach the targeted levels. For example, the actual deficit for fiscal year 1991, the year originally targeted for a balanced budget, was $270 billion. Although different reasons are cited for the failure of fixed deficit targets, including relying on excessively optimistic budget estimates, clearly more sweeping changes in budget policy or larger sequestration reductions would not have been supported by the prevailing political consensus.

In the fall of 1990, the Congress and the President amended the GRH act and the Congressional Budget Act to put in place procedures that established a new philosophy of deficit control for the budget process. Set forth in the Budget Enforcement Act of 1990 (BEA), those new procedures no longer set a goal tied to a fixed deficit target Instead, the BEA established annual limits on total discretionary appropriations and a pay-as-you-go (PAYGO) requirement for mandatory spending and revenue legislation through fiscal year 1995. If discretionary appropriations were enacted that exceeded annual limits, or if mandatory spending or revenue legislation was enacted that caused a net increase in the deficit for a fiscal year, a sequestration would occur to eliminate the excess amount or deficit increase. The discretionary spending limits and the PAYGO requirement were extended through 1998 in the Omnibus Budget Reconciliation Act of 1993.

Unlike the fixed deficit targets under the GRH act, the discretionary spending limits and PAYGO requirements have been met. The limits and the PAYGO requirement have been honored in each fiscal year, and they have proven to be effective in deterring legislation that would increase the deficit.

The BEA has been criticized for not going far enough. Indeed, during the years immediately following the 1990 budget agreement, the deficit increased significantly. However, that increase was not caused by legislation in violation of the BEA. Rather, it stemmed from worse-than-anticipated economic performance and higher-than-expected health care costs, which drove down current-law revenues and drove up current-law spending. Those are some of the same factors that made relying on fixed deficit targets enforced by sequestration unsustainable and led to the BEA procedures currently in effect. What critics really mean is that, in their view, the budget agreements that the BEA helps to carry out were not ambitious enough. The BEA procedures do not force sterner agreements to be forged, although they do not stand in the way of such agreements.

SELECTED REFORM PROPOSALS

The proposals that the Subcommittee is now considering cover a wide range of topics. Some are comprehensive and others narrow in scope. I will discuss just a few of the major proposals, concentrating on ones that have been proposed in earlier Congresses and have been the subject of previous committee hearings and other review.

A Joint Budget Resolution

Those policymakers who advocate converting the budget resolution to a joint budget resolution that must be enacted into law point to last year as an example of the need for this reform. It is better, they say, to use the budget resolution as a vehicle to force the President and the Congress to reach broad budget agreement early in the year so that veto confrontations and other conflicts over individual spending and revenue measures will not occur later in the year.

It is unclear whether budget agreement between the President and the Congress will be more forthcoming if the budget resolution becomes the formal vehicle for carrying it out. However, such a change would probably alter the fundamental purpose of the budget resolution as a means for the Congress to establish its own budget priorities. Last year, because the Congress did not have to wait for the President to begin its budget process, it could make significant progress on annual appropriation measures and other bills, several of which were signed into law. Harder to gauge is whether momentum toward political agreement with the President may have been created as the Congress proceeded with its own budget process. Would the President have modified his budget proposal last year in the same way without the steady drumbeat of budgetary legislation coming from the Congress? Can it be argued that the momentum created by the budget resolution and other legislation moved the President closer to the Congress's position, even if agreement still has not been reached?

Biennial Budgeting

One of the proposals before this Subcommittee also calls for a form of biennial budgeting. Under biennial budgeting, some or all of the annual budget cycle would be converted to a biennial cycle, with budget resolutions, appropriation bills, authorization measures, and other budgetary legislation (or some combination of those measures) considered only every other year.

The impact of biennial budgeting probably would vary depending on the types of measures to which it was applied. One proposal that the Subcommittee is considering would convert the budget resolution to a two-year cycle and make it a joint resolution. In that case, the Congress and the President would have to weigh the consequences of setting overall budget policy only every other year. Because budget projections and estimates can change dramatically in relatively short periods, reviewing budget policies annually can be helpful, even if those policies cover multiyear periods. Also, until the long-range deficit picture improves, it may be advisable to revisit budget policies more rather than less frequently.

Biennial budgeting might have its greatest impact in the annual appropriation process. Proponents of biennial appropriations contend that appropriating every other year would have payoffs in improved planning for federal agencies and more time for Congressional oversight. Opponents are concerned that biennial appropriations might diminish the effectiveness of Congressional control of spending and simply necessitate supplemental appropriations or other adjustments in the off year.

Mandatory Spending Cap

The deficit cannot be brought under control without significantly reducing the rate of growth in mandatory spending. Consequently, control of mandatory spending represents one of the greatest challenges facing the budget process. With the baby-boom generation's retirement beginning only 15 years from now, dealing with entitlement growth will become even more critical.

In late 1991, when it started to become apparent that unanticipated mandatory spending increases under current law would erode much of the savings from the 1990 budget agreement, proposals began to surface for some type of cap on mandatory spending similar to the limits on discretionary spending that had proved so successful under the BEA.

Two proposals for a mandatory spending cap now before the Subcommittee illustrate some of the issues involved with such initiatives. One proposal would limit mandatory spending to a predetermined rate of increase and provide for a sequestration of amounts exceeding the limit. Another would set target levels that would trigger expedited consideration of deficit reduction legislation if the targets were exceeded.

Mandatory spending caps linked to sequestration may suffer from the same problem that affected fixed deficit targets under the GRH act. They establish spending targets for entitlement programs that are at odds in some cases with the underlying law for those programs. At some point, a conflict is created between the requirements of the process and the underlying program in which reductions must be made. Furthermore, in the case of entitlement law, the process requirements may also conflict with legal commitments that are enforceable by the courts. Spending limits for appropriations work because the spending is not encumbered by such problems and is generally provided anew each year.

Another potential problem is that spending for Medicare and Medicaid--two of the largest and fastest growing entitlement programs--currently outpaces spending for most other entitlements. Large increases in those health care entitlements might trigger massive reductions in other programs, even though spending for those other programs may be relatively more controlled.

Mandatory spending targets enforced by expedited legislative procedures generally would require the Congress and the President to consider legislation to reduce any excess but would not guarantee that the targets be met. It is not clear whether a forced legislative track can be effective when fundamental differences on policy are the cause of inaction. However, given the limitations of the budget process in forging political consensus on such matters, more restrictive procedural alternatives would not be advisable. Ultimately, if the problem is the inconsistency of underlying law and the nation's budgetary goals, the laws themselves must be changed.

Regulatory Budget

Certain proposals before the Subcommittee would require new information on the costs and benefits of federal regulations to be prepared by the Office of Management and Budget and the Congressional Budget Office. Those and other proposals for a regulatory budget present substantial practical difficulties.

One of the most significant problems would be collecting and analyzing the vast amount of data and information needed to produce reliable cost estimates. Some of the costs and benefits cannot be measured reliably, and any attempted measurement of them would be arbitrary. With respect to the Congressional Budget Office, the information requirements imposed by regulatory budget proposals would be beyond our current capacities. Simply providing more resources would not solve those problems and could in fact divert necessary resources away from our core responsibility of providing budgetary information and analysis to the Congress.

Capital Budget

The Subcommittee is also considering proposals for a capital budget. In general, a capital budget would establish procedures to account for spending on building public capital and record it separately from spending on current consumption.

The budget process generally does not distinguish between spending on investments and spending on current consumption. It might be a useful step to modify the budget process so that it would make such a distinction. However, depending on its design, a capital budget might also lead to a serious loss of budget discipline. With the current focus on long-term economic growth, it is important to differentiate government consumption from public investment, but redefining the budget process to meet this need could be a highly risky option.

OTHER GENERAL CONSIDERATIONS

In examining those and other reforms represented in the draft Omnibus Budget Act, the Subcommittee may wish to consider the following general considerations as well.

Unintended Consequences

The Subcommittee should proceed cautiously as it seeks to combine various proposals into an omnibus package. Proposals adopted independently may have one set of consequences, but when combined they are apt to acquire quite different characteristics. For example, requiring that the budget resolution be enacted into law and providing for automatic continuing appropriations at the beginning of the fiscal year might have unintended effects under current circumstances. If automatic continuing appropriations fund programs at levels more to the President's liking than those being proposed by the Congress, would this requirement inordinately strengthen the President's positions in budget negotiations over the resolution? Even the recently enacted line-item veto could possibly interact with an enacted budget resolution in ways that should be carefully considered.

Competing Goals of Budget Process Reform

In fashioning budget reform legislation, it may not be possible to accommodate all goals. Efforts to simplify and streamline may be at odds with a desire for greater discipline and control. GRH and the BEA are criticized for adding excessive complexity to the budget process, but they are complex largely to improve budget discipline and to circumscribe the authority of the President and of his Office of Management and Budget in administering the sequestration process.

Accounting for the Costs of Carrying Out Reform

In evaluating various reform proposals, particularly omnibus proposals, it is also important to recognize the costs of putting them in place. Major procedural change creates new burdens and alters established practices. An important consideration is whether the advantages of change outweigh the inevitable inefficiencies that will result as officials responsible for carrying out the changes devise appropriate new mechanisms and procedures. Often, some of the costs may not be apparent or may take some time to sort out. For example, the impact of the Unfunded Mandates Reform Act enacted last year is significant but cannot yet be established. Some of the reforms that the Subcommittee is considering appear to be at least as sweeping.

Significant Reforms Have Been Adopted in the 104th Congress

The 104th Congress has already been active in the area of budget process reform. As I just mentioned, last year the Congress established new procedures for controlling unfunded mandates. More recently, the Congress approved and the President signed the Line Item Veto Act. The unfunded mandates requirement went into effect this year, but the President's new authority on the line-item veto will not take effect until January 1, 1997.

The Line Item Veto Act grants the President the power to cancel certain new spending or tax provisions that have been enacted into law. Proponents and opponents of the law disagree strongly about its necessity and potential effectiveness. However, both sides agree that it represents a shift in power to the President. How that power shift will affect the annual budget process is more difficult to predict but should be taken into account as further reform is considered.

CONCLUSION

Because the budget process works well does not mean that it is perfect or that it should not be reevaluated when circumstances change. For example, if agreement on balanced budget legislation is reached, serious consideration probably will be given to whether the deficit reduction procedures now in effect under the BEA should be modified accordingly. Also, although the budget process now successfully controls new spending and tax actions under BEA procedures, other problems remain. Future deficits continue to be driven by projected increases in existing mandatory spending. Yet it is unclear if there is any procedural substitute for controlling mandatory spending other than reaching agreement on direct changes in the programs themselves.

In any event, the basic purposes and limitations of the budget process should be kept in mind. The budget process generally is intended to allow a consensus to work its will in setting budget policy. Over the years, it has performed that task admirably. When it has been modified to force policy changes without an underlying consensus on those changes, it has failed. Much of the evidence of the apparent failure in the budget process actually reflects disagreements over budget policy. The budget process cannot force consensus on budget policy when it does not exist, and it should not be modified in an attempt to do so.

Mr. HORN. Well, thank you. That is very helpful.

Let me ask you, getting back to, can CBO and OMB get some agreement on some assumptions, has CBO ever catalogued the— what has CBO recommended, let's say, over the last 5 years? What has OMB recommended? Who turned out to be closest to right, et cetera? And if there are, what are the types of assumptions that we could secure agreement on, in your judgment? And what are the types of assumptions that we can secure agreement on that are just so politicized, it is hopeless?

Mr. BLUM. Actually, Mr. Chairman, with respect to the economic forecasts made by both the Congressional Budget Office and the administration, we do periodically publish an analysis comparing the forecasts with what actually happened. The last such analysis that we published was in the Economic and Budget Outlook: An Update last summer, and I would be happy to send that analysis to you.

What it shows——

Mr. HORN. What I would like is an exhibit in the record at this point.

If you could give us, let's say, under Bush and under Clinton— let's just start there—the particular statement that was made, either a figure on economic growth or whatever, and what did CBO say, what did OMB say, we can look back now at least to the first 2 years of Clinton and the 4 years of Bush and say, what happened?

Mr. BLUM. We will be happy to supply that for the record, Mr. Chairman.

Mr. HORN. Thank you.

[The information referred to follows:]

Appendix A

Evaluating CBO's Record of Economic Forecasts

Since issuing its first forecast in 1976, the Congressional Budget Office (CBO) has compiled a record of economic predictions that compares favorably with the track records of five Administrations and the consensus forecasts of a sizable sample of private-sector economists. Although the margin is slight, CBO's forecasts have generally been closer than the Administration's to the actual values of several economic indicators that are important for projecting the budget. Moreover, during the 12 years for which comparisons are possible, CBO's forecasts have been about as accurate as the average of the 50 or so forecasts that make up the *Blue Chip* consensus survey. Comparing CBO's forecasts with that survey suggests that when CBO's economic predictions missed the mark by a wide enough margin to contribute to sizable misestimates of the deficit, those errors probably reflected limitations that confronted all forecasters.

These conclusions echo the findings of previous studies published by the Congressional Budget Office and other government and academic reviewers. They emerge from an evaluation of the accuracy of short-term forecasts for four economic indicators: growth in real (inflation-adjusted) output, inflation in the consumer price index (CPI), interest rates on three-month Treasury bills in both nominal and real terms, and interest rates on 10-year Treasury notes and Aaa corporate bonds. In carrying out this evaluation, CBO compiled two-year averages of its forecasts for the four indicators and compared them with historical values as well as with the corresponding forecasts of the Administration and the *Blue Chip* consensus.

Both CBO and the Administration have tended to err toward optimism in their forecasts over a two-year horizon. In other words, the average forecast error for real growth was an overestimate, and the average error for inflation was an underestimate. The Administration has been more optimistic than CBO in forecasting interest rates, with the average error being an underestimate. Overall, the average errors in the Administration's two-year forecasts were slightly larger than in CBO's. Finally, CBO's forecasts appear to be about as accurate as those of the *Blue Chip* consensus over the period for which comparable *Blue Chip* forecasts are available (1982-1993).

CBO's and the Administration's longer-term (five-year) projections of average growth in real output were generally optimistic, but CBO's errors were much smaller than the Administration's. For the longer-term projections of real gross national product, CBO's errors were only slightly larger on average than those in its short-term forecasts of real output. Again, CBO's projections were about as accurate as those of the *Blue Chip* consensus over the comparable period (1979-1990).

The differences among the three forecasts, however, are not large enough to be statistically significant. The small number of forecasts available for the analysis makes it difficult to distinguish meaningful differences in their performance from differences that might arise randomly. Thus, the statistics presented here are not reliable indicators of the future performance of any of the forecasters.

Sources of Data for the Evaluation

Evaluating CBO's forecasting record requires compiling the basic historical and forecast data for growth in real output, CPI inflation, and interest rates. Although each of those series has an important influence on budget projections, an accurate forecast of the two-year average growth in real output is the most critical economic factor in accurately estimating the deficit for the upcoming budget year. Two-year average forecasts published in early 1994 and 1995 could not be included in this evaluation because historical values for 1995 and 1996 are, of course, not yet available.[1] The data were therefore compiled using forecasts published early in the years 1976 through 1993.

Selection of Historical Data

Which historical data to use for the evaluation was dictated by the availability of actual data and the nature of the individual forecasts examined. Although CBO, the Administration, and *Blue Chip* all published the same measure for real output growth, selecting a historical series was difficult because of periodic benchmark revisions to the actual data.[2] By comparison, not all of the forecasters published the same measures for CPI inflation and interest rates, but the selection of historical data for those series was clear-cut.

Real Output Growth. Historical two-year averages of growth in real output were developed from calendar year averages of the quarterly chain-type annual-weighted indexes of real gross national product (GNP) and real gross domestic product (GDP) published by the Bureau of Economic Analysis (BEA). The fact that several real GNP and GDP series were discontinued because of periodic benchmark revisions meant that they were unsuitable historical series.

For example, during the 1976-1985 period, the three forecasters published estimates for a measure of growth in real GNP that was based on 1972 prices, the measure published by BEA at the time. In late 1985, however, BEA discontinued this 1972-dollar series and began to publish GNP on a 1982-dollar basis. As a result, an official series of values for GNP growth in 1972 dollars is not available for years after 1984; thus, actual two-year average growth rates are not available to compare with the forecasts made in early 1984 and 1985. From 1986 to 1991, forecasters published estimates of growth in real GNP based on 1982 prices. BEA revised the benchmark again in the second half of 1991; it discontinued the 1982-dollar GNP and began to publish GNP on a 1987-dollar basis.[3] Consequently, the historical annual series for 1982-dollar GNP is available only through 1990, and actual two-year average growth rates are not available for the forecasts made in early 1990 and 1991.

By periodically updating the series to reflect more recent prices, BEA's benchmark revisions yield a measure of real output that is more relevant for analyzing contemporary movements in real growth. But the process makes it difficult to evaluate forecasts of real growth produced over a period of years for series that are subsequently discontinued. The difficulties presented by periodic revisions of the data are avoided here by using one of BEA's alternative measures of real GNP and GDP, the chain-type annual-weighted index. This index is discussed in Appendix B.

CPI Inflation. Two-year averages of inflation in the consumer price index were calculated from calendar year averages of monthly data published by the Bureau of Labor Statistics. Before 1978, the bureau published only one consumer price index series, known today as the CPI-W (the price index for urban

1. The Clinton Administration adopted CBO's economic assumptions as the basis for its budget in early 1993. As a result, the errors for the early 1993 forecast are virtually the same for CBO and the Administration.

2. Before 1992, CBO, the Office of Management and Budget, and *Blue Chip* used gross national product to measure output. However, beginning in early 1992, all three forecasters began to publish forecasts and projections of gross domestic product instead.

3. With the 1992 benchmark revision, GDP replaced GNP as the central measure of national output.

wage earners and clerical workers). In January 1978, however, it began to publish a second, broader consumer price index series, the CPI-U (the price index for all urban consumers). CBO's comparison of forecasts used both series.

Until 1992, the Administration published its forecasts for the CPI-W, the measure used to index most of the federal government's expenditures for entitlement programs. By contrast, for all but four of its forecasts since 1979 (1986 through 1989), CBO based its inflation forecast on the CPI-U, a more widely cited measure of inflation and the one now used to index federal income tax brackets. The *Blue Chip* consensus has always published its forecast of the CPI-U. Although both the CPI-U and CPI-W may be forecast with the same relative ease, and annual fluctuations in the two series are virtually indistinguishable, they differ in some years; for that reason, CBO used historical data for both series to evaluate the alternative forecast records.

Interest Rates. Two-year averages of nominal short- and long-term interest rates were developed from calendar year averages of monthly data published by the Board of Governors of the Federal Reserve System.

The forecasts of short-term interest rates were compared using historical values for two measures of the interest rate on three-month Treasury bills: the new-issue rate and the secondary-market rate. The Administration forecasts the new-issue rate, which corresponds to the price of three-month bills auctioned by the Treasury Department--that is, it reflects the interest actually paid on that debt. CBO forecasts the secondary-market rate, which corresponds to the price of the three-month bills traded outside the Treasury auctions. Because such transactions occur continually in markets that involve many more traders than do Treasury auctions, the secondary-market rate provides an updated evaluation by the wider financial community of the short-term federal debt. *Blue Chip* has alternated between these two rates: it published the new-issue rate from 1982 to 1985, switched to the secondary-market rate during the 1986-1991 period, and then returned to the new-issue rate in 1992. Clearly, there is no reason to expect the two rates to differ persistently; indeed, the differences between their calendar year averages are minuscule.

The various forecasts of long-term interest rates were likewise compared using historical values for two measures of long-term rates: the 10-year Treasury note rate and Moody's Aaa corporate bond rate. A comparison of forecasts is only possible beginning in 1984 because not all of the forecasters published projections of long-term interest rates before that year. For forecasts made in early 1984 and 1985, CBO projected the Aaa corporate bond rate. Beginning with its early 1986 forecast, however, CBO switched to the 10-year Treasury note rate. The Administration has always published its projection for the 10-year Treasury note rate, but *Blue Chip* has published the Aaa corporate bond rate.

Separate historical values for real short-term interest rates were calculated using the nominal short-term interest rate and inflation rate appropriate for each forecaster. In each case, the two-year average nominal interest rate was discounted by the two-year average rate of inflation. The resulting real short-term interest rates were very similar. Since there is no agreed-upon method for calculating real long-term interest rates, they were not included in the evaluation.

Sources of Forecast Data

The evaluation used calendar year forecasts and projections, which CBO has published early each year since 1976, timed to coincide with the publication of the Administration's budget proposals. The Administration's forecasts were taken from the Administration's budget in all but one case: the forecast made in early 1981 came from the Reagan Administration's revisions to President Carter's last budget. The corresponding CBO forecast was taken from CBO's published analysis of President Reagan's budget proposals. That forecast did not include the economic effects of the new Administration's fiscal policy proposals.

The average two-year forecasts of the *Blue Chip* consensus survey were taken from those published in the same month as CBO's forecasts. Because the *Blue Chip* consensus did not begin publishing its two-year forecasts until the middle of 1981, the first consensus forecast available for use in this comparison was published in early 1982. Average five-year projections, however, are published by *Blue Chip* only two or three times a year. All but one of its five-year projections used in this evaluation were published in March; the 1980-1984 projection was published in May.

Measuring Forecast Performance

Following earlier studies of economic forecasts, this evaluation of CBO's forecasts focused on two aspects of their performance: statistical bias and accuracy.

Bias

The statistical bias of a forecast is the extent to which the forecast can be expected to differ from what actually occurs. CBO's evaluation used the *mean error* to measure statistical bias. That statistic--the arithmetic average of all the forecast errors--is the simplest and most widely used measure of forecast bias. Because the mean error is a simple average, however, underestimates and overestimates offset each other in calculating it. As a result, the mean error imperfectly measures the quality of a forecast--a small mean error would result either if all the errors were small or if all the errors were large but the overestimates and underestimates happened to balance out.

Accuracy

The accuracy of a forecast is the degree to which forecast values are narrowly dispersed around actual outcomes. Measures of accuracy more clearly reflect the usual meaning of forecast performance than does the mean error. This evaluation used two measures of accuracy. The *mean absolute error*--the average of the forecast errors without regard to arithmetic sign--indicates the average distance between forecasts and actual values without regard to whether individual forecasts are overestimates or underestimates. The *root mean square error*--calculated by first squaring all the errors, then taking the square root of the arithmetic average of the squared errors--also shows the size of the error without regard to sign, but it gives greater weight to larger errors.

Measurement Issues

These three statistics do not exhaust the available supply of measures of forecast performance. For example, to test for statistical bias in CBO's forecasts, previous studies have used measures that are slightly more elaborate than the mean error. Those studies have generally concluded, as does this evaluation, that CBO's short-term economic forecasts do not contain a statistically significant bias.[4]

In addition, a number of methods have been developed to evaluate a forecast's efficiency. Efficiency indicates the extent to which a particular forecast could have been improved by using additional information that was at the forecaster's disposal when the forecast was made.[5] The *Blue Chip* consensus forecasts represent a wide variety of economic forecasters and thus reflect a broader blend of sources and methods than can be expected from any single forecaster. The use of the *Blue Chip* forecasts in this evaluation can therefore be interpreted as a proxy for an efficient forecast. The fact that CBO's forecasts are about as accurate as *Blue Chip*'s is a rough indication of their efficiency.

4. Another approach to testing a forecast for bias is based on linear regression analysis of actual and forecast values. For details of that method, see J. Mincer and V. Zarnowitz, "The Evaluation of Economic Forecasts," in Mincer, ed., *Economic Forecasts and Expectations* (New York: National Bureau of Economic Research, 1969). That approach is not used here because of the small sample size. However, previous studies that have used it to evaluate the short-term forecasts of CBO and the Administration have not been able to reject the hypothesis that those forecasts are unbiased. See, for example, M.T. Belongia, "Are Economic Forecasts by Government Agencies Biased? Accurate?" *Review*, Federal Reserve Bank of St. Louis, vol. 70, no. 6 (November/December 1988), pp. 15-23.

5. For studies that have examined the relative efficiency of CBO's forecasts, see Belongia, "Are Economic Forecasts by Government Agencies Biased?"; and S.M. Miller, "Forecasting Federal Budget Deficits: How Reliable Are U.S. Congressional Budget Office Projections?" *Applied Economics*, vol. 23 (December 1991), pp. 1789-1799. Although both of the studies identify series that might have been used to make CBO's forecasts more accurate, they rely on statistics that assume a larger sample than is available. Moreover, although statistical tests can identify sources of inefficiency in a forecast after the fact, they generally do not indicate how such information can be used to improve forecasts when they are made.

More elaborate measures, however, are not necessarily reliable indicators when the sample of observations is small, such as the 18 observations that make up the sample of CBO's two-year forecasts. Small samples present three main types of problems for evaluating forecasts, including forecasts based on the simple measures presented here. First, small samples reduce the reliability of statistical tests that are based on the assumption that the underlying population of forecast errors follows a normal distribution. The more elaborate tests of forecast performance all make such an assumption about the hypothetical ideal forecast with which the actual forecasts are compared. Second, in small samples, individual forecast errors have a relatively large weight in the calculation of summary measures. The mean error, for example, can fluctuate in arithmetic sign when a single observation is added to a small sample. Third, the small sample means that CBO's forecast history cannot be used in a statistically reliable way to indicate either the direction or the size of future forecasting errors.

Apart from the general caution that should attend statistical conclusions based on small samples, there are several other reasons to view this evaluation of CBO's forecasts with particular caution. First, the procedures and purposes of CBO's and the Administration's forecasts have changed over the past 19 years and may change again in the future. For example, in the late 1970s, CBO characterized its long-term projections as a goal for the economy, whereas it now considers its projections to be what will prevail on average if the economy continues to reflect historical trends. Second, an institution's forecasting track record may not foretell its future abilities because of changes in personnel or methods. Finally, forecast errors increase when the economy is more volatile. All three forecasters made exceptionally large errors when forecasting for periods that included turning points in the business cycle.

CBO's Forecasting Record

This analysis evaluated the Congressional Budget Office's forecasts over two-year and five-year periods. The period of most interest for forecasters of the budget is two years. Because the Administration's and CBO's winter budget publications focus on the budget projection for the fiscal year beginning in the following October, an economic forecast that is accurate not only for the months leading up to the budget year but also for the budget year itself will provide the basis for a more accurate forecast of the deficit. A five-year horizon is used to examine the accuracy of longer-term projections of growth in real output.

Short-Term Forecasts

Historically, CBO's two-year forecasts are slightly more accurate than the Administration's and suffer from slightly less statistical bias. In most cases, however, the differences are slim. Furthermore, CBO's forecasts are about as accurate as *Blue Chip*'s average forecasts.

An accurate forecast of two-year growth in real output is the most important factor in minimizing errors in forecasting the deficit for the budget year. Accurate forecasts of nominal output, inflation, and nominal interest rates are less important for forecasting deficits now than they were in the late 1970s and early 1980s. The reason is that given current law and the level of the national debt, inflation increases both revenues and outlays by similar amounts. Revenues increase with inflation because taxes are levied on nominal incomes. Outlays increase because various entitlement programs are indexed to inflation and because nominal interest rates tend to increase with inflation, which in turn raises the cost of servicing the federal debt.[6]

Real Output Growth. For the two-year forecasts made between 1976 and 1993, CBO had a slightly better record than the Administration in forecasting growth in real output (see Table A-1). On average, both CBO's and the Administration's forecasts tended to be overestimates. CBO was closer to the true value in eight of the 18 forecasts made between 1976

6. Rules of thumb for estimating the effect on the deficit of changes in various macroeconomic variables are given in Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1996-2000* (January 1995), pp. 77-81.

and 1993, the Administration was closer in six periods, and the two forecasters had identical errors in four periods. CBO's forecasts of real growth during the 1982-1993 period were, on average, about as accurate as those of the *Blue Chip* consensus.

Forecast errors tend to be larger when the economy is more unstable. That tendency can be clearly seen in the forecasts of real GNP growth by comparing the large errors for 1979 through 1983--when the economy went through its most turbulent recessionary period of the postwar era--with the smaller errors recorded for later years. Similarly, the recent business cycle accounts for the large errors in the forecasts made in 1989 through 1991; during that period, CBO's errors were only slightly larger than those of the *Blue Chip* consensus.

CPI Inflation. The records for forecasting the average annual growth in the consumer price index over a two-year horizon were very similar (see Table A-2). Both CBO and the Administration underestimated future inflation in their forecasts for 1977 through 1980, and both tended to overestimate it in their forecasts for 1981 through 1986. The average measures of bias and accuracy were virtually the same for CBO and the Administration. CBO was closer to the true value in six of the 18 periods, the Administration was closer in eight periods, and the two forecasters had identical errors in four periods. For the 1982-1993 period, CBO's forecasts of inflation were about as accurate as those of both the Administration and *Blue Chip*.

Nominal Interest Rates. For the 1976-1993 forecasts, CBO's record was about as accurate as the Administration's for nominal short-term interest rates over a two-year horizon (see Table A-3). On average, the Administration tended to underestimate nominal short-term interest rates; CBO's mean error was zero over this period. CBO was closer to the true value in eight of the 18 periods, the Administration was closer in nine periods, and the two forecasters had identical errors in one period. However, for the 1982-1993 period, the mean absolute error of CBO's forecasts was slightly above those of the Administration and *Blue Chip*.

For the 1984-1993 forecasts of long-term interest rates, CBO did significantly better than the Administration (see Table A-4). The Administration tended to underestimate rates, and its mean error was larger than CBO's. In addition, the Administration's forecasts had a larger mean absolute error and root mean square error. CBO was closer to the true value in six of the 10 periods, the Administration was closer in three periods, and the two forecasters had identical errors in one period.

CBO's forecasts of long-term interest rates were about as accurate as those of the *Blue Chip* consensus. Both CBO and *Blue Chip* tended to overestimate long-term rates. CBO had a mean error of 0.3 percentage points compared with 0.4 percentage points for *Blue Chip*.

Real Short-Term Interest Rates. For the forecasts made in 1976 through 1993, CBO had a slight edge over the Administration in estimating real short-term interest rates (see Table A-5). Again, the Administration was more likely than CBO to underestimate interest rates, and its mean error was greater. CBO and the Administration recorded similar mean absolute and root mean square errors. CBO's forecasts were closer to the actual value in 10 of the 18 periods, the Administration's were closer in seven, and the two had identical errors in one period. For forecasts made between 1982 and 1993, CBO's errors were generally similar in both direction and magnitude to those of the *Blue Chip* consensus.

Longer-Term Projections

In projecting real GNP growth for the more distant future, measured here as five years ahead, the Administration's errors were larger than CBO's (see Table A-6). Although this comparative advantage for CBO does not directly affect the estimates of the deficit for the budget year, accuracy in the longer term is obviously important for budgetary planning over several years. Neither the Administration nor CBO, however, considers its projections to be its best guess about the year-to-year course of the economy. The Administration's projections each year are based on the adoption of the President's budget as submitted, and for most years CBO has considered its projections an indication of the average future performance of the economy if major historical trends continue. Neither institution attempts to anticipate cyclical fluctuations in the projection period.

CBO's projections of longer-term growth in real GNP were closer than the Administration's to the actual value in 12 of the 15 periods. The Administration's projections showed an upward bias of 1.4 percentage points compared with an upward bias of 1.0 percentage point for CBO. Those biases occurred largely because the projections made in early 1976 through 1979, which CBO and the Administration presented as target rates of growth, did not incorporate the recessions of 1980 and 1982. Through the subsequent years of expansion until the most recent recession, the upward bias was much smaller for the Administration's projections and smaller yet for CBO's.

The size of the root mean square errors for the entire period for CBO and, to a lesser extent, the Administration also resulted largely from errors in projections made during the first four years. CBO had a definite edge in the projections made in January 1980 through 1982 and a lesser edge in later years. Again, CBO's projections were about as accurate as those of the *Blue Chip* consensus over the comparable period.

Table A-1.
Comparison of CBO, Administration, and *Blue Chip* Forecasts of Two-Year Average Growth Rates for Real Output (By calendar year, errors in percentage points)

	Actual				CBO		Administration		*Blue Chip*	
	1972 Dollars	1982 Dollars	1987 Dollars	Chain-type Annual-Weighted Index	Forecast	Error	Forecast	Error	Forecast	Error
GNP										
1976-1977	6.7	4.8	4.8	5.2	6.2	0.9	5.9	0.7	a	a
1977-1978	5.2	5.0	4.7	5.1	5.5	0.4	5.1	0.1	a	a
1978-1979	3.9	3.9	3.8	4.2	4.7	0.6	4.7	0.6	a	a
1979-1980	1.3	1.1	1.1	1.4	2.7	1.3	2.9	1.5	a	a
1980-1981	1.1	0.9	0.5	1.0	0.5	-0.5	0.5	-0.5	a	a
1981-1982	0.2	-0.3	-0.4	0	2.1	2.2	2.6	2.7	a	a
1982-1983	0.7	0.5	0.7	0.6	2.1	1.5	2.7	2.0	2.0	1.4
1983-1984	5.2	5.2	4.9	5.2	3.4	-1.8	2.6	-2.6	3.5	-1.7
1984-1985	b	5.1	4.4	4.8	4.7	-0.1	4.7	-0.1	4.3	-0.5
1985-1986	b	3.0	2.8	2.8	3.3	0.5	3.9	1.1	3.2	0.4
1986-1987	b	3.1	2.9	2.9	3.1	0.3	3.7	0.8	3.0	0.1
1987-1988	b	3.9	3.5	3.5	2.9	-0.6	3.3	-0.2	2.8	-0.6
1988-1989	b	3.5	3.3	3.3	2.4	-0.9	3.0	-0.3	2.1	-1.2
1989-1990	b	1.7	2.0	2.0	2.5	0.5	3.2	1.2	2.2	0.2
1990-1991	b	c	0.3	0.3	2.0	1.8	2.8	2.5	1.9	1.7
1991-1992	b	c	0.7	0.6	1.6	1.1	1.4	0.8	1.2	0.6
GDP[d]										
1992-1993	b	c	2.7	2.3	2.6	0.3	2.2	-0.1	2.3	0
1993-1994	b	c	3.6	3.0	2.9	-0.1	2.9	-0.1	3.0	0
Statistics for 1976-1993										
Mean error	*	*	*	*	*	0.4	*	0.6	*	*
Mean absolute error	*	*	*	*	*	0.9	*	1.0	*	*
Root mean square error	*	*	*	*	*	1.1	*	1.3	*	*
Statistics for 1982-1993										
Mean error	*	*	*	*	*	0.2	*	0.4	*	0
Mean absolute error	*	*	*	*	*	0.8	*	1.0	*	0.7
Root mean square error	*	*	*	*	*	1.0	*	1.3	*	0.9

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators*; Department of Commerce, Bureau of Economic Analysis.

NOTES: Actual values are the two-year growth rates for real gross national product (GNP) and gross domestic product (GDP) last reported by the Bureau of Economic Analysis, not the first reported values. Forecast values are for the average annual growth of real GNP or GDP over the two-year period. The forecasts were issued in the first quarter of the initial year of the period or in December of the preceding year. Errors are forecast values minus actual values; thus, a positive error is an overestimate. The chain-type annual-weighted index of actual GNP or GDP was used in calculating the errors.

* = not applicable.

a. Two-year forecasts for the *Blue Chip* consensus were not available until 1982.

b. Data for 1972-dollar GNP and GDP are available only through the third quarter of 1985.

c. Data for 1982-dollar GNP and GDP are available only through the third quarter of 1991.

d. With the 1992 benchmark revision, GDP replaced GNP as the central measure of national output.

Table A-2.
Comparison of CBO, Administration, and *Blue Chip* Forecasts of Two-Year Average Inflation Rates in the Consumer Price Index (By calendar year, errors in percentage points)

	Actual		CBO		Administration		*Blue Chip*	
	CPI-U	CPI-W	Forecast	Error	Forecast	Error	Forecast	Error
1976-1977	6.1	6.1	7.1	1.0	6.1	0	a	a
1977-1978	7.0	7.0	4.9	-2.1	5.2	-1.8	a	a
1978-1979	9.4	9.5	5.8	-3.7	6.0	-3.5	a	a
1979-1980	12.4	12.5	8.1	-4.3	7.4	-5.0	a	a
1980-1981	11.9	11.9	10.1	-1.8	10.5	-1.4	a	a
1981-1982	8.2	8.1	10.4	2.1	9.7	1.6	a	a
1982-1983	4.6	4.5	7.2	2.6	6.6	2.1	7.2	2.6
1983-1984	3.8	3.3	4.7	1.0	4.7	1.5	4.9	1.1
1984-1985	3.9	3.5	4.9	1.0	4.5	1.0	5.2	1.3
1985-1986	2.7	2.5	4.1	1.4	4.2	1.7	4.3	1.6
1986-1987	2.8	2.6	3.8	1.2	3.8	1.2	3.8	1.0
1987-1988	3.9	3.8	3.9	0.1	3.3	-0.5	3.6	-0.2
1988-1989	4.4	4.4	4.7	0.3	4.2	-0.2	4.3	-0.1
1989-1990	5.1	5.0	4.9	-0.1	3.7	-1.3	4.7	-0.4
1990-1991	4.8	4.6	4.1	-0.7	3.9	-0.7	4.1	-0.7
1991-1992	3.6	3.5	4.2	0.6	4.6	1.1	4.4	0.8
1992-1993	3.0	2.9	3.4	0.5	3.1	0.2	3.5	0.5
1993-1994	2.8	2.7	2.8	0.1	2.8	0.1	3.3	0.6
Statistics for 1976-1993								
Mean error	*	*	*	-0.1	*	-0.2	*	*
Mean absolute error	*	*	*	1.4	*	1.4	*	*
Root mean square error	*	*	*	1.8	*	1.8	*	*
Statistics for 1982-1993								
Mean error	*	*	*	0.7	*	0.5	*	0.7
Mean absolute error	*	*	*	0.8	*	1.0	*	0.9
Root mean square error	*	*	*	1.0	*	1.2	*	1.1

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators*; Department of Labor, Bureau of Labor Statistics.

NOTES: Values are for the average annual growth of the consumer price index (CPI) over the two-year period. Before 1978, the Bureau of Labor Statistics published only one consumer price index series, known today as the CPI-W (the price index for urban wage earners and clerical workers). In January 1978, however, the bureau began to publish a second, broader consumer price index series, the CPI-U (the price index for all urban consumers). For most years since 1979, CBO forecast the CPI-U; from 1986 through 1989, CBO forecast the CPI-W. The Administration forecast the CPI-W until 1992, when it switched to the CPI-U. *Blue Chip* forecast the CPI-U for the entire period. The forecasts were issued in the first quarter of the initial year of the period or in December of the preceding year. Errors are forecast values minus actual values; thus, a positive error is an overestimate.

* = not applicable.

a. Two-year forecasts for the *Blue Chip* consensus were not available until 1982.

Table A-3.
Comparison of CBO, Administration, and *Blue Chip* Forecasts of Two-Year Average Interest Rates on Three-Month Treasury Bills (By calendar year, errors in percentage points)

	Actual		CBO		Administration		*Blue Chip*	
	New Issue	Secondary Market	Forecast	Error	Forecast	Error	Forecast	Error
1976-1977	5.1	5.1	6.2	1.1	5.5	0.4	a	a
1977-1978	6.2	6.2	6.4	0.2	4.4	-1.8	a	a
1978-1979	8.6	8.6	6.0	-2.6	6.1	-2.5	a	a
1979-1980	10.8	10.7	8.3	-2.4	8.2	-2.6	a	a
1980-1981	12.8	12.7	9.5	-3.2	9.7	-3.1	a	a
1981-1982	12.4	12.3	13.2	0.9	10.0	-2.4	a	a
1982-1983	9.7	9.6	12.6	3.0	11.1	1.4	11.3	1.6
1983-1984	9.1	9.1	7.1	-2.0	7.9	-1.1	7.9	-1.2
1984-1985	8.5	8.5	8.7	0.3	8.1	-0.4	9.1	0.5
1985-1986	6.7	6.7	8.5	1.8	8.0	1.3	8.5	1.8
1986-1987	5.9	5.9	6.7	0.9	6.9	1.0	7.1	1.2
1987-1988	6.2	6.2	5.6	-0.6	5.5	-0.7	5.7	-0.5
1988-1989	7.4	7.4	6.4	-0.9	5.2	-2.1	6.1	-1.2
1989-1990	7.8	7.8	7.5	-0.3	5.9	-1.9	7.5	-0.3
1990-1991	6.5	6.4	7.0	0.6	6.0	-0.4	7.1	0.7
1991-1992	4.4	4.4	6.8	2.4	6.2	1.8	6.4	2.0
1992-1993	3.2	3.2	4.7	1.5	4.5	1.3	4.6	1.4
1993-1994	3.6	3.6	3.4	-0.2	3.4	-0.2	3.8	0.2
Statistics for 1976-1993								
Mean error	*	*	*	0	*	-0.7	*	*
Mean absolute error	*	*	*	1.4	*	1.5	*	*
Root mean square error	*	*	*	1.7	*	1.7	*	*
Statistics for 1982-1993								
Mean error	*	*	*	0.5	*	0	*	0.5
Mean absolute error	*	*	*	1.2	*	1.1	*	1.1
Root mean square error	*	*	*	1.5	*	1.3	*	1.2

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators*; Federal Reserve Board.

NOTES: Values are for the geometric averages of the three-month Treasury bill rates for the two-year period. The actual values are published by the Federal Reserve Board as the rate on new issues (reported on a bank-discount basis) and the secondary-market rate. CBO forecast the secondary-market rate; the Administration forecast the new-issue rate. *Blue Chip* alternated between the two rates, forecasting the new-issue rate from 1982 to 1985, the secondary-market rate from 1986 to 1991, and the new-issue rate again beginning in 1992. The forecasts were issued in the first quarter of the initial year of the period or in December of the preceding year. Errors are forecast values minus actual values; thus, a positive error is an overestimate.

* = not applicable.

a. Two-year forecasts for the *Blue Chip* consensus were not available until 1982.

Table A-4.
Comparison of CBO, Administration, and *Blue Chip* Forecasts of Two-Year Average Long-Term Interest Rates (By calendar year, errors in percentage points)

	Actual		CBO		Administration		*Blue Chip*	
	10-Year Note	Corporate Aaa Bond	Forecast	Error	Forecast	Error	Forecast	Error
1984-1985	11.5	12.0	11.9	-0.1	9.7	-1.8	12.2	0.2
1985-1986	9.1	10.2	11.5	1.3	10.6	1.5	11.8	1.7
1986-1987	8.0	9.2	8.9	0.9	8.7	0.7	9.9	0.8
1987-1988	8.6	9.5	7.2	-1.4	6.6	-2.0	8.7	-0.8
1988-1989	8.7	9.5	9.4	0.7	7.7	-1.0	9.8	0.3
1989-1990	8.5	9.3	9.1	0.6	7.7	-0.8	9.5	0.3
1990-1991	8.2	9.0	7.7	-0.5	7.2	-1.0	8.7	-0.3
1991-1992	7.4	8.5	7.8	0.4	7.3	-0.1	8.7	0.3
1992-1993	6.4	7.7	7.1	0.7	6.9	0.5	8.4	0.7
1993-1994	6.5	7.6	6.6	0.2	6.6	0.2	8.2	0.6
Statistics for 1984-1993								
Mean error	*	*	*	0.3	*	-0.4	*	0.4
Mean absolute error	*	*	*	0.7	*	0.9	*	0.6
Root mean square error	*	*	*	0.8	*	1.1	*	0.7

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators*; Federal Reserve Board.

NOTES: Actual values are for the geometric averages of the 10-year Treasury note rates or Moody's corporate Aaa bond rates for the two-year period as reported by the Federal Reserve Board. CBO forecast the 10-year Treasury note rate in all years except 1984 and 1985. The Administration forecast the 10-year note rate, but *Blue Chip* forecast the corporate Aaa bond rate. Data are only available beginning in 1984 since not all of the forecasters published long-term rate projections before then. The forecasts were issued in the first quarter of the initial year of the period or in December of the preceding year. Errors are forecast values minus actual values; thus, a positive error is an overestimate.

* = not applicable.

Table A-5.
Comparison of CBO, Administration, and *Blue Chip* Forecasts of Two-Year Average Real Interest Rates on Three-Month Treasury Bills (By calendar year, errors in percentage points)

	Actual				CBO		Administration		*Blue Chip*	
	New Issue		Secondary Market							
	CPI-U	CPI-W	CPI-U	CPI-W	Forecast	Error	Forecast	Error	Forecast	Error
1976-1977	0.9	-0.9	-0.9	-0.9	-0.8	0.1	-0.6	0.3	a	a
1977-1978	0.8	-0.7	-0.8	-0.7	1.5	2.2	-0.8	-0.1	a	a
1978-1979	-0.7	-0.8	-0.7	-0.8	0.2	1.0	0.1	0.9	a	a
1979-1980	-1.4	-1.5	-1.4	-1.5	0.2	1.7	0.7	2.2	a	a
1980-1981	0.8	0.9	0.7	0.8	-0.5	-1.2	-0.7	-1.6	a	a
1981-1982	3.8	4.0	3.7	3.9	2.6	-1.2	0.3	-3.7	a	a
1982-1983	4.8	4.9	4.7	4.9	5.0	0.3	4.2	-0.8	3.8	-1.0
1983-1984	5.1	5.7	5.1	5.6	2.2	-2.9	3.1	-2.6	2.9	-2.3
1984-1985	4.4	4.9	4.4	4.8	3.6	-0.8	3.4	-1.4	3.6	-0.8
1985-1986	3.9	4.1	3.9	4.1	4.2	0.3	3.6	-0.4	4.0	0.1
1986-1987	3.0	3.2	3.0	3.2	2.8	-0.4	3.0	-0.3	3.2	0.2
1987-1988	2.3	2.4	2.3	2.3	1.7	-0.6	2.1	-0.2	2.0	-0.3
1988-1989	2.8	2.9	2.8	2.9	1.7	-1.2	1.0	-1.9	1.8	-1.1
1989-1990	2.6	2.6	2.6	2.6	2.5	-0.2	2.1	-0.6	2.7	0.2
1990-1991	1.6	1.7	1.5	1.7	2.8	1.2	2.0	0.3	2.9	1.3
1991-1992	0.8	0.9	0.7	0.9	2.5	1.8	1.5	0.6	1.9	1.2
1992-1993	0.2	0.4	0.2	0.3	1.3	1.0	1.3	1.1	1.1	0.8
1993-1994	0.8	1.0	0.8	0.9	0.5	-0.3	0.6	-0.3	0.5	-0.4
Statistics for 1976-1993										
Mean error	*	*	*	*	*	0.1	*	-0.5	*	*
Mean absolute error	*	*	*	*	*	1.1	*	1.1	*	*
Root mean square error	*	*	*	*	*	1.3	*	1.4	*	*
Statistics for 1982-1993										
Mean error	*	*	*	*	*	-0.1	*	-0.5	*	-0.2
Mean absolute error	*	*	*	*	*	0.9	*	0.9	*	0.8
Root mean square error	*	*	*	*	*	1.2	*	1.1	*	1.0

SOURCES: Congressional Budget Office; Office of Management and Budget; . ggert Economic Enterprises, Inc., *Blue Chip Economic Indicators*; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

NOTES: Values are for the appropriate three-month Treasury bill rate discounted by the respective forecast for inflation as measured by the change in the consumer price index. The forecasts were issued in the first quarter of the initial year of the period or in December of the preceding year. Errors are forecast values minus actual values; thus, a positive error is an overestimate.

CPI-U = consumer price index for all urban consumers; CPI-W = consumer price index for urban wage earners and clerical workers; * = not applicable.

a. Two-year forecasts for the *Blue Chip* consensus were not available until 1982.

Table A-6.
Comparison of CBO and Administration Projections of Five-Year Average Growth Rates for Real GNP (By calendar year, errors in percentage points)

	Actual				CBO		Administration		*Blue Chip*	
	1972 Dollars	1982 Dollars	1987 Dollars	Chain-type Annual-Weighted Index	Forecast	Error	Forecast	Error	Forecast	Error
1976-1980	4.2	3.4	3.3	3.7	5.7	2.0	6.2	2.5	a	a
1977-1981	3.1	2.8	2.6	3.1	5.3	2.2	5.1	2.1	a	a
1978-1982	1.6	1.4	1.2	1.6	4.8	3.2	4.8	3.2	a	a
1979-1983	1.3	1.0	1.1	1.3	3.8	2.5	3.8	2.5	3.1	1.8
1980-1984	2.1	1.9	1.7	2.0	2.4	0.4	3.0	1.0	2.5	0.5
1981-1985	b	2.6	2.4	2.6	2.8	0.1	3.8	1.1	3.0	0.4
1982-1986	b	2.7	2.6	2.7	3.0	0.2	3.9	1.2	2.7	0
1983-1987	b	4.0	3.7	3.8	3.6	-0.2	3.5	-0.4	3.5	-0.4
1984-1988	b	4.1	3.7	3.9	4.0	0.1	4.3	0.4	3.5	-0.4
1985-1989	b	3.3	3.1	3.1	3.4	0.3	4.0	0.9	3.4	0.3
1986-1990	b	2.8	2.7	2.8	3.3	0.6	3.8	1.0	3.1	0.4
1987-1991	b	c	2.0	2.0	2.9	0.9	3.5	1.4	2.7	0.6
1988-1992	b	c	1.9	1.8	2.6	0.7	3.2	1.4	2.5	0.7
1989-1993	b	c	1.7	1.5	2.3	0.8	3.2	1.7	2.6	1.0
1990-1994	b	c	1.9	1.6	2.3	0.7	3.0	1.3	2.4	0.8
Statistics for 1976-1990										
Mean error	*	*	*	*	*	1.0	*	1.4	*	*
Mean absolute error	*	*	*	*	*	1.0	*	1.5	*	*
Root mean square error	*	*	*	*	*	1.4	*	1.7	*	*
Statistics for 1979-1990										
Mean error	*	*	*	*	*	0.6	*	1.1	*	0.5
Mean absolute error	*	*	*	*	*	0.6	*	1.2	*	0.6
Root mean square error	*	*	*	*	*	0.9	*	1.3	*	0.7

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators*; Department of Commerce, Bureau of Economic Analysis.

NOTES: Actual values are for the five-year growth rates for real gross national product (GNP) last reported by the Bureau of Economic Analysis, not the first reported values. Projected values are for the average growth of real GNP over the five-year period. The majority of the projections were issued in the first quarter of the initial year of the period or in December of the preceding year. Errors are projected values minus actual values; thus, a positive error is an overestimate. The chain-type annual-weighted index of actual GNP was used in calculating the errors.

* = not applicable.

a. Five-year forecasts for the *Blue Chip* consensus were not available until 1979.

b. Data for 1972-dollar GNP are available only through the third quarter of 1985.

c. Data for 1982-dollar GNP are available only through the third quarter of 1991.

Mr. HORN. Now are there some assumptions that come to mind where you think the task force of the two institutional bodies, OMB and CBO, could reach some agreement as professionals on this matter as to what are the base ingredients, the building blocks, that go into that assumption. Has that ever been tried with OMB?

Mr. BLUM. No, it has never been tried, Mr. Chairman, and for the simple reason that the Congress did not want the Congressional Budget Office to work with the administration to come up with a common set of economic assumptions.

The view—and this certainly has been expressed to us by the Budget Committees is that the Congressional Budget Office is to provide an independent source of information to the Congress. In the end, it is the Congress itself that can decide what set of economic assumptions it wishes to use for its annual budget plans.

We do have a record, looking back over time, where the Congress has chosen, for example, to use administration economic assumptions for budget plans. Since 1990, however, the Budget Committees have been steadfast in using the CBO assumptions.

Mr. HORN. Well, looking back to 1990, where has CBO been off base in its assumptions?

Mr. BLUM. Economists of all stripes have a particularly difficult time in forecasting turning points in the business cycle. I think we all fail in our ability to recognize exactly when there's an upturn or a downturn.

Frequently, for example, it takes a board of economists, working under the National Bureau of Economic Research, for example, a long time to decide when, in fact, in the past a turning point was made. That was looking back, looking forward is even more difficult.

So I would say the biggest problem we have is being able to tell you, in a timely fashion, exactly when the economy is likely to take off or to go down.

Mr. HORN. Are there any indicators that we are not using now, either at OMB or CBO, that you think, as a professional, ought to be added to the mix?

Mr. BLUM. I'm not aware of any, Mr. Chairman.

We take our assignment quite seriously, and I think we are constantly on the lookout for the best information that we can lay our hands on.

I know that in preparing our own forecasts, we study very seriously the forecasts made by other forecasters in the forecast community. These are summarized each month, for example, in the Blue Chip indicators, which is a summary of 50 of the major private forecasters in the country.

Typically, the starting point, when we are doing our own forecast, is the consensus of private forecasters. We are quite reluctant to make sharp departures in one direction or another from what the forecast community, in fact, is telling us.

Mr. HORN. At the beginning of each congressional year, the CBO's professional staff testifies before the Budget Committee of the House. I assume you do?

Mr. BLUM. Yes, sir, we do. In fact, Dr. O'Neill last week testified before both the House Budget Committee and the Senate Budget

Committee on our latest economic forecast and assumptions and our budget projections.

Mr. HORN. Are you also asked to testify before the Ways and Means Committee?

Mr. BLUM. We have in the past done that, Mr. Chairman. We have not been asked during this Congress, however.

Mr. HORN. In other words, Mr. Archer has not had you in the 104th, but you were in the 103d and 102d?

Mr. BLUM. Yes, sir, that's correct.

We have also from time to time testified before the Senate Appropriations Committee and the Senate Finance Committee on the general economic and budget outlook.

Mr. HORN. How about the House Appropriations Committee? Have you testified before the House Appropriations Committee?

Mr. BLUM. No, sir, we have not.

Mr. HORN. Well, that is what I have long felt for about 30 years is what is lacking around here, or at least since you had CBO in 1974, and, I felt it even before that, that there ought to be a way the Appropriations Committees and the revenue committees on this side, Ways and Means and Appropriations, at least have some dialog of the various key people in the economic process and the budget process family—CBO, Council of Economic Advisors, chairman of the Federal Reserve Board, maybe an objective look by the Comptroller General, so forth.

Mr. BLUM. In all fairness, Mr. Chairman, I should observe that the House Appropriations Committee over a number of years in the past, not recently, that I am aware, has held overview hearings where the Director of OMB and Secretary of the Treasury and other witnesses from the administration typically have presented an overview of the President's proposals.

But I think all of these sessions tend to focus on the policy recommendations that the administration is making and not so much attention is paid to the overall economic outlook. I think that is left to the Budget Committees and to the Joint Economic Committee to pursue.

Mr. HORN. Well, you could be right, because the Democrats in the Congress don't think the Republican administrations are credible and Republicans in Congress don't think the Democratic administrations are credible, that you sort of have an overview hearing that everybody gets to give their propaganda, and maybe that is why some of the variable chairs don't even want to see them around.

It is too bad. I would like to get this down to where at least there is a little propaganda, but to get them in the room and have a dialog.

It seems to me if you get them in the room with the chairman of the Federal Reserve Board on monetary policy, even though they are talking primarily fiscal policy, it might make for an interesting dialog, or get them in the room with some of the staff of the Comptroller General that could take a look at some of these things and be to us what CBO is to us; it is a professional resource to call on, to look at all sides here, and not just to be pushing for one side or the other.

Mr. BLUM. Well, we certainly would welcome the opportunity to talk to more groups about our forecasts and longer-run assumptions.

Mr. HORN. Does the CBO have specific recommendations that didn't get into the statement, but still are good recommendations that maybe we ought to know out there and just consider them as we are looking through the whole bag of people's ideas and what do you do about the budget process?

Mr. BLUM. I think, Mr. Chairman, our experience has been that the budget process has evolved over time. Changes have been made, as I have indicated. Some have worked much better than others.

By and large, I would observe that the process has been an extremely flexible one in the sense that the changes have been adopted to meet problems as they arose. But in our view, at the present time the process is working wonderfully as a means by which the majority can put together an overall budget plan and provide the overall discipline for the Congress in putting together legislation that would implement such a plan.

The problem has been that the other major player in the process—namely, the President—hasn't agreed, and this, I think, is not a procedural problem so much as a basic policy difference between the two bodies.

Mr. HORN. Well, I would certainly agree, it is a basic political difference. Whether it is a basic policy difference, I am dubious, very frankly, on some things, but it certainly is a political difference. Maybe when the campaign year is over, we can get down to business.

On the biennial budget, a number of people have suggested that over the years. I just wonder, given the tremendous number of decisions that are made here, is that really practical for this Congress when we look at the—when you are dealing with 3 fiscal years right now in the administration and you are still dealing in parts of Congress?

We do give them reprogramming authority of some sort, and maybe that ought to be looked at, as to whether it is as extensive as it was 30 years ago and as flexible as it was.

I just wonder, should we really be worried that we only handle the budget once every 2 years and not do it every year?

Mr. BLUM. Well, I think it has its attractions for people—both Members of Congress and administration officials who feel that all the time seems to be devoted to the budget in the sense that the issues are never resolved for any lengthy period of time, and so a biennial budget certainly has some appeal.

I think the problem with it, at this particular time, is, when we are struggling to reach budgetary balance, it's not clear to me, at least, that this is the time to move to a biennial budget. It seems to me this is something that takes, as we are experiencing, very hard work that needs to be done almost continuously in order to achieve that objective.

Perhaps when we have reached some kind of, as an economist would say, budgetary equilibrium, it might be time to give this some very serious consideration.

Mr. HORN. One last question.

Most Governors, when they have a deficit that faces them, use the freeze to bring the State budget back into balance. Of course, as you know, 43 of the Governors have the Line Item Veto, which we have now given the President starting in January 1997.

Has CBO considered a freeze mechanism and reforms of the 1974 Budget Act? What are the pluses and minuses of that, and how would you see it working?

Mr. BLUM. In effect, we are working right now in essentially a freeze situation. The budget plan that was adopted by the Congress last year and embodied in the Balanced Budget Act essentially contemplated a nominal freeze in discretionary spending over a 6- to 7-year period.

So I don't think there is anything that prevents the Congress from doing this if this is the policy that the Congress wishes to pursue.

My only observation is that a freeze is easier to accomplish in the short run than it is over a long period of time. Certainly, in looking at a freeze for discretionary spending that ignores the costs of inflation for 1 year is not a major problem. We are talking about inflation, say, on the order of 3 percent a year. But when you extend that over, for example, a 6- or 7-year period, that compounds. And at the end of that period a freeze would mean a cut on the order of 25 percent in real terms from the amounts of money to support services.

That 25 percent cut—in real terms means, in the case of defense, for example, a smaller force structure, less planes being shipped, and other major weapons systems that could be procured, and the like.

So I think in the short run this is something that can be done, has been done, but to extend that over a lengthy period of time, I think you will find it increasingly harder to live within that framework.

Mr. HORN. Well, it depends on what the percent of the freeze does. Is that not—is that not true?

Mr. BLUM. Oh, absolutely. I mean, I'm just using the normal definition of a freeze, which is usually expressed in nominal terms, which is the same amount of money this year as was spent the year before in current-dollar terms, and similarly extending that out.

For example, if you extended it out even a longer period of time—say, 40 years—you are talking about reducing the real level of resources by 75 percent.

Mr. HORN. Well, obviously we would exempt certain sacred cows from that—Social Security, Medicare and maybe even Medicaid. Beyond that, I don't know that we have exempted too much, and maybe the retirement funds, I am sure, so forth, trust fund type arrangements or pseudo trust fund that we honor as trust funds.

But it just seems to me that that is—if Governors find that a useful way to do business, I don't understand why the President of the United States and this Congress can't find it a useful way to do business, with the exception of the sacred cows which all demagogic political challengers will be looking for incumbents to slip and say something along that line.

So we are not going to slip. We are just going to say, is there not a better way?

And the one advantage of the freeze is this: That, true, you try to make as many decisions as you can by a majority to cut what you think is unessential and that might be quite essential to somebody else, and a freeze gets the reaction that, well, I don't like it but they are doing it to everybody else or almost everybody else, so I guess it's fair.

And since thousands of decisions of—individual decisions have gone into each of these budget ceilings, or budget amounts, or whatever designation you want, with which we deal, this one is simply saying, hey, these are tough times; we have got to get some budget discipline; can we not take 1 or 2 percent off, hold it constant for 2 or 3 years, take another look at it always? No Congress binds a future Congress.

But at least it would seem to me that fairness is seen by most people. They don't like it, but they know it is fair. It has worked at the State level. I don't understand why the Federal level cannot also use a similar mechanism.

Mr. BLUM. Well, as I indicated, Mr. Chairman, in fact that is part of the budget plan that the Congress had adopted last year, and I'm fully expecting the Budget Committees to adopt a similar plan this year when they take up the budget resolution for the next budget cycle.

Mr. HORN. But as you say, it is limited strictly to discretionary now. Is that not true?

Mr. BLUM. Not entirely. Last year, for example, as part of the budget plan, there were, as they are known, reconciliation instructions to the various other committees, besides the Appropriation Committees, that have jurisdiction over the various permanent laws that govern spending programs that are not dependent upon the annual appropriation cycle.

And I think that reconciliation procedure, in fact, has worked well since it was essentially invented for that purpose back in 1981. And the reason that it has worked is precisely the reason that you just stated for why a freeze can work in the sense that all the parties feel that they have to contribute something, and when that is done, we have found that it is possible to put together what otherwise individually might be very painful changes in spending laws, but when they are put together in a package, political support can be obtained.

Mr. HORN. I believe there have been some Federal district court decisions that have criticized congressional freezes when they have been made, and especially with entitlements, and the statements have been made by various judges that Congress has to go beyond a simple freeze to specifically instruct how the cuts will be made in an entitlement and not simply leave it up to the executive branch to implement. Is CBO familiar with those cases at all?

Mr. BLUM. Yes, sir. I think that does illustrate the basic problem when you are dealing with the entitlement programs, that a formula approach—or setting caps or whatever, freezes, as you like—to the extent that the basic law is not altered by changing the parameters that govern those programs, then the courts are likely to call a foul and to say, no, that doesn't work.

Mr. HORN. Could CBO furnish for the record at this point the titles of those cases and, in essence, what the judges held? I think your general counsel knows that information; and could you furnish it, just to educate our colleagues on the subject?

Mr. BLUM. We would be happy to do so.

We also, earlier this year, prepared a paper on mandatory spending controls that does provide a general description of the nature of the problem on the one hand and the different types of proposals that have been made in the Congress and that the subcommittee is considering; and I think you would find that also very useful.

Mr. HORN. Good. Anything you have that you think would be helpful along that line, please furnish it and we will put it at this point in the record.

Mr. BLUM. We would be happy to do so, Mr. Chairman.

Mr. HORN. Thank you very much. We appreciate your coming on this.

[The information referred to follows:]

The cases in this sampling stand for the proposition that the Congress may, by statute, obligate the government to make payments despite a lack of sufficient appropriations to make such payments. Failure to appropriate funds to meet a statutory obligation may prevent the government from making a disbursement, but the obligation remains. A subsequent appropriation of insufficient funds does not extinguish or reduce the original obligation.

This list is drawn from a number of courts over many years. It is not intended to be exhaustive, but rather to demonstrate that the rule enunciated here is a widely accepted principle of appropriations law.

Armster v. United States District Court for the Central District of California, 792 F.2d 1423 (1986)

New York Airways v. United States, 369 F.2d 743 (1966)

Thomas Gibney v. The United States, 114 Ct.Cl. 38 (1948)

Seatrain Lines, Inc. v. The United States, 99 Ct.Cl. 272 (1943)

Department of Education: Recording of Obligations Under the Guaranteed Student Loan Program, 65 Comp. Gen. 4 (1985)

Veterans Administration: Recording and Liquidating Obligations for Benefits, B-226801 (1985)

CBO PAPERS

MANDATORY SPENDING CONTROL MECHANISMS

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PREFACE

This Congressional Budget Office (CBO) paper analyzes methods of controlling mandatory spending through the budget process. It catalogs both the methods that are now in place and mechanisms that have been proposed in recent years. In the case of the proposed mechanisms, it also examines how well they might perform according to certain criteria. The paper was prepared in response to a request from the Subcommittee on Legislative and Budget Process of the House Committee on Rules.

Neal Masia of CBO's Special Studies Division wrote the paper under the direction of Robert Hartman and Marvin Phaup. James Blum, Gail Del Balzo, James Horney, Philip Joyce, Richard Kasten, Constance Rhind, and David Torregrosa offered helpful suggestions. Jeffrey Holland provided the data for Table 1 Leah Mazade edited the paper, and Christian Spoor proofread it. L. Rae Roy prepared the report for publication.

June E. O'Neill
Director

February 1996

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SUMMARY AND INTRODUCTION

The Congress has often enacted laws that entitle people, states, or other entities fulfilling certain eligibility requirements to receive payments or benefits from the federal government. (An example of such legislation is the Social Security Act of 1935, which authorized the Social Security program and was later amended to authorize the Medicare program.) In addition, other laws that do not technically establish entitlements nevertheless obligate the federal government to make specified mandatory payments. Spending of that nature is often referred to as mandatory spending because the law requires that the funds be made available. (Entitlements are a subset of mandatory spending.) In some cases, such as Social Security, payments take place without an annual appropriation; in other cases, such as Medicaid, the Congress by law must pass an appropriation bill. Spending that is not mandatory, such as spending for defense or for the Commerce Department, is usually called discretionary. The law does not require that funds for such programs be made available annually; however, most discretionary spending is provided for in 13 regular annual appropriation bills.

Over the past two decades, mandatory spending has been growing rapidly, both as an absolute amount and as a percentage of total spending. Federal spending for mandatory programs now accounts for about 12 percent of gross domestic product and over 54 percent of federal budget outlays. In recent years, policymakers have struggled to control such expenditures, but most observers believe that those efforts have fallen short. Although the Congress made (or proposed) significant cuts in mandatory programs in 1995 (as it did in the Omnibus Budget Reconciliation Acts of 1990 and 1993), the likelihood of continued high rates of growth has left many Members feeling frustrated. Therefore, legislators have also been considering changes in the way mandatory spending bills are considered in the legislative and budget processes.

Observers frequently note that it is difficult to link changes in the budget process with particular policy outcomes--the failure of the Balanced Budget and Emergency Deficit Control Act of 1985 (also known as Gramm-Rudman-Hollings) supports that observation. The budget process is much better at enforcing compliance with explicit changes in policy, as it has done under the Budget Enforcement Act of 1990, than at producing changes through indirect means. The attempt now under way to enact policies that would result in a balanced budget in seven years is an example of the former case, in which changes in policy precede changes in process. In fact, if the Congress implements the policies that it is now considering, the short-term search for mechanisms to control mandatory spending might end because the programs driving the large increases in that spending--Medicare and Medicaid--would exhibit lower rates of growth.

Yet in the light of past failures, many Members are concerned about the credibility, over the long term, of plans to balance the budget. As a result, they seek alternatives to ensure that spending will not increase in the future. Supporters of changes in the budget process contend that those changes can at least point policymakers in the direction of reducing spending and can help to frame politically sensitive issues in a way that might allow those issues to be considered in that context. Furthermore, proponents point out that well-designed process changes can introduce credible penalties for failing to act, which might encourage substantive legislative changes

The Congress has several methods of controlling mandatory spending. Clearly, the most direct way is simply to change each underlying law that specifies who is to receive benefits and in what amounts It is, however, politically burdensome to vote to cut previously enacted levels of spending (In the extreme case, some mandatory programs--such as Social Security--cannot even be discussed without provoking controversy.) Tools now in place for controlling spending recognize that difficulty: for example, large deficit reduction packages (also known as reconciliation bills) combine cuts in spending with other measures, requiring legislators to vote the entire package up or down; and the pay-as-you-go process raises the prospect of an across-the-board sequestration (that is, a cancellation of budgetary resources) if new spending is not offset by tax increases or spending reductions.

The current Congress has tried to control spending directly by converting some mandatory programs into block grants to the states or by embedding fail-safe provisions in spending legislation. (Fail-safe provisions specify actions that shall occur in the event of unexpected increases in spending.) Because, however, the Congress has not controlled mandatory spending using the tools that are now available, reformers have proposed new methods of control with certain goals in mind. Among them are to ensure the desired result (for example, lower spending); to apply the cuts flexibly, when needed; to maintain accountability as a characteristic of the mechanism; and to keep the approach relatively simple. All proposals may be evaluated on their ability to meet those goals; in addition, other aspects must be considered (such as the mechanisms' potential effects on the social safety net).

Proposals under consideration in recent years include ending the mandatory status of all such programs, creating explicit caps on mandatory spending that are analogous to the caps on discretionary spending that are already in place, introducing targets for overall deficit reduction but with optional enforcement, and controlling spending by program area using automatic reductions when necessary. Most of the plans achieve some of the reformers' goals but not all of them. Some plans seem likely to control spending at the cost of reduced flexibility, whereas others are so flexible that nothing is assured. Some approaches look good in theory but would be so complicated that they could probably never be implemented; others are quite simple but would take away part of the social safety net. Some systems would ensure cuts in spending by threatening to sequester funds from all programs regardless of whether spending in only some of those programs was too high, whereas others plan to penalize only the programs with funding shortfalls--which increases accountability in theory but raises doubts about execution. This paper catalogs the methods for controlling mandatory spending that are now in place and discusses recent proposals for new ones. It also analyzes how those mechanisms might be assessed.

MANDATORY SPENDING: HOW MUCH WILL IT GROW, AND WHY IS IT MANDATORY?

As noted earlier, mandatory spending, in both absolute dollar terms and as a percentage of total government spending, has been growing for years and is projected to continue to grow under current policies (see Table 1).[1] In dollar terms, total mandatory spending is projected to increase from $881 billion to $1.6 trillion over the 1996-2005 period; as a percentage of all federal spending, it is projected to grow from just over 55 percent in 1996 to about 64 percent in 2005. After debt service and offsetting receipts are taken into account, it becomes clear that the remainder of all federal spending--that is, discretionary spending--constitutes only a small (and, over the years, increasingly smaller) proportion of the total budget.

The Congressional Budget Office (CBO) distinguishes between means-tested programs (which provide cash, benefits that are equivalent to cash, or services to people who meet a test of need based on income, assets, or other criteria) and non-means-tested programs (which do not base eligibility on such a test). In 1996, non-means-tested programs make up over 77 percent of all mandatory spending; the two largest non-means-tested programs, Medicare and Social Security, represent nearly 62 percent of total mandatory spending. Medicaid, which requires recipients to satisfy a means test, is the third-largest mandatory program and accounts for more than 11 percent of all mandatory spending. By 2005, CBO projects that non-means-tested programs will decrease to about 74 percent of mandatory spending. Social Security and Medicare together are projected to remain at about 62 percent of mandatory spending, but Medicaid is projected to grow to over 14 percent.

Another useful way to view the growth of mandatory spending programs is to consider the rates of growth projected for their overall spending (see Table 2). From that perspective, Medicare and Medicaid are not only two of the largest programs, but they are also two of the programs that are projected to grow the fastest over the

1. Debt service and offsetting receipts are not included in this discussion. Legislation may affect offsetting receipts directly, but it affects debt service only indirectly.

TABLE 1. CBO BASELINE PROJECTIONS FOR MANDATORY SPENDING
(By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Means-Tested Programs										
Medicaid	97	107	118	130	142	157	173	190	209	229
Food Stamps[a]	26	28	29	31	32	33	35	36	38	40
Supplemental Security Income	24	29	32	35	41	37	44	47	51	59
Family Support	18	18	19	19	20	20	21	22	23	23
Veterans' Pensions	3	3	3	3	3	3	3	3	3	3
Child Nutrition	8	8	9	10	10	11	11	12	12	13
Earned Income Credit	19	20	21	22	23	24	25	25	26	27
Student Loans[b]	2	2	2	2	3	3	3	3	3	3
Other	4	4	5	5	5	6	6	7	7	8
Total, Means-Tested Programs	201	220	238	256	279	294	32	345	371	405
Non-Means-Tested Programs										
Social Security	349	367	386	405	425	447	469	493	518	545
Medicare	196	216	236	258	281	305	332	362	396	435
Subtotal	546	583	622	663	706	752	801	855	915	981
Other Retirement and Disability										
Federal civilian[c]	44	46	49	51	54	57	59	62	65	68
Military	28	29	31	33	34	35	37	38	40	41
Other	4	4	4	4	5	5	5	5	5	5
Subtotal	76	80	84	89	93	97	101	105	109	114
Unemployment Compensation	24	25	26	27	28	29	31	32	33	34
Other Programs										
Veterans' benefits[d]	17	19	19	20	22	23	23	24	25	26
Social services	6	6	6	6	6	6	6	6	6	6
Credit reform liquidating accounts	-4	-6	-7	-6	-6	-6	-6	-6	-6	-7
Other	15	18	19	21	20	21	21	20	20	20
Subtotal	34	36	37	40	41	44	44	44	45	46
Total, Non-Means-Tested Programs	680	724	769	819	868	922	977	1,036	1,102	1,175
Total Mandatory Spending										
In Billions of Dollars	881	945	1,007	1,075	1,147	1,215	1,297	1,380	1,473	1,580
As a Percentage of Federal Spending	55.2	56.7	58.0	59.1	60.1	61.0	61.8	62.5	63.2	64.1
As a Percentage of GDP	12.0	12.3	12.5	12.7	12.9	13.0	13.2	13.4	13.7	13.9

SOURCE: Congressional Budget Office.

NOTES: Spending for major benefit programs shown in this table includes benefits only. Outlays for administrative costs of most benefit programs are classified as domestic discretionary spending; Medicare premium collections are classified as offsetting receipts.

Numbers may not add to totals because of rounding. GDP = gross domestic product.

a. Includes nutrition assistance to Puerto Rico.
b. Includes both direct and guaranteed loans.
c. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.
d. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

TABLE 2. CBO BASELINE PROJECTIONS FOR THE PERCENTAGE INCREASE IN GROWTH RATES OF TOTAL SPENDING FOR MANDATORY PROGRAMS

Program	1996-2000	1995-2005
Supplemental Security Income	71	146
Medicaid	46	136
Medicare	43	122
Child Nutrition	25	63
Social Security	22	56
Federal Civilian Retirement[a]	23	55
Food Stamps[b]	23	54
Veterans' Benefits[c]	29	53
Student Loans[d]	50	50
Military Retirement	21	46
Earned Income Credit	21	42
Family Support	11	28
Veterans' Pensions	0	0
Social Services	0	0

SOURCE: Congressional Budget Office.

a. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.
b. Includes nutrition assistance to Puerto Rico.
c. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.
d. Includes both direct and guaranteed loans.

next five to 10 years. Social Security is expected to grow moderately over the next 10 years, but that growth will accelerate after the 10-year window, when the baby boomers begin to retire. Welfare programs other than Medicaid constitute a relatively small share of the budget and, with the exception of Supplemental Security Income, are not projected to grow very fast.[2]

Several explanations can be put forward for why Social Security, Medicare, and Medicaid make up such a large percentage of present and future total mandatory spending. One is the scope of the programs: most legal residents over age 65 are eligible to receive benefits under Social Security and Medicare, regardless of their level of income. Demographic shifts, such as increased life expectancies, have also contributed to continued and projected growth. Other reasons for high levels of spending and projected rates of growth in Medicare are increased health care consumption by the eligible population and inflation in the medical care industry, which is high relative to overall increases in prices. Moreover, benefits under Social

2. Total spending for the Supplemental Security Income programs is still projected to be much lower than spending for Medicare or Social Security.

Security and other retirement programs depend not only on inflation and demographic changes but on real wages (that is, wages adjusted for inflation)--the increase in real wages that analysts expect in future years implies higher levels of benefits in the future.

Policymakers have aimed their recent budget-cutting efforts at Medicare and Medicaid in particular, because they are such big targets. In the case of Medicare, a perceived threat of insolvency in the system has fueled those activities. In contrast, Social Security has been placed "off the table" in current budget negotiations. Other attempts to control mandatory spending have focused on welfare, which usually denotes means-tested programs. For example, some lawmakers have advocated repealing those programs in favor of block grants to states (see the later discussion).[3] The choice of a specific control method will depend in part on what role legislators envision for mandatory programs. It therefore seems worthwhile to examine the reasoning behind the existence of mandatory programs as well as the problems critics contend those programs cause.

What Are the Advantages of Mandatory Spending Programs?

Mandatory spending programs provide benefits to a broad range of people. Although each individual entitlement or mandatory program has been designed to achieve a particular set of goals, it is possible to distinguish broadly between two main purposes of many of the programs: acting as a social "safety net" and enhancing people's ability to plan for the longer term. (That categorization is not exhaustive, but most mandatory programs are intended to serve at least one of those purposes and some serve both.) The distinction is useful because attempts to control mandatory spending through the budget process might have different effects on the ability of such programs to serve the broad purposes for which they were intended.

Social Safety Net. Many taxpayers and policymakers believe that society should ensure a minimum standard of living for the U.S. population. In this century, government has come to play a large role in providing that minimum level of subsistence. According to proponents of spending for mandatory programs, that function becomes especially important when the U.S. standard of living is threatened by economic downturns or other unavoidable events. Advocates argue that programs such as Medicaid, Aid to Families with Dependent Children (AFDC), and Food Stamps are a social safety net, providing some people with subsistence and the means to cope with medical or financial emergencies. In hard economic times, mandatory

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3. Other CBO publications, such as the annual deficit reduction volume, present options for cutting spending through particular programmatic changes such as changing the retirement age, reducing or eliminating cost-of-living adjustments, means-testing more programs, or establishing work requirements for welfare recipients.

spending programs can act as automatic stabilizers, arresting declines in income that might otherwise plunge families and individuals into extreme poverty.

Longer-Term Planning. Some mandatory programs, most notably Medicare and Social Security, provide benefits to recipients regardless of their current income.[4] Medicare and Social Security are two of the federal government's most staunchly defended programs; indeed, Social Security is usually excluded from discussions about controlling mandatory spending and is afforded special treatment in the budget. The broad support for these programs probably stems in part from the fact that people who do not currently receive benefits will eventually be entitled to them. Aside from the redistributional component of the programs, many taxpayers view them as part of their personal insurance and retirement plans. Proponents argue that it is in that sense that mandatory programs serve their second main purpose: as an aid or supplement to midrange and long-term financial planning. Even if the programs were originally intended only as a safety net, people now view their benefits as personal assets that they expect to receive in the future. In some cases, it is the only form of insurance in which they participate.

Many observers claim that programs such as Social Security and Medicare benefit society as well as individuals by improving the long-term manageability of retirement planning. With a well-planned retirement, many taxpayers can avoid using the short-term safety net as a long-term solution when their wage-earning days are behind them. Thus, proponents maintain that the programs provide not only personal but social insurance: they reduce the likelihood of beneficiaries' becoming a burden on society by forcing future recipients to contribute to social insurance while they are working.

What Are the Objections to Mandatory Spending?

Mandatory spending programs have critics as well as supporters. Some of those opponents worry that the structure of the programs leads to inevitably high rates of growth. Others contend that many of the programs offer the wrong incentives to recipients or ensure that the government plays an unacceptably large role in the lives of taxpayers.

Rapid Spending Growth. The fundamental objection that most critics have to the current system of mandatory spending is that there is no explicit budget constraint on most of the programs. Instead, spending rises or falls according to economic

4. To the extent that the benefits are subject to taxation (as is the case with some Social Security benefits and most federal employee pensions), the value of after-tax benefits can depend on a recipient's current income; however, eligibility for benefits does not.

fluctuations, program participation rates, the behavior of individual states, and demographic shifts. Furthermore, spending for two of the largest programs, Medicare and Medicaid, depends on increases in the price of medical care, which have recently been quite large and are fueled by advances in medical technology and the behavior of medical care providers.

Without changes in the laws governing mandatory programs, the high rates of spending for them will probably continue indefinitely. Many policymakers worry about the open-endedness that statement implies, which is one reason they have been looking for ways to set limits on spending. The Congress has also been considering wholesale changes to the programs themselves--for example, one proposal that has received much attention is to transform some welfare programs (in particular, Medicaid) into block grants to individual states. The idea behind that approach is to limit federal funds for the programs and let the states grapple with unexpected increases in prices, with utilization rates for some kinds of care that are higher than anticipated, and with other such changes.

Incentive Problems. Criticisms of mandatory spending programs are usually couched in terms of improvements to their incentive structure or their overall scope. Some critics contend that the programs themselves may provide incentives that encourage the type of behavior that created a need for the programs in the first place. Those critics rarely support abolishing all social safety net programs; rather, their objections relate to which contingencies the government ought to address.

A related problem that some people have with government insurance programs is the way they affect beneficiaries' planning. Although a social safety net is intended to fill gaps in income that might arise from events that are beyond a person's control, mandatory spending programs create incentives for future recipients to intentionally plan for gaps (that they know will be filled by government benefits) over the middle and long terms. For example, the amount of money many workers save for retirement depends on their expectations about future benefits, and the amount of health insurance they purchase in later years depends on what they think they will receive in Medicare benefits.

The Proper Role of Government. Some programs that are intended to help people plan for the long term provide assistance to recipients who would not be excessively burdened by the loss of some (or even in some cases, all) of their benefits. Some people take issue with the government's large role in income redistribution in this country and question why the government transfers wealth (in the form of benefits) to recipients who do not need it. Such critics usually point to open-ended mandatory programs as an example of the government's overstepping its appropriate role in the lives of residents. One approach that has been frequently proposed to resolve this issue is to means-test a wide range of benefits, thereby reducing the overall scope of government payments and activities.

MECHANISMS NOW IN PLACE FOR CONTROLLING MANDATORY SPENDING

The Congress currently has several ways it can limit mandatory spending; the most important are the rules for budget resolutions and reconciliation established by the Congressional Budget and Impoundment Control Act of 1974 and the pay-as-you-go (PAYGO) process set up in the Budget Enforcement Act of 1990. In addition, some people believe that certain methods of treating mandatory spending legislation can act as controls. Two examples are block grants and fail-safe provisions.

Reconciliation

Reconciliation was included as part of the 1974 act, but it was not used in its current broad form until the early 1980s. In the reconciliation process, the Congress considers a number of changes in mandatory spending programs and revenues at one time, in large omnibus measures. The committees responsible for the spending programs are directed by the Congress's concurrent resolution on the budget to recommend changes to the law that will result in a certain amount of projected spending or revenue. The process is optional, but it has been used with increased frequency in recent years. Usually, the group of reforms is presented as a deficit reduction measure and is voted on under restrictive rules in both Houses of Congress. Packaging the reforms into an omnibus proposal is crucial: although cuts to individual programs might be defeated on a case-by-case basis, considering them together (in an up-or-down vote) increases the chances of their being passed. (Legislators can correctly claim that they have voted for deficit reduction, thus mitigating the political cost of their vote by appealing to a sense of shared sacrifice.)

PAYGO Rules and Sequestration

The Balanced Budget and Emergency Deficit Control Act of 1985 (the Balanced Budget Act) introduced the idea of sequestration into the budget process. The Balanced Budget Act established deficit targets for each year through 1991. If the Congress did not meet one of the targets, a sequestration would be triggered; that is, across-the-board reductions would be made automatically in both mandatory and discretionary spending. The idea behind the mechanism was that the Congress would ensure that the deficit reduction targets were met to avoid the unpleasant alternative of across-the-board reductions in programs. Some programs were protected from the sequestration; in particular, many mandatory programs were either excluded from cuts or the cuts were severely limited. As a result, discretionary programs were exposed to potentially large-scale reductions. By 1990, however, the targets had been rendered meaningless, and in 1993 they were not extended. The failure of the Balanced Budget Act to control spending and reduce the deficit led to the consideration of alternative mechanisms.

The Congress carried over the basic idea of sequestration as an enforcement mechanism to its next reform, the Budget Enforcement Act of 1990 (BEA). The act eliminated fixed deficit reduction targets as a restraint and instead set out pay-as-you-go rules for the budget process. The new rules basically required that the projected net effect of all mandatory spending and revenue legislation enacted in a fiscal year be deficit neutral within that year and for five subsequent fiscal years; that requirement was (and still is) enforced by a sequestration mechanism. CBO and the Office of Management and Budget keep track of all new direct spending and revenue legislation on a scorecard, and if the scorecard shows a projected net addition to the deficit at the end of the budget cycle, a sequestration eliminates the increased spending. In concentrating only on the effects of new legislation, the BEA has a much narrower focus than the Balanced Budget Act. Some people cite that difference as the reason for the relative success of the BEA.

The two types of sequestration mechanisms differ in several ways. First, under the BEA, the amount to be sequestered is limited to the amount that is added to the deficit on the PAYGO scorecard--rather than some predetermined overall deficit reduction target such as those found in the Balanced Budget Act Second, under the BEA but not under the Balanced Budget Act, increases in mandatory spending programs under current law cannot trigger a PAYGO sequestration, although those programs would still be cut if a sequestration was triggered by new legislation. Third, and perhaps most important, PAYGO rules hold the Congress harmless for changes in economic conditions and other factors that affect the baseline (the benchmark for measuring the budgetary effects of proposed changes in federal revenues or spending) Unlike the Balanced Budget Act, the BEA requires only that new legislation be projected to be deficit neutral for each fiscal year. It guarantees neither a total maximum level of mandatory spending nor that the new legislation will actually be deficit neutral in the end. Rather, the PAYGO rules guarantee that projected spending and revenues under new legislation will add up to zero on a deficit scorecard or a sequestration will be triggered to cut spending. What the two mechanisms have in common is that they were both intended to provide incentives for the Congress to hold down spending increases and to enforce a particular decision about the level of spending control--whether that decision be to control only new legislation or the deficit overall.

Block Grants

The 104th Congress has been particularly interested in changing means-tested programs that are currently administered, in whole or in part, by the states. That group of mandatory spending programs, which includes Medicaid and AFDC, makes up a large part of what is commonly thought of as welfare. Today, most federal funding for those programs takes the form of matching grants to states, and the matching rate (the amount that the federal government contributes for each dollar the state contributes) depends inversely on per capita state income. States generally have some latitude in setting eligibility standards and benefit levels, subject to certain minimum program characteristics that are necessary to qualify for federal funds. Many (but not all) block-grant proposals would use the current levels of funding for each state as a baseline, and simply require that the level of federal funds to be spent by each state in future years be determined by adjusting the current level for inflation or other changes. Other block-grant proposals would go farther and eliminate the mandatory aspect of the spending, requiring that new funds be voted on and distributed to states on a regular basis. Most welfare programs would be repealed, leaving states with much broader latitude to determine how to distribute funds among their programs. Proponents believe this approach would effectively limit spending for mandatory programs; critics question the long-run viability of vesting states with greater responsibility for the programs.

Fail-Safe Mechanisms

Fail-safe provisions are included in legislation to specify contingency plans for particular programs in the event that spending is higher than originally anticipated. (The approach is a fallback provision that specifies precisely how, if necessary, spending is to be cut.) The detailed nature of many fail-safe mechanisms often contributes to the contentiousness surrounding consideration of what are generally complex bills, but proponents believe that their inclusion ensures that spending will be controlled. However, many policymakers doubt that the provisions would be faithfully executed if they were invoked to reduce spending.

RECENTLY PROPOSED CONTROL MECHANISMS

Detailed below are specific proposals for additional mechanisms to control mandatory spending that have been introduced as legislation in the 103rd and 104th Congresses. It is worth reiterating that all of those mechanisms are ways of changing either laws, benefit levels, or other program characteristics when the Congress does not make those changes directly in stand-alone legislation or when the changes that it does make are judged insufficient. Of course, the Congress may change the specific substantive laws underlying mandatory programs at any time, which would eliminate the need for other (that is, procedural) reforms to control spending. In fact, one might state that the most obvious and direct mechanism for reducing mandatory spending is just to change the underlying laws directly. But because each such program sharply enhances the well-being of specific groups, the political realities faced by legislators often make cutbacks unpalatable, if not impossible.

Overall Cap with Automatic Enforcement

The mechanism proposed under this approach would focus on overall mandatory spending as its core concern. (Some examples of proposals are H.R. 2060, introduced by House Majority Leader Richard Armey in the 104th Congress; S. 149, introduced by Senator Phil Gramm, also in the 104th Congress; and H.R. 883, H.R. 4585, and S. 377, all introduced in the 103rd Congress.) The approach would require total spending to be at or below a particular level and would try to enforce that requirement through sequestration. (In its attempt to use sequestration for enforcement, the mechanism is a descendant of both the Balanced Budget Act and the PAYGO system.) Social Security is explicitly excluded from all consideration under this approach, although there is no technical reason why it could not be made subject to the provisions of the various bills.

The Armey bill is a useful representative to examine in greater detail. It would use the current year's spending for all mandatory programs, after adjusting for inflation and changes in the eligible population, as the baseline with which spending levels in future years would be compared. Overall spending above the level implied by the adjusted baseline in any year would trigger an across-the-board sequestration for all nonexempt programs. The bill contains very detailed provisions and limitations on how much, and in what general order, programs may be cut. Means-tested programs would be limited to cuts of 1 percent, federal retirement and veterans' benefits would be limited to cuts of 2 percent, and Medicare would be limited to 4 percent. The remaining nonexempt programs would be cut by a uniform percentage to make up the difference.[5] The bill also contains global spending limits (that would apply to discretionary spending as well) for a seven-year period. If those limits were exceeded, a second sequestration would take effect.

5. The bill's limitations on and exclusions of the biggest mandatory programs raise an interesting question: what would happen if there was not enough spending left in the remaining programs to carry out the entire sequestration?

Overall Spending Target with Optional Enforcement

The approach taken in H.R. 4064, which was introduced by Congressman John Spratt in the 103rd Congress, would be to codify an overall target for mandatory spending similar to that instituted by Executive Order 12857 after the Omnibus Budget Reconciliation Act of 1993. A useful way to look at the Spratt bill is as an extension of the reconciliation process; the approach is intended to make it more likely that reconciliation-style legislation will be enacted.

The bill calls for the Office of Management and Budget to project levels of overall mandatory spending under current law for several fiscal years. Those projections would be treated as targets. Each year, the President would have to include in the Administration's budget submission a review of mandatory spending that contained a comparison of the original targets and the most recent projections. The budget would also contain a special "direct spending message." (Direct spending is a synonym for mandatory spending.) That message would contain either detailed recommendations on how to reconcile the difference between the targets and the projections or a special resolution stating the reasons for not recommending any changes. The Administration's budget already includes such a message in order to comply with the executive order, but the Spratt proposal would handle it differently: the Congress would consider the direct spending message as either additional reconciliation directions to be included in the budget resolution or, if no resolution was passed, as a separate measure. In short, the Spratt approach would require the Congress to explicitly consider only mandatory spending above a previously established current-law baseline. The Congress could waive that requirement if it either raised the targets or set aside the point of order against considering budgets that contained spending above those targets. If overall mandatory spending was not above the total "target" baseline, no change would be required or recommended.

Caps on Spending Areas with Automatic Enforcement

Some proposals, including H.R. 1516, introduced by Congressman Peter Visclosky in the 104th Congress, focus on more narrow program areas as an alternative to across-the-board mandatory cuts. The Visclosky bill contains controls on both overall spending and spending by program area. The bill would establish targets for deficit reduction to be achieved through changes to mandatory spending and revenues over the next seven years. In some respects, this bill can be seen as a superstructure resting on the current PAYGO rules: it would establish a scorecard, analogous to the current PAYGO one but treating spending and revenue legislation separately and modifying the goal of deficit neutrality. Instead of neutrality, the scorecard would include--as an expenditure--the amount of mandated deficit reduction to be derived from mandatory spending in a given year, with new legislation making up the difference. Another change from the PAYGO rules is that if a sequestration was triggered, it might involve automatic tax increases in addition to or instead of automatic spending cuts. The route taken would depend on whether the shortfall was due to legislation that lowered revenues or raised expenditures.

Another important point of divergence between the Visclosky plan and PAYGO is that the Visclosky bill creates an optional spin-off law that, if enacted, would change the potential sequestration from a general to a program-specific one. At any time, the Congress could create such a law, analogous to reconciliation instructions, that would prescribe changes in policy. Those changes would result in reductions in spending or increases in revenue, or both, that mandatory spending programs would be required to contribute toward deficit reduction in that year. The law would specify amounts of spending reductions or revenue increases that the respective committees would then propose. If a spin-off law was in place and the scorecard was out of balance, sequestrations would be triggered and applied specifically to the programs of committees that failed to produce the savings demanded in the law.

Eliminating Mandatory Status

Mandatory spending programs are often called uncontrollable because the amount to be spent each year in many cases is determined only by applying current law to a pool of beneficiaries. (Conversely, spending is usually called controllable if an explicit dollar amount is appropriated for each year.) Under current law, the amount to be spent on mandatory programs each year depends on several factors: the benefits established by law, the number of applicants (which in turn is determined in part by economic conditions and other uncontrollable circumstances such as natural disasters), and rules that may be established, interpreted, or changed by individual states, courts, and regulators. Some critics of mandatory spending argue that the open-ended approach to funding those programs is inappropriate. They support switching from open-ended funding to annual appropriations for all programs.[6]

H.R. 2929, introduced by Congressman Christopher Cox in the 103rd Congress, would eliminate open-ended mandatory spending by requiring that an explicit amount be appropriated each year for each program. In addition, heads of agencies that administer the programs would be given broad authority to make decisions about policy to ensure that funding did not run out during the fiscal year. The plan would cause a major shift in decisionmaking power from the authorizing committees to the

6. Many mandatory programs already receive annual appropriations (for example, AFDC and Medicaid). However, because they are entitlements, the amount of the appropriation is required by law, and thus they cannot be directly controlled.

appropriations committees--who would gain the authority to set spending limits--and from the Congress to the agencies. In theory, enforcing mandatory "caps" of that kind would be relatively easy: as with most appropriations, when the money to be obligated for a fiscal year ran out, no further commitments could be made.[7] Thus, whatever level of spending the Congress decided on during the budget process would theoretically be enforced without further action. In order for the approach to work, the legislation entitling eligible individuals to benefits would have to be repealed, otherwise, beneficiaries might be entitled to funds that it would be illegal to obligate

ISSUES IN CONTROLLING MANDATORY SPENDING

Reformers who seek to control mandatory spending by changing the way it is treated in the legislative and budget processes have several criteria for judging how well the mechanisms that have been put forth would fulfill their ultimate goal of ironclad spending control. Yet those criteria may conflict, requiring trade-offs between them. It is useful to consider such trade-offs so that any potential mechanism can be assessed according to how well it achieves the overall intended effect.

Many reformers put the dependability of a spending control mechanism at the top of any list of necessary attributes. Those reformers want mechanisms without loopholes and "escape hatches" to ensure that the level of mandatory spending agreed to on a particular date is attained. Consider, for example, the role played in the budget process by projections. Determining levels of spending in future years depends on projections of future-year variables, and those projections are inherently imprecise. If changes in the legislative or budget process (or both) can reduce policymakers' dependence on future-year projections or diminish the sensitivity of programs to economic changes, the goal of improved control will be easier to achieve.

Another attribute that some reformers consider vital is flexibility. Legislators might, for example, wish to pick and choose which programs to restrain at any given time; alternatively, they might want to delay reductions in funding during economic downturns. Many of the proposals for change address that issue by including explicit provisions that reduce or eliminate spending cuts in times of economic distress. In addition, most proposals insulate certain programs (in particular, Social Security) from the budget axe by granting them special rules or exemptions.

A third attribute that some policymakers value is accountability--in other words, a sense of "fair play" within the control mechanism. For example, some reformers

7. There are exceptions to this rule (such as Pell grant appropriations) in which programs have borrowing authority and forward-funding capabilities that effectively allow them to borrow from future-year appropriations.

believe that it is unfair to penalize programs in one area for spending overages in unrelated areas, as can happen with an across-the-board sequestration that is triggered by overspending on a handful of programs. Those reformers argue that enforcement should be targeted toward the individual programs or spending areas responsible for increases, which would require legislators and committees with jurisdiction for those programs to maintain control of them. Fairness in this context has nothing to do with changes in the well-being of beneficiaries but rather with fairness to legislators and committees.

Another characteristic of a control mechanism that is important to many Members is simplicity. The budget process is already quite complicated and time-consuming, and a legitimate concern is that a control mechanism might make it even more so In addition, a complicated mechanism would be easier to circumvent than one that was simpler and more transparent.

Finally, the credibility of the enforcement procedure built into the mandatory spending control mechanism is a concern for some observers. Penalties in the mechanisms have generally been designed to be serious enough to impel legislators to avoid them. But critics argue that in some circumstances, legislators might waive those penalties, once they were triggered, because they would be too harsh to enforce. In that case, control might be only sporadic and would depend more on legislative preferences than on the mechanism itself.

Using the Criteria to Evaluate Currently Available and Proposed Mechanisms

It is easy to see that many of the criteria for evaluating mandatory spending control mechanisms conflict with each other, which creates fundamental tensions in designing such a mechanism. On the one hand, a mechanism that ensures a particular level of spending sacrifices some flexibility; on the other, a mechanism that is less rigid risks the use of that flexibility to avoid spending control. A method that protects certain programs may do so to the detriment of unprotected ones, forcing them to bear a disproportionate--and in some views, unfair--burden. To enforce compliance, the mechanisms must carry severe penalties; yet those penalties must be credible when the time comes to impose them. Finally, all of the above tensions relate to the mechanism itself. However, the proposals' differing impacts on the underlying social goals of the programs' proponents should also play a role in the design of a control mechanism.

Dependability. No control option can promise to achieve a particular amount of deficit savings, because to some extent, all estimates of spending rely on uncertain future-year projections. However, some mechanisms rely less heavily on projections than do others, and some methods attempt to enforce a particular level of comprehensive limits on projected expenditures whereas others do not.

Some of the mechanisms that were discussed earlier (the PAYGO rules and the approaches in the Armey, Visclosky, and Cox bills) are automatic; others (the reconciliation process, fail-safe provisions, block grants, and the approach in the Spratt bill) are optional. Optional mechanisms usually rate poorly on the criterion of dependability precisely because they are optional. Mechanisms that rely on automatic enforcement offer, at least in theory, greater dependability. But the Balanced Budget Act's failure to control spending showed that even so-called automatic control mechanisms may not work that way in practice. Perhaps the Armey plan has a better chance of success than the Balanced Budget Act had because its sequestration mechanism is more detailed and might be feasible, at least in the current Congressional climate. Still, the Congress might find ways to avoid any severe sequestrations triggered by the plan (just as it did under the Balanced Budget Act) The Visclosky proposal uses global sequestration only as a fallback position, encouraging committees to come up with the necessary changes beforehand. Indeed, imposing discipline at that level might lead committees to consider spending cuts in anticipation of a more narrowly targeted sequestration, which would increase the chance that the mechanism would be effective.

The Cox approach would ensure a fairly firm level of control in the sense that once spending levels for individual programs had been determined, no further action would be necessary on the part of the Congress to enforce those decisions. However, under the Cox plan, no explicit level of maximum spending would be set in advance. In election years (that is, every other year), legislators might have a considerable incentive to increase spending, as they used to for Social Security programs before automatic cost-of-living adjustments were instituted. Therefore, the Cox plan could not guarantee that the level of spending legislators decided on would be lower than current or projected levels; in fact, spending could be higher.

Flexibility. Mechanisms that are optional and that are not enforced automatically clearly rate high on the criterion of flexibility, in part because they allow decision-makers to pick and choose programmatic changes that will produce the required savings. In addition, optional mechanisms operate on a year-to-year basis, making it easier for policymakers to respond to current economic conditions. Including fail-safe provisions in original legislation offers a different type of flexibility: that approach permits committees to consider exactly which cuts are appropriate in the event of excess spending. Of course, if the time for cuts arrived and the prespecified reductions were not deemed appropriate, the legislation would have to be changed to avoid the cuts. It might be more difficult politically to carry out the cuts in individual programs than to execute all the cuts together, as in reconciliation.

The block-grant approach offers a third type of flexibility. States could use the grant dollars as they wished, but the Congress would lose virtually all of its ability to set policy for programs that had been turned over to the states. Because the same program would fare differently in different states, it would be impossible to determine in advance the trade-offs that states would make in allocating funds among those programs.

Mechanisms that attempt to provide automatic enforcement may seem inherently more inflexible than those that are optional; however, the nation's experience with the Balanced Budget Act showed that some enforcement mechanisms may be less rigid than they appear to be. The PAYGO process is flexible at several levels: the costs of new legislation can be offset by other mandatory spending reductions or by tax increases chosen by the authorizing committees, and the amount to be sequestered may be reduced or eliminated as a result of economic or technical changes. But the PAYGO process does not permit the Congress to consider trade-offs among years, which might be appropriate for some programs. Furthermore, the PAYGO rules do not allow trade-offs between mandatory and discretionary programs, which are considered under separate sets of rules. The Armey plan would have some built-in flexibility, given that the maximum sequestration amount differs among programs; however, some people would argue that this feature only makes the plan inflexible in a different way. Further evidence of flexibility might be found in the fact that the Armey proposal would allow spending to increase based on hikes in inflation and in the eligible population.

The Visclosky approach offers at least some flexibility since the spin-off law is a built-in option. In addition, the approach allows for adjustments based on increases in inflation. If a spin-off law was enacted, the committees would be directly responsible for determining which programs should be cut (or which revenues increased).

Finally, the Cox plan offers yet another type of flexibility in that levels of spending under its approach are decided on explicitly for each year. But under that plan, the Congress would transfer to the heads of executive branch agencies much of its flexibility to determine the details of individual programs. In particular, it would lose its ability to decide how programs would be cut when money fell short.

Accountability. Mechanisms with across-the-board sequestrations can lead to situations in which the programs that are causing the unexpected increases in spending are not held accountable for those overages. Even if the sequestration was triggered by only a handful of programs, all would face reductions under an across-the-board action. In that kind of system, incentives for committees to make cuts that they were certain would lead to decreased spending would not be as strong as they might be. The reason is that committees would be encouraged to "free ride" off the savings created by other committees, who would share the burden if spending was higher than it should be. Protecting some programs would make the mechanism even more unfair for the remaining unprotected ones.

This problem would occur with the Armey plan, for example, even with its different maximum sequestrations for different program areas. The Armey bill would add considerable uncertainty to the spending process because large, unanticipated outlays in one program could lead to reductions in other, unrelated programs. For example, suppose that Medicaid was the only program whose expenditures exceeded expectations and that they were too high by 5 percent. Those conditions would trigger a sequestration. However, under the plan, Medicaid could be reduced by only 1 percent; consequently, other programs might be forced to absorb larger percentage reductions to make up the difference.

The opposite end of the spectrum of accountability is presented in the Visclosky approach. Under that plan, if a spin-off law was enacted and a committee did not abide by the changes that the spin-off law put into place, that committee's programs would be the only ones to suffer. Some observers might suggest that such a procedure goes too far, and that holding committees fully liable for spending overages in their program areas could result in excessive burdens on programs that were obviously being used more heavily than the Congress originally anticipated. Perhaps most important, jurisdictional issues between the two houses of Congress would have to be resolved.

The Cox approach would shift a great deal of accountability to the executive branch agencies, with agency heads being responsible for ensuring that their programs did not overspend. In theory, agencies would not spend more than the amounts appropriated for their programs. If they did, then the Congress might still be held accountable; however, it is also possible that agency heads might be blamed instead for not implementing the proper changes Similarly, if spending did not exceed the appropriated amounts because of reductions in services, agency heads might be held accountable, although some people might feel that, regardless of any delegations of power, the Congress was ultimately responsible for program activities.

Optional mechanisms and strategies such as reconciliation and the Spratt approach, if they were exercised, would make committees accountable for controlling projected spending. But because optional approaches usually do not include any kind of automatic enforcement, they cannot hold anyone accountable for spending overages. In contrast, fail-safe provisions would hold committees accountable for increases in spending, but only to the extent that the committees chose to use such provisions in the first place.

Simplicity. Systems (such as reconciliation and the Spratt proposal) that encourage the Congress to consider spending changes as a package add a considerable layer of complexity to the budget negotiation process because the reconciliation bill is generally quite large and laden with controversial proposals.[8] Plans that use a sequestration for enforcement (for example, the Armey bill) could also affect negotiations on the budget and might lead to complex maneuvering when the time came to implement the sequestration. The advantages of the Visclosky approach come at the price of yet another layer of budgeting rules and procedures: the approach is difficult to understand at first (or second) glance, and the spin-off process is itself quite complicated.

In theory, block grants would be relatively simple to execute and could remove some contentious decisions from the annual Congressional agenda. The Cox approach also simplifies the legislative process, although the approach introduces potential political complications as well. The procedures under the Cox plan are simple; however, that approach might be the most time-consuming of all, because the Congress could be deadlocked in debate over controversial programs each year.

Credibility. Two types of credibility are relevant to the proper choice of a mandatory spending control mechanism. First, one must consider the credibility of the enforcement mechanism itself; as discussed earlier, it relates to dependability. A broader issue to consider is that some mechanisms with automatic enforcement of restraints on mandatory spending could place the government in the position of reneging on benefits it had previously agreed to provide. For example, explicit caps on spending might force the government to break promises it had made in law.

It is not clear what the Congress would do when faced with the prospect of a mandatory spending control mechanism such as a cap that would actually limit further spending in a given fiscal year. There are two possibilities: either an automatic enforcement component would be triggered to reduce spending, or the Congress would change the mechanism (or circumvent it) to accommodate the increase in spending implied by the law. If the Congress viewed obligations established in legislation in the same light as contractual obligations (or if it believed that voters viewed them that way), it might attempt to raise or avoid the caps. Most people seem to view the benefits of some mandatory spending programs, such as Civil Service Retirement and Social Security, as earned benefits that the government is morally obliged to pay, even if it is not legally required to do so. Whether the avoidance of spending controls would become a regular event (similar to the increase in the debt ceiling) is an open question. Similarly, whether legislation to avoid

8. The Byrd rule in the Senate offers some control by restricting extraneous provisions in reconciliation bills. Although the rule does not apply directly to the House, it applies to conference reports and thus indirectly constrains the actions of the House as well.

spending caps would be used as a vehicle for reforming the budget process is also unclear.[9]

Other Considerations

In addition to the criteria discussed thus far, broader issues must be considered when evaluating mandatory spending control mechanisms: in particular, assessing the impact that proposed mechanisms might have on the social safety net and long-term planning, and determining whether a mechanism would create conflicts between laws or introduce improper delegations of spending authority.

Effects on the Social Safety Net and Long-Term Planning. The flexibility inherent in the optional approaches (such as the reconciliation process) implies that in times of economic trouble, appropriate programs can be sustained. In contrast, automatic enforcement components--in particular, sequestrations--have potentially large implications for the social safety net because it is precisely during cyclical downturns that spending for the programs that the net comprises is expected to be high. If sequestration reduced benefits automatically without regard for economic conditions, the "cushion" provided by mandatory spending programs would be smaller. Of course, a sequestration can be designed to have more or less impact on particular programs. (For example, arguments that the Armey proposal would eliminate the social safety net founder because means-tested programs under the plan would be limited to reductions of 1 percent.) If anything, what can be said is that automatic sequestrations will make the net more porous.

Keeping the safety net intact would mean undercutting the long-term planning goal of mandatory spending programs. With the exception of Social Security, programs that are designed to promote long-term income stability and medium- and long-term planning, such as Medicare and the retirement funds, would be subject to more volatility than they would be if the safety net was subject to larger-scale sequestrations.

The implications for the social safety net of sequestrations by program area would probably be greater under the Visclosky plan than under the Armey approach. First, passing a spin-off law such as the one envisioned in the Visclosky bill would mean that when a safety net program went over its limit and triggered a sequestration, only that program (or related programs managed by the same committee) would be affected. Second, the Visclosky plan (unlike the Armey and

9. The analogy to the debt limit is not exact, in the sense that raising the debt ceiling is "must-pass" legislation and therefore often (although not this year) seen as veto-proof. In contrast, legislation to raise caps on mandatory spending would probably not be truly veto-proof if the President was strongly against mandatory spending increases

most other proposals) would not exclude Social Security; nor would it set limits on the sequestration of means-tested programs or Medicaid. If one of the programs that are designed to promote income stability triggered a sequestration, that stability might be diminished. However, in contrast to a system of global caps, those programs would be reduced only by the amount by which they were "over"--they would not suffer further instability as a result of overspending by other programs. Thus, under a mechanism with sequestrations by program area, the overall burden of cuts could shift somewhat toward the safety net programs as compared with the distribution of cuts under the Armey plan.[10]

The implications for the safety net of moving to block-grant financing could well be quite broad. First, without federal direction, states could reduce or eliminate any programs they chose. More important, they could cut back on the money they allocated to safety net programs. Under current law, states can only receive funds when they spend some of their own money. If they received federal money without having to spend their own funds, as they would if federal funds were distributed in block grants according to current levels, the incentive for states to provide their own funds would be weakened. At the margin, the price a state pays for an additional dollar of welfare benefits under current law is less than a dollar because of federal matching funds; that price would rise to a dollar if the matching program was eliminated. Many states--in particular, poor states with large numbers of recipients--would probably reduce spending for welfare programs. With higher marginal prices, services would be cut. To complicate matters further, widening differences among states' welfare policies might spark increased migration between states.

Changing the open-ended nature of mandatory programs, as the Cox bill proposes, would affect both their inclusion in the safety net and their promotion of long-term stability. Without the open-ended feature, the social safety net would remain intact only as long as funds were available from appropriations. Supporters of programs that make up the net find that circumstance worrisome in the context of unexpected downturns in the economy. For example, if high levels of unemployment or inflation caused funds to be spent faster than the appropriators had originally anticipated, only limited funds might be available for the social safety net programs when they were needed most. In addition, subjecting mandatory spending programs to potentially large changes in their annual appropriations would be antithetical to the goal of enhancing long-term planning and stability. If the Congress determined benefit levels and program features annually, a considerable amount of uncertainty would necessarily be transferred from the federal government to the beneficiaries of current mandatory spending programs.

10. That conclusion rests on the specifics of the proposals discussed. If, for example, the sequestrations by program area were limited in some way, the conclusion would change accordingly.

Delegation of Spending Authority. Many of the proposed mechanisms delegate some spending authority to entities outside of the Congress; the amount of delegation differs for each proposal. Under the Spratt plan, for example, the President would simply be required to submit to the Congress recommendations for reconciliation (or to explain why the Administration was not recommending such changes) in the case of projected increases in spending. In those circumstances, if the Congress was delegating anything at all, it would be only the power to propose legislation--and it delegates that in many other situations. At the other extreme, under the Cox proposal, the Congress might delegate broad authority to agency heads to determine program rules; proposals to transform programs into block grants would delegate similar authority to the states. In between those extremes are examples such as the Armey bill, under which the executive branch would be charged with sequestering funds from the mandatory spending programs but would do so according to strict guidelines laid down by the Congress. Given current case law, the Supreme Court would probably rule that the delegation of spending power that is implicit in most of the plans for controlling mandatory spending is constitutional.

Conflicts of Law. Laws may come into conflict under some of the proposals.[11] In particular, under the Cox plan, the benefits authorized in legislation (and to which a group of recipients is therefore entitled) might not be available after the appropriated funds ran out; alternatively, some benefits might not be available at the levels implied by legislation for some or all recipients. Although predicting the outcome of a legal challenge in any particular circumstance is impossible, one could envision a situation in which a court gave greater priority to the underlying entitlement than to any subsequent cap on the total amount available for that benefit. Thus, any legislative proposal that did not address the issue explicitly would face a potentially successful legal challenge.

CONCLUSIONS

This paper has presented a catalog of options for controlling mandatory spending as well as salient criteria for evaluating those options. Fundamental tensions exist between the goal of mandatory spending control and the desire of some people to maintain what they consider to be positive characteristics of mandatory spending programs.

This paper does not recommend a specific mechanism. Instead, it evaluates each proposal according to the various criteria that observers generally agree are necessary

11. Although generally the most recent law is the one that prevails, there are situations in which conflicts could occur. For example, if the funding legislation and the substantive legislation for a program were passed as part of the same bill, neither would be more recent; the two laws would simply be inconsistent if the funds were insufficient.

for effectiveness. The reason reform is being sought through the budget process is that policymakers have observed that spending continues to grow and policies have not been altered enough to offset that growth. Consequently, proponents of reform believe that something must be done. That "something" might be to consider spending reductions in a new way, or to cut spending automatically, or to do something else. In any case, whatever is done through the budget or legislative process is a substitute for direct changes to legislation. On the one hand, if the reason for the lack of sufficient changes up to this point is that legislative incentives encourage lawmakers to shy away from such decisions, reforms in process might steer legislators in the direction they really want to go. On the other hand, if the reason for inaction is that legislators are not convinced that reduced spending for mandatory programs is worth the social or political costs, even the best-designed control mechanism may fail to rein in that spending.

Mr. HORN. Panel three is the distinguished Comptroller General of the United States. Mr. Bowsher, if you would come forward, we would be glad to swear you in.

[Witnesses sworn.]

Mr. HORN. All four witnesses have affirmed.

Please proceed, but as you know, looking us in the eye is always better than reading the statement.

STATEMENT OF CHARLES A. BOWSHER, COMPTROLLER GENERAL, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY DONALD CHAPIN; JEFFREY STEINHOFF; AND SUSAN IRVING

Mr. BOWSHER. I will summarize my statement, Mr. Chairman, and would be pleased if you would include my full statement in the record.

Mr. HORN. It is, automatically.

Mr. BOWSHER. I think you summarized well in your opening statement, Mr. Chairman, the problems with our accounting-budgeting-financial systems here for many years. When the Congress passed the Budget and Accounting Act of 1950, they expected the systems of our Government to be modernized over the years and to provide good information, information that the Members of Congress and the public and the taxpayers could understand; and the truth of the matter is we did not achieve it. But I do believe that in the last 4 or 5 years you have enacted a series of legislative initiatives to make some real progress.

In other words, with the CFO Act of 1990 and the GMRA Act of 1994, we are setting in place the legislative basis for modernizing the accounting and the financial reporting and the auditing of the Federal Government. I think it is long overdue.

When we saw the New York City fiscal crisis in 1975, we brought forth the proper reforms and the legislation and the Single Audit Act of 1984, to make real progress there, and I think it is long overdue that we do the same here at the Federal level.

The memorandum of understanding that I worked out with Treasury and OMB in 1990 to update the standards for the Federal Government, why we have made real progress there, and we have issued all the basic standards, and I think that that is going to be a big step forward. Once we add the performance reporting of the GPRA legislation, I think we will have the basis to produce very meaningful financial reports and eventually some good information on program costs and performance reporting that should allow Government officials, both in the executive branch and in the Congress, to understand where the money is going and what are we getting for it—in other words, outcomes-based emphasis.

I do believe we still have some real problems on the budget side. I think we have far too much detail there. I think one of my key words often in talking about the budget process and the information is to "streamline." I think it is badly needed there. I think the process, too—you know, we are having a very hard time this year getting appropriations bills through, but this is not unusual. I remember when I was serving as Assistant Secretary of the Navy, why they changed the fiscal year and there was a new Secretary of the Navy from Rhode Island—Senator Chafee now; at that time he was a former Governor—and he turned to maybe, I think, one of your former colleagues, Frank Sanders from the Appropriations Committee, who was Assistant Secretary of the Navy, and he says, Frank, why are we changing the fiscal year? We have just now got all of the States on the June 30 fiscal year, and all of the universities and most of the nonprofits.

And I also remember Frank saying to—his answer, he said, Mr. Secretary, he said, it is so that we don't ever again have to have a continuing resolution. And we all know how that has worked out.

So I really do believe that it would be better to streamline some of the processes that we have in the budget area and to look at the chart of accounts that we have built up over the years which is very, very complicated and see if we can't streamline that.

I also think that you need a proper breakout. I think right now there is a great debate on whether to take some items off of the budget, and I think Congressman Wise raised the issue. Some years back we prepared some breakouts, leaving the unified budget as a final total column, you might say, so that the economists truly can see what is the impact of Federal expenditures on the economy. But a proper breakout into the operating areas, the capital—we generally like to refer to it as "investment" now—and then the interest costs or the financing costs and the trust funds; and I think if you got a proper breakout, then I think the American public and I think the Members of the Congress could understand much better what the budget is all about. I do believe this would be very helpful.

We think also in the budget arena that one of the important things is to keep a focus on the long term. In other words, we have issued some reports starting in 1990 that show that we are getting into some very serious financial problems here; we already were in as of 1990. We issued a report that said the budget truly was closer to $400 billion in deficit than what the official records were indicating. And now that we have made progress bringing down the deficit here, why I think it is awfully important to keep a focus on, what are some of the big program areas like health care on the domestic side of the budget? We still have to come up with answers in those major program areas if we are going to get the budget in a balanced position in the early part of the next century.

I think also, in just running departments; in other words, if you are trying to manage a department in the Federal Government, why you have to have a long-range view as to where you are going with your people, with your systems, investments, with your facilities, and certainly when you get over to defense and some of your weapons systems and things like that. So I think it is awfully important if the budget can show the long-term impact of what is happening here.

I have already mentioned the investment component. We have moved more to a consumption percentage, you might say, in our budget than we have historically, less in investment. I think that is something that should be highlighted more properly than it maybe has been in the past.

As far as enforcement of what has actually happened, we have been looking at a look-back kind of provision that we think would be helpful, that the Congress should consider so that if there are misestimations or miscalculations somewhere along the line, why there would be some method to deal with that.

As I say, in the financial reporting, we think that we are making real good progress.

On the legislative, now, it is going to take a lot of hard work to get the systems and the agencies so that they can produce the statements, produce the cost information and, of course, the performance measures. And I think one of the big things in a few years would be to try to link the two together; in other words, bring budget and accounting much better into some kind of a unified financial management system, have it on the PC so that everybody in the Congress could have the information, everybody at OMB and CBO, and also in the agencies.

I think we are still, if you really think about our systems, we are still very much dealing with a lot of disjointed systems that get pulled together at the end; and with modern technology, that is not needed any longer. We could really link it all together—a big effort, but something that I think needs to be done.

Mr. Chairman, that is a summary of our presentation. We would be pleased to answer any questions that you may have.

[The prepared statement of Mr. Bowsher follows:]

Statement of Charles A. Bowsher
Comptroller General of the United States

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss improvements that should be made in how the federal government budgets and manages its finances. Throughout my tenure, I have stressed the need for fundamental reforms to ensure that more timely, reliable, and useful information is available for managing and assessing the government's financial condition and operating performance. Such reforms are critical if our federal government is ever to attain proper accountability over hundreds of billions of taxpayer dollars and these reforms are essential prerequisites to achieving broader management reforms.

I am pleased to say that in the last 6 years a solid framework for improving financial management finally has been established. This base has been laid by (1) the original Chief Financial Officers (CFO) Act of 1990 and its subsequent expansion through the Government Management Reform Act of 1994, (2) the creation of the Federal Accounting Standards Advisory Board (FASAB) in 1990, and (3) efforts made to improve the budget process through such actions as enactment of credit reform. During this period, many professionals involved in budgeting, accounting, and management reporting have devoted a great deal of thought and effort to developing a vision for more effective and understandable financial management reporting for the federal government.

Today I will discuss the need to build upon this foundation as well as outline additional areas for further reforms. I will begin with some changes we have suggested to improve the budget process even within its current basic design; most of these go to the need to increase the recognition of the long-term implications of budget decisions and to strengthen accountability. Then I will turn to the important set of reforms underway, which would further enhance budget decision-making as well as broader accountability for the government's use of and care for taxpayer funds. Moreover, as the quality of financial data and of federal reports on costs and performance improves through implementation of the CFO Act and the Government Performance and Results Act (GPRA) as well as the introduction of new accounting concepts and standards, these enhancements must be more fully integrated into the budget decision-making process to permit better-informed budget decisions.

This is not a simple agenda. Nor will it be accomplished in a year. But we have laid a good foundation, and there is reason to expect continued progress.

BUDGET PROCESS: IDEAS FOR IMPROVEMENT

Today there is widespread frustration with the budget process. It is attacked as confusing, time-consuming, burdensome, and repetitive. In addition, the results are often disappointing to both participants and observers. Although frustration is nearly universal, there is less agreement on what specific changes would be appropriate. This is not surprising. It is in the budget debate that the government determines in which areas it will be involved and how it will exercise that involvement. Disagreement about the best process to reach such important decisions and how to allocate precious resources is to be expected.

We have made several proposals based on a good deal of GAO work on the budget, including the structure of the budget and the budget process.[1] These proposals emphasize the need to improve the recognition of the long-term impact of today's budget decisions and advance steps to strengthen or better ensure accountability.

Focus on the long term

In previous reports and testimonies, we have said that the nation's economic future depends in large part upon today's budget and investment decisions.[2] Therefore, it is important for the budget to provide a long-term framework and be grounded in a linkage of fiscal policy with the long-term economic outlook. This would require a focus both on overall fiscal policy and on the composition of federal activity.

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[1]See Budget Process: History and Future Directions (GAO/T-AIMD-95-214, July 13, 1995); Budget Process: Some Reforms Offer Promise (GAO/T-AIMD-94-86, March 2, 1994); and Budget Issues: Incorporating an Investment Component in the Federal Budget (GAO/AIMD-94-40, November 9, 1993).

[2]See The Deficit and the Economy: An Update of Long-term Simulations (GAO/AIMD/OCE-95-119, April 26, 1995); Budget Policy: Prompt Action Necessary To Avert Long-Term Damage to the Economy (GAO/OCG-92-2, June 5, 1992); and Budget Policy: Long-term Implications of the Deficit (GAO/T-OCG-93-6, March 25, 1993).

In previous reports we have cautioned that the objective of enhancing long-term economic growth through overall fiscal policy is not well served by a budget process which focuses on the short-term implications of various spending decisions. It is important to pay attention to the long-term overall fiscal policy path, to the longer-term implications of individual programmatic decisions, and to the composition of federal spending.

We have suggested that budget decisions be made within the context of a chosen long-term fiscal policy path and multiyear enforceable budget agreements. Although the multiyear focus of the Budget Enforcement Act of 1990 (BEA) represents a significant step away from focusing only on the very short-term, planning for longer-range economic goals requires exploring the implications of budget decisions well into the future. By this, we do not mean detailed budget projections could be made over a 30-year time horizon, but it is important to recognize that for some programs a long-term perspective is critical to understanding the fiscal and spending implications of a decision. The current 5-year time horizon may work well for some programs, but for retirement programs, pension guarantees, and mortgage-related commitments--for example--a longer-time horizon is necessary.

Although the surest way of increasing national savings and investment would be to reduce federal dissaving by eliminating the deficit, the composition of federal spending also matters. We have noted that federal spending can be divided into two broad categories based on the economic impact of that spending–consumption spending having a short-term economic impact and investment spending intended to have a positive effect on long-term private sector economic growth. We have argued that the allocation of federal spending between investment and consumption is important and deserves explicit consideration. However, the current budget process does not prompt the executive branch or the Congress to make explicit decisions about how much spending should be for long-term investment. The budget functions along which the resolution is structured represent one categorization by "mission," but they are not subdivided into consumption and investment. Appropriations subcommittees provide funding by department and agency in appropriations accounts that do not distinguish between investment and consumption spending. In short, the investment/consumption decision is not one of the organizing themes for the budget debate.

We have suggested[3] that an appropriate and practical approach to supplement the budget's focus on macroeconomic issues would be to incorporate an investment component within the discretionary caps set by BEA. Such an investment component would direct attention to the trade-offs between consumption and investment but within the overall fiscal discipline established by the caps. It would provide policymakers with a new tool for setting priorities between the long term and the short term. Within the declining unified budget deficit path, a target for investment spending could be

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[3]See Budget Structure: Providing an Investment Focus in the Federal Budget (GAO/T-AIMD-95-178, June 29, 1995) and Budget Issues: Incorporating an Investment Component in the Federal Budget (GAO/AIMD-94-40, November 9, 1993).

established for the appropriate level of investment to ensure that it is considered formally in the budget process.

Enforcement, accountability, transparency

In addition to changes aimed at improving the focus on the long-term, we have continued to emphasize the importance of enforceability, accountability, and transparency. We describe these three elements together because it is difficult to have accountability without an enforcement mechanism and without transparency to make the process understandable to those outside it. Accountability in this context has several dimensions: accountability for the full costs of commitments that are to be made and accountability for actions taken–which requires targeting enforcement to actions. In addition, it may encompass the broader issue of taking responsibility for responding to unexpected events. Transparency is important not only because in a democracy the budget debate should be accessible to the citizenry but also because without it, there can be little ultimate accountability to the public.

In this area, as in others I discuss today, there has been progress. For example, enforcement provisions in BEA have worked within their scope: the discretionary caps and controls on expanding entitlements have held. The design of the law has provided accountability for the costs of actions taken and for compliance with rules. However, accountability for the worse-than-expected deficits in the past has been diffuse. For credibility and for success, we need to consider bringing more responsibility for the results of unforeseen actions into the system.

We have previously suggested[4] that Congress might want to consider introducing a "lookback" into its system of budgetary controls. Under such a process, the current Congressional Budget Office (CBO) deficit projections would be compared to those projected at the time of a prior deficit reduction agreement and/or the most recent reconciliation legislation. For a difference exceeding a predetermined amount, the Congress would decide explicitly–through a vote–whether to accept the slippage or to act to bring the deficit path closer to the original goal by mandating actions to narrow this gap.

A similar–but more narrowly focused–process could be used to look at the path of mandatory spending.[5] Under such a procedure, direct spending targets for several fiscal years could be specified. If the President's budget showed that these targets were exceeded in the prior year or would likely be exceeded in the current or budget years, the President would be required to recommend whether none, some, or all of the overage

[4]See Budget Process: Issues Concerning the 1990 Reconciliation Act (GAO/AIMD-95-3, October 7, 1994) and Budget Process: History and Future Directions (GAO/T-AIMD-95-214, July 13, 1995).

[5]See Budget Policy: Issues in Capping Mandatory Spending (GAO/AIMD-94-155, July 18, 1994) and Budget Process: History and Future Directions (GAO/T-AIMD-95-214, July 13, 1995).

should be recouped. The Congress could be required to vote either on the President's proposal or an alternative one.

Neither of these "lookback" processes determine an outcome; both seek to increase accountability for decisions about the path of federal spending. Taken together, the changes we have suggested, which could be made within the current budget process, would move us toward increased focus on important decisions and increased accountability for those decisions. Also, as discussed below, additional financial reporting and management reforms underway hold tremendous potential for helping to improve greatly the quality of information available to further enhance budget decision-making.

FINANCIAL REPORTING AND MANAGEMENT: THE BASIS FOR FUTURE PROGRESS

The budget should be formulated using accurate and reliable financial data on actual spending and program performance. Audited financial statements and reports ought to be the source of these data. Ideally, we should expect such reports to address (1) the full costs of achieving program results, (2) the value of what the government owns and what it owes to others, (3) the government's ability to satisfy future commitments if current policies were continued, and (4) the government's ability to detect and correct problems in its financial systems and controls.

Unfortunately, financial accounting information to date has not always been reliable enough to use in federal decision-making or to provide the requisite public accountability for the use of taxpayers' money. Good information on the full costs of federal operations is frequently absent or extremely difficult to reconstruct and reliable information on federal assets and liabilities is all too often lacking. While GAO has been actively urging improvements in this area for over 20 years, complete, useful financial reporting is not yet in place.

The good news is that tools are now being put in place that promise to get the federal government's financial house in order. First, beginning for fiscal year 1996, all major agencies, covering about 99 percent of the government's outlays, are required to prepare annually financial statements and have them audited. Second, an audited governmentwide financial statement is required to be produced every year starting with fiscal year 1997. Third, FASAB is recommending new federal accounting standards that will yield more useful and relevant financial statements and information.

The basis for much of this progress is the CFO Act's requirements for annual financial statement audits. Audits for a select group of agencies under the Act's original pilot program highlighted problems of uncollected revenues and billions of dollars of unrecognized liabilities and potential losses from such programs as housing loans, veterans compensation and pension benefits, and hazardous waste cleanup. Such audits are bringing important discipline to agencies' financial management and control systems.

Thanks to the benefits achieved from these pilot audits, the Congress extended this requirement, in the 1994 Government Management Reform Act, to the government's 24 major departments and agencies.

That act also mandated an annual consolidated set of governmentwide financial statements–to be audited by GAO–starting for fiscal year 1997. These statements will provide an overview of the government's overall costs of operations, a balance sheet showing the government's assets and liabilities, and information on its contribution to long-term economic growth and the potential future costs of current policies. These reports will provide policymakers and the public valuable information to assess the sustainability of federal commitments.

The CFO Act also went beyond these auditing and reporting requirements to spell out an agenda of other long overdue reforms. It established a CFO structure in 24 major agencies and the Office of Management and Budget (OMB) to provide the necessary leadership and focus. It also set expectations for

- the deployment of modern systems to replace existing antiquated, often manual, processes;

- the development of better performance and cost measures; and

– the design of results-oriented reports on the government's financial condition and operating performance by integrating budget, accounting, and program information.

I have testified before the Congress many times about the benefits being achieved as the CFO Act reforms are implemented.[6] Moreover, agency efforts to implement GPRA and the new accounting standards recommended by FASAB will further enhance the usefulness of accountability reporting to decisionmakers by integrating performance measures into the reports and developing reports more specifically tailored to the government's needs.

FASAB Efforts

The creation of FASAB was the culmination of many years of effort to achieve a cooperative working relationship between the three principal agencies responsible for overall federal financial management–OMB, Treasury, and GAO. Its establishment represents a major stride forward because financial management can only improve if these principal agencies involved in setting standards, reporting, and auditing work together. As you know, FASAB was established in October 1990 by the Secretary of the Treasury, the Director of OMB, and me to consider and recommend accounting principles

[6]For additional discussion of the benefits being derived from the CFO Act and the challenges remaining to be addressed, see Financial Management: Continued Momentum Essential to Achieve CFO Act Goals (GAO/T-AIMD-96-10, December 14, 1995) and Managing for Results: Strengthening Financial and Budgetary Reporting (GAO/T-AIMD-95-181, July 11, 1995)

for the federal government. The 9-member board is comprised of representatives from the three principals, CBO, the Department of Defense, one civilian agency (presently Energy), and three representatives from the private sector, including the Chairman, former Comptroller General Elmer B. Staats. FASAB recommends accounting standards after considering the financial and budgetary information needs of the Congress, executive agencies, other users of federal financial information and comments from the public. OMB, Treasury and GAO then decide whether to adopt the recommended standards; if they do, the standards are published by GAO and OMB and become effective.

FASAB will soon complete the federal government's first set of comprehensive accounting standards developed under this consensus approach. Key to the FASAB approach for developing these standards was extensive consultation with users of financial statements early in its deliberations to ensure that the standards will result in statements that are relevant to both the budget process as well as agencies' accountability for resources. Users were interested in getting answers to questions on such topics as:

- Budgetary integrity–What legal authority was provided to finance government activities and was it used correctly?

- Operating performance–How much do programs cost and how were they financed? What was achieved? What are the government's assets and are they well managed? What are its liabilities and how will they be paid for?

– Stewardship–Has the government's overall financial capacity to satisfy current and future needs and costs improved or deteriorated? What are its future commitments and are they being provided for? How will the government's programs affect the future growth potential of the economy?

– Systems and control–Does the government have sufficient controls over its programs so that it can detect and correct problems?

The FASAB principals have approved eight basic standards and statements, which I will refer to as FASAB standards in my testimony today, and approval of the final one for revenue accounting is expected this spring. This will complete the body of basic accounting and cost accounting standards for all federal agencies to use in preparing financial reports and developing meaningful cost information. The basic standards and statements are:

– Objectives of Federal Financial Reporting–A statement of general concepts on the objectives of financial reporting by the U.S. government providing the basic framework for the Board's work.

– Entity and Display–A statement of general concepts on how to define federal financial reporting entities and what kinds of financial statements those entities should prepare.

- Managerial Cost Accounting Concepts and Standards–A statement of general concepts combined with a statement of specific standards emphasizing the need to relate cost information with budget and financial information to provide better information for resource allocation and performance measurement.

- Accounting for Selected Assets and Liabilities–A statement of specific standards for accounting for basic items such as cash, accounts receivable, and accounts payable.

- Accounting for Direct Loans and Loan Guarantees–A statement of accounting standards responding to the Credit Reform Act of 1990.

- Accounting for Inventory and Related Property–A statement of standards for accounting for inventories, stockpiled materials, seized and forfeited assets, foreclosed property, and goods held under price support programs.

- Accounting for Liabilities of the Federal Government–A statement of standards for federal insurance and guarantee programs, pensions and post-retirement health care for federal workers, and other liabilities, including contingent liabilities.

- Accounting for Property, Plant and Equipment–A statement of standards for accounting for the various types of property (including heritage assets), plant and equipment held by the government.

- Accounting for Revenue and Other Financing Sources- A statement of standards for accounting for inflows of resources (whether earned, demanded, or donated) and other financing sources.

A standard for stewardship reporting is also scheduled for completion this spring. While not part of the package of basic standards, it will help inform decisionmakers about the magnitude of federal resources and financial responsibilities and the federal stewardship role over them.

The standards and new reports are being phased in over time. Some are effective now; all that have been issued will be effective for fiscal year 1998. OMB defines the form and content of agency financial statements in periodic bulletins to agency heads. The most recent guidance incorporates FASAB standards for selected assets and liabilities, credit programs, and inventory. In the fall, OMB will be issuing new guidance reflecting the rest of the FASAB standards.

Since the enactment of the CFO Act, OMB's form and content guidance has stressed the use of narrative "Overview" sections preceding the basic financial statements as the best way for agencies to relate mission goals and program performance measures to financial resources. Each financial statement includes an Overview describing the agency, its mission, activities, accomplishments, and overall financial results and condition. It also should discuss what, if anything, needs to be done to improve either program or financial performance, including an identification of programs or activities that may need significant future funding. OMB also requires that agency financial statements include a balance sheet, a statement of operations, and a statement reconciling expenses reported on the statement of operations to related amounts presented in budget execution reports.

Based on FASAB's standards, OMB is making efforts to design new financial reports that contain performance measures and budget data to provide a much needed, additional perspective on the government's actual performance and its long-term financial prospects. Financial reports based on FASAB's standards will provide valuable information to help sort out various kinds of long-term claims. The standards envision new reports on a broad range of liabilities and liability-like commitments and assets and asset-like spending. Liabilities, such as the federal debt, would be reported on a balance sheet, along with assets owned by federal agencies, like buildings.

Stewardship reporting in the financial statements, a new concept developed by FASAB, will report on potential future claims that represent commitments of the government that are not sufficiently firm to warrant recognition as liabilities on the balance sheet. FASAB is still considering what types of estimates would be most useful if stewardship reporting is applied to social insurance. To give a picture of the government's capacity to sustain current public services, stewardship reporting will also include 6-year projections of receipt and outlay data for all programs based on data submitted for the President's budget.

Stewardship reports based on FASAB standards would also provide information on federal investments intended to have future benefits for the nation, thus providing actual data on the budget's investment component that GAO has recommended and which I discussed earlier. Stewardship reporting would cover federal investments and some performance information for programs intended to improve the nation's infrastructure, research and development, and human capital due to their potential contribution to the long-term productive capacity of the economy. These kinds of activities would not be reflected on the balance sheet because they are not assets owned by the federal government but rather programs and subsidies provided to state and local governments and the private sector for broader public purposes. Stewardship reporting recognizes that, although these investments lack the traditional attributes of assets, such programs warrant special analysis due to their potential impact on the nation's long-term future.

Linking costs to the reported performance levels is the next challenge. FASAB's cost accounting standards–the first set of standards to account for costs of federal government programs–will require agencies to develop measures of the full costs of carrying out a mission or producing products or services. Thus, when implemented, decisionmakers would have information on the costs of all resources used and the cost of support services provided by others to support activities or programs–and could compare these costs to various levels of program performance.

Perseverance will be required to sustain the current momentum in improving financial management and to successfully overcome decades of serious neglect in fundamental financial management operations and reporting methods. Implementing FASAB standards will not be easy. FASAB has allowed lead time for implementing the standards so that they can be incorporated into agencies' systems. Nevertheless, even with this lead time, agencies may have difficulty in meeting the schedule. It is critical that the Congress and the executive branch work together to make implementation successful.

As the federal government continues to improve its accountability and reporting of costs and performance, the more useful and reliable data need to be used to influence decisions. That brings me to the task of better integrating financial data and reports into the budget decision-making process.

MAKING BETTER INFORMED BUDGET
DECISIONS BASED ON IMPROVED
FINANCIAL DATA AND REPORTS

The ultimate goal of more reliable and relevant financial data is to promote more informed decision-making. For this to happen, the financial data must be understood and used by program managers and budget decisionmakers. The changes underway to financial reporting have been undertaken with a goal of making financial data more accessible to these decisionmakers. The budget community's involvement in the FASAB standard-setting process has contributed to this. Still, the future challenge remains to further integrate financial reports with the budget to enhance the quality and richness of the data considered in budget deliberations. Improving the linkages between accounting and budgeting also call for considering certain changes in budgeting such as realigned account structures and the selective use of accrual concepts.

The chief benefit of improving this linkage will be the increased reliability of the data on which we base our management and budgetary decisions. The new financial reports will improve the reliability of the budget numbers undergirding decisions. Budgeting is a forward-looking enterprise, but it can clearly benefit from better information on actual expenditures and revenue collection. Under FASAB standards, numbers from the budget will be included in basic financial statements and thus will be audited for the first time. Having these numbers audited was one of the foremost desires of budget decisionmakers consulted in FASAB's user needs study and stems from their suspicion that the unaudited numbers may not always be correct.

The new financial reports will also offer new perspectives and data on the full costs of program outputs and agency operations that are currently not reported in the cash-based budget. Information on full costs generated pursuant to the new FASAB standards would provide decisionmakers a more complete picture of actual past program costs and performance when they are considering the appropriate level of future funding. For example, the costs of providing Medicare are spread among at least three budget accounts. Financial reports would pull all the relevant costs together.

Realigning Account Structures

The different account structures that are used for budget and financial reporting are a continuing obstacle to using these reports together and may prevent decisionmakers from fully benefiting from the information in financial statements. Unlike financial reporting, which is striving to apply the full cost concept when reporting costs, the budget account structure is not based on a single unifying theme or concept. The current budget account structure evolved over time in response to specific needs.[7]

The budget contains over 1,300 accounts. They are not equal in size; nearly 80 percent of the government's resources are clustered in less than 5 percent of the accounts. Some accounts are organized by the type of spending (such as personnel compensation or equipment) while others are organized by programs. Accounts also vary in their coverage of cost, with some including both program and operating spending while others separate salaries and expenses from program subsidies. Or, a given account may include multiple programs and activities.

[7]For further discussion, see Budget Account Structure: A Descriptive Overview (GAO/AIMD-95-179, September 18, 1995).

When budget account structures are not aligned with the structures used in financial reporting, additional analyses or crosswalks would be needed so that the financial data could be considered in making budget decisions. If the Congress and the executive branch reexamine the budget account structure, the question of trying to achieve a better congruence between budget accounts and the accounting system structure, which is tied to performance results, should be considered.

The Selective Use of Accrual
Concepts in the Budget

In addition to providing a new, full cost perspective for programs and activities, financial reporting has prompted improved ways of thinking about costs in the budget. For the most part, the budget uses the cash basis, which recognizes transactions when cash is paid or received. Financial reporting uses the accrual basis, which recognizes transactions when commitments are made regardless of when the cash flows.

Cash-based budgeting is generally the best measure to reflect the short-term economic impact of fiscal policy as well as the current borrowing needs of the federal government. And for many transactions, such as salaries, costs recorded on a cash basis do not differ appreciably from accrual.

However, for a select number of programs, cash-based budgeting does not adequately reflect the future costs of the government's commitments or provide appropriate signals on emerging problems. For these programs, accrual-based reporting may improve budgetary decision-making. The accrual approach records the full cost to the government of a decision–whether to be paid now or in the future. As a result, it prompts decisionmakers to recognize the cost consequences of commitments made today.

Accrual budgeting is being done under the Credit Reform Act for credit programs such as the federal family education loan program and the rural electrification and telephone direct loan program. It may be appropriate to extend its use to other programs such as federal insurance programs–an issue we are currently studying at the request of the Chairman, House Budget Committee. Our work to date has revealed shortcomings with cash-based budgeting for insurance programs, but also highlighted difficulties in estimating future costs for some of them due to the lack of adequate data or to sensitivity to the assumptions used to model future costs. The potential distortions arising from the cash-based approach must be weighed against the risks and uncertainties involved in estimating longer-term accrued costs for some programs. Our upcoming report on budgeting for insurance will address these issues.

Small changes in the right direction are important, but to make the kind of difference we are all seeking will require pulling all this together for budget and oversight.

PUTTING IT ALL TOGETHER AND MAKING IT WORK

Thanks in large part to the legislative impetus of the CFO Act and GPRA, decisionmakers will ultimately have available unprecedented, reliable information on both the financial condition of programs and operations as well as the performance and costs of these activities. While these initiatives carry great potential, they require continued support by the agencies and the Congress.

GPRA set forth the major steps federal agencies need to take towards a results-oriented management approach. They are to (1) develop a strategic plan, (2) establish performance measures focused on "outcomes" or results expressed in terms of the real difference federal programs make in people's lives and use them to monitor progress in meeting strategic goals, and (3) link performance information to resource requirements through annual performance plans.

I have supported the intent of GPRA and believe that it offers great potential for enhancing decision-making and improving the management of federal programs. A growing number of federal agencies is beginning to see that a focus on outcomes can lead to dramatic improvements in effectiveness. However, our work also has shown that a fundamental shift in focus to include outcomes does not come quickly or easily.[8] The

[8]Managing For Results: Achieving GPRA's Objectives Requires Strong Congressional Role (GAO/T-GGD-96-79, March 6, 1996).

early experiences of many GPRA pilots show that outcomes can be very difficult to define and measure. They also found that a focus on outcomes can require major changes in the services that agencies provide and processes they use to provide those services.

Given that the changes envisioned by GPRA do not come quickly or easily, strong and sustained congressional attention to GPRA implementation is critical. Without it, congressional and executive branch decisionmakers may not obtain the information they need as they seek to create a government that is more effective, efficient, and streamlined. Authorization, appropriation, budget, and oversight committees all have key interests in ensuring that GPRA is successful, because once fully implemented, it should provide valuable data to help inform the decisions that each committee must make.

OMB has attempted to prompt progress by giving special emphasis in its budget submission guidance to increasing the use of information on program performance in budget justifications. In preparation for the fiscal year 1997 budget cycle, OMB held performance reviews last May with agencies on performance measures and in September 1995 issued guidance on preparing and submitting strategic plans. Further progress in implementing GPRA will occur as performance measures become more widespread and agencies begin to use audited financial information in the budget process to validate and assess agency performance.

GAO, OMB, and the CFO Council have also given thought as to how to best report data and information to decisionmakers. While there are a myriad of legislatively mandated reporting requirements under separate laws, such as GPRA, the Federal Managers' Financial Integrity Act, the CFO Act, and the Prompt Pay Act, decisionmakers need a single report relating performance measures, costs, and the budget. This reporting approach is consistent with the CFO Council's proposal for an Accountability Report, which OMB is pursuing.

On a pilot basis, OMB is having six agencies[9] produce Accountability Reports providing a comprehensive picture of each agency's performance pursuant to its stated goals and objectives. The ultimate usefulness of the Accountability Report will hinge on its specific content and the reliability of information presented. We will work with OMB and agencies throughout the pilot program. We agree with the overall streamlined reporting concept and believe that, to be most useful, the Accountability Report must include an agency's financial statements and related audit reports.

Accountability reports could then be used as the basis for annual oversight hearings, something I have long advocated. Such serious scrutiny of programs and activities is especially important as we seek to reduce the deficit. Oversight hearings based on complete sets of reports could be the basis for considering changes in federal roles and in

[9]The six pilot agencies are the Departments of the Treasury and Veterans Affairs; the General Services, Social Security, and National Aeronautics and Space Administrations; and the Nuclear Regulatory Commission.

program design as well as reviewing the adequacy of agencies' accountability and performance.

Finding the most effective reporting and analytical approaches will require a great deal of collaboration and communication. Appropriations, budget, and authorizing committees need to be full partners in supporting the implementation of these initiatives. The new financial reports based on FASAB's recommended standards will provide much-needed additional perspective on the long-term prospects for government programs and finances. It can be used with other kinds of actuarial and economic analyses already available in making budget decisions.

CONCLUSION

In conclusion, reforms are needed on three fronts–in the budget process, in accountability and reporting for costs and performance, and in using the improved reports to better inform policy and budget decisions. Improved financial management and reports are essential to improving the government's ability to provide accountability for public resources. Continuing fiscal pressures will place a premium on the proper stewardship of increasingly scarce public resources. Recent efforts to improve federal financial reporting will, if properly implemented, provide the tools needed to redress long-standing weaknesses.

Improved financial reports and data should also better help policymakers sort out competing claims in the budget process. Improved financial data on the current and future stakes involved in our decisions may help policymakers make decisions focused more on the long-term consequences. The public also stands to gain from these initiatives, both from improved accountability for public resources and more informed decisions.

Mr. Chairman, this concludes my statement. I would be happy to respond to questions.

Mr. HORN. Thank you very much.

The gentleman from Virginia, Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman.

Let me just ask, we had a huge debate in the House last week over trust funds, how trust funds are allocated, to find out if they are really not trust funds. I mean, the local government, if we had treated trust funds the way the Federal Government treats trust funds, we would all be in jail. They are moving them back and forth, a lot of confusion.

The Highway Trust Fund was the issue last year, it will be the Social Security Trust Fund, but there are literally dozens and dozens and dozens of such trust funds within the government. Do you have any thoughts in terms of realigning that?

Mr. BOWSHER. That is one of the reasons why we advocated this better breakout, it shows better the way it is being accumulated. Some years back, we did kind of a prototype for the Congress because I think it is frustrating and confusing to the average person.

There is no question, we have issued reports pointing out that the money that is taken in and put into the trust funds is basically a bookkeeping entry over at the Treasury, and that the funds are used for other expenses; and what you have at the Treasury today are accounts that are set up and that, but when you come right to the Social Security Trust Fund, you are building up a huge IOU there, you might say, that eventually you have to have cash.

So that means that sometime in the future, in the next century, why somebody is going to have to be able to produce cash to pay off what is on the books as far as what the trust fund actually owes. So there is no question; that is, the excess money that is coming in on those trust funds today is being used for regular expenditures of the Federal Government.

Mr. DAVIS. Does anybody have a breakout of what all the trust funds are?

Mr. HORN. I think the gentleman makes an excellent suggestion. Let's put at this point in the record, what are those funds that we call trust funds, even if they don't act as trust funds some days?

Mr. BOWSHER. We have that information. We have produced it in the past, and if you would like us to——

Mr. HORN. At this point in the record, without objection.

Ms. IRVING. We will supply a copy for you.

[The information referred to follows:]

Table 1: Trust Nonrevolving Fund Accounts

Dollars in millions

Agency/Bureau	Account	Account ID	Actual 1995 Net Budget Authority	Actual 1995 Net Outlays
Department of Agriculture				
Agricultural Marketing Service	Miscellaneous trust funds	[illegible]	[illegible]	108
Agricultural Research Service	Miscellaneous contributed funds	[illegible]-8211-0-7-352	11	12
Animal and Plant Health Inspection Service	Miscellaneous trust funds	12-9971-0-7-352	7	8
Food Safety and Inspection Service	Expenses and refunds, inspection and grading of farm products	12-8137-0-7-352	3	3
Foreign Agricultural Service	Miscellaneous contributed funds	12-8232-0-7-352	3	3
Forest Service	Cooperative work trust fund	12-8028-0-7-302	565	349
Forest Service	Reforestation trust fund	12-8046-0-7-302	30	27
Natural Resources Conservation Service	Miscellaneous contributed funds	12-8210-0-7-300	0	1
Office of the Secretary	Gifts and bequests	12-8203-0-7-352	1	0
Rural Utilities Service	Rural telephone bank equity fund	12-8139-0-7-452	0	0
Department of Commerce				
International Trade Administration	Foreign service national separation liability trust fund	13-8344-0-7-602	0	0
Department of Defense--Civil				
Armed Forces Retirement Home	Armed forces retirement home	84-8522-0-7-705	59	57
Corps of Engineers -Civil	Coastal wetlands restoration trust fund	96-8333-0-7-301	35	12
Corps of Engineers -Civil	Harbor maintenance trust fund	96-8863-0-7-301	521	519
Corps of Engineers -Civil	Inland waterways trust fund	20-8861-0-7-301	55	93
Corps of Engineers -Civil	Oil spill research	96-8868-0-7-301	1	1
Corps of Engineers -Civil	Rivers and harbors contributed funds	96-8862-0-7-301	134	121
Education Benefits	Education benefits fund	97-8098-0-7-702	180	180
Military Retirement	Military retirement fund	97-8097-0-7-602	27905	27797
Department of Defense--Military				
Trust Funds	Foreign national employees separation pay	97-8165-0-[illegible]	139	129
Trust Funds	National security education trust fund	97-8168-0-7-05[illegible]	[illegible]	6
Trust Funds	Other DOD trust funds	21-9971-0-7-05[illegible]	25	24
Trust Funds	Voluntary separation incentive fund	97-8335-0-7-051	80	143
Department of Energy				
Energy Programs	Advances for cooperative work	89-8575-0-7-271	4	8
Department of Health and Human Services				
Health Care Financing Administration	Federal hospital insurance trust fund	20-8005-0-7-571	109861	114883
Health Care Financing Administration	Federal supplementary medical insurance trust fund	20-8004-0-7-571	66953	65213
Health Resources and Services Administration	Vaccine injury compensation program trust fund	20-8175-0-7-551	51	51
Program Support Center	Miscellaneous trust funds	75-9971-0-7-551	53	46

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Dollars in millions

Agency/Bureau	Account	Account ID	Actual 1995 Net Budget Authority	Actual 1995 Net Outlays
Department of the Interior				
Bureau of Indian Affairs	Cooperative fund (papago)	14-8366-0-7-452	2	1
Bureau of Indian Affairs	Miscellaneous trust funds	14-9973-0-7-999	357	239
Bureau of Land Management	Miscellaneous trust funds	14-9971-0-7-302	8	8
Bureau of Mines	Contributed funds	14-8287-0-7-306	3	2
Bureau of Reclamation	Reclamation trust funds	14-8070-0-7-301	23	20
Minerals Management Service	Oil spill research	14-8370-0-7-302	6	4
National Biological Service	Donations and contributed funds	14-8356-0-7-303	0	0
National Park Service	Construction (trust fund)	14-8215-0-7-401	0	8
National Park Service	Miscellaneous trust funds	14-9972-0-7-303	12	7
United States Fish and Wildlife Service	African elephant conservation fund	14-8154-0-7-303	1	1
United States Fish and Wildlife Service	Contributed funds	14-8216-0-7-303	3	4
United States Fish and Wildlife Service	Sport fish restoration	14-8151-0-7-303	243	238
Department of Justice				
Radiation Exposure Compensation	Radiation exposure compensation trust fund	15-8116-0-7-054	1	32
Department of Labor				
Employment Standards Administration	Black lung disability trust fund	20-8144-0-7-601	987	987
Employment Standards Administration	Special workers compensation expenses	16-9971-0-7-601	145	128
Employment and Training Administration	Unemployment trust fund	20-8042-0-7-999	25282	25203
Department of State				
Administration of Foreign Affairs	Foreign Service retirement and disability fund	19-8186-0-7-602	447	447
Administration of Foreign Affairs	Foreign service national separation liability trust fund	19-8340-0-7-602	7	6
Administration of Foreign Affairs	Miscellaneous trust funds	19-9971-0-7-153	3	1
Department of Transportation				
Bureau of Transportation Statistics	Aviation statistics, airport and airway trust fund	69-8392-0-7-407	0	0
Coast Guard	Boat safety	69-8149-0-7-403	58	67
Coast Guard	Coast Guard general gift fund	69-8533-0-7-403	0	0
Coast Guard	Emergency fund	69-8313-0-7-304	50	38
Coast Guard	Payment of claims	69-8312-0-7-304	5	5
Coast Guard	Trust fund share of expenses	69-8314-0-7-304	61	61
Federal Aviation Administration	Facilities and equipment (Airport and airway trust fund)	69-8107-0-7-402	1960	2638
Federal Aviation Administration	Grants in aid for airports (Airport and airway trust fund)	69-8106-0-7-402	67	1826
Federal Aviation Administration	Research, engineering and development (Airport and airway trust fund)	69-8108-0-7-402	252	232
Federal Aviation Administration	Trust fund share of FAA operations	69-8104-0-7-402	2450	2546
Federal Highway Administration	Federal-aid highways	69-8083-0-7-401	20876	19113
Federal Highway Administration	Highway-related safety grants	69-8019-0-7-401	0	9
Federal Highway Administration	Miscellaneous highway trust funds	69-9972-0-7-401	-11	106
Federal Highway Administration	Miscellaneous trust funds	69-9971-0-7-999	4	8
Federal Highway Administration	Motor carrier safety grants	69-8048-0-7-401	83	66
Federal Highway Administration	State infrastructure banks	69-8297-0-7-401	0	0
Federal Railroad Administration	Trust fund share of next generation high-speed rail	69-9973-0-7-401	-145	0

Table 1: Trust Nonrevolving Fund Accounts

Dollars in millions

Agency/Bureau	Account	Account ID	Actual 1995 Net Budget Authority	Actual 1995 Net Outlays
Federal Transit Administration	Discretionary grants (Highway trust fund)	69-8191-0-7-401	1691	2029
Federal Transit Administration	Trust fund share of expenses	69-8350-0-7-401	1150	1150
National Highway Traffic Safety Administration	Highway traffic safety grants	69-8020-0-7-401	196	161
National Highway Traffic Safety Administration	Operations and research (Highway trust fund)	69-8016-0-7-401	47	6
Office of the Secretary	Payments to air carriers (trust fund)	69-8304-0-7-402	23	29
Office of the Secretary	Trust fund share of rental payments	69-8066-0-7-407	42	42
Research and Special Programs Administration	Alaska pipeline task force	69-8346-0-7-407	-1	0
Research and Special Programs Administration	Trust fund share of pipeline safety	69-8121-0-7-407	2	2
Saint Lawrence Seaway Development Corporation	Operations and maintenance	69-800[illegible]-0-7-403	10	10
Department of the Treasury				
Financial Management Service	Rebate of Saint Lawrence seaway tolls	20-8865-0-7-808	2	2
United States Customs Service	Harbor maintenance fee collection	20-8870-0-7-751	0	0
United States Customs Service	Refunds, transfers and expenses, unclaimed, and abandoned goods	20-8789-0-7-751	4	3
Department of Veterans Affairs				
Veterans Benefits Administration	National Service Life Insurance fund	36-8132-0-7-701	1348	1249
Veterans Benefits Administration	Post-Vietnam era veterans education account	36-8133-0-7-702	22	58
Veterans Benefits Administration	United States government life insurance fund	36-8150-0-7-701	9	18
Veterans Health Administration	General post fund, national homes	36-8180-0-7-705	26	27
Environmental Protection Agency				
Environmental Protection Agency	Hazardous substance superfund	20-8145-0-7-304	1354	1472
Environmental Protection Agency	Leaking underground storage tank trust fund	20-8153-0-7-304	70	73
Environmental Protection Agency	Oil spill response	68-8221-0-7-304	20	22
Funds Appropriated to the President				
Agency for International Development	Foreign service national separation liability trust fund	72-8342-0-7-602	5	2
Agency for International Development	Miscellaneous trust funds, AID	72-9971-0-7-151	0	3
Military Sales Programs	Foreign military sales trust fund	11-8242-0-7-155	14868	13417
Military Sales Programs	Kuwait civil reconstruction trust fund	11-8238-0-7-155	0	0
Peace Corps	Peace Corps miscellaneous trust fund	11-9972-0-7-151	1	1
Legislative Branch				
Botanic Garden	Gifts and donations	09-8292-0-7-801	0	0
Legislative Branch Boards and Commissions	John C. Stennis Center for Public Service Development trust fund	09-8275-0-7-801	1	0
Legislative Branch Boards and Commissions	U.S. Capitol preservation commission	09-8300-0-7-801	6	2
Library of Congress	Gift and trust fund accounts	03-9971-0-7-503	25	15
United States Tax Court	Tax Court judges survivors annuity fund	23-8115-0-7-602	1	0
National Aeronautics and Space Administration				
National Aeronautics and Space Administration	Science, space, and technology education trust fund	80-8978-0-7-503	1	1
Office of Personnel Management				
Office of Personnel Management	Civil service retirement and disability fund	24-8135-0-7-602	48604	38435

Table 1: Trust Nonrevolving Fund Accounts

Dollars in millions

Agency/Bureau	Account	Account ID	Actual 1995 Net Budget Authority	Actual 1995 Net Outlays
Other Independent Agencies				
American Battle Monuments Commission	Contributions	74 8569 0 7 705	5	10
Appalachian Regional Commission	Miscellaneous trust funds	46 9971 0 7 452	5	5
Barry Goldwater Scholarship & Excellence in Education Foundation	Barry Goldwater Scholarship and Excellence in Education Foundation	95 8281 0 7 502	4	3
Christopher Columbus Fellowship Foundation	Christopher Columbus Fellowship Foundation	76-8187-0-7-502	0	0
Corporation for National and Community Service	Gifts and contributions	95-9972-0-7-506	104	6
Farm Credit System Financial Assistance Corporation	Financial assistance corporation trust fund	78 8202 0 7 351	5	0
Federal Emergency Management Agency	Bequests and gifts	11 8244 0 7 453	0	0
Harry S. Truman Scholarship Foundation	Harry S. Truman memorial scholarship trust fund	95 8296 0 7 502	3	3
James Madison Memorial Fellowship Foundation	James Madison Memorial Fellowship Trust Fund	95 8282 0 7 502	3	2
Japan-United States Friendship Commission	Japan-United States friendship trust fund	95 8025 0 7 154	1	2
Morris K. Udall Scholarship & Excellence in National Environment	Morris K. Udall Scholarship and Excellence in National Environmental Policy Foundation	95-8615-0-7-502	1	0
National Archives and Records Administration	National archives gift fund	88-8127-0-7-804	0	0
National Science Foundation	Donations	49-8960-0-7-251	31	22
Railroad Retirement Board	Rail Industry Pension Fund	60-8011-0-7-601	2955	2930
Railroad Retirement Board	Railroad social security equivalent benefit account	60-8010-0-7-601	8118	8152
Railroad Retirement Board	Railroad unemployment insurance trust fund	60-8051-0-7-603	81	79
Railroad Retirement Board	Supplemental Annuity Pension Fund	60-8012-0-7-601	79	91
United Mine Workers of America Benefit Funds	United mine workers of America 1992 benefit plan	95-8260-0-7-551	10	10
United Mine Workers of America Benefit Funds	United mine workers of America combined benefit fund	95-8295-0-7-551	326	326
United States Information Agency	American studies endowment fund	67-8166-0-7-154	0	0
United States Information Agency	Eastern europe student exchange endowment fund	95-8272-0-7-154	0	0
United States Information Agency	Foreign service national separation liability trust fund	67-8341-0-7-602	4	3
United States Information Agency	Israeli Arab and Eisenhower exchange fellowship program	95-8276-0-7-154	1	1
United States Information Agency	Miscellaneous trust funds	67-9971-0-7-154	2	1
Social Security Administration				
Social Security Administration	Federal disability insurance trust fund	20-8007 0 7 651	39993	41380
Social Security Administration	Federal old-age and survivors insurance trust fund	20-8006 0 7 651	213294	214474
The Judiciary				
Federal Judicial Center	Gifts and donations, Federal Judicial Center Foundation	10-8123-0-7-752	1	1
Judicial Retirement Funds	Claims court judges retirement fund	10-8124-0-7-602	1	0
Judicial Retirement Funds	Judicial officers' retirement fund	10-8122-0-7-602	24	8
Judicial Retirement Funds	Judicial survivors' annuities fund	10-8110-0-7-602	31	7

Source: GAO Budget Database

Table 2: Special Fund Accounts

Dollars in millions

Agency/Bureau	Account	Account ID	Actual 1995 Net Budget Authority	Actual 1995 Net Outlays
Department of Agriculture				
Agricultural Marketing Service	Funds for strengthening markets, income, and supply (section 32)	12-5209-0-2-60[illegible]	476	495
Agricultural Marketing Service	Perishable Agricultural Commodities Act fund	12-5070-0-2-352	8	8
Forest Service	Forest Service permanent appropriations	12-9921-0-2-806	86	320
Forest Service	Forest Service permanent appropriations	12-9922-0-2-302	209	248
Forest Service	Land acquisition accounts	12-9923-0-2-300	67	74
Forest Service	Operations and maintenance of quarters	12-5219-0-2-302	7	7
Forest Service	Range betterment fund	12-5207-0-2-302	5	4
Forest Service	Resource management timber receipts	12-5220-0-2-302	0	0
Department of Commerce				
National Oceanic and Atmospheric Administration	Aircraft procurement and modernization	13-1459-0-2-376	0	28
National Oceanic and Atmospheric Administration	Fishing vessel and gear damage compensation fund	13-5119-0-2-376	2	1
National Oceanic and Atmospheric Administration	North pacific fishery observer fund	13-5102-0-2-376	5	0
National Oceanic and Atmospheric Administration	Promote and develop fishery products and research pertaining to American fisheries	13-5139-0-2-376	9	4
Department of Defense--Civil				
Corps of Engineers Civil	Permanent appropriations	96-9921-0-2-999	12	17
Forest and Wildlife Conservation, Military Reservations	Forest products program	21-5285-0-2-302	0	0
Forest and Wildlife Conservation, Military Reservations	Wildlife conservation	97-5095-0-2-303	2	2
Department of Defense--Military				
Operation and Maintenance	Defense cooperation	97-5187-0-2-051	-1	0
Operation and Maintenance	Disposal and lease of DOD real property	97-3922-0-2-051	57	13
Operation and Maintenance	Kaho Olawe Island Conveyance, Remediation, and Environmental Restoration Fund	17-5185-0-2-051	50	6
Operation and Maintenance	Overseas military facility investment recovery	97-5193-0-2-051	38	1
Operation and Maintenance	Restoration of the Rocky Mountain Arsenal	21-5098-0-2-051	2	3
Department of Energy				
Energy Programs	Alternative fuels production	89-5180-0-2-271	-4	0
Energy Programs	Nuclear waste disposal fund	89-5227-0-2-271	393	375
Energy Programs	Payments to States under Federal Power Act	89-5105-0-2-806	2	3
Energy Programs	Uranium enrichment decontamination and decommissioning fund	89-5231-0-2-271	301	349
Power Marketing Administration	Construction, rehabilitation, operation and maintenance, Western Area Power Administrat	89-5068-0-2-271	184	285
Power Marketing Administration	Falcon and Amistad operating and maintenance fund	89-5178-0-2-271	0	0

Table 2: Special Fund Accounts

Dollars in millions

Agency/Bureau	Account	Account ID	Actual 1995 Net Budget Authority	Actual 1995 Net Outlays
Department of Housing and Urban Development				
Housing Programs	Interstate land sales	86 5270 0 2-376	0	0
Housing Programs	Manufactured home inspection and monitoring	86 5271 0 2-376	12	10
Management and Administration	Office of federal housing enterprise oversight	86 5272 0 2-371	10	11
Department of the Interior				
Bureau of Indian Affairs	Miscellaneous permanent appropriations	14 9925 0 2-999	70	74
Bureau of Indian Affairs	Operation and maintenance of quarters	14 5051 0 2-452	6	6
Bureau of Indian Affairs	Tribal Economic Recovery funds	14 5197 0 2-452	86	11
Bureau of Land Management	Land acquisition	14-5033-0-2-302	13	12
Bureau of Land Management	Miscellaneous permanent payment accounts	14-9921-0-2-999	81	163
Bureau of Land Management	Permanent operating funds	14-9926-0-2-302	5	5
Bureau of Land Management	Range improvements	14-5132-0-2-302	10	9
Bureau of Land Management	Service charges, deposits, and forfeitures	14-5017-0-2-302	9	9
Bureau of Reclamation	Central Valley Project Restoration fund	14-5173-0-2-301	34	24
Bureau of Reclamation	Colorado River dam fund, Boulder Canyon project	14-5656-0-2-301	38	32
Bureau of Reclamation	Emergency fund	14-5043-0-2-301	1	1
Bureau of Reclamation	General administrative expenses	14-5065-0-2-301	54	50
Bureau of Reclamation	General investigations	14-5060-0-2-301	14	14
Bureau of Reclamation	Operation and maintenance	14-5064-0-2-301	275	259
Central Utah Project	Utah reclamation mitigation and conservation account	14-5174-0-2-301	12	3
Minerals Management Service	Leases of lands acquired for flood control, navigation, and allied purposes	14-5248-0-2-302	1	1
Minerals Management Service	Mineral leasing and associated payments	14-5003-0-2-806	474	474
Minerals Management Service	National forests fund, payment to States	14-5243-0-2-302	2	2
National Park Service	Concessions improvement accounts	14-5169-0-2-303	14	14
National Park Service	Everglades restoration fund	14-5160-0-2-302	0	0
National Park Service	Fee collection support, national park system	14-5057-0-2-303	12	13
National Park Service	Historic preservation fund	14-5140-0-2-303	46	47
National Park Service	Land acquisition and State assistance	14-5035-0-2-303	72	112
National Park Service	Miscellaneous permanent appropriations	14-9924-0-2-303	1	1
National Park Service	Operation and maintenance of quarters	14-5049-0-2-303	12	11
Office of Surface Mining Reclamation and Enforcement	Abandoned mine reclamation fund	14-5015-0-2-999	183	210
United States Fish and Wildlife Service	Cooperative endangered species conservation fund	14-5143-0-2-303	34	33
United States Fish and Wildlife Service	Land acquisition	14-5020-0-2-303	66	79
United States Fish and Wildlife Service	Migratory bird conservation account	14-5137-0-2-303	46	38
United States Fish and Wildlife Service	Miscellaneous permanent appropriations	14-9923-0-2-303	247	191
United States Fish and Wildlife Service	National wildlife refuge fund	14-5091-0-2-806	19	20
United States Fish and Wildlife Service	North American wetlands conservation fund	14-5241-0-2-303	9	10
United States Fish and Wildlife Service	Operation and maintenance of quarters	14-5050-0-2-303	1	2
United States Fish and Wildlife Service	Wildlife conservation and appreciation fund	14-5150-0-2-303	2	2

Table 2: Special Fund Accounts

Dollars in millions

Agency/Bureau	Account	Account ID	Actual 1995 Net Budget Authority	Actual 1995 Net Outlays
Department of Justice				
Drug Enforcement Administration	Diversion control fee account	15-5131-0-2-751	61	43
Immigration and Naturalization Service	Breached Bond/Detention Fund	15-5126-0-2-751	15	15
Immigration and Naturalization Service	Immigration examinations fee	15-5088-0-2-751	356	356
Immigration and Naturalization Service	Immigration legalization	15-5086-0-2-751	3	3
Immigration and Naturalization Service	Immigration user fee	15-5087-0-2-751	303	303
Immigration and Naturalization Service	Land border inspection fee	15-5089-0-2-751	1	1
Legal Activities	Assets forfeiture fund	15-5042-0-2-752	488	547
Legal Activities	United States trustee system fund	15-5073-0-2-752	79	76
Office of Justice Programs	Crime victims fund	15-5041-0-2-754	179	138
Department of Labor				
Employment Standards Administration	Panama Canal Commission compensation fund	16-5155-0-2-602	12	6
Department of State				
Other	Fishermen's guaranty fund	19-5121-0-2-376	0	0
Other	Fishermen's protective fund	19-5116-0-2-376	0	0
Other	International Center, Washington, D.C.	19-5151-0-2-153	0	-1
Other	International litigation fund	19-5177-0-2-153	0	1
Department of Transportation				
Research and Special Programs Administration	Emergency preparedness grants	69-5282-0-2-407	7	6
Research and Special Programs Administration	Pipeline safety	69-5172-0-2-407	34	19
Department of the Treasury				
Bureau of Alcohol, Tobacco and Firearms	Internal revenue collections for Puerto Rico	20-5737-0-2-806	206	206
Departmental Offices	Department of the Treasury forfeiture fund	20-5697-0-2-751	268	184
Departmental Offices	Presidential election campaign fund	20-5081-0-2-808	69	23
United States Customs Service	Customs services at small airports	20-5694-0-2-751	1	1
United States Customs Service	Miscellaneous permanent appropriations	20-9922-0-2-806	138	135
Department of Veterans Affairs				
Veterans Health Administration	Medical care cost recovery fund	36-5014-0-2-703	104	102
Environmental Protection Agency				
Environmental Protection Agency	Exxon Valdez Settlement fund	68-5297-0-2-304	0	0
Funds Appropriated to the President				
Federal Drug Control Programs	Special forfeiture fund	11-5001-0-2-802	0	0

Table 2: Special Fund Accounts

Dollars in millions

Agency/Bureau	Account	Account ID	Actual 1995 Net Budget Authority	Actual 1995 Net Outlays
General Services Administration				
Federal Property Resources Activities	Disposal of surplus real and related personal property	47-5254-0-2-804	1	1
Supply and Technology Activities	Expenses of transportation audit contracts and contract administration	47-5250-0-2-804	14	13
Legislative Branch				
Library of Congress	Payments to copyright owners	03-5175-0-2-376	196	316
Other Independent Agencies				
Federal Communications Commission	Universal service fund	27-5183-0-2-376	4300	4300
Federal Financial Institutions Examination Cncl Appraisal Subcom	Registry fees	95-5026-0-2-376	4	2
Federal Retirement Thrift Investment Board	Program expenses	26-5290-0-2-803	34	34
The Judiciary				
Courts of Appeals, District Courts, and other Judicial Services	Judiciary automation fund	10-5114-0-2-752	107	117
Courts of Appeals, District Courts, and other Judicial Services	Judiciary filing fees	10-5100-0-2-752	57	0
Courts of Appeals, District Courts, and other Judicial Services	National Fine Cente	10-5115-0-2-752	6	3
Courts of Appeals, District Courts, and other Judicial Services	Registry administration	10-5101-0-2-752	4	4

Source: GAO Budget Database.

Table 3: Trust Revolving Fund Accounts

Dollars in millions

Agency/Bureau	Account	Account ID	Actual 1995 Net Budget Authority	Actual 1995 Net Outlays
Department of Agriculture				
Agricultural Marketing Service	Milk market orders assessment fund	12-8412-0-8-351	0	0
Department of Defense--Civil				
Armed Forces Retirement Home	Soldiers' and airmen's home revolving fund	84-8463-0-8-705	0	-1
Department of Defense--Military				
Trust Funds	Department of the Air Force trust revolving funds	57-9982-0-8-051	0	0
Trust Funds	Department of the Navy trust revolving funds	17-9981-0-8-051	0	0
Trust Funds	Surcharge collections, sales of commissary stores, defense	97-8164-0-8-051	0	-5
Department of Justice				
Federal Prison System	Commissary funds, Federal prisons (trust revolving fund)	15-8408-0-8-753	0	-22
Department of Transportation				
Coast Guard	Miscellaneous trust revolving funds	69-9981-0-8-403	0	0
Federal Highway Administration	Right-of-way revolving fund liquidating account	69-8402-0-8-401	-20	3
Department of the Treasury				
Comptroller of the Currency	Assessment funds	20-8413-0-8-373	0	9
Department of Veterans Affairs				
Veterans Benefits Administration	Veterans special life insurance fund	36-8455-0-8-701	1	-37
Office of Personnel Management				
Office of Personnel Management	Employees and retired employees health benefits fund	24-9981-0-8-551	0	-324
Office of Personnel Management	Employees life insurance fund	24-8424-0-8-602	0	-916
Other Independent Agencies				
National Archives and Records Administration	National archives trust fund	88-8436-0-8-804	0	1

Source: GAO Budget Database.

(935204)

Mr. DAVIS. You mention that there is a 6-year solid framework for improving financial management based on the CFO Act, the creation of the Federal Accounting Standards Advisory Board and efforts to improve credit reform. Where do we go from here? Do you think we need legislation at this point?

Mr. BOWSHER. No, I really don't. I think we have the legislation now, what has been passed, and I think now the big thing is to actually carry it out, carry out this legislation successfully. I think that means that the agencies and the executive branch have got to get their systems in order.

We are going to be doing the audits, along with the IGs and some of the CPA firms, and we will be reporting on an annual basis to the Congress on how well that is coming along. So I think the legislative base is there. Now I think the big thing is to try to make sure that the Government agencies can get the job done; and I think in the final analysis, I would like to see the integration of the budget and the accounting done properly with modern computers and information systems.

Mr. DAVIS. OK. Thank you very much. Those are my questions. I yield back.

Mr. HORN. Let me add on this question.

You have been an Assistant Secretary; you have known practically every Cabinet officer since that time in both parties. If you were sitting in the Cabinet now, what tools would you say you needed to effectively run your department? You just mentioned you thought this framework that you and previous Congresses have put on the books is very helpful, but what would you like to have if you were over there right now trying to run one of these agencies?

Mr. BOWSHER. Sure. Well, I would like to have monthly reporting on where do I stand against my budget, and I would like it on the proper breakdown. In other words, I would like to know where I stand on my payroll; I would like to know if I have any capital projects. Like when I was the Assistant Secretary of the Navy, one of the things we set up, which they later abandoned, was a monthly reporting on the status of the major weapons systems, so—you have to have that information.

In other words, I always remember one of the retired admirals came back after going into the private sector and he said, I am surprised at the power and the influence of the comptroller of the corporation, because, he said, he has all the scorekeeping and everything like that. Well, that is what the Comptroller and the Chief Financial Officer of the 24 largest agencies of the Federal Government now have to have, and they should be able to present it to their Cabinet officer, and the Cabinet officer then could make some good decisions at that point.

The problem is, so much of the information now is estimates on the budget, and as you have been kind of pointing out here, Mr. Chairman, a lot of it is not looked back at—in other words, a lot of estimates. And we move on to the next budget year, and then more estimates; and so I think what you need—you have to know your payroll costs, your operating costs, your capital costs. If you have some trust funds, you would want to know that separately and things like that.

Mr. HORN. Do you think Cabinet officers have sufficient reprogramming authority?

Mr. BOWSHER. I think basically, yes. Now, I haven't looked at that recently.

Mr. HORN. Has GAO got a list of the reprogramming authorities that this Congress has, or any Congress, in the budget? Could we get that out of you?

Ms. IRVING. I think we can get part of it. As you know, each appropriations subcommittee provides guidelines.

Mr. HORN. Right, I do know that. I have traced a lot of them.

Ms. IRVING. My guess is that each Cabinet department would answer that question slightly differently.

Mr. HORN. If we could get from GAO, what are the standard reprogramming authorities and also what are some of the unusual ones that pop up——

Mr. BOWSHER. Sure, yes.

Mr. HORN [continuing]. And how that process worked.

It used to be—and I don't know if it is right now, because I just haven't checked—that you needed the sign-off of the chairman and ranking member of both the authorization and appropriations committee in each House. I don't know if that still holds true or not, but if you could throw that in as to how that process works, I think since we are using these hearings as an educational device for our colleagues, it would be helpful to have it all in one place.

[The information referred to follows:]

GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-272080

June 7, 1996

The Honorable Steve Horn
Chairman, Subcommittee on Government Management,
Information and Technology
Committee on Government Reform and Oversight
House of Representatives

Dear Mr. Chairman:

At the Subcommittee's April 23, 1996, hearing on federal budget and financial management reform, you requested that we provide for the record (1) information on limitations to federal agencies' reprogramming authority and (2) a list of federal trust funds. To meet your request, this letter provides a brief explanation of the concept of reprogramming and examples of the types of limitations the Congress imposes on federal agencies' authority to reprogram. Further, we have provided a brief description and a list of federal trust and special fund accounts. We have included special fund accounts because of their similarity to trust fund accounts.

REPROGRAMMING AUTHORITY

Reprogramming is the shifting of funds from one object or program to another within an appropriation or fund account for purposes other than those contemplated at the time of appropriation. The authority to reprogram is implicit in an agency's responsibility to manage its funds; no statutory authority is necessary. The shifting of funds between accounts is called a transfer. An agency may not transfer funds unless it has statutory authority to do so.

As a matter of law, an agency is free to reprogram unobligated funds as long as the expenditures are within the general purpose of the appropriation and are not in violation of any other specific limitation or otherwise prohibited. While there are no governmentwide reprogramming guidelines, the Congress exercises control over an agency's spending flexibility by providing guidelines or non-statutory instructions on its authority to reprogram. Reprogramming frequently involves some form of notification to the appropriation and/or legislative committees. In a few cases, the notification process is prescribed by statute. However, in most cases, the committee review process is nonstatutory, and derives from instructions in committee reports, hearings, or correspondence, or from informal arrangements between the appropriations and/or legislative committees prior to reprogramming. Sometimes a committee or subcommittee may require both notification and committee approval. Courts have recognized that nonstatutory limitations are not binding on an agency; compliance is largely a matter of "keeping faith" with the appropriate committees.

The following are examples of reprogramming restrictions the Congress has placed on individual agencies and departments. The restrictions on reprogramming authority in the first set of examples are included in committee reports; the restrictions in the second set are imposed by statute.

I. Reprogramming Authority Restrictions Included in Committee Reports[1]

Coast Guard

1. Acquisitions, Construction, and Improvements Account Reprogramming that results in a significant change in the scope of a project as described in the Coast Guard budget justification submitted to the Congress, the creation of a new project that exceeds the cost limitation for minor projects, termination of a project, or an increase or decrease of more than $1 million or 15 percent of the total amount appropriated for a particular project (whichever is less) requires that the chairmen of the House and Senate Transportation Appropriations Subcommittees be informed of the proposed action and allowed at least 30 days in which to respond.
2. Alteration of Bridges Account. Reprogramming that results in an increase or decrease in a project's funding by more than $500,000 or 25 percent of the project's funding basis (whichever is less) requires that the chairmen of the House and Senate Transportation Appropriations Subcommittees be informed of the proposed action and allowed at least 30 days in which to respond.

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[1]See HR Rep. 104-177 and HR Conf. Rep. 104-286.

3 Research, Development, Test, and Evaluation Account. Termination of a project (other than completion), starting a new project with a total estimated cost of more than $200,000, and a net increase or decrease to a project of more than $200,000 or 25 percent of the project basis (whichever is less) requires that the chairmen of the House and Senate Transportation Appropriations Subcommittees be informed of the proposed action and allowed at least 30 days in which to respond.

II. Reprogramming Authority Restrictions Imposed by Statute[2]

Department of State

Funds appropriated for the Department of State shall not be available for obligation or expenditure through any reprogramming of funds

- which creates new programs;
- which eliminates a program, project, or activity;
- which increases funds or personnel by any means for any project or activity for which funds have been denied or restricted by the Congress;
- which relocates an office or employees;
- which reorganizes offices, programs, or activities;
- which involves contracting out functions which had been performed by federal employees; or
- which involves a reprogramming in excess of $250,000 or 10 percent, whichever is less, and which (1) augments existing programs, projects, or activities, (2) reduces by 10 percent or more the funding for any existing program, project, activity, or personnel approved by the Congress, or (3) results from any general savings from a reduction in personnel which would result in a change in existing programs, activities, or projects approved by the Congress.

However, funds shall be available for obligation or expenditure if the Committee on Foreign Affairs of the House of Representatives and the

[2]22 U.S.C. Sec. 2706.

Committee on Foreign Relations of the Senate are notified 15 days in advance of the proposed reprogramming.

TRUST AND SPECIAL FUNDS

Trust fund accounts are budget accounts that are designated as "trust funds" by law. They are usually financed by earmarked collections. There are two types of trust fund accounts–revolving and nonrevolving–appearing in the President's budget. A revolving trust fund account is used to carry out a cycle of business-type operations and is authorized to be credited with collections. An example is the Commissary Funds, Federal Prisons, which uses profits from the sale of goods to inmates to purchase general welfare and recreational items. A nonrevolving trust fund account records revenues collected for a specific purpose or programs designated in law as trust funds. Nonrevolving trust fund accounts finance programs such as Social Security and Medicare.[3]

We have included special funds with the list of trust funds because of their similarity to trust fund accounts. Special fund accounts–although not designated as trust fund accounts in authorizing legislation–like trust fund accounts, are earmarked by law for a specific purpose. The Nuclear Waste Disposal Fund and the Historic Preservation Fund are examples of special fund accounts.

The enclosure lists all current trust nonrevolving fund accounts, trust revolving fund accounts, and special fund accounts appearing in the President's 1997 budget.

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We are sending copies of this letter to the Ranking Democrat of your Subcommittee and to the Chairmen and Ranking Democrats of the Senate and House Appropriations and Budget Committees. Copies will also be sent to others upon request.

[3]A trust fund account is classified as either an expenditure or a receipt account. A receipt account records income; expenditure accounts record outlays. Trust fund expenditure accounts are listed individually in the budget documents; trust fund receipt accounts are not. For additional information on trust fund accounts, see Budget Issues: Earmarking in the Federal Government (GAO/AIMD-95-216FS, August 1, 1995)

B-272080

I hope this information is helpful to you. Please contact me at (202) 512-9142 if you or your staff have any questions concerning this letter. Hannah Laufe, Senior Evaluator, was a major contributor to this letter.

Sincerely yours,

Susan J. Irving
Associate Director, Budget Issues

Enclosure

Mr. HORN. I yield to the gentleman from Florida, Mr. Scarborough, for questions.

Mr. SCARBOROUGH. Thank you, Mr. Chairman. I just have a quick question for the panel.

The budget process is so complex and confusing to the average American. In fact, I will be honest with you, I am a freshman, this is my first term here, and there are still things that I get blind-sided by every week. You always hear back home, you guys need to make it simpler, you have a lot of lawyers running the place.

I guess my question is this: Have we broken this process down to make it as simple as possible, or do you think there is a way that we can come up with a budget process, the practices and procedures, year in and year out, that the average American with a college education can understand; and if so, what would be some of your recommendations?

Mr. BOWSHER. I think that is exactly where we should get to, and we are not there. In other words, the streamlining here—what we have been doing is, we have been adding process. If you think about it, we had the authorizing process, we had the appropriation, we then passed the Budget Act of 1974, and we added more process, and then the Gramm-Rudman added more process, and then you come with some others in 1990 and 1992. So what you keep doing is you keep adding process on, and you never sit back and streamline out what is needed. I think for new Members of the Congress it must be terribly confusing.

I think also, as I mentioned earlier, a chart of accounts has been built up over the years by various issues and various Members that wanted to emphasize certain things and everything like that. So, you know, we did a study recently that showed that a large percentage of the accounts have very small percentages of the dollars.

So I think a lot of streamlining really is necessary here before you are going to be able to, one, understand it as an elected representative and, I think, to explain it to your constituents. I think you need a good breakout as to what your budget is all about. You don't have that right now.

Mr. SCARBOROUGH. What would be the first step, the first concrete step?

Mr. BOWSHER. Well, I think one of the first steps here is what we are working on now, which is to try to get the accounting and the financial management straightened out, so—how we actually spend the money. I think getting some of that reporting straightened out is a good first step.

I think to eventually link the budget into some kind of a unified system here would make—would get the job done. But I think my first step would be to get a better breakout of the budget, a better summary, so that you could understand it better.

I think we discussed here a few minutes ago the complexity of the trust funds and some of the other things like that. I think if you could get a better breakout of that, it would be much better than what we are living with, you might say.

Mr. SCARBOROUGH. When you talk about "unified," you mean having the appropriations and the authorization process united together? Is that what you are talking about?

Mr. BOWSHER. No, I will leave that up to the Congress as to how to do the committee structure.

Mr. SCARBOROUGH. Well, would that simplify matters? From your vantage point, would that be a positive reform?

Mr. BOWSHER. A positive form?

Mr. SCARBOROUGH. Reform. Would it make it simpler?

Mr. BOWSHER. I would put more emphasis on getting the system reformed, so that each committee, whatever role they play, would have good information and some kind of PC, you might say, to work on the information in the different program areas.

Ms. IRVING. I think what the Comptroller General is referring to, the unified budget, is that even if you do the breakouts for clarification, you want to be able to add it all up so that you can see the impact of the Federal Government on the economy, the total amount it takes out and how it spends, whether it calls it a trust fund tax or income tax, and whether it spends it on investment or consumption—we have advocated some breakouts that show you what decisions you are making, but in the end you want to roll it all up so that you know your total.

Mr. SCARBOROUGH. Are you confident, yourself, personally, that by the end of this process we can come up with something that the American people can understand?

Mr. BOWSHER. Well, I think it is doable, I really do. But I think all organizations have a tendency to become very bureaucratic and to keep adding process and accounts and everything; and I think every once in a while you have to streamline it back.

I think one of the things is that Don Chapin, down here, has been in charge of our effort to get the accounting standards improved. I think when we can issue some of those reports in the next couple of years, you are going to see a much more clear understanding of how the Government is spending taxpayer money.

Mr. SCARBOROUGH. OK. Thanks. I appreciate it.

Mr. HORN. Let me just followup on some of that.

I realize your reluctance to get into telling the Congress how to reorganize itself. It is a reluctance I don't share, and you shouldn't either. That is why we gave you one term, and you are getting freer and freer to speak your piece, OK?

Mr. BOWSHER. That is right, yes.

Mr. HORN. OMB, when they review the budget, has basically five programmatic areas that they look at and coordinate the budget, as I remember—and that has been true for 30 years—that where you have Defense and State, international affairs, all properly in one area, they are interchangeable. We have a Defense Department, if diplomacy fails, so forth and so on.

Now, it comes up here and, as you know, the Executive Budget has only existed since Warren Harding, despite two Presidents arguing for it before that. The President does have a way to look at a unified budget. It comes up here as a recommendation of the President regardless of priority. It has these five programmatic areas that feed into that unified budget, and we tear apart the pages, chop it up into 13 appropriations subcommittees. And we have done it for 50 to 70 years in this current reenactment, and certainly since the Legislative Reorganization Act of 1946; and we look at it in pieces, and we have very little integration.

Now, granted, the 1974 process is an attempt to make that integration by forcing integration through caps and so forth and so on by various budget functions.

Do you think there is a better way to do it, looking at it objectively, knowing we can't do a thing to you if you have something somebody around here doesn't like?

Mr. BOWSHER. Let me even describe it a little more, if I could, Mr. Chairman; and that is, when I served there at the Pentagon, I remember Stan Rieser, who served nearly 7 years as Secretary of the Army, said that he really had to learn three separate accounting or budgeting systems to be the Secretary of the Army, because he had the appropriations process, he had the new program system that McNamara had put in. And the Army never changed; they still had the Army system.

He said, in the first part of the year, I am up there dealing with OSD on the program structure, and then I am dealing on the appropriations structure with the Comptroller, who interfaces with the Congress and the Appropriations Committee, and then when I finally get the money, I dole it out according to the old system.

Well, what we ought to do is get the one system that the Congress uses, that the executive branch uses, that OMB uses, and I think all of these different processes and systems—you are never going to get through it in any fiscal year as long as you don't get it streamlined. And I think you have to streamline some of the committee structure; I just don't want to tell you quite how to do it.

Mr. HORN. Well, let's face it. One way to start—and we all know it might not happen, although it is that vote on getting the Transportation Trust Funds off budget that showed that the place is not completely immovable, and that Appropriations wasn't happy with that vote, obviously. And whether they try to make some Members unhappy in their unhappiness, we don't know, but we will see.

Transportation and Infrastructure happens to be the largest committee in the House now. Appropriations used to be that, and we have a few more on our side.

But in looking at this, let's face it. If you went to five large program areas up here to relate that, the five large program areas in OMB rather than the 13 fragmented thing, you could do that through subcommittees and whatnot, where you would have a semi-cardinal, maybe a monsignor instead of a cardinal, as we call them, and they would be pulling these things together; and then they could get the broader perspective that the executive branch has when they review these budgets. We don't have that broad perspective.

We might be forced to have a little reconciliation by the Budget Committee's intrusion into this process, and it just seems to me that we have to focus our energies more to come up with a decent review.

There is enough work there for everybody. You could do it in subcommittees, to put larger groupings, and then reporting to the full committee; because most of this, as you know, is done at the subcommittee level, just by the volume of it all. But at least we would be talking apples and apples when we are looking at a particular area of budget numbers.

I know if I were a Presidential appointee, the first two people I would head for, or maybe three groups, would be the Comptroller General's staff that relates to whatever agency it is that they are talking about; the OMB staff, that is the institutional memory of the Government in those two places; and the Appropriations staff here who have dealt with this for years, regardless of who is in charge generally.

But I just would welcome your thoughts there.

Let's move back to the 1974 Budget Act. Besides what you have said in your statement, what do you feel we ought to do as we take a look at the 1974 Budget Act, and how do you think that has worked? You were around when that—I am sure, maybe you were still in private industry.

Mr. BOWSHER. I was back in private practice when that was passed.

Mr. HORN. But you have had a lot of reason to look at that act. What is right with it and what is wrong with it?

Mr. BOWSHER. Well, I think one of the problems with it is that you have created more process and didn't take away any previous process. In other words, I really think that to a certain extent you brought in the McNamara concept, which never worked on time at the Pentagon. When I got there—I was the last member of the McNamara team—I was surprised that the McNamara system wasn't working on time; the press was that it was working very well.

But I think one of the big problems is that most decisionmakers only want to make a tough decision once in a year's time, and so what you are doing now with having added the budget process there in 1974 is, you are just all the time asking the Members of Congress to make tough decisions on the same issue, and so you are just budgeting all year long. And then you can't even make the deadlines when you are supposed to make the deadlines.

So one more time, lots of times, the big decision gets made in some kind of a hurry at the end or something like that. But I just think you have bought in too much process and it just can't work. I think people can't understand it, either.

Mr. HORN. Well, I agree with you. If you had your druthers, which parts would you peel away?

Mr. BOWSHER. Well, I would look at the whole procedure and start peeling away in some kind of organized fashion and then come back and present it to the leaders of the Congress.

Mr. HORN. Well, you have looked at the whole procedure over 16 years. Now, where would you start peeling it away? What do you think are the sillier things we are doing? That is my word, not your word.

Mr. BOWSHER. Well, I think—trying to make the decisions too often, I think is one of the sillier things.

Mr. HORN. Well, it is a new form of term limits is what it is. You make enough decisions, they soon have enough on you in your constituency that you are no longer here making those decisions.

Mr. BOWSHER. Yes. So I think your idea of getting some kind of a system where the OMB looks at it the same way as the Congress looks at it—and I would take it one step further. I would go back and make sure that when OMB looks at that defense area, that then the Secretary of Defense and the service secretaries, they are looking at the same system, too.

In other words, I would streamline it all the way back to that point, and then I would bring it right up through and into the Congress. And then I would get the committee structure lined up to, as you say, the subcommittees and that, that deal with that kind of a structure. Then I think you would simplify a lot of your decisionmaking and not have so much redundancy.

We have often talked about you do need—like you said there earlier, and some of the other witnesses, I think you need an overall hearing of some sort where you bring the revenue and the expenditure people together and your best experts in the Government to try to sort out, you know, what is the economy doing. And if you could get some kind of understanding there and everything like that, why I think that would make a lot of sense.

Mr. HORN. Do you think in the case of GAO that you have sufficient expertise there to make a contribution to that dialog?

Mr. BOWSHER. Oh, sure. I really do.

Mr. HORN. I thought you did.

Mr. BOWSHER. GAO has a lot of capability here.

Mr. HORN. Good. Well, we would certainly welcome those suggestions. I think we are going to hold a hearing probably at the full committee level before you escape.

Mr. BOWSHER. OK.

Mr. HORN. And we want a full confession of what you would have liked to have done that you didn't do. But I am warming you up today for that.

Mr. BOWSHER. All right, fine.

Mr. HORN. OK. Thank you. If there is nothing else to say on this panel, why thank you all for coming and your testimony here. We will follow it up as usual with maybe some more technical questions that weren't asked.

Mr. BOWSHER. Sure.

Mr. HORN. We would appreciate it if you would answer those.

Mr. BOWSHER. Certainly.

Mr. HORN. Thank you.

Mr. HORN. We are now on Panel four. We have Controller DeSeve and Assistant Secretary Muñoz.

[Witnesses sworn.]

Mr. HORN. The two witnesses affirmed.

STATEMENT OF G. EDWARD DeSEVE, CONTROLLER, OFFICE OF FEDERAL FINANCIAL MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET; AND GEORGE MUÑOZ, ASSISTANT SECRETARY FOR MANAGEMENT AND CHIEF FINANCIAL OFFICER, DEPARTMENT OF THE TREASURY

Mr. HORN. Let's proceed, Mr. DeSeve, with you, and then followed by Assistant Secretary Muñoz.

Mr. DESEVE. Thank you very much, Mr. Chairman and members of the committee. I would like to thank this committee for its work to support the Chief Financial Officers Act, improve Federal management, and restore public confidence in Government.

I am pleased to be here today to provide an overview of how the administration continues to improve the way Government manages its finances and programs, and how it informs its citizens about the President's budget, including: Execution of the Chief Financial Officers Act; implementation of the Government Performance and Results Act; implementing accountability reports; Federal accounting standards development; Electronic funds transfer; Debt collection, which I know is dear to your heart; and, the notion of a citizen's budget.

I would also like to comment on the proposed legislation, the Financial Management Improvement Act, and proposals to create separately an Office of Management and an Office of Budget.

Implementation of the CFOs Act. The CFOs Act and its subsequent modification by the Government Management Reform Act, together with the Government Performance and Results Act and such statutes as the Federal Managers' Financial Integrity Act and the Inspector General Act, taken as a whole, establish a framework for improved accountability and better, more timely information for the Congress, the President and the public. Throughout my testimony, I will emphasize the ways in which these statutes work together and buildupon each other to achieve our mutual goal of a well-managed government which earns its citizens' confidence.

Federal agencies prepare strategic plans, with an initial plan to be submitted to OMB and the Congress by September 30, 1997. Federal agencies must also prepare annual performance plans setting out specific performance goals for each fiscal year, starting with fiscal year 1999. OMB then will prepare a governmentwide performance plan based on agency plans, with a level of program performance to be achieved corresponding to the funding level in the President's budget. Federal agencies will submit annual reports to the President and Congress which compare actual performance with the goals that were previously set in the performance plan.

We are in the midpoint of the 4-year period for changing Government processes, systems and practices before the Government Performance Results Act takes place in 1997.

The CFO Council has made GPRA implementation one of its highest priorities. In its May 1995 report, "Implementation of the Government Performance and Results Act," the Council stated that, "Existing planning, budgeting, program evaluation and fiscal accountability processes should be integrated with GPRA requirements to ensure consistency and reduce duplication of effort."

In September, 1995 OMB issued two documents instructing agencies on the preparation and submission of strategic plans—a memorandum from Director Alice Rivlin to agency heads, and a new part 2 to OMB Circular A–11. In the memorandum, Ms. Rivlin stated that the OMB A–11 revision is "the first step in a larger effort to link various GPRA requirements to the budget process."

GPRA reaches a critical phase in the next few months. An April 11, 1996 memorandum from Director Rivlin to agency heads outlined how OMB will conduct reviews this summer and fall on an agency-by-agency basis to assess where agencies stand on strategic plans in anticipation of 1997.

The effort being undertaken by the congressional leadership to increase the understanding of GPRA signals Congress' commitment to realize this law's potential. We would be pleased to help you, Mr.

Chairman, and those charged with this task in any way you believe would be helpful.

Accountability reports: The CFO Council, in a January, 1995 report, entitled "Streamlining Government-wide Statutory Reports," proposed there be two annual reports: a planning and budget report in the fall of the year, and an accountability report in the spring of the year. The planning and budget report is consistent with OMB's revision of circular A–11, which addresses the GPRA integration. The accountability report would consolidate the FMFIA reporting process, audited financial statements and performance information into a single document. OMB proposed to the Congress that six agencies undertake a pilot using authority granted in the Government Management and Reform Act to test the accountability concept, and Congress has concurred.

I have with me this morning four of those reports, and if the committee hasn't gotten them yet, I would be happy to get them. One is from NASA; the second is from the NRC, which is so new that it isn't even bound yet—we are still at the printer with this one—and the third is the first one that was prepared this year from the Social Security Administration, followed, both in January, by the GSA.

GSA's must be very exciting, because it is wrapped in plastic. You can't get into it. You have to take the plastic off in order to get into the meat of it.

But I think each of these—as Mr. Bowsher noted in his testimony, each of these is the basis for excellent oversight by the relevant committees. They contain customer service and other kinds of performance information.

SSA asks the question, for example, how do we get better public confidence in Social Security? How do we deal with specific problems in some of the trust funds, and how do we meet those problems? Those are precisely the kinds of questions we think need to be addressed in budgeting.

In addition, here is the audited financial statement with a clean opinion from the accounting firm or from the IG for each of these entities. So that we have clean opinions, performance information and information about the process of ensuring integrity, and they are not huge.

Mr. HORN. Well, that is helpful. That is very helpful. Could you maybe get us 10 sets of those to share with the minority and the majority?

Mr. DESEVE. Absolutely. We will get you three immediately; and as I say, NRC is actually at the GPO now being bound.

Mr. HORN. Personal copies for the members who are here this morning, and then also for the staff.

Mr. DESEVE. Absolutely.

Beyond the reporting structure, the Federal Accounting Standards Advisory Board, FASAB, which is jointly composed of OMB, Treasury and GAO, has created a series of underlying Federal accounting standards for the first time. The last standard, revenue, is now in the process of being approved. That should be done within the next 30 days, and for the first time we will have a comprehensive set of standards available to all Federal agencies.

OMB will then issue its form and content, which we think is something that we would like to talk very much with Congress about, because we think the way reports are structured and the way budget formats are presented should also be integrated.

We go into the operational aspects of the Government when we talk about Electronic Benefits Transfer and Electronic Funds Transfer. EBT provides direct deposit and Electronic Funds Transfer to those individuals without formal banking relationships, and also provides for electronic delivery, in kind, of many benefits. Electronic Funds Transfer now represents about 51 percent of the Treasury's 852 million payments each year, representing about $676 billion of the overall disbursements. The importance of EBT and EFT is that, when integrated with accounting systems, they can themselves provide off-line, privatized transaction processing.

We have gone into extensive use of the International Merchant Purchase Authorization, or IMPAC, card, which allows the Federal Government to make vendor payments more quickly, complying with the Prompt Pay Act, but also has the capacity to have our accounting done off-line by private entities.

Debt collection: I would like to express the administration's continued appreciation, Mr. Chairman, to you and to Congresswoman Maloney and to members of this committee for the prompt action on H.R. 2234, as amended, and Senate 1234, the Debt Collection Improvement Act of 1995. This bipartisan initiative will result in debt collection reform programs while protecting the rights of debtors.

Administrative offsets, salary offsets, cross-servicing agreements, expanding private collection activities, establishing gain-sharing, and providing Electronic Funds Transfer are modern new processes that you and others on the committee have actively supported.

We also, as you know, strongly support and hope to see included in the bill the nonjudicial foreclosure provisions and the automatic tax levy provisions of the act. We realize there is some concern about these in Congress, but we continue to support them very much.

When we talk about a Citizens' Guide to the Budget at OMB, we actually talk about this very small book which I find extremely helpful when I am talking to groups outside the Federal Government who don't know the Federal budget. It describes in graphic detail where the money comes from, where the money goes, has international comparisons; and then shows spending by function, spending by agency, catalogs the Federal deficit, the Federal debt, and also talks about the President's priorities. For those who are a little more computer literate, you can have your own CD–ROM copy.

We will be happy again, if the committee doesn't have this, or you can go to a CFO Council-sponsored web site called Finance Net and you can have the budget on the Internet. So we believe the accessibility of the budget in that way is extremely important and will continue to support that.

The Accounting Standardization Act proposed by Senator Brown: The administration believes that the FASAB process for establishing accounting standards, as envisioned by the agreement between GAO, OMB and Treasury, is working. The MOU signed by Treasury and the related financial statement preparation and auditing requirements of the CFO Act and GMRA achieve the same management ends without further legislation. The administration would be happy to continue to have a dialog with this committee and Senator Brown; however, we do not believe any legislation in this area is needed at this time.

Separate Office of Management and Office of Budget: OMB serves the President. Recent evidence, both here and abroad, suggests that integrating management and responsive responsibilities, not separating them, is the most effective approach. The GAO's December 29, 1995 report, "Changes Resulting From the OMB 2000 Reorganization," describes the results of a reorganization that integrated OMB's budget analysis, management review, and policy development roles.

The GAO found, one, that there has been greater attention to agency management issues after OMB 2000 was implemented; two, a greater variety of management issues were presented in more depth in fiscal year 1996 documents than in previous years documents; and three, these results reflected a clear commitment of OMB's top officials to ensure the treatment of management issues in the budget cycle.

Lessons learned from other national governments underscore that management reforms are likely to fail if management considerations are seen as distinct from budgetary policies, because management reform often has budgetary consequences.

This concludes my testimony, and I would be happy to answer any questions that you might have.

Mr. HORN. Thank you very much for that testimony. We will have some questions, if you could stay.

[The prepared statement of Mr. DeSeve follows:]

Statement of G. Edward DeSeve

Controller, Office of Management and Budget

Before the Subcommittee on Government Management, Information, and Technology

Government Reform and Oversight Committee

United States House of Representatives

Regarding the Federal Budget Process and Financial Management Reform

April 23, 1996

Introduction

Thank you Mr. Chairman and Members of the Committee. First, let me thank this Committee for the work it has done to support the Chief Financial Officers Act (CFOs Act), improve Federal management, and restore the public's confidence in Government.

I am pleased to be here today to provide an overview of how the Administration continues to improve the way the Government manages its finances and programs, and how it informs its citizens about the President's budget, including:

- Chief Financial Officers Act Execution
- Government Performance and Results Act Implementation
- Accountability Reports

- Federal Accounting Standards
- Electronic Funds Transfer
- Debt Collection, and
- A Citizen's Budget

I would also like to comment on the proposed legislation, *The Financial Management Improvement Act*, and proposals to create, separately, an Office of Management and Office of Budget.

Chief Financial Officers Act Implementation

The CFOs Act of 1990 and its subsequent modification by the Government Management Reform Act (GMRA) of 1994, the Government Performance and Results Act (GPRA) of 1993, and such statutes as the Federal Managers' Financial Integrity Act (FMFIA) and the Inspector General Act, taken as a whole, establish a framework for improved accountability, and better, more timely information for the Congress, the President, and the public. Throughout my testimony, I will emphasize the ways in which these statutes work together and build upon each other to achieve our mutual goal of a well managed Government which earns its citizen's confidence.

I will also refer repeatedly to the work of the Federal Chief Financial Officers (CFOs) Council, composed of all of the CFOs and Deputy CFOs in the 24 agencies subject to the CFOs Act, as well as officials from OMB and the Department of the Treasury. The Council has taken a leadership role in setting Government-wide priorities for financial management. The Council's three top priorities are: (1) improving financial systems; (2) implementing the Government Performance and Results Act; and (3) issuing accounting standards and financial statements.

Government Performance and Results Act Implementation

The GPRA is intended to transform fundamentally how Government programs and operations are managed. GPRA requires that:

1. Federal agencies prepare strategic plans, with an initial plan to be submitted to OMB and the Congress by September 30, 1997

2. Federal agencies prepare annual performance plans, setting out specific performance goals for a fiscal year, starting with fiscal year 1999

3. OMB prepares a Government-wide performance plan, based on agency plans, with the level of program performance to be achieved corresponding to the funding level in the President's Budget, starting with the fiscal year 1999 budget; and

4. Federal agencies submit an annual report to the President and Congress which compares actual performance with the goals that were previously set in the performance plan, with the first report six months after the end of fiscal year 1999.

The Act includes provisions giving managers greater flexibility by allowing the waiver of various administrative controls and limitations. In return, managers are expected to be more accountable for the performance of their programs and operations.

We are in the mid-point of this four-year period for changing Government processes, systems, and practices before the law takes full effect in 1997. Recognizing the comprehensive nature of GPRA, the CFO Council has made GPRA implementation one of its highest priorities. In the CFO Council's May 1995 report, *Implementation of the Government Performance and Results Act*, the Council stated that:

> "Existing planning, budgeting, program evaluation and fiscal accountability processes should be integrated with GPRA requirements to ensure consistency and reduce duplication of effort. In addition, other management improvement efforts, such as implementation of the CFO Act and FMFIA, customer service initiatives, reengineering, TQM, etc. should be incorporated into the GPRA framework to capitalize on the synergy and availability of key information and to improve responsiveness to customers and other stakeholders."

Prior to GPRA coming into full effect, the law provides for several sets of pilot projects to test and demonstrate whether performance plans and performance reports will work as intended. Activities in 27 departments and agencies have been designated as performance measurement pilots, with over 70 individual pilot projects. The pilot projects range from the very large -- the entirety of the Social Security Administration and the Internal Revenue Service -- to the very small. Nearly 450,000 civilian and military employees are covered by these pilot projects. Depending on when they were designated, the pilot projects have submitted up to three separate annual performance plans. With the final set of plans submitted in the Spring of 1995, assessments are now being done on both the agency experience and the overall quality of these plans.

Anticipating the requirement for strategic plans, OMB issued two important documents in September 1995 -- a memorandum from Director Alice Rivlin to agency heads entitled, *Strategic Plans, Budget Formulation and Execution* and a new Part 2 to OMB Circular A-11, *Preparation and Submission of Annual Budget Estimates*, providing instructions on the preparation and submission of agency strategic plans. In the memorandum, the Director stated that the OMB A-11 revision is "the first step in a larger effort to link various GPRA requirements to the budget process."

GPRA implementation reaches a critical phase in the next few months. Strategic plans and effective measures must be in place this year to make GPRA successful when it comes on line in 1997. This summer and fall, OMB will conduct reviews to test how the agency GPRA process will work and permit an assessment of where agencies stand on their strategic plans in anticipation of 1997. On April 11, 1996, the OMB Director sent a memorandum to the Heads of Executive Departments and Independent Agencies outlining this summer and fall review process.

The effort being undertaken by the Congressional leadership to increase the understanding of GPRA signals Congressional commitment to realize this law's potential. We would be pleased to help you, Mr. Chairman, and those charged with this task in any way you believe would be helpful, including sharing both materials being used to brief Executive branch employees, and the illustrative experiences and lessons learned from the past three years of effort.

Accountability Reports

The CFO Council, in a January 1995 report entitled *Streamlining Government-wide Statutory Reports*, proposed that there be two annual reports -- a Planning and Budget Report and an Accountability Report. The Planning and Budget Report, consistent with OMB's revision of Circular A-11, addresses the integration of GPRA with other current requirements. The Accountability Report would consolidate the FMFIA report, the audited financial statement, and performance information into a single document. It would provide the Congress, the President, and the public with comprehensive, clear, and concise information in one place on how well an agency is managed and how well it is performing its mission.

The concept of an Accountability Report is, the Administration believes, consistent with Senator Roth's and Senator Glenn's December 8, 1994, letter to Comptroller General Bowsher that a "practical management framework" is needed to coordinate the management reforms that have been enacted over the past 15 years.

The Government Management Reform Act (GMRA) Section 404 permits the Director of OMB to consolidate or adjust the frequency and due dates of any statutorily required report for which OMB has financial management responsibility between January 1, 1995, and September 30, 1997, after consultation with the Congress. Under this authority, OMB proposed to the Congress that six agencies undertake a pilot testing of the Accountability Report concept, and Congress concurred. So far, four of these six agencies -- Social Security Administration, General Services Administration, National Aeronautics and Space Administration, and the Nuclear Regulatory Commission -- have submitted their FY1995 Accountability Reports. SSA and GSA were able to issue their reports in December 1995, less than three months after the close of the fiscal year. NASA issued its report in March 1996. The Nuclear Regulatory Commission issued its report this month. Treasury and Veterans Affairs will submit their reports as their audited financial statements are completed.

SSA's Accountability Report is a good example of how an agency can integrate its audited financial statements with performance information to produce an informative document. It provides an agency overview, which includes SSA's Mission, followed by 10 pages of Key Goals and Performance Measures. The financial statements follow, with supplemental information, including FMFIA assurances and identification of material weaknesses, information on debt collection and prompt payment, and more detailed program performance information. The auditor's report completes the package. The CFO Council is conducting an evaluation of these FY1995 Accountability Reports and is considering the expansion of the pilot project for FY1996.

Federal Accounting Standards

Underlying both the CFOs Act and GMRA is the need for a comprehensive set of Federal accounting standards and principles. The Federal Accounting Standards Advisory Board, or FASAB, was established by a Memorandum of Understanding among the three principal agency heads -- the Secretary of the Treasury, the Director of OMB, and the Comptroller General -- concerned with overall financial management in the Federal Government. At that time, the Government did not have a comprehensive set of accounting standards. However, it was recognized that a comprehensive set of standards was needed, and that compliance with these standards must be measured on a regular basis in order to ensure the integrity of the financial information reported to America's taxpayers, managers, elected officials, and policy makers.

FASAB has recommended a framework for Federal financial reporting and the basic standards needed to carry it out. To date, FASAB has completed work on the following basic concept statements, accounting standards, and cost standards -- all of which have been adopted by OMB, Treasury, and GAO:

- *Objectives of Federal Financial Reporting*
- *Entity and Display*
- *Accounting for Selected Assets and Liabilities*
- *Accounting for Direct Loans and Loan Guarantees*
- *Accounting for Inventory and Related Property*
- *Managerial Cost Accounting Concepts and Standards*
- *Accounting for Liabilities of the Federal Government*, and
- *Accounting for Property, Plant, and Equipment.*

The latter standard is pending a 45 day review period by Congress, as required by the CFOs Act.

The following standard has been recommended by FASAB, and is under consideration by the three principals:

- *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.*

Finally, the following standard is substantially complete, and FASAB expects to make its recommendation to the three principals shortly:

- *Supplementary Stewardship Reporting.*

Approval of the revenue standard by the three principals will mark the completion of the basic accounting and cost accounting standards called for by the National Performance Review.

Once issued by OMB, these standards become GAAP -- Generally Accepted Accounting Principles -- for Executive Branch agencies. After issuing the standards, OMB will fulfill its responsibility to prescribe the form and content of agency financial statements by modifying its existing *Form and Content of Financial Statements* guidance to incorporate the new standards. The revised *Form and Content* guidance is expected to be complete by the end of September.

Electronic Benefits and Funds Transfer

Much progress has been made in the Government's efforts to deliver electronically almost all payments to individuals who receive wage, salary, or retirement payments.

EBT. Electronic Benefits Transfer (EBT) provides direct deposit and electronic funds transfer services to those without a formal banking relationship. EBT also provides for the electronic delivery of in-kind benefits, such as nutrition and health benefits. The Federal Government is on schedule to implement EBT nation-wide by 1999. All 50 States are working to provide EBT to beneficiaries of State-administered benefit programs by 1999 as well. To support this, the Federal Government is working to expand the scope of programs delivered through EBT.

EFT. Regarding Electronic Funds Transfer (EFT), the Government Management Reform Act of 1994 requires that payment be made electronically to all individuals who start to receive wage, salary, or retirement payments after January 1, 1995. Much progress has already been made. About 51 percent of the Treasury's 852 million payments were made electronically in 1995, representing 66 percent ($676 billion) of the dollar value of Treasury's disbursements ($1.022 trillion).

Most vendor payments cannot be made electronically until there is a convenient mechanism which establishes an electronic relationship between the Government and the vendor. Vendors should be able to register once with their bank and once with the Federal Government to invoice and receive payment for services electronically To accomplish this, the General Services Administration (GSA) is sponsoring several pilot tests using commercial payment networks. In the mean time, the International Merchant Purchase Authorization Card (IMPAC) allows the Federal Government to move forward quickly to make vendor payments electronically. IMPAC Card use grew 42 percent in FY1995 and is expected to continue to grow rapidly. Currently, only one in four transactions that could be made with the IMPAC card is made that way.

EBT and IMPAC enable the Federal Government to make nearly all payments electronically by establishing electronic relationships among the Federal Government, vendors, and those individuals without formal banking relationships.

Included in the Debt Collection Provisions of H.R. 3019, *The Balanced Budget Down Payment Act*, is language which would phase in direct deposit and electronic funds transfer by 1999 for nearly all wage, salary, and retirement payments, almost all vendor and expense reimbursement payments, as well as benefit payments. While the Federal Government's initiatives are proceeding -- and would continue to proceed -- without this language, the provision would accelerate the transition to making nearly all Federal payments electronic by 1999. The Administration supports this language.

Debt Collection

I would like to express the Administration's continued appreciation to you, Mr. Chairman, to Congresswoman Maloney, and to the members of this Committee for the prompt action on H.R. 2234, as amended, and S.1234 the *Debt Collection Improvement Act of 1995*. This bipartisan legislative initiative will result in a comprehensive reform of the Federal debt collection program while protecting the due process rights of the debtors. Among some of the significant provisions that the Administration is prepared to implement as quickly and effectively as possible are:

- Administrative offsets of payments to delinquent borrowers
- Requiring an annual Salary Offset Program for delinquent Federal employees
- Encouraging agencies to use cross-servicing arrangement for debt collection

- Expanding the use of private collection services and attorneys to collect delinquent debt
- Barring delinquent debtors from additional credit until the delinquency is resolved
- Providing for the phase-in of electronic funds transfer-direct deposit for almost all Federal payments to individuals and vendors, and
- Establishing gain-sharing for agencies that improve their credit management and debt collection performance.

The Administration strongly supports the non-judicial foreclosure and the automated tax levy provisions that it proposed with the Debt Collection Improvement Act, and looks forward to working with Congress on these issues.

A Citizen's Budget

Elected officials and program managers and analysts are not the only beneficiaries of our efforts to improve budget and management information. The public should be served as well. Citizens deserve a budget in which spending, assets, liabilities, and performance are clearly reported. With the enactment of the CFOs Act, GMRA, GPRA and other financial management innovations such as the Consolidated Financial Statement, the Government is currently moving in that direction.

In addition, technology offers unprecedented opportunities for providing taxpayers with information about how their Government is allocating and managing their resources. The Administration is committed to promoting the public's access to such information. Toward this end, the President's FY1997 Budget is being widely distributed through the Internet, CD-ROM, and documents targeted to the public.

Accounting Standardization Act

With respect to the *Accounting Standardization Act*, proposed by Senator Brown, the Administration believes that the FASAB process for establishing accounting standards, as envisioned by the agreement between GAO, OMB and Treasury, is working. This belief was reflected earlier in my testimony. The Administration shares with Senator Brown the goal that all Government entities account for similar activities consistently and in the same manner from one fiscal year to the next. The Memorandum of Understanding signed by GAO, OMB and Treasury, and the related financial statement preparation and auditing requirements of the CFOs Act and GMRA achieve the same end without further legislation. The Administration would be happy to continue to have a dialogue with this committee and Senator Brown to further explore the ramifications of the Senator's proposed legislation.

Separate Office of Management and Office of Budget

The proposal before this Subcommittee would split OMB into a statutory Office of Management -- combining the policy and oversight functions of the General Services Administration and the Office of Personnel Management -- and a separate Office of Budget.

As you know, OMB serves the President. OMB's activities are part of a comprehensive whole -- from policy development through program implementation and evaluation. Within the Office of the President, these responsibilities should be carried out in as integrated a manner as possible, not through fragmented organizations. Management reform is a means, not an end in itself. It is an essential aspect of Government strategy that is designed to support sound fiscal policy, improve service to the public, rationalize the distribution of tasks between the private and public sectors, and lower the cost of Government. Recent evidence from both here and abroad suggests that integrating budget and management responsibilities, not separating them, is the most productive and effective approach.

The General Accounting Office's (GAO's) recent (December 29, 1995) report *Changes Resulting From the OMB 2000 Reorganization* describes the results of a major reorganization that integrated OMB's budget analysis, management review, and policy development roles. GAO found that:

> ". . . there was greater attention to agency management issues in the fiscal year 1996 budget process (after OMB 2000 was implemented) than in the fiscal year 1995 process. A greater variety of management issues were presented in more depth in the fiscal year 1996 documents than in previous years' documents. These results reflected the clear commitment of OMB's top officials to ensure the treatment of management issues in the budget cycle."

Lessons from other national Governments also support this view. At a recent symposium of the Organization for Economic Cooperation and Development (OECD), ministers responsible for public management from the 26 OECD countries identified common features of successful governance reforms. What became apparent was that reform efforts are likely to fail if management considerations are seen as distinct from budgetary policies. Countries moving toward public sector reform are building alliances between these efforts and see them as mutually reinforcing. Indeed, important aspects of many reform agendas are inherently budgetary in nature. These include controlling the costs of direct Government operations, providing financial flexibility to permit resources to be used more effectively, financing essential training, reallocating tasks to the private or voluntary sectors and assessing performance.

Conclusion

Only through an integrated approach exemplified by OMB 2000 can the Federal Government effectively address the complex issues raised in an era of limited financial resources, downsizing, restructuring and other management challenges -- successfully work better and cost less.

This concludes my testimony. I would be happy to answer any questions you might have.

Mr. HORN. Assistant Secretary Muñoz is next. If we could try to summarize it, I am going to have to finish with this panel in 10 minutes.

Mr. MUÑOZ. Chairman Horn, distinguished members of the committee, ladies and gentlemen, on behalf of Secretary Robert Rubin and the Department of the Treasury, I want to thank you for the opportunity to come before you today to discuss the Federal budget process and financial management reform—especially yourself, Representative Horn, for the personal leadership that you have taken in this whole area of financial management.

The best way we can serve the American people is by assuring them that the dollars they send to Washington, DC, are being used responsibly, being spent with private-sector style, control and accountability. That idea is central to President Clinton, Vice President Gore and the related efforts to reinvent government. Central as well is legislation like the CFO Act.

First and foremost, I would like to assert that the Chief Financial Officers Act is working. Because of the CFO Act, we are better off today than we were just 5 years ago when it comes to financial management reform. I will not go into all details of how those changes have occurred, but I would like to point out the important role that the CFO Council has played in bringing about financial management.

Over the past few years, the CFO Council's growing influence and leadership have positively affected key aspects of financial management across government. The CFO Council is comprised of CFOs and Deputy CFOs from each of the 24 largest Federal agencies. The CFO Council has been very helpful in implementing the act and related statutes, as well as recommendations of the National Performance Review for improving financial management.

I would like to submit for the record, Chairman Horn, the first report that the CFO Council is issuing on how the CFO Council and the CFOs throughout government are implementing the financial management recommendations of the National Performance Review.

Mr. HORN. Without objection, it will be included at this point in the record.

[Note.—The report entitled, "Improving Financial Management" can be found in subcommittee files.]

Mr. MUÑOZ. And because we have already heard from Mr. DeSeve on certain of the products of that CFO Council, having to do with the GPRA and the Single Accountability Report, which we are very proud of, we will not go into that.

I would like to shift to what Treasury is doing.

The Department of Treasury has also taken many actions to implement the CFO Act and financial management reform. It has established its own CFO Council in which all Treasury bureaus participate. Through this Treasury Council, we have done several things. I would like to highlight a few of these.

First, we have reduced our core accounting systems from nine to five. Our objective is to reduce them to two, one for manufacturing and one for nonmanufacturing.

Second, we have achieved substantial growth in audit coverage. By the end of fiscal year 1996, we plan to have 100 percent of Treasury bureaus to have audited financial statements performed.

Third, we have integrated performance measures in the budget. The Department of Treasury has taken an aggressive posture in implementing GPRA. Under the direction of Secretary Rubin and the CFO's office, all Treasury bureaus are now required to submit strategic plans and financial statements containing performance information. This information will be incorporated into a comprehensive departmental budget submission for fiscal year 1998.

Further, the development of cost accounting systems has been identified as a priority for the Department, which will augment our ability to develop performance measures. The efforts of the CFO Council and our own internal efforts at Treasury should position us well to meet all of the requirements envisioned when GPRA takes full effect in 1997.

Fourth, we have established a framework for financial statements.

Fifth, we have prepared for the governmentwide financial statement. Treasury is working diligently with the Office of Management and Budget and the General Accounting Office to meet its mandate for a fiscal year 1997, consolidated, governmentwide financial statement. A task force made up of agency CFOs and IGs is also providing valuable advice to ensure that all necessary financial information is available for the governmentwide audited financial statement.

I do have some recommendations for consideration by your committee. First, it is important that all agency CFOs have full fiscal responsibility, including budget. Under the CFO Act, agencies do have some latitude in implementing an organizational structure for various functions. In particular, the budget formulation process is not identified as a mandatory duty of the agency CFO.

At Treasury, I have the necessary leverage to ensure that fiscal matters are carried out with consistency. I utilize this leverage by having the full support of Secretary Rubin, but further, I have both budget formulation and execution, as well as all financial accounting and reporting, under my span of control.

Some CFOs at other Federal agencies do not have this dual area. It is my personal opinion that a CFO, to be truly effective in carrying out the fiscal duties and responsibilities of an agency, both budget formulation and execution, as well as GPRA, must be under his or her span of control.

Mr. Chairman, the belief here is not so much that at any stage a CFO should have this dual responsibility, but rather in the early stages of any agency when there is so much work to be done, it is important that the CFO in fact have that leverage. Otherwise, that work will not be done as quickly.

My second recommendation is to empower the CFO with flexibility in audit cycles; from either a governmentwide or departmentwide perspective, it may not always be cost-effective to have full financial statement audits performed for all entities or all accounts. Consideration should be given to the financial management discipline displayed by the entity which can be documented by previously issued, audited financial statements.

Our recommendation here is that if an agency has already received audited financial statement, clean, audited opinions year in and year out, and there are sufficient controls in place, the CFO should have some discretion to say that the agency is now functioning in a way that the people demand, that the government demands, and to perhaps skip a period and put them on a different cycle so that we make sure that the agency does not come off track, but maybe we can save some money.

In conclusion, I am in full agreement with my colleagues from the CFO Council, as well as the testimony of Mr. DeSeve, who have worked very hard in bringing life to the CFO legislation. As every year passes by, our Federal agencies are better able to protect the integrity of our operations and more fairly report on our financial condition.

I would like to conclude by asking this committee to recognize that much of the Chief Financial Officers Act, the Government Performance and Results Act and the Government Management Reform Act have set out the right goals and principles. Now, sufficient time and discipline is required to fully implement these statutes before we begin to realize their full benefit.

Thank you, sir.

Mr. HORN. Thank you. That is a very helpful statement.

[The prepared statement of Mr. Muñoz follows:]

George Muñoz
Assistant Secretary for Management
& Chief Financial Officer
Department of the Treasury

INTRODUCTION

Representative Horn, distinguished members of the Committee, ladies and gentlemen. On behalf of Secretary Robert Rubin and the Department of the Treasury, I want to thank you for the opportunity to come before you today to discuss the Federal budget process and financial management reform. The best way we can serve the American people is by assuring them that the dollars they send to Washington, D.C. are being used responsibly, being spent with private sector style control and accountability. That idea is central to President Clinton, Vice President Gore and their related efforts to reinvent government. Central as well, is legislation like the CFO Act.

CFO ACT IS WORKING

First and foremost, the Chief Financial Officers Act is working. Because of the CFO Act, we are better off today than we were just five years ago when it comes to financial management reform. Let me list some of these successes Governmentwide and at the Treasury Department.

CFO Council Plays a Major Role. One of the most important actions of the CFOs, was the utilization of the CFO Council as a vehicle for improving financial management throughout the Federal Government. Over the past few years, the CFO Council's growing influence and leadership have positively affected key aspects of financial management across the Government. The CFO Council is comprised of the CFOs and Deputy CFOs from each of the 24 largest Federal Agencies. The CFO Council has been very active in helping to implement the CFO Act, and related statutes, as well as, the recommendations of the National Performance Review for "Improving Financial Management". I will highlight a few examples of this work, and would like to submit for the record a full listing of CFO Council activities, with respect to the National Performance Review financial management recommendations.

One of the more notable areas of improvement is with the preparation and audit of entities' financial statements. In 1990, there were three entities with audited financial statements -- only one of which obtained a clean audit opinion. Through the passage of the CFO Act and the support of the CFO Council, there has been significant growth in audited financial statements. As of July 1995, 100 entities have prepared audited financial statements of which 59 received clean audit opinions.

Guidelines on GPRA Implementation. The CFO Council issued guidance entitled "Implementation of the Government Performance and Results Act (GPRA)". As we approach 1997 when GPRA takes full effect, the CFO Council will continue its efforts to further integrate performance measures into the budget process and to assist all agencies in implementation, through the development of best practices, case studies, and outreach seminars.

Consolidating Multiple Reports into a Single Accountability Report. Under the authority of the Government Management Reform Act, the CFO Council has taken a leadership role in helping to define how the government should proceed with streamlining its financial management reporting process. Several Agencies have produced a single accountability report that combines core financial management reporting -- audited financial statements, Federal Managers' Financial Integrity Act, Prompt Payment Act, and Civil Monetary Penalties. Working with OMB, the CFO Council is assessing the pilot reports and will be recommending further actions.

Based on this short, but illustrative, list of actions taken by the Governmentwide CFO Council, I would hope that this Committee would view the CFO Council as a source of information and advice on the further development of financial management reform, legislation and ideas.

Treasury Advancements. The Department of the Treasury has also taken many actions to implement the CFO Act and financial management reform. It has established its own CFO Council in which all Treasury bureaus participate. Through this Treasury Council, we have:

One, We Have Reduced Core Accounting Systems from 9 to 5. Over the past five years, Treasury has reduced the number of core financial management systems within the Department from nine to five. Our goal is to further reduce to two systems, one for manufacturing and one for non-manufacturing by 1998. In addition, Treasury is developing a Departmental database containing current and historical information supplied by our bureaus. The Treasury Information Executive Repository (TIER), is designed to function as a warehouse where financial data will be collected through a Standard General Ledger (SGL) trial balance or by other data elements for every Treasury Fund Symbol maintained by the bureaus. Once the financial data is collected, we will be able to produce financial reports that will enable us to perform system-designed integrity checks, trend analysis, consolidations, comparisons, and projections for financial management decision making purposes;

Two, We Have Achieved Substantial Growth in Audit Coverage. The preparation and subsequent audit of entities financial statements has also grown over the last few years. For fiscal year 1994, approximately $1.316 trillion, or 81 percent of Treasury's total collections and expenditures, was audited. Audits performed include the Internal Revenue Service and the U.S. Customs Service. In fiscal year 1995, this list will grow to 82 percent by the inclusion of the Bureau of Alcohol, Tobacco and Firearms with an increase of $13.5 billion in revenue being audited. By the end of fiscal year 1996, it is planned that 100 percent of Treasury bureaus will have audited financial statements performed;

Three, We Have Integrated Performance Measures in the Budget. The Department of the Treasury has taken an aggressive posture in implementing GPRA. Under the direction of Secretary Rubin and the CFO's office, all Treasury bureaus are now required to submit Strategic Plans and financial statements containing performance information. This information will be incorporated into a comprehensive Departmental budget submission for fiscal year 1998. Further, the development of cost accounting systems has been identified as a priority for the Department, which will augment our ability to develop performance measurement information. The efforts of the CFO Council and our own internal efforts at Treasury, should position us well to meet all the requirements envisioned when GPRA takes full effect in 1997;

Four, Established the Framework for Financial Statements. The Department of the Treasury has been a major participant in the activities of the Federal Accounting Standards Advisory Board (the Board). The Board will soon finish the formidable task of completing the basic set of Federal accounting standards, as it was urged to do by the National Performance Review. These standards are approved by the Secretary of the Treasury, the Comptroller General, and the Director of the Office of Management and Budget, and then issued by OMB. We at Treasury are proud to have been a major player in this important effort; and,

Five, Prepared for Governmentwide Financial Statement. Treasury is working diligently with the Office of Management and Budget and the General Accounting Office to meet the mandate for a fiscal year 1997 consolidated governmentwide financial statement. A task force made up of agency CFOs and IGs is also providing valuable advice to ensure that all necessary financial information is available for the Governmentwide audited financial statement.

RECOMMENDATIONS

I do have some recommendations for the consideration by your Committee.

Important That All Agency CFOs Have Full Fiscal Responsibility Including Budget. Under the CFO Act, agencies do have some latitude in implementing an organizational structure for various functions. In particular, the budget formulation process is not identified as a mandatory duty of the agency CFO. At Treasury, I have the necessary leverage to ensure that fiscal matters are carried out with consistency. I have this necessary leverage by having the full support of Secretary Rubin. Further, I have both budget formulation and execution, as well as, all financial accounting and reporting under my span of control. Some CFOs at other agencies do not have this.

It is my personal opinion that for a CFO to be truly effective in carrying out the fiscal duties and responsibilities of an agency, both budget formulation and execution, as well as GPRA, must be under his or her span of control. My opinion is also supported by the Government-wide Chief Financial Officers Council. The CFO Council has made known its position through the approval and issuance of its "Guidance for CFO Organizations Required by the Chief Financial Officers Act."

Empower CFO with Flexibility in Audit Cycle. From either a Governmentwide or Departmentwide perspective, it may not always be cost effective to have full financial statement audits performed for all entities or accounts. Consideration should be given to the financial management discipline displayed by the entity which can be documented by previously issued audited financial statements. Once an entity can demonstrate they maintain sufficient management control structures, adequate financial management systems and reporting, and have received unqualified audit opinions for several years, you need to question the benefit of continuing a yearly audit.

For example, at Treasury, for fiscal year 1994, total revenue and expenditures subject to audit under GMRA would have been $1.6 trillion dollars from 12 Treasury bureaus and many accounts. The three largest revenue collectors are -- the Internal Revenue Service $1.21 trillion, the U.S. Customs Service $21.5 billion, and ATF $13.5 billion. Most likely, these entities would always be subject to audit. However, if smaller entities can demonstrate they maintain adequate financial management discipline as described above, the CFO should have the ability to decide if annual, full blown audits need to be performed each and every year, versus some other type of cyclical audit or review of selected accounts. I suggest this issue for your consideration as well.

CONCLUSION

I am in full agreement with my colleagues from the CFO Council who have worked very hard in bringing to life the CFO legislation. As every year passes by, our Federal Agencies are better able to protect the integrity of our operations, and more fairly report on our financial condition. I would like to conclude by asking this Committee to recognize that much of the Chief Financial Officers Act, the Government Performance and Results Act, and the Government Management Reform Act have set out the right goals and principles. Now, sufficient time and discipline is required to fully implement these statutes, before we begin to realize their full benefit.

Mr. HORN. Let me go back to Mr. DeSeve's statement. Let me just read off each of these seven basic bills you are talking about, and give me about a one-word summation of progress there.

For example, the Chief Financial Officers Act execution. How would you grade it? Is this an A, a B, a C?

Mr. DESEVE. I would grade it similarly to how Mr. Bowsher has graded it, A minus to high B.

Mr. HORN. Government Performance and Results Act implementation?

Mr. DESEVE. Incomplete. We don't know yet. We are about halfway through the process. OMB is going to be looking very carefully at strategic plans and performance plans now. We need to get the Congress involved.

It is very important that appropriators, authorizers, as well as the oversight committees, very much engage. If they ask the questions inherent in GPRA, it will be successful.

Mr. HORN. Excellent point.

Accountability reports?

Mr. DESEVE. Good start. First four are done, the next two should be done within 30 days. We would like to expand that to other departments, and we believe we will, using OMB guidance as the vehicle.

So I give those a B plus, A minus, somewhere in that same area.

Mr. HORN. Federal accounting standards.

Mr. DESEVE. The FASAB folks, starting in 1990, have done an excellent job; there is a long way to go. The standards—although basic standards are in place, giving them a good B, they themselves know that there are other arenas in which they must carry this fight, beginning to take accounting data and budgetary data.

There is an excellent article by a man named Anthony in this month's American Government Accounting Journal that talks about the integration of that data. Mr. Bowsher has long been arguing for having good, timely data.

Mr. HORN. How about electronic—well, how would you sum it up then, a B?

Mr. DESEVE. B.

EBT is also an incomplete at this point. We have two alliances and groups of States that are starting out, and we will know in about a year how well they are doing. Two other groups of States are coming along. So good progress has been made, but we are not there yet.

Mr. HORN. So that is an incomplete?

Mr. DESEVE. That is an incomplete.

Mr. HORN. I will be putting in the legislation later this week on our side and ask the minority and the majority to join me.

Mr. DESEVE. Very much appreciate your sponsoring that.

Mr. HORN. And debt collection?

Mr. DESEVE. Debt collection, we hope we are going to get a grade in the next week. We are awaiting the grade on that one. We think if we get it, it will be an A plus.

Mr. HORN. Have you been engaged or are you aware of the negotiations between the Department of Justice and the real estate community on this?

Mr. DESEVE. We have, and we hope that those will be resolved by allowing nonjudicial foreclosure to go forward. That is the OMB position and continues to be.

Mr. HORN. Citizens' Budget?

Mr. DESEVE. Probably not as good a grade. It started last year within OMB. I am going to give it a B minus. We can do more work, and again, I think if we can get some agreement with the Congress on how to disseminate congressional action information in a vehicle, that might be helpful as well.

Mr. HORN. Some of our members—Chris Cox, I think was one of the first, who is chairman of the Policy Committee now—have tried to put out a budget summation for the average citizen and send it out as a newsletter to raise the level of knowledge.

Mr. DESEVE. We think that is an excellent idea.

Mr. HORN. Yes, that would be very helpful.

I notice the Financial Management Service of Treasury put out in 1993 a prototype that consolidated financial statements, looking back on that; and that was put out in 1976 to 1993, and they haven't really done it. The U.S. Annual Report, compiled by the same group, fiscal year 1994, really doesn't include the consolidated financial statements.

So I take it we have nothing since fiscal year 1993 that pulls the financial statements together?

Mr. MUÑOZ. We do have another prototype. It was late in 1994, that just came out recently, I believe, but we will provide the committee with that.

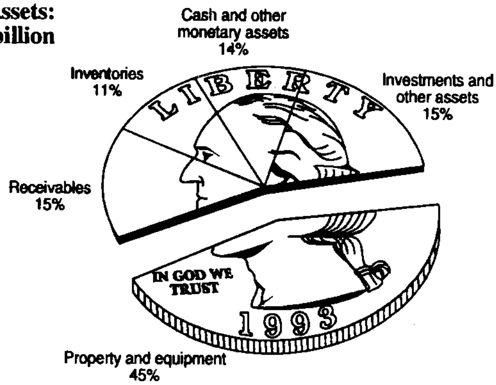
Mr. HORN. OK. We will put it at this point in the record, without objection.

[The information referred to follows:]

Major Categories of Assets, as of September 30, 1993

Assets are resources owned by or owed to the Federal Government that are available to pay liabilities or to provide future public services. The next chart is derived from the Statements of Financial Position (page 13). It depicts the major categories of assets as of September 30, 1993, as a percentage of total assets. The components for each of these categories are contained in Notes to the Financial Statements.

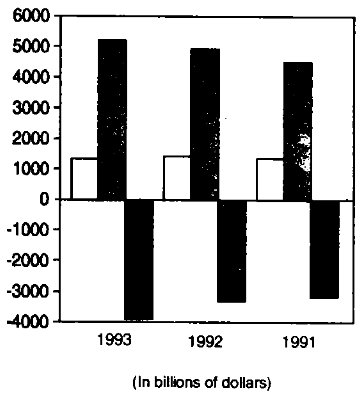
Total Assets: $1,362.4 billion



Assets, Liabilities, and Accumulated Position, as of September 30, 1991-1993

The adjacent graph depicts assets, liabilities, and accumulated position reported in the Statements of Financial Position, as of September 30, 1991 through 1993.

Assets
Liabilities
Accumulated position

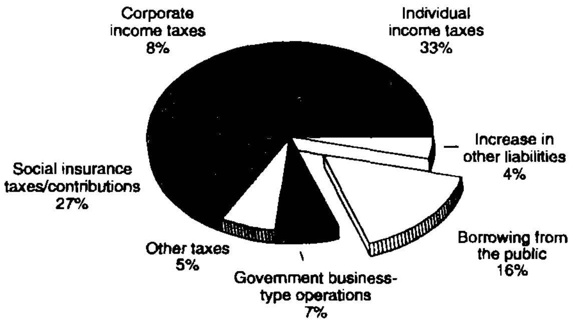


FOR MORE INFORMATION 13,20 SEE PAGES

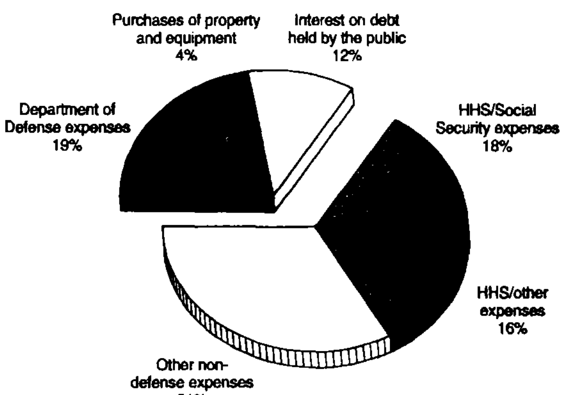
Sources of Funds Provided and Applied

The charts on this page are derived from the Statements of Operations (page 14) and the Statements of Cash Flows (page 15) Figures represent percentages for fiscal 1993

Funds Provided



Funds Applied



FOR MORE INFORMATION 14,15

Mr. HORN. The Government Performance and Results Act, we are clear on when the ax is falling on the implementation of that. We are talking 1997, as you suggested; and as I recall within our various other hearings, Defense will not be in compliance at that time. Do we know of any other agency of the 24 that would not be in compliance?

Mr. DESEVE. We do not. We have surveyed all of them.

Mr. HORN. So it is only DOD then, essentially?

Mr. DESEVE. DOD will be audited. It will have an audit done on its books. The only question is whether they are going to get a clean opinion or not, and whether it is going to be a disclaimer.

Mr. HORN. Where are they in consolidating their 49 separate accounting systems?

Mr. DESEVE. I don't have the numbers. They are in the teens, I believe at this point. They are moving very rapidly to do it, especially in the payroll/personnel area.

Mr. HORN. OK. Let me ask, just as a general question—you have heard some of the questions we were asking earlier. How do we get OMB, CBO, for example, to agree on some economic assumptions, and should the Congress and OMB work more closely together during the budget appropriations authorization process, and if so, what kind of forms of cooperation are we talking about? Do you have any thoughts on that?

Mr. DESEVE. I am going to ask Mr. Muñoz to comment, as well, because a lot of our economic assumptions, especially on the revenue side, come from our friends in the Treasury.

I think that the adversarial process that we have may, in fact, be a healthy one on the estimation side. I don't think that the difference in the baselines—we have a piece of information I would like to share with you. And I will ask Barry Anderson, who is our Associate Director for Budget, to send it on up, that shows the convergence over time of the estimates of CBO and OMB; and we think they are close enough that they give people a good bracket along the way. So I wouldn't change that process.

George may want to comment as far as revenue estimates from Treasury side.

Mr. HORN. Well, we will put that exhibit in the record at this point.

[The information referred to follows:]

Question. **Please show the economic assumptions of OMB and CBO for each budget cycle during this Administration, to determine if they are coming closer.**

Answer. The attached pages show the economic assumptions for the President's budget, and the corresponding assumptions from the annual CBO Economic and Budget Outlook, for the 1994 through 1997 budget cycles. The differences in assumptions are summarized in the table below. More detailed, year-by-year breakdowns are provided in Attachment 1. The table shows that the differences overall have been well within the normal range of variation in economic forecasts. In addition, the differences have declined modestly over the last four years.

DIFFERENCES BETWEEN OMB AND CBO ECONOMIC ASSUMPTIONS
(Average differences over six-year forecast horizon, in percent)

	1994 Budget			1995 Budget			1996 Budget			1997 Budget		
	OMB	CBO	**Cycle 1/**	OMB	CBO	**Cycle**	OMB	CBO	**Cycle**	OMB	CBO	**Cycle 2/**
Real GDP growth	2.8	2.5	**(0.2)**	2.7	2.7	**(0.0)**	2.5	2.3	**(0.2)**	2.3	2.1	**(0.2)**
Growth in GDP deflator	3.0	2.3	**(0.7)**	2.9	2.6	**(0.3)**	3.0	2.8	**(0.2)**	2.7	2.7	**0.0**
CPI inflation	3.3	2.7	**(0.5)**	3.3	3.0	**(0.3)**	3.2	3.4	**0.2**	2.9	2.9	**0.1**
Unemployment rate	6.1	6.2	**0.1**	5.9	5.9	**0.1**	5.8	5.8	**(0.0)**	5.7	6.0	**0.3**
Interest rates:												
91-day Treasury bills	4.6	4.3	**(0.3)**	4.1	4.4	**0.3**	5.6	5.4	**(0.2)**	4.3	4.2	**(0.1)**
10-year Treasury notes	6.5	6.6	**0.1**	5.8	6.1	**0.3**	7.2	6.9	**(0.3)**	5.1	5.4	**0.2**
Average absolute difference			**0.3**			**0.2**			**0.2**			**0.1**

1/ Baseline economic assumptions for the President's 1994 Budget were based on CBO's January 1993 assumptions. Comparison shows the difference between these assumptions and the Administration's forecast.

2/ For consistency with 1997 Budget, uses CBO post-policy assumptions.

Note: For real GDP, deflator, and CPI, differences are CBO minus OMB fourth quarter over fourth quarter growth rates. For unemployment and interest rates, differences are in annual averages. Differences are averaged over six year forecast horizon (e.g. 1993-1998 for 1994 Budget cycle).

Mr. MUÑOZ. The only thing, sir, I think Mr. DeSeve is correct that when you are trying to develop an economic model for forecasting the future, you will have as many viewpoints as you have people making that forecast.

We have very competent people at the Treasury Department, very competent people at OMB, and very competent people here in Congress. All have contributed toward a formula that is acceptable. The debate will always continue as to whether you expand on that formula and include dynamic forecasting, for example, as was testified to this morning.

I would endorse Bowsher's comments that nothing major is really required in the budgeting area, and we should move very cautiously, because these formulas are delicately arrived at and, as you know, a slight percentage change could make an assumption so positive that in fact we may end up in the red down the road because of that forecast.

Mr. HORN. You say they are delicately arrived at, but regardless of organization, people have great suspicion of the numbers coming out of the executive branch as just hokey, and really more of a campaign variety than solid economic analysis. And I am talking both Republican and Democratic administrations; I am not just picking on you, I am picking on your predecessors. I don't see any difference.

Mr. MUÑOZ. The corrective mechanism is that there is a continuous debate every year; as you know, these plans get revised based on what is happening out in the economy. The economy is very dynamic. I am not sure that anybody can really argue just one point of view.

Mr. HORN. Well, we agree it is dynamic, but we don't see too many people taking the dynamism into account. I mean, aren't you basically still operating, as CBO is, on a static type of budget analysis?

Mr. DESEVE. That is correct.

Mr. MUÑOZ. That is correct.

Mr. HORN. Where are the dynamics?

Mr. DESEVE. I guess, Mr. Chairman, we would like to share with you the historical forecast that OMB has used and the actual reality of what occurred along the way, and the same information from CBO, so that you can make your judgments.

Mr. HORN. Good. Let's put that at this point in the record, without objection.

[The information referred to follows:]

Question. **Please provide OMB's views on the issue of "Dynamic Scoring"**

Answer. ***Summary:*** "Dynamic scoring" would introduce a dangerous degree of arbitrariness into the budget process. It would start down a slippery slope toward manipulation and consequent weakened budget discipline.

- A common caricature is that there are two kinds of budget estimates: "static" estimates, which ignore changes in taxpayer behavior; and "dynamic" estimates, which take such changes of behavior into account.

  However, budget estimates already take into account changes in ***individual economic behavior*** -- but not ***overall economic performance***. Estimates of revenue losses from liberalizations of rules for individual retirement accounts or for capital gains, for instance, have assumed that taxpayers would deposit more money into IRAs or realize more capital gains. However, these estimates have not assumed that the economy would grow faster or that unemployment would fall. The primary reason is that overall economic resources are limited, and that the Administration's budget and the monetary policy of the Federal Reserve are already chosen to make the economy grow as fast as possible. Therefore, changes in tax or spending policy could not separately create additional economic resources, or yield additional economic growth.

- The first major problem with dynamic scoring is that it would be inherently ***arbitrary***. Current budget scoring, while subject to some judgment, is essentially objective; the major economic variables are held fixed, and the range of differences in estimates because of technical factors is usually fairly small. If similarly narrow ranges of uncertainty on dynamic estimates could be found, OMB might favor them. However, because the knowledge of the response of the economy to tax and spending changes is quite limited, dynamic estimates by different analysts -- particularly those who espouse some ideological agenda -- typically come to wildly different conclusions.

A prominent example was the Reagan economic program. Technically, the estimates of the 1981 tax cuts were not dynamic; they did not themselves show an increase in revenues. However, at the same time that the tax cuts were considered, the separate estimate of economic growth was jacked up so far that projected revenues increased sharply in the future even with the tax cut, yielding the incredible prediction of budget balance in 1984. Partly as a result of the experience of the 1980s, the center of gravity in the economics profession is that supply-side effects of tax cuts are very small, and take many years to materialize.

The second major problem with dynamic scoring is that it would set a ***dangerous precedent***. Every advocate of a policy change would claim that it would improve the economy and "pay for itself." Once the precedent of dynamic scoring was set, it would be hard to restrict dynamic scoring. No anointed arbiter of such scorekeeping power could remain impartial forever. The application of dynamic scoring would be especially subject to logrolling: you agree to score my policy as a money machine, and I'll do the same for yours. The list of potential cost-free proposals is virtually endless.

Finally, instituting dynamic scoring would run serious ***procedural risks***. Currently, the Budget Act requires all OMB scoring to be based on the economic and technical assumptions in the budget for that year. The budget presents a single economic forecast, and so OMB scoring is based on that forecast. Therefore, presentation of a dynamic forecast would require a change in the budget law. Once a bill amending the Budget Act to adopt dynamic scoring was in motion with the blessing of the relevant Committees, ***any*** part of the Budget Act could be changed without a point of order. Furthermore, dynamic scoring would result in some bills being scored as costing more, rather than less. Thus, proposing dynamic scoring for one particular initiative might well worsen the chances of funding it and other desirable initiatives.

Also, because of the arbitrary nature of dynamic scoring, there would be an inevitable tendency to predict greater savings, leading to higher deficits and a severe weakening of budget discipline. The constantly shifting economic forecast, changing with each new piece of "dynamic" legislation, would send confusing and unnerving signals to the private sector. Differences between OMB and CBO estimates would arouse more finger-pointing, posturing and loss of faith in government.

Mr. DESEVE. We stand very proud, especially in the last 4 years, of the work that has been done, the forecasting that has been done. We think that a rosy scenario doesn't live here any more. She has moved on to another time and another place, hopefully, and the notion of what is one man's dynamism is another man's rosy scenario.

So we have to be very careful that when we use the projections over time, that the multiplier effect or whatever one wants to call it, does not distort the linear changes that we know will occur on the expenditure side. So we are very much opposed to that notion of dynamic scoring.

To answer the second part of your question, though, in terms of a process, I would very much like to work with appropriations committees, authorizing committees, budget committees and this committee, perhaps to develop some pilots that demonstrate how the information contained in audited financial statements, in the President's budget submission, might easily flow through to the appropriations committees at the time following the President's budget decision, and would be available to them both on an actual basis as well as on an estimated basis. You can think in terms of a spreadsheet with multiple columns.

The spread sheet containing both information that the President is proposing, historical information about that budget account, and the performance associated with that. We are not there yet in every department, but there are departments who could prototype that.

But, again, we need that pull. We need the pull of those appropriating committees.

I frankly think it's a waste that departments have to submit one set of information for the Presidential budget submission and a second set for congressional justification. I think there ought to be a more seamless process.

Mr. HORN. I completely agree with you.

Mr. DESEVE. We would love to find a prototype. I think the only way to find that is by getting the committees' clerks to want to pursue the process in that way. We are very open to doing that, and we will look for opportunities, especially as we implement GPRA, to allow that to happen.

Mr. HORN. Has any session been held by OMB with the committee staff here?

Mr. DESEVE. We have, as recently as last week, met with Senate Oversight Committee and House Oversight Committee staff from this full committee as well as the full committee on the other side and made that offer, and I have offered to testify.

There was a joint hearing that Mr. Clinger and Mr. Stevens held to brief the membership. They appropriately did not invite OMB. It was really a set of outside entities, as well as GAO. We believe there will be a second hearing, and we are—we are more than delighted to testify there and have made the same offer to that committee staff as we have just made here today.

Mr. HORN. You heard me ask Mr. Bowsher the question of reprogramming authority and the degree to which—maybe, Mr. Muñoz, you want to get into this—the degree to which various Cabinet departments have this authority, and should there be a different type of reprogramming authority? Is it sufficient?

What is the thinking in this area? If you are in the executive branch, can you really run your agencies?

Mr. MUÑOZ. Reprogramming is very helpful. At Treasury we have a 10 percent, or $500,000, whichever is the higher, that we can reprogram within the bureau. If we wanted to transfer between bureaus, that is a flexibility we would like to have, and in the past our appropriators have supplied us with a 2 percent transferability amount, always with the consent of Congress; also the same thing with reprogramming.

On the transfer authority, that is something that we engage our appropriators with, and if we make our case, they have been very helpful in allowing us to do it. In all cases, any money shifting does require approval of our appropriators.

Mr. HORN. It is strictly approval of the appropriators? The authorizing committees don't come into it?

Mr. MUÑOZ. Once our budget has already been—has been passed, as I understand it, as long as we are within our appropriate—our authorized authority, we can reprogram or transfer within that authorized area.

Mr. HORN. Who keeps track of how this reprogramming authority works in the executive branch? Is that OMB, essentially, that is logging where these provisions are? And who signs off and all of that?

Mr. DESEVE. The review is done account-by-account at OMB. The agencies themselves are the repositories of the reprogramming information. We review the requests for reprogramming.

Mr. HORN. I think if OMB could furnish an entry at this point in the record of where the reprogramming authority is and who signs off on it at the congressional level, as well as the executive level.

Mr. DESEVE. We would be happy to do that.

Mr. HORN. Just to get it straight as to how the system is working and should it be more flexible.

Mr. DESEVE. Sure. It will vary agency by agency, Mr. Chairman.

[The information referred to follows:]

Question. **Please provide a description of who in OMB is responsible for re-programming authority. Please provide information about how the reprogramming process works.**

Answer. OMB clearance of budget-related materials for Congress, including agency re-programming requests, is described in OMB Circular No. A-11, section 12.9 (b). These materials are required to:

> "be provided to OMB in such a manner as to allow OMB five working days to review the material. OMB review of reprogramming requests may take longer than five working days under certain circumstances (e.g., if these requests have not been coordinated in advance with the OMB representative or if supporting materials have not been provided concurrently)."

The OMB Resource Management Office responsible for an agency is also responsible for the clearance of the agency's reprogramming requests.

Mr. HORN. Well, I am interested in, is there still a role for authorizing members to sign off and if it is—obviously, if it is already assumed to be authorized, maybe they don't. On the other hand, maybe they should.

In terms of the basic balance sheet idea, asset/liability management, is that going to be the most difficult to implement in terms of asset labeling and this kind of thing?

Mr. DESEVE. I would say the liability side is probably even more difficult than the asset side. Once the assets are valued, there is then an agreement on that value over time and it's unlikely that they will change.

Mission assets, things like weapons systems and so on, are actually relatively easy to value because we don't try to go out and have the depreciated cost of an aircraft carrier. We talk about the cost in different ways.

Liabilities are much more complicated. When we think about the environmental clean-up liabilities that we face, the disposal of nuclear materials, we may, in fact, identify more liabilities than we knew about and have a very difficult time in estimating the cost of those liabilities.

So we think the liability side, rather than the assets side—I am not saying that the asset side is easy, but what we have done is, we have gotten 13 different groups of CFOs and program managers with GAO and OMB, and we are going through each of these issues very specifically under the aegis of the CFO Council, and we are answering the questions. As we answer them, the liability side appears to be the most difficult.

Mr. HORN. How are you going to place a value on a priceless situation such as Yosemite and Yellowstone?

Mr. DESEVE. We call those stewardship assets, or mission assets. We don't attempt to place a value on it. We simply record the size of the facility, describe the use of the facility, and indicate that a value is not appropriate.

Nor is it on the White House, for example. Is that an office building, or is it a commercial location with a residence in the second two floors? Is it a duplex? We are not really sure.

Mr. HORN. How about the public lands which are used for grazing? You can put a value on that, I would think.

Mr. DESEVE. You can put a value on it, but the question is, will it be used for grazing long-term? Does it have a mission responsibility, or is it, in fact, leased out? If it is leased out long-term, you can capitalize the value of the lease. If it is an annually renewable lease, then it is much more difficult to establish a capitalized value.

Where there is an economic stream, we do use the economic stream for that purpose.

Mr. HORN. So on the liability side then, you say that is more difficult than the asset side. And what particular liabilities pose to be the most difficult?

Mr. DESEVE. Environmental clean-up around, for example, the——

Mr. HORN. Well, you mentioned that, and a good example is the Pentagon——

Mr. DESEVE. Correct.

Mr. HORN [continuing]. Which doesn't seem to ask for the money, and when they have it, they don't seem to use it.

Am I misadvised on that? Are they doing something in environmental clean-up?

Mr. DESEVE. We believe they are on a base-by-base situation. I can't comment—I'm just not familiar enough with——

Mr. HORN. Is anybody in OMB monitoring that to see if they are doing anything?

Mr. DESEVE. Yes, we are.

Mr. HORN. Well, I would like that exhibit put in the record.

Mr. DESEVE. We will be happy to.

Mr. HORN. Because I will tell you, I hear gripes from all over America, from colleagues, on, when are they going to put some money in to clean up some of these bases they have ordered closed?

[The information referred to follows:]

Question. **Description of how OMB is assessing DOD's environmental clean-up costs and monitoring DOD's execution of clean-ups, on a base-by-base basis.**

Answer. To date, 760 military installations and 2,200 formerly-used defense properties have more than 15,000 sites where cleanup action is underway. Due to this large number of sites, OMB assesses the DoD cleanup budget, for both active and closing bases, on a more macro level. DoD's current approach to cleanup is to evaluate the relative risk of sites. (The comparative risk reduction categories of high, medium, and low are employed.) This past year, OMB worked closely with the Department in implementing performance measures to ensure that the Service cleanup budgets are based on reducing relative risk priorities. This will allow the Department to prioritize its cleanup work, in addition to meeting milestones in legal agreements.

In addition, OMB and the Office of Secretary of Defense (OSD) hold budget hearings, as part of the joint OMB/OSD budget review, with the Services on their cleanup requests. During these hearings, OMB examines the following:

- Is the Department executing cleanup funding as planned by cleanupphasei.e. studies, actual cleanups, administrative costs, etc.?

- Has sufficient funding been budgeted for the Services to meet milestones in legal agreements?

- Is relative risk being reduced at DoD sites?

- How is funding being allocated through the Base Closure and Realignment account for cleanups at closing bases?

As a result of these hearings, OMB and OSD, draft a Program Budget Decision paper for that determines the President's budget request for the DoD cleanup program.

Mr. DESEVE. One of the benefits of the audit and financial statement is forcing, agency by agency, not just the Pentagon but all agencies to deal with those costs and to reflect them for the first time in their financial statements.

Mr. HORN. OK.

Some say, are we really pursuing all of the business style innovations that American business has been doing? Has the Chief Financial Officers Council looked at some of those, and is there anything we are missing that ought to be done?

What is your feeling on that?

Mr. MUÑOZ. In fact—the CFO Council is where a lot of creative thinking is being done and putting into place some of these modern technologies.

I will take, for example, our travel program. We have an example where an agency, GSA, has developed an approach to accounting for tracking and facilitating the processing of our travel procedures. Once we expose it to the council, and people have an opportunity to ask questions, there is a briefing to all the members. Members start adopting that and accepting that.

That's just one case of a whole list of items that this council really becomes a breeding place for exchanging best practices.

The debt collection—if I may just add one thing, the debt collection legislation that you have taken a strong leadership role in, is something that has excited the council, because it really will clean up some of their books and their receivables. It will allow the right incentives to come into play. And the council played a very close role in advising OMB in some of the negotiations that were taking place, as well as Treasury.

Mr. HORN. Well, we think it has been doing very creative things, and obviously we want to be helpful in any way we can when legislation is involved.

Mr. DESEVE. I would like to use one more example, because I know that the folks in FEI are testifying in the next panel, and you might ask them as well. Dennis Fischer, the CFO from GSA, along with Bill Topolewski, his deputy, and a couple of other folks in the electronic commerce area are going to New York tomorrow. They are meeting with the New York chapter of the Financial Executives Institute and particularly with major utility companies, because we believe there is a very easy way to handle invoicing for utilities and rents.

There are bills that come every month. We are not going to get to a divorce from GPU, we are not going to get a divorce from Potomac Electric—so that the bill and the payment can be easily handled electronically if we can agree with our vendors how that handshake can work. We want to extend that into electronic commerce.

We have been working very closely with Rocky Mountain Bank, with the Visa network, and with other networks in having them take over major functions of expenditure-processing that the Federal Government now does.

So we are very excited about the work with FEI as well as the electronic-commerce work that's going on.

Mr. HORN. Since you mentioned GSA, you remind me that one of the things I gave Roger Johnson when I first met him, were the, I think, four or five invoices that we get every time we order pencils from their Kansas City supply center for our district office.

And I must say, there is no need for all of those, that I can see, and I suggested at that time—but they are still sending us four or five invoices—that, why can't they send us one, and if our quirky financial system wants two, we will Xerox it and ship it to them? Or if anybody else's quirky financial system wants four, let the agency do it. Why should GSA be chopping down trees to put this out?

Is there any way we can stop that nonsense?

Mr. DESEVE. You shouldn't get any invoices. You should get the IMPAC card. And I am going to have Dennis Fischer contact the folks who run your office and get them, even on a pilot basis, in Congress, on the plastic program, because then what you get is, you get a full listing of all expenditures. So when you want to buy pencils, either you use the IMPAC card in the GSA catalog or you go to Staples and you use the card and receive a monthly bill.

Mr. HORN. And you say that is available to congressional offices?

Mr. DESEVE. If it isn't, we are going to figure out how to make it available.

Mr. HORN. Good.

Mr. DESEVE. If you buy through GSA, you should be able to——

Mr. HORN. We are a part of the American Government.

Mr. DESEVE. That's right. If you buy through GSA, you should be able to use the IMPAC card, and we will find a way to do it.

Mr. HORN. Good. Progress has been made this morning.

I think that is really all the questions I had. There are some more technical questions. As usual, we will ship them down. If you will be good enough to answer those, why, great.

I think your testimony has been very helpful, as usual, and we thank you for coming.

Mr. DESEVE. Thank you very much, Mr. Chairman.

Mr. HORN. OK. We are now on panel five, and we have Mr. Wurtz, Mr. Sheridan, and Mr. Jasper to complete that.

If you would rise, gentlemen, and raise your right hand.

[Witnesses sworn.]

Mr. HORN. The three witnesses have affirmed.

We will just go down as it is in the agenda. We start with the Honorable Donald Wurtz, Chief Financial Officer, Department of Education.

Welcome.

STATEMENTS OF DONALD R. WURTZ, CHIEF FINANCIAL OFFICER, DEPARTMENT OF EDUCATION; TED SHERIDAN, PRESIDENT, SHERIDAN MANAGEMENT CORP., AND CHAIRMAN, COMMITTEE ON GOVERNMENT LIAISON, FINANCIAL EXECUTIVES INSTITUTE; AND HERBERT N. JASPER, FELLOW, NATIONAL ACADEMY OF PUBLIC ADMINISTRATION, FOR DAVID CHU

Mr. WURTZ. Thank you, Mr. Chairman.

If it is all right with you, I will summarize my remarks and submit the written testimony for the record.

First, on behalf of the CFO Council, I would like to express my deep appreciation to you, Mr. Chairman, and members of this subcommittee for sponsoring the Debt Collection Improvement Act and working so closely with us to make it happen. What we have done here should be a model for future legislative initiatives.

What I would like to talk about is the existing tools that we have in legislation now and what we have done with them, and use the Department as an example. We have, of course, had almost all of the people testifying today talk about the three primary acts involved here, the CFO Act of 1990, the GPRA of 1993, and the GMRA of 1994. These three laws have strengthened the statutory underpinning of Federal financial management.

Coupled with the Federal Managers' Financial Integrity Act, the Cash Management Improvement Act, and the Inspector General Act, I believe we have ample legislation to protect the taxpayers' interest and accomplish the Federal Government's financial management goals. Governmentwide, we have been using this legislation to move forward in a positive manner on a number of fronts.

Some examples of what we have done at the Department of Education: For example, with those tools, under the CFO Act, we are redesigning the Department's automated financial management systems to ensure reliable data to meet the needs of the Department's program managers and ultimately the recipients of the Department's programs.

I don't know whether you know, Mr. Chairman, but most of the Government's financial management systems of the past have been essentially funds control systems. They haven't been true integrated financial management systems. We can't have adequate cost accounting data. We aren't able to produce a financial report at the end of a given period with ease, and you can't imagine the level of work that we have to go to, to actually produce a financial statement to be audited. That will change when we complete our EDCAPS—our Education Central Automated Processing System—which will be fully implemented in fiscal 1997.

For the past several years, though, under the CFO Act, we have prepared financial statements for our revolving funds and received audits on them, just like that done in the private sector. Our experiences with the two 1994 loan program audits underlies the benefits of this process in terms of the lessons learned.

We were very pleased to receive an unqualified opinion on the direct loan program, but nevertheless, in presenting that clean report, the auditors also made several suggestions for making operations in management of that successful program even more effective and efficient.

Conversely, on the FFEL program, the guaranteed loan program, the auditors were unable to express an opinion because the data we received from guarantee agencies, private lenders, and other outside parties had been found to be unreliable. But that finding has also led us to undertake a data quality improvement initiative that involves analysis and verification of information in the National Student Loan Data System and other efforts with the lender guarantor and school communities to make the data more reliable.

For the first time, we are preparing financial statements covering fiscal year 1995 to be audited for the Department as a whole in advance of the fiscal year 1996 requirement by the GMRA.

For this audit, we have implemented many suggestions from prior audits, and regardless of the opinion that we may receive on that this year, it's clear that our management systems and the financial reports that they help produce are getting more accurate, reliable, and useful every year.

Under GPRA, we are one of the first agencies to have a comprehensive strategic plan, which was completed in December 1994, well ahead of the legislative deadline.

Our plan has four goals, one of which addresses management reforms internal to the Department.

Under GMRA, we are currently completing our fiscal year 1995 accountability report, which will feature our first ever Department-wide financial statements and the result of an independent audit. It will also include the reporting requirements of the Federal Managers Financial Integrity Act and the Prompt Payment Act, as well as the semiannual report on audit followup, and will also report on our performance toward the departmental goals detailed in our strategic plan.

This report streamlining provision of GMRA brings some sense to the current tangle of separate reports required of agencies at various points throughout the year. We need, however, to go beyond the current pilot status accorded to only six agencies, and if I were to suggest legislation, it would be to expand GMRA beyond the pilot efforts.

At the Department of Education, financial management improvement activities have expanded beyond the specific activities required by the CFO Acts and GPRA and GMRA.

For example, we have streamlined our operations, eliminating about 45 programs over the past 3 years, totaling about $450 million.

We are cutting our staff, with plans to reduce by 616 full-time employees, or 12 percent, over the period 1995 to 2000.

We have taken steps to eliminate or reinvent unnecessary or burdensome regulations. We have already eliminated 79 percent of our regulations in elementary, secondary, and bilingual education.

We have reengineered our discretionary grant process, cutting the steps involved by more than 50 percent. At the same time, we have continued to stress accountability.

The Department has strengthened the student financial aid gatekeeping function that keeps ineligible schools out of Federal student financial assistance programs.

We have reduced the national student loan default rate to an all-time low, cutting it almost in half, from 22.4 to 11.6 percent. Since 1992 the net outlays for the student loan default have dropped by more than two-thirds, from $1.7 billion to $400 million.

Mr. Chairman, where I think we could truly benefit is through a stronger partnership with the congressional committees with legislative responsibility over the functions we perform. Working more closely together on issues like financial systems infrastructure, performance measurement, accounting standards, and financial statements can only result in better understanding by both the executive branch agencies and by the appropriate congressional committees.

In summary, I believe that legislation currently exists on which we can work together to continue to strengthen financial management. I am pleased with the successes we have had at the Department of Education, and, as I said earlier, with good honest dialog through regular oversight hearings and other face-to-face discussions, we are all more likely to succeed in our respective roles.

That concludes my testimony, Mr. Chairman, and I would be happy to answer any questions you may have.

[The prepared statement of Mr. Wurtz follows:]

Donald R. Wurtz
Chief Financial Officer
Department of Education

INTRODUCTION

Thank you Mr. Chairman and members of the Committee for the opportunity to testify during this legislative oversight hearing. I'd like to share my thoughts on the need for new legislation to strengthen the financial management and budget processes. With enactment of the Debt Collection Improvement Act, I believe we will not need any major new legislation.

Regarding the Debt Collection Improvement Act, I would like to emphasize the Department of Education's support for this critical piece of legislation. It will go far in providing us with the necessary tools to collect debts owed to the Department. Given our focus on postsecondary student financial aid, and the amount of federal funds involved, the issue of debt collection is very significant for us.

While I understand the Debt Collection Improvement Act has not yet been signed into law, I would also like to comment briefly on the process that was followed in shepherding this important initiative through the Congress. I think what is most noteworthy about this particular piece of legislation is the way the executive and legislative branches of government joined together in a common partnership to design legislation that will ultimately enable the Federal Government to perform its work more efficiently and effectively and to realize substantial savings for the American taxpayer.

It was the close interaction and cooperation among all parties involved in this bill—both houses of Congress, the Office of Management and Budget, the Treasury Department and the credit agencies—that brought about this success. In particular, I want to call to attention the role the Chief Financial Officers Council and the Federal Credit Policy Working Group played in working with the various committees on the Hill to produce a bill that has such widespread support.

Finally on behalf of the CFO Council, I would like to express my deep appreciation to Congressman Horn and the members of this Subcommittee for sponsoring the legislation and working so closely with us to make it happen. What we have done here should be a model for future legislative initiatives.

In the balance of my testimony today, I will direct my remarks initially to the legislation that Congress has enacted and what we have been able to do as a result of this legislation. I will then make some suggestions that I believe would build on what we—the Executive Branch and the Congress—have accomplished so far.

EXISTING LEGISLATION: THE TOOLS AT HAND, AND WHAT WE HAVE DONE WITH THEM

The nineties have seen the enactment of critical financial management and budget legislation. Under the terms of the **Chief Financial Officers (CFO) Act of 1990**, agencies are required to centralize financial management functions under the leadership of a chief financial officer, prepare annual financial statements that conform with generally accepted accounting principles, and consolidate and modernize financial information systems. The Government Performance and Results Act (GPRA) of 1993 established requirements for agencies to develop strategic plans and performance measures for all key programs, set performance goals and report annually on actual performance compared to goals. Finally, the Government Management Reform Act (GMRA) of 1994 sets March 1, 1997 as the deadline for executive branch agencies to submit audited financial statements for FY 1996, and March 31, 1998 for a consolidated audit covering all executive branch accounts and associated activities for FY 1997. Annual audits are due on those dates in the following years. GMRA also authorizes a report streamlining pilot project wherein a number of stand-along statutory reports will be consolidated into two annual reports.

These three laws have strengthened the statutory underpinning of federal financial management. Coupled with the Federal Managers' Financial Integrity Act, the Cash Management Improvement Act, and the Inspector General Act, I believe we have ample legislation to protect the taxpayers' interests and accomplish the federal government's financial management goals. Governmentwide, we have been using this legislation to move forward in a positive manner on a number of fronts.

The Chief Financial Officers Council deserves a great deal of credit. In addition to its role in the Debt Collection legislation which I spoke of earlier, this organization's various committees have taken the legislative tools, developed plans of action and shepherded to completion important projects in the areas of financial systems, report streamlining, and financial statements and standards. I currently serve as Vice Chair for Legislation on the Council and I know how it has served as a catalyst for change.

Using the Department of Education as an example, I would like to walk you through how the key legislation has enabled us to make significant improvements in financial management. I believe the Department will serve as a good example in this regard, particularly because we had been criticized for long-standing management problems by the GAO and the Congress for a number of years. In the past several years, however, we have worked very hard to turn things around, and I believe we have made substantial improvements. To a large extent, the progress we have made is a function of the CFO Act, GMRA, and GPRA. But equally important has been this Administration's resolve to make government work better and cost less.

Here are several examples of what we have done at the Department of Education with the available tools:

CFO Act

We are redesigning the Department's automated financial management systems to ensure reliable data to meet the needs of the Department's program managers and ultimately, the recipients of the

Department's programs—learners of all ages. Delivering reliable financial data to the Department's program managers and maintaining accurate and up-to-date account information for educational institutions and students is our goal.

For the past several years under the CFO Act we prepared financial statements for our revolving funds and received audits on them just like those done in the private sector. The audits provided a basis for building discipline into ongoing program and financial operations, which assures that prescribed management policies are consistently followed.

Our experiences with two FY 1994 loan program audits underlines the benefits of this process in terms of the lessons learned. We were pleased to receive an unqualified opinion by independent auditors on the William D. Ford Federal Direct Loan Program. Nevertheless, in presenting this clean report, the auditors also made several suggestions for making the operations and management of this successful program even more effective and efficient.

Conversely, for the Federal Family Education Loan Program (FFELP), the auditors were unable to express an opinion because the data we receive from guaranty agencies, private lenders and other outside parties has been found to be unreliable. This finding has led us to undertake a data quality improvement initiative that involves analysis and verification of information in the National

Student Loan Data System (NSLDS) and other efforts with the lender, guarantor and school communities to make FFELP data more reliable.

This Administration introduced the Direct Loan program as a simpler, more efficient student loan program, without the financial intermediaries in the guaranteed loan program that have not been able to send in auditable financial records on loan transactions. Institutions of higher education may choose which program best suits their needs, and the Direct Loan program has been received with enthusiasm.

Further, the Department of Education has made every effort to edit and correct the data submitted by the guaranty agencies now and in the past, but it is unlikely that Education can get the quality of data needed except as it is able to bring data collection under its direct control through use of federal contractors.

For the first time, we are preparing financial statements covering FY 1995 to be audited for the Department as a whole. For this audit we have implemented many suggestions from prior audits. For the FFELP data, the NSLDS-enhanced data is combined with expert analysis and review by an actuarial consultant. Regardless of the auditors' opinion, it is clear that our management systems and the financial reports they help produce are getting more accurate, reliable and useful every year.

GPRA

We have been aggressive in the development and use of strategic planning. We are one of the first agencies to have a comprehensive strategic plan, which was completed in December 1994, well ahead of the legislative deadline. Our plan has four goals: three are aimed directly at the needs of our primary customers—learners of all ages. The fourth goal addresses management reforms internal to the Department. The plan cuts across organizational boundaries and includes performance indicators to provide accountability.

GMRA

We are currently completing our FY 1995 Accountability Report which will feature our first ever Departmentwide financial statements and the results of an independent audit. It will also include the reporting requirements of the Federal Managers' Financial Integrity Act and the Prompt Payment Act, as well as the Semiannual Report on Audit Follow-up. The Accountability Report will also report on our performance toward the Departmental goals detailed in our strategic plan.

This report streamlining provision of GMRA brings some sense to the current tangle of separate reports required of agencies at various points throughout the year, consolidating important information and presenting it in a manner that makes sense to the reader and describes how well the agency performed.

We need, however, to go beyond the current pilot status accorded to only six agencies. Report streamlining needs to be pushed throughout the government. Currently, GMRA supports only the efforts of the six pilot agencies.

Reengineering and Streamlining

At the Department of Education, financial management improvement activities have expanded beyond the specific activities required by the CFO Act, GPRA and GMRA. This is a natural and positive consequence of the change spawned by these laws. This ripple effect also serves as a catalyst and enhances the kind of change the laws seek to bring about. For example:

We have streamlined our operations, eliminating about 45 programs over the past three years, totaling over $450 million.

The Department is cutting its staff, with plans to reduce by 616 full time employees, or 12 percent, over the period 1995 to 2000. We are coping with lower staff levels by means of improved technology, prioritizing tasks, and redeployment and training of existing personnel.

We have taken steps to eliminate or reinvent unnecessary or burdensome regulations, while continuing to ensure that money is spent for the purposes specified by Congress. The Department has already eliminated 79 percent of its regulations in elementary, secondary and bilingual education. Almost all remaining regulations have been revised to reflect the Secretary's emphasis on flexibility and results.

We have reengineered our discretionary grant process. It previously involved 487 steps and we pared it down to 221. Beyond the benefits of saving time and money, the reengineered process is more responsive to customers.

At the same time, we have continued to stress accountability. The Department has strengthened the student financial aid "gatekeeping" function that keeps ineligible schools out of federal student financial assistance programs. We have reduced the national student loan default rate to an all-time low, cutting it almost in half from 22.4 to 11.6 percent over the most recently reported three-year period which ended with FY 1993. Since 1992, the net outlays for student loan defaults have dropped by more than two-thirds—from $1.7 billion to $400 million.

WHAT CONGRESS CAN DO—HONEST DIALOGUE

I would like to shift my remarks now to address what I think would benefit all of us—more dialogue. What we would like to see from Congress is forthright, constructive dialogue to build on the foundation established by the existing legislation. We face some very difficult challenges in managing the financial resources of the federal government. We think we have most of the legislative authority we need right now to meet those challenges. Where I think we could truly benefit is through a stronger partnership with the congressional committees with legislative responsibility over the functions we perform. Working more closely together on issues like the financial systems infrastructure, performance measurement, accounting standards and financial statements can only result in better understanding by both the executive branch agencies and by the appropriate Congressional committees. In the executive branch, a better understanding of the legislative "big picture" will help us to carry out the intent of the laws that authorize the programs we manage. For the Congressional committees, this dialogue will lead to a better understanding of the issues, problems, and challenges we face. I welcome and appreciate the opportunity to have this dialogue with the Congress.

With good honest dialogue through regular oversight hearings and other face-to-face discussion, we are all more likely to succeed in our respective roles.

Delays in Appropriations

Stringing together a series of continuing resolutions in this fiscal year has been harmful to the Department, but more importantly, it has inflicted real pain on the school districts throughout the nation.

For states, schools and school districts, the issue is planning. Lacking an annual appropriation, there is no way to effectively make important decisions on issues that are contingent on future funding levels.

For most States and school districts, the need to make decisions on staff hiring and on signing contracts for educational services is now—early spring. These decisions are being made without knowing the level of funds they will receive from Federal education programs.

The State of California is a good example of how school districts need to plan. In that state, schools have to plan their budgets and make hiring plans several months before the beginning of the school year. California State law requires districts to notify teachers by March 15 if they will be retained for the following school year For this reason, it is essential for California schools to know the level of federal funding they will receive. Forward-funding makes this information available when it is needed. If Federal funds allocated for teacher salaries are cut, however, California still must pay its teachers, a burden that could break already stretched State and local budgets.

Without an annual appropriation, our customers cannot benefit from the long-standing practice of forward funding federal education programs. State and local officials are big proponents of this forward funding mechanism because its helps grant recipients to plan for the effective use of federal funds well in advance of their need. This advance notice also improves the effectiveness of education programs by promoting coordinated funding and close cooperation from Federal, State, and local authorities.

In the private sector, it would be unthinkable to expect managers to plan and run their operations without a strong base of knowledge about the level of funding that will be available. School principals, superintendents, school boards and federal managers should be given the same consideration with regard to the level of federal financial resources they can expect, and on which they can base their plans.

CLOSING

In summary, I would like to reiterate that much has been done in the past several years in the area of financial and budget improvement. The existing legislation which we have just discussed exemplifies how the legislative and executive branches working together can create a basis for sound financial management for the agencies and the programs they administer.

Legislation currently exists on which we can work together to continue to strengthen federal financial management. I am pleased with the successes we have had at the Department of Education. As I said earlier, with good, honest dialogue through regular oversight hearings and other face-to-face discussion, we are <u>all</u> more likely to succeed in our respective roles.

I appreciate the opportunity to share with you my perspective on these critical issues. I am confident that this committee will work diligently to continue to support responsible budgeting and financial management practices.

Now I would be happy to answer any questions you may have.

Mr. HORN. Well, thank you.

We are going to proceed with the other witnesses before we get to questions. But let me just say at this point that we thank you, Mr. Wurtz, for appearing this morning, because I understand this will be your last appearance before this subcommittee as the Chief Financial Officer of the Department of Education and that you will be retiring in a couple of weeks and heading home to California. It is as warm out there as it is here, I want you to know, having been there yesterday.

On behalf of this committee and subcommittee, I would like to thank you for your public service. As Education CFO, without question, you have really made a tremendous difference in that Department, with your emphasis on accountability. You have also helped the leadership position in the Government, in the Chief Financial Officers Council, and, as I said earlier, I think they have done a splendid job, and I know your leadership has been part of it.

So we wish you the very best in your retirement.

Mr. WURTZ. Thank you.

Mr. HORN. I will say to you what I said to the Comptroller General, who is about to retire. You are now free to talk your piece and your mind. You don't have to worry about us or the crowd in the executive branch. We would just like from you the benefit of your experience, and I think that would be very helpful.

Mr. WURTZ. Thank you, Mr. Chairman.

Mr. HORN. Where are you retiring to in California?

Mr. WURTZ. Carmel.

Mr. HORN. Carmel is a good place. It is second to Long Beach. I grew up near Carmel at San Juan Bautista. Do you know where that is?

Mr. WURTZ. I know it very well.

Mr. HORN. That is one of the great historic mission towns in California. That is where Captain Freemont of the Topographical Engineers first raised the American flag in California. But José Castro, the general to the Mexican Army, looked up to him. San Juan was the military headquarters, and Monterey the political headquarters. So you will see José had two houses, one in Monterey, one in San Juan when he thought the Yankees were getting close.

So good luck in Carmel, a beautiful area.

Mr. WURTZ. Thank you very much.

Mr. HORN. OK. We will now go to our next witness this morning in the order we are going, and that is Mr. Sheridan, president of the Sheridan Management Corp. and chairman of the Committee on Government Liaison for the Financial Executives Institute.

Mr. Sheridan.

Mr. SHERIDAN. Good morning, Mr. Chairman.

FEI has been before this committee and others in our duty, as we see it, to provide a voice from without the Beltway, and we, too, share the luxury, as will soon be Mr. Wurtz' case and soon will be Chuck Bowsher's, that you can't fire us. To that end, we try to speak with some degree of candor.

My written testimony will speak at length to the issues, many of which—almost all of which—have been addressed here earlier.

So I will move to just a general assessment in the interest of having time available for questions.

Principally, we endorse, without qualification, the unification of the three efforts of the Chief Financial Officers Act, the GPRA Act, and to bring that into consonance with the budgetary process, and that has been spoken to most eloquently in other areas.

We feel that this is important in order to achieve some of the objectives of improving the overall budgetary process, and one of the concerns that we have had is that the presentation of material in the budgeting process has been obscured by certain conventions that have been adopted, for procedural and perhaps for political reasons, and that is an obfuscation by bringing together elements that really should be separated, and one of them is the capital budgeting notion. We have spoken before this committee before, and we have included that in our written testimony.

We clearly feel that that is an element that should be separated, if only for the visibility. We further feel that to present offsetting accounts or trust accounts that don't allow us to have the full visibility of the revenue that's coming into this Government and the expenditures that are going out is clearly wrong, and so we would—we would urge that there be means taken to provide the visibility, because if we don't know, truly know, the money that is coming in and going out, I would submit that it would be very difficult, indeed, to begin a true revolution in the budgeting process.

I mentioned earlier about the integrity of the financial data that is coming up. That has been the principal undertaking of the CFO Act, and I think much progress has been made, but until we can convince those people that—who are in the field that have to perform the activities leading up to the creation of financial statements, as Mr. Wurtz so carefully pointed out, it is a difficult process indeed.

Unless we can convince those people that the integration of the performance side and bringing together a meaningful way to look at the financial statements, it will just be an exercise. I think this will go a long way to help that.

There are three elements that arose out of my research which came mainly from the Congressional Research Service, because the topic was so, so vast that it was difficult to comprehend and bring it together.

One of the things that concerns us is the codification of accounting standards, and that was spoken to earlier. I would like to speak to it to a greater degree. Accounting standards are not clear-cut, hard-edged instruments. They are, by their very nature, judgmental.

For instance, Ed DeSeve spoke about the assets, the value of assets, and, even more so, the liability side. I fear that if either the OMB circulars or the FASAB judgments are brought into codification, with the attendant ability to bring them before a court of judgment, that the litigation would be monumental, and I am not sure that it would be productive.

Another thing that came clear, and George Muñoz did not mention it in his discussions, but since we have talked about this privately, I will say it, and that is the question of the manipulation—and I will use that word advisedly—of the duration of Treasury debt. By that I mean conscientiously moving the maturities closer to the short end of the yield curve, with what appears to me to be a political motivation underlying reducing interest costs, which is, I would submit, a very, very dangerous thing to do.

Any treasurer that was around in the late seventies that met his career on the short end of the yield curve is probably selling cars some place, and the Treasury has had a hands-off policy in terms of the maturities. The marketplace knows that. The marketplace is smart enough to be able to play a game against that, and I would submit that this is something that, whether it be the Hill in having a voice in this or whether it be the White House, this is something that should be addressed with very grave caution, and my friends on the street—and I have been on the street or a CFO for 30 years—say that when the politicians begin to meddle in such things as interest rates, we must be careful.

I will also, since I am in a position that I can't get fired——

Mr. HORN. Let me say, I think you have strong support for that statement from the majority. The chairman of the Policy Committee, Christopher Cox, was very strong on that in his comments to Secretary Rubin eyeball-to-eyeball that, as far as we were concerned, some of that manipulation might well be impeachable. We were very unhappy as that proceeded. So I am glad to hear you make your comments on this.

Mr. SHERIDAN. Well, since I probably have earned Bob Rubin's animosity as a result of that comment, I will say, on the other side of the ledger, that the street has great concern that he might miss a step and not be able to do the legerdemain that he has occasioned over the last period of time and really lead us into a default on the debt.

And I think much has been diminished in the concern simply because we got away with it, and from the perspective of the financial markets, the underpinnings of most derivatives and most of the higher order financials come from a very small base, and that base is the treasuries. And from this, you build swaps and options and a whole host of other things, and that underpinning of the sanctity of the repayment of the principal and interest on a timely basis is what keeps this mechanism together. It is a huge market, and to have it default, even from one manamoment, the consequences of unwinding this swap, unless one has ever tried to unwind one of those transactions, you never know who the participants are in this.

And I would just submit, and I think we would all have to agree, that to play a sort of political chicken with something that is as important as the maintenance of the financial markets, and which none of us truly understand how they work, but if we were to put ourselves in a position to try to test it, I think it would possibly have very grave consequences.

Since I have probably gotten myself in enough trouble for 1 day, I will cease.

Mr. HORN. No. We want honesty. So go ahead.

Do you have any other points you want to make?

Mr. SHERIDAN. No, sir. I would comment later on, if you wish, on the work that FEI has done with Ed DeSeve and with the CFO Council in electronic commerce, and that meeting will be the first step tomorrow in trying to bring some private sector perspective and even cooperation in bringing some of the tools that have been at work for many, many years.

For instance, you go down to the corner Citibank, and you have had funds transfer from your PC for 10 or 15 years, and I think some of the things that they have learned, or GE Credit or others, and those in the paying of utilities bills, will be of great benefit to the Government, and we are most pleased to participate in this.

Mr. HORN. If you want to elaborate on that right now, go ahead.

Mr. SHERIDAN. Yes, sir. Well, to go all the way back to the financial statements and the problems that we have, most of our problems stem from the lack of integrity of the data that goes into the system in the first place, and it generally goes in in a manual fashion. Then it is rechecked and looked at by others and manipulated, and there is manual intervention all along the road.

That sort of system also does not lend itself to the compilation of data in such a fashion that you can take material from a so-called feeder system, a functional system, and bring it into the financial statements.

If we could reduce all of the entrants into a digital bit stream either through imaging or through smart cards, we can do this as a start, then we can begin to have the comprehensive system that could speed the creation not only just of financial systems but the means to manage better. And we, from the private sector, have been doing this for many years.

We see many, many similarities where we could do just one for one almost off the shelf, or means by which the interface between the public sector and the private, let us say at the Treasury and the banking system, could move together, and I think some great strides have been taken, and we are looking forward to assisting in this process.

Mr. HORN. Very good.

Mr. HORN. Our last witness on this panel is an old friend of this committee. Herbert N. Jasper, fellow of the National Academy of Public Administration, will give a statement prepared by David Chu, who is also a fellow of the National Academy of Public Administration.

And, Mr. Jasper, please proceed.

Mr. JASPER. Thank you, Mr. Chairman.

As noted, my name is Herb Jasper. I am testifying today on behalf of the National Academy of Public Administration. I should point out, however, that with one exception, neither the Academy nor any of its standing or ad hoc panels has taken a position on any of the matters that I will address. But this statement was developed through a discussion among senior persons with broad and relevant experience.

As the Chair and the staff know, I played an active role in fashioning the Congressional Budget and Impoundment Control Act of 1974, so I am especially pleased to have this opportunity to share my views with the subcommittee.

Mr. HORN. Confession is always good for the soul, Herb.

Mr. JASPER. We welcome your invitation to discuss the Federal budget process and the draft Omnibus Budget Act.

The broad scope of OBA leads us to observe that the next important steps in improving Federal budgeting and financial management depend on the successful coordination and eventual integration of work already under way.

It is our opinion that the current budget process is basically sound. Its principal structure and provisions have lasted for more than 20 years. In contrast, the earlier efforts to engage the Congress in comprehensive and integrated budget making foundered after a year or two.

Likewise, legislation to introduce more discipline into the process, such as the Gramm-Rudman-Hollings legislation in its several forms, has not proved to be viable. The hallmark of the Congressional Budget Act is that it allows the Congress to work its will year by year.

Of course, many participants and observers are dissatisfied with the results of both the executive and congressional budget processes. But the budget is principally a reflection and accommodation of many conflicting objectives and contending interests. Even the most perfect process could not be expected to resolve those differences to everyone's satisfaction. Any process will be subject to the same strains and struggles we have experienced in recent years.

The current process provides a workable way of channeling inevitable differences toward negotiations and agreements in order to produce a budget. Regardless of the outcomes, the process has greatly strengthened the Congress' attention to, capacity in, and influence over macroeconomic policies.

We believe that achieving greater stability in the budget process is now of higher priority than further alterations in the process. Some proposed changes could actually harm, rather than improve, the budget process.

Preoccupation with modifying the process, moreover, diverts attention from another important policy consideration: Improving the performance of government, including the performance of the executive branch and Congress in formulating the budget.

Rather than modifying the processes, we suggest greater emphasis on bringing together the various existing parts of the budget and financial management laws. We should strive to make them work better in the interest of defining appropriate Federal functions and achieving higher performance in tandem with continued cost savings.

There has been a substantial amount of financial management legislation enacted in recent years which creates new legal and managerial responsibilities. The new information generated by these requirements could prove enormously useful to managers and policymakers alike, or it could drown them in a flurry of paperwork and useless data.

For example, the Chief Financial Officers Act and the Government Performance and Results Act require agencies to meet new requirements and provide additional information related to performance and cost for evaluation by policymakers in both branches.

These measures have substantial promise if they are effectively implemented, but there is so much that is new and it has come so fast that the Federal Government already runs the risk of administrative and legislative indigestion.

Moreover, even as agencies are struggling to understand and implement these legislative requirements, they are being required to cut back their personnel. If agencies lack the capacity and support systems they need, improvements such as performance measurement are likely to be delayed and could flounder.

One agency Inspector General recently observed that with so much effort in downsizing, streamlining, reengineering, and performance measurement, there was nobody left to do the work.

We suggest that Congress allow more time to integrate the improvements now required in budget and financial management with those coming from the renewed emphasis on performance and results. Important and interdependent elements of management flow from different legislative bases, with the consequent danger of fragmentation in operation. Rather than still more legislation, we think Congress should emphasize time, capacity, and incentives to implement and integrate what is already there.

Coordination and integration of these many financial improvements is a big job. It must be done deliberatively and incrementally so that the new systems gain acceptance by the users. Changes in the structure of the executive branch of the Government may be required as well. Perhaps the Office of Management and Budget can coordinate this large-scale effort, but new mechanisms may be needed, especially since the OMB 2000 reorganization terminated the General Management Division that used to have the capacity for a governmentwide perspective on management.

For example, two different panels of the Academy in 1983 and 1988 recommended the creation of an Office of Federal Management to focus precisely on these kinds of issues, as has your committee.

Congress may also need to consider changes in its own structure. For example, Congress may want to review the responsibilities of the budget, authorizing and appropriations committees and the subcommittee structure of the Appropriations Committees.

Mr. Chairman, this subcommittee is performing a valuable service in focusing on the budget and financial management needs of the government. We thank you for the opportunity to testify on this important topic. Fellows of the Academy will be following these events as they unfold, and we remain available to assist you at any time.

I'd be pleased to answer any questions.

[The prepared statement of Mr. Chu follows:]

Mr Chairman and Members of the Committee:

My name is David Chu. I am a Fellow of the National Academy of Public Administration, and am testifying today on behalf of the Academy. I am pleased to appear before this Subcommittee to discuss the Federal budget process and financial management reform.

This is a very broad subject. Indeed, at first glance it may appear to be too broad. However, it highlights the reality that the next important steps in improving Federal budgeting and financial management depend on the successful coordination and eventual integration of work already underway in several different parts of the management landscape.

It is our opinion that the current budget process is basically sound. To be sure, many people may be dissatisfied with the results of that process. But the budget is principally a reflection of the many conflicting objectives and contending interests. Even the most perfect process could not be expected to fully resolve these differences to everyone's satisfaction.

This is not to say that the process is perfect or that improvements should not be made. However, any process which is established will be subject to the same strains and struggles we have experienced in recent years. The current process provides a workable way of channeling inevitable differences towards negotiations and agreements among the contending parties in order to produce a budget for the federal government.

We believe that achieving greater stability in the budget process is now of higher priority than further alterations in the process aimed at resolving what are basically differences in political philosophy and interest. Some proposed changes could actually harm. rather than improve, the budget process. Constant preoccupation with modifying the process, moreover, diverts attention from another important policy consideration: improving the performance of government.

By performance, we mean assuring that taxpayers are getting value for their money: Is the money going for appropriate purposes, and is it being used efficiently and effectively?

Rather than tinkering legislatively with the process, we suggest greater emphasis on bringing together the various parts of the budget and financial management system already established by legislation to make them work in the interest of higher performance, in tandem with continued cost savings.

There has been a substantial amount of financial management legislation enacted in recent years which creates new legal and managerial responsibilities. The new information generated by these requirements could prove enormously useful to managers and policy-makers alike, or it could drown them in a new flurry of paperwork and useless data. For example, the Chief Financial Officers (CFO) Act and the Government Performance and Results Act require agencies to meet new requirements, provide additional information related to performance and costs, and to produce new financial reports. These measures show great promise, if they are effectively implemented. But there is so much that is new, and it has come so fast, that the federal government runs the risk of administrative indigestion.

Moreover, even as agencies are struggling to understand and implement these legislative requirements, they are being required to cut back their personnel. If agencies lack the capacity they need to implement these requirements -- including staff with up-to-date management skills equipped with similarly up-to-date systems and technology in budget, finance, information, and performance measurement -- they are likely to be delayed, and could flounder, in their attempts to cut costs and improve performance.

What is needed is some breathing room to properly coordinate, eventually integrate, and ultimately relate the new information and reporting requirements to the budget process. These enhancements in information are more likely to improve budgeting and financial management than further legislative changes in the processes themselves.

We suggest that Congress allow some time to integrate the improvements now required in budget and financial management with those flowing from the renewed emphasis on performance and results. At present, important and interdependent elements of management flow from different legislative bases, with the consequent danger of fragmentation in operation. Rather than still more legislation, Congress should emphasize time, capacity, and incentives to implement and integrate what is already there -- and make it work.

To be sure, some legislative changes may be in order, especially if they are geared toward clarifying and integrating legislation already on the books. For example, it may be desirable to consolidate reporting processes now prescribed in several different pieces of legislation into one report. This might require minor legislative changes.

Coordination and integration of these many financial improvements is a big job for the entire federal establishment. It should be done deliberatively so that implementation is successful, and the new systems gain acceptance by the users. It may well be that changes in the structure of the Executive Branch of the government will be required as well. Perhaps the Office of Management and Budget can coordinate this large scale effort. But other mechanisms may also be needed. For example, a panel of the Academy has recommended creation of an

Office of Federal Management to focus precisely on these kinds of issues.

Congress may also need to consider changes in its own structure to achieve cohesion in policy-making, budgeting, and oversight that parallels efforts to achieve similar cohesion in the implementation of policy and programs in the Executive Branch. For example, Congress may want to review the relative responsibilities of the authorizing and appropriation committees, and the subcommittee structures of the appropriation committees. And it may want to determine how to reconcile conflicts between sound accounting principles and budget accounts that confound policy makers and program managers alike.

Congress might also consider establishing a bipartisan commission with membership from both the legislative and executive branches to address these issues in a comprehensive manner, monitor progress, and report back to the Congress on their findings and recommendations. A similar commission was used successfully to develop consensus on budget concepts in the late 1960's.

Mr. Chairman, this subcommittee is performing a valuable service in focussing on the budget and financial management needs of the government. We thank you for the opportunity to testify on this important topic. Members of the Academy will be following these events as they unfold, and we remain available to assist you when requested.

David S.C. Chu

David S.C. Chu was born in New York City on May 28, 1944, and was educated at Yale University. He received his BA in Economics and Mathematics in 1964 and his Ph.D. in Economics in 1972.

Mr. Chu is currently Director of RAND's Washington Office and Associate Chairman of RAND's Research Staff.

Mr. Chu served as Assistant Secretary of Defense (Program Analysis and Evaluation) for 1988 until January 1993; he had earlier exercised similar responsibilities as Director, Program Analysis and Evaluation (1981-1988). In these positions he advised the Secretary and Deputy Secretary of Defense on the allocation of the Department's resources, helping plan the forces and weapons systems that determine long-term defense capabilities. He supervised an immediate staff of 130, and a computer and research effort of nearly equal size. His contributions over the period 1981-1993 were recognized by the Wanner Memorial Award of the Military Operations Research Society.

Prior to his Pentagon appointments, Mr. Chu was the Assistant Director of the Congressional Budget Office for National Security and International Affairs (1978-1981). During his tenure he supervised the preparation of over two dozen major reports on national security and international economic issues for various committees of the Congress, on subjects ranging from the management of military manpower, to U.S. forces for NATO, to trade and aid Policies.

Earlier, Mr. Chu served as an economist with RAND (1970-1978), and was also the Associate Head of the Economics Department (1970-1978). Mr. Chu served in the U.S. Army from 1968-1970.

Mr. Chu is a member of Phi Beta Kappa, and was an Honorary Woodrow Wilson Fellow. During his graduate study he held fellowships from the National Science Foundation and the Foreign Area Fellowship Program. He has been awarded the Department of Defense Medal for Distinguished Public Service with Silver Palm and the National Public Service Award of the National Academy of Public Administration, of which he is a Fellow

Mr. HORN. Thank you very much.

Since you mentioned the recommendations of the Academy and this committee for a separate office of management, let me read you Mr. DeSeve's testimony on that and see if you have any reaction. Obviously, he is speaking as an official of the Office of Management and Budget.

I am just trying to find it here.

Mr. JASPER. I think I recall what he said. I can speak to it, if you would like.

Mr. HORN. What he said was the following, just to get it on the record. He said:

> The proposal before this subcommittee would split OMB into a statutory office of management, combining the policy and oversight functions of the General Services Administration, the Office of Personnel Management, and a separate office of budget. As you know, OMB serves the President. OMB's activities are part of a comprehensive whole, from policy development through program implementation and evaluation Within the Office of the President, these responsibilities should be carried out in as integrated a manner as possible, not through fragmented organizations. Management reform is a means, not an end in itself. It is an essential aspect of government strategy that is designed to support sound fiscal policy, improve service to the public, rationalize the distribution of tasks between the private and public sectors, and lower the cost to government. Recent evidence from both here and abroad suggest that integrating budgeted management responsibilities, not separating them, is the most productive and effective approach.

What is your reaction to that?

Mr. JASPER. Yes. I am pleased to have an opportunity to discuss that matter.

As you may recall from my credentials, I once worked in something called the Government Organization Branch of the former Bureau of the Budget. It was the predecessor of the General Management Division that I noted in my testimony, has recently disappeared. So I have some firsthand experience with what we used to do there and what they do not now do there.

With respect to OMB 2000, I think what it did was fine insofar as it involved the transfer of agency-specific management expertise from a central management office to the budget examining divisions now named resource management divisions.

What was missing already in OMB, and which was exacerbated by the reorganization, is a capacity to look governmentwide on systems integration, integrating these various statutes that we have talked about that tumble upon each other out of the Congress' mill and which do not serve to contribute to an integrated process of management.

There are issues, for example, in separation of powers that the Government Organization Branch used to focus upon. We used to comment on draft legislation and advise the White House, solicit the opinions of the Justice Department. No one there now advises on those matters, except on an ad hoc basis.

Mr. HORN. Now let me ask on that point, there has been historically an Office of Legislative Reference. That function is still there in OMB, is it not?

Mr. JASPER. That's correct.

Mr. HORN. But they would get their substantive reaction from the management group?

Mr. JASPER. Exactly. I worked in the Office of Legislative Reference after I left the Office of Management and Organization, so

I am experienced with both ends of that system—and what the Office of Legislative Reference does is farm out, both to agencies and within OMB, to the divisions and the offices, the proposed legislation or testimony for comment.

The point is, on these matters, there's no one to send them to. If you send them to the PAD, the program associate director in the division, he or she is likely to take a policy-program-agency perspective on the matter rather than a Presidential perspective or a governmentwide implications perspective, so that there is a major gap in the capacity of OMB under OMB 2000.

Mr. HORN. Now there is a Deputy Director of OMB for Management.

Mr. JASPER. That's correct.

Mr. HORN. Isn't that office supposed to fulfill that duty?

Mr. JASPER. That's correct. What the reorganization did was as follows: There are three statutory offices, as you know, financial management, procurement policy, and information and regulatory affairs. The first two were relieved of a substantial number of their personnel, who were assigned to the divisions, and to the extent they were working the agency-specific problems, again, I think that's fine.

OIRA somehow or other survived without having its personnel reassigned, although it was suggested after some initiatives on regulatory reforms had been accomplished they, too, would have a substantial number of personnel transferred.

But both because these offices have statutory status and, therefore, OMB couldn't disestablish them, and because OMB recognized that they had a governmentwide policy coordinating an integrating function, they did not completely strip them of their personnel, whereas, with respect to the General Management Division, which did not have statutory status, they ignored the fact that there were governmentwide perspectives that needed to be addressed and they transferred 100 percent of those people, save one person who is a special assistant to Mr. Koskinen.

So I think that they had a major gap, and the curious thing is that when your committee had its press conference on the excellent committee report with the recommendation in it that we are talking about, Elaine Kamarck, the Vice President's chief assistant on NPR and governmentwide management matters, was interviewed by the press, and she said, of course, "you can't separate management from budget."

How ironic. The Vice President's Office, for 2 years, had virtually transferred the general Government management function from OMB to the Vice President's Office, and she is telling the reporter, you can't do it. They did it. And what's left is, as I said, agency-specific management in the divisions. And that's fine.

So if you were to create an Office of Federal Management, I would not suggest you go back into OMB 2000 and take out the people that were reassigned to the divisions. Leave them there. That's fine. But you need to create a capacity on governmentwide issues of the sort we are talking about.

Note that at your hearing on executive branch restructuring, you didn't have an OMB witness, as I recall. Isn't that strange?

Mr. HORN. We found a lot of strange things. The latest is the one you just gave me, which confirms other statements out of that office in terms of the truth does not seem to matter sometimes.

So that is your answer. It is a very good one. We shall put that to good use.

Mr. JASPER. I hope it's helpful.

Mr. HORN. Well, let me ask, gentlemen: You sat through a lot of the testimony this morning, and obviously the interest is looking at the 1974 act. Are there things that should be done that have not been done in that act? Are there things that are being done under the act that make no sense?

And if so, since you all have been operating officers either in private business or in Government, what would be the most useful things that might be done to change any aspect of the act that would be helpful to advancing the comprehensibility of the budget to both members of the executive branch and the legislative branch, to the average citizen?

I think the citizens' budget is obviously a good idea. Put it in simple English. But what is your thinking, as you have listened to the rest of the witnesses this morning? Do you have any comments? Did they say things that either please you or displease you? And if so, who displeased you and who pleased you? And any other ideas that weren't voiced.

Mr. SHERIDAN. Well, in terms of improving clarity, at least for those of us outside the beltway, the notion was brought up of, what does this Government actually do? What are either the five areas or, as the Congress sees it, the 13 areas?

I think if there were some way to restate the purposes and then to be able to attach the financial assets, either in terms of investment or activities, to those in a fashion that would flow from those activities up to the legislative and budget and the oversight and the appropriations, if all of that were one clear track, then I think, coming up for the decisionmaking, that would clarify things in all minds.

Also, when the budgets come back down to those that have to operate them, it would be much more clear-cut.

One of the problems that I see in working with people at the field level is that there are three or four sets of books. One of the things that happens is, one thinks one is buying one F–16. One is probably buying 60 different appropriations packages, and those do not naturally flow into a bookkeeping kind of system.

The same way when one goes out to see a program under management. You may have individuals representing, in effect, five different appropriations and is redundancy, but you have to keep the bookkeeping in that fashion so that you are in accordance with law and at the same time try to reorganize it in such a fashion that it also reflects what you are doing as a business, that there could be a streamlining of functions both up and back down. I think that would be a starting point in improvement.

Mr. HORN. That is a very interesting suggestion.

Have you tried that out on some of the committee staff or members?

Mr. SHERIDAN. I understand that there is going to be born some sort of group that will be discussing budgetary matters in the near future, and I have been invited to come and visit with them, and I certainly will make that thought known.

Mr. HORN. Yes.

Any other thoughts, Mr. Wurtz?

Mr. SHERIDAN. Mr. Wurtz.

Mr. WURTZ. I would say that I certainly support the idea of capital budgeting, that we have to have some means of having a more comprehensive basis to plan for the future, because right now we have to compete for those capital improvements with all of our day-to-day, ongoing administrative costs. So you can't adequately plan for the future; you just have to fish with everybody else.

But I would say, with respect to the idea of OMB management versus budget, that there is a reality and the budget side does carry the big stick. And without that, I think it would be very difficult to really try to get comprehensive management reform.

And I must say that with respect to the Department of Education, we have had strong support, by the budget side as well as the management side, in getting the funds necessary to improve our financial management systems. So that's been very, very key from that perspective.

Another area is obviously multiyear budgets and the ability to use prior-year funds that haven't been expended in some way in a meaningful fashion to create working capital funds to work with on an ongoing basis.

The way that works now is, some—some agencies have those funds to be able to carry out their financial management and other accounting and other issues in which they are able to carry those over and bill currently to the program services for their current services. That depends on each appropriation committee, as to whether or not those funds are established. So there's nothing governmentwide that you have.

So in our Department we don't have them, whereas in HHS they have them. This resulted in differences during the shutdown, for example, and everybody was wondering, why can HHS pay certain funds out and the Department of Education can't, even though prior-year funds had already been obligated?

The fact was, we didn't have current-year money to be able to pay the employees to pay out those funds. Therefore, we didn't pay them out, and everybody is saying well, HHS is paying out; why aren't you?

Well, HHS had a capital fund—or rather a working capital fund in which they were able to continue to pay the employees to make the payments of prior-year obligations. So those kinds of differences create differences throughout the agencies that don't make any sense to the public. They just don't understand why that's occurring.

Mr. HORN. That's a very interesting point.

Mr. Jasper, do you have any reaction there to Mr. Wurtz' comments on the Office of Management?

Mr. JASPER. Well, a couple of comments. First, my colleagues, including a former head of the Management Office when I was part of it, have, I think, testified before this committee and certainly have stated this matter frequently, that they do not recall a single instance where they needed the teeth or the clout of the budget process favorably to influence events in regard to management improvements that they were proposing.

Second, the emphasis I am placing in my comments is on governmentwide issues that are of immediate interest to—should be of immediate interest to the President, rather than of interest just to a particular agency.

Let me give you an example of what happened with the Government Performance and Results Act. The gentleman who specialized in that function was in the General Management Division. As part of the reorganization, they transferred him to an examining division. The head of that division thought it was such an anomaly that he offered to give the person back to the general management area and sacrifice the billet that was involved.

They were so wedded to this concept of complete disbursal that they refused to take the gentleman back, with or without the billet.

After a few months, however, they discovered that this really was curious, to have a person in one of the examining divisions be the governmentwide GPRA expert. So they did finally reassign him, but not to the management area. They reassigned him to the Budget Review Division.

I don't mean to suggest that was illogical, because what Alice Rivlin and John Koskinen had been trying to do, and I think correctly, is integrate performance measurement into the budget process. So it was not particularly illogical to put this person in the Budget Review Division, but it underlines my point, which is that it was a governmentwide function that needs to be performed centrally in OMB, not in one of the divisions.

There are lots of examples that I could cite similar to that. Among them, of course, are the issues, for example, in processing Executive orders. When I was in the Government Organization Branch, we routinely wrote or reviewed Executive orders, parceling out functions among departments and agencies that were within the President's province to do.

If you look at the Executive orders that came out of the National Performance Review, you will be aghast at their imperfection, inconsistency, and errors. They obviously were drafted by amateurs. They were not reviewed professionally by experts in Government organization and management. They define agencies incorrectly within and among the Executive orders. They do not know the difference between an independent agency and an independent regulatory agency.

So the capacity——

Mr. HORN. That is Political Science 1. So you are beginning to really worry me.

Mr. JASPER. Exactly. But if you look at that series of Executive orders that came out of NPR, many of which, it is alleged, were drafted by outside experts or outside nonexperts, I would have to say, you would be very disturbed at the lack of precision and accuracy in those Executive orders. That's the kind of thing that there is a general management capacity required to do, and it used to reside in the predecessors to Koskinen's organization. It does not now reside there.

Another example: He came up with some proposals, a proposed charter for Government corporations. My colleagues in the Academy, who are alumni of the Budget Bureau, criticized that draft very sharply, and as a result of input from people outside the government, the charter for government corporations was drastically revised, and now Koskinen points to it as an example of how the system works. It worked only because we had people in the National Academy of Public Administration who weighed in on a pro bono basis to tell them what they didn't know. We need the capacity in the Government to do this sort of work, not just outside.

Mr. HORN. Well, we are fortunate the Academy has been created. Any other comments on other witnesses' testimony at all?

Mr. SHERIDAN. Well, several witnesses dealt with the notion of trying to improve the quality of the forecasting or economic data that's entering into the system, and I think that is entirely valid, and I think we all know, if we have more than two economists, we are going to have at least seven different opinions on this side and this and this, that, and the other.

I think one of the elements that would be worthy of mentioning is the fact that in trying to examine what is really happening in the economy, there are only a few really important drivers, and those are the ones that will really relate to the revenue side of the budget, and whereas it's nice to know all things about all matters economic, they do not necessarily go down to the heart of how much will be coming in from the tax side from the various elements of taxation.

I would submit that it would be worthwhile to bring those elements into sharp focus by trying to identify those elements that have the greatest return on the leverage that are imposed so that you can really have some sense that, when we do this, the linkage is there that you will have a good idea of what we will come down with, because if you look at both CBO and OMB's assumptions, such that you can understand, they weren't that far wrong.

And I would submit that if you could look at them and then be able to play in a simulation model, if you will, a what-if game—and Chuck Bowsher mentioned PCs—these kind of simulation programs that could emulate the budget process are not that difficult.

Now everybody says my particular business is more difficult than any other, and I am sure that the Congress would say that, but it has been possible for so-called rocket scientists or others in Wall Street to do the same sort of thing with the financial markets, and I think that we could bring together some people who have done this sort of thing with this budgetary group that is being formed to give some thoughts on a means by which we could clarify the process and perhaps even improve the process of budgeting by then.

Mr. JASPER. Could I comment on the forecasting matter?

Mr. HORN. Yes.

Mr. JASPER. As subcommittee counsel will recall, when we were revising the Congressional Budget Act in the Senate, we were faced with the issue of what kind of CBO, if any, to have. The House bill contemplated a smaller, less visible, less powerful office. The Senate bill contemplated a much bigger and more impressive office.

As an alumnus of the Budget Bureau, I recalled vividly the lesson I learned from Charlie Schultz, a former Budget Director, when he had left and was at the Brookings Institution doing what became a series on alternative budgets, "Setting National Priorities," I think it was called.

Mr. HORN. Put it in readable language that we can all understand.

Mr. JASPER. Right. In the preface to the first volume, Charlie said something along these lines: "The President's budget is a document designed to persuade the Congress not to inform it."

And I was struck by that, and as a committee staffer working on the Congressional Budget Act, I said my objective is to equip the Congress so they will know where the lies, the exaggerations, the gaps are in the President's budget, because here is a former Budget Director, on the record, saying that the budget does all of those bad things. It's part of the political process.

So we ended up in the Senate opting for a larger, more powerful, more influential Congressional Budget Office, and I think it has worked.

I recall that Alice Rivlin was asked a question, actually at an Academy luncheon, about: Now that she is in OMB, how does she feel about CBO being its competitor? She said, "I think it is a good idea. It makes us both more honest. I think the competition is much more helpful."

I have also had the occasion to pursue this issue of forecast with Jim Blum, who was your witness this morning, when I was working on the Academy's study of GAO, and I asked him exactly the question you asked him: "How, on balance, did CBO's and OMB's estimates compare over the years?" The public record seemed to suggest CBO was much better.

Jim said candidly, "We have been about equal. Sometimes they are better, and sometimes we are better." And as Mr. DeSeve said this morning, in the last few years I think the record shows OMB has been slightly better. So I don't think it's a major issue.

The problems in forecasting are well known to all of us. There is some likelihood that, no matter how accurate the forecast is, particularly when the two branches are controlled by opposition parties, the other branch will find them disgraceful, however accurate they may be, and I think the reverse is true as well.

So I think it's part of the political process. I think that they do consult somewhat. As I am sure you know, CBO has all the budget records on computers that OMB has. They share the data. They have the same information. They consult the same economists. They also consult different economists. And I think the tension between the two branches on fashioning national policy is a perfectly wholesome tension, and I think it has worked out OK.

Mr. HORN. You and James Madison would agree then.

Mr. JASPER. Absolutely.

Mr. HORN. Well, you have got good company on your side.

Mr. JASPER. Thank you.

Mr. HORN. You are familiar with the work of the Joint Tax Committee staff that has existed for probably 50 years.

Mr. JASPER. Right.

Mr. HORN. Do you think the CBO relationship to its committees—in this case primarily Ways and Means, Appropriations, Budget—are as well developed as the Joint Tax staff? Because, as you know, in the case of Finance in the Senate and Ways and

Means on our side, Joint Tax has worked for as long as I can remember, from the fifties up, for both committees, and it has been a nonpartisan, professional staff.

Do you feel that the CBO has developed along that line, or is there something missing?

Mr. JASPER. I think there are some significant differences. The Joint Tax Committee staff really works as if it's the full-time staff of the Joint Committees and has a much more intimate relationship with the processes of those committees, therefore, than a large 200-person office that serves the whole Congress. I think the roles are slightly different so that you couldn't look for too much similarity.

I will say this, that when the Congressional Budget Act was passed, I tried to persuade Alice Rivlin, the first director, that she needed to pay equal attention to revenues and expenditures. She came out of work that focused on expenditures rather than revenues, and she was hard to convince.

She said, "Well, the Joint Tax Committee will take care of that." I said, "If you will look at the Congressional Budget Act closely, you will see that it gives equal emphasis to revenues and expenditures because it's only the combination of the two that produces the deficit or surplus."

She did finally establish an assistant director to concentrate on taxation. But, of course, she couldn't take over the role of the Joint Tax Committee. That probably would have been difficult to achieve, even if she had sought to.

But I think there was a perhaps slighting of the revenue side of the equation when the Congressional Budget Act was implemented.

Mr. HORN. Very good.

Any other comments any of you wish to make?

Well, if not, we thank you, all three, for appearing. It has been very helpful, and a good dialog has been established.

Mr. JASPER. Thank you.

Mr. HORN. Thank you very much for coming.

Let me now thank the staff of the subcommittee that worked on this hearing, headed by J. Russell George, the staff director and general counsel; and to my immediate left, Harrison Fox, the professional staff member directly involved; and Andrew Richardson, clerk; and for the minority staff, we have Matt Pinkus and Mark Stephenson.

And who am I missing this morning, folks? Is that it? And then Anna Miller on our staff should have been on here. And then we have the official reporters, Mindi Colchico and Julie Bryan.

We thank you all, and, with that this hearing is adjourned.

[Whereupon, at 12:32 p.m., the subcommittee was adjourned.]

FEDERAL FINANCIAL MANAGEMENT AND ACCOUNTING REFORM

THURSDAY, APRIL 25, 1996

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:30 a.m., in room 311, Cannon House Office Building, Hon. Tom Davis presiding.

Present: Representatives Horn, Davis, and Maloney.

Staff present: J. Russell George, staff director and counsel; Harrison Fox, professional staff member; Andrew G. Richardson, clerk; David McMillen, Mark Stephenson, and Liza Mientus, minority professional staff members.

Mr. DAVIS [presiding]. A quorum being present, the Subcommittee on Government Management, Information, and Technology will come to order. This morning we are holding a legislative hearing which will examine various Federal financial management and accounting reform proposals.

This hearing is the final day of a three-part examination of Federal budget, financial management, and accounting activities as they are practiced by the legislative and executive branches.

Over the last 75 years, at least 15 major acts and dozens of supplementary legislative provisions have structured the legislative and executive branch budget, financial management, and accounting procedures and processes.

Financial management and accounting reforms are possible in six broad areas. The first four areas—helping Congress make better decisions, controlling mandatory (entitlement) spending, expanding budget information, and managing Federal fiscal and debt policy. These four topics have been examined during the first 2 days of our hearings. Our focus today will be on improving financial management and accounting and implementing performance budgeting.

I ask that the witnesses today consider the following questions: One, how can we strengthen congressional involvement with Federal agencies as they develop goals and measures to implement GPRA? Two, what role should Congress assume in overseeing OMB's role in guiding performance management? Three, should Congress work to consolidate Federal planning and reporting requirements? Four, what can Congress do to ensure prudent and appropriate Federal program evaluations? Five, should Congress start using performance budgeting data now or phase it in slowly using duplicate budget systems or elaborate cross-walks?

Today's hearing includes witnesses from private sector organizations, including Jesse Hughes, associate dean, College of Business and Public Administration, Old Dominion University, representing the American Accounting Association; Morgan Kinghorn, director, Coopers & Lybrand Consulting; and Richard Roberts and Diane Dudley of KPMG. A Congressional Research Service presentation will be made by Ron Moe, senior specialist.

We thank you all for joining us and look forward to your testimony.

Mr. DAVIS. Mr. Horn has some other comments that I think he will make when he comes in.

At this point I think our first witness is Representative Campbell, and we are happy to have you, Tom. Thank you for being here.

Oh, I am sorry.

Mrs. MALONEY. I would like my comments to be placed in the record as read.

Mr. CAMPBELL. Noting the presence of your chairman, I will desist.

Mrs. MALONEY. I would like my statement to be in the record.

Mr. HORN. My statement and the ranking minority member's will be put in the record as read, and Mr. Campbell will not have to waste his time here.

[The prepared statement of Hon. Carolyn Maloney follows:]

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Opening statement -- Rep. Carolyn B. Maloney
Hearing on "Federal Management and Accounting Reform

Thursday, April 25, 1996

Mr. Chairman, it is always timely to talk about ways to improve the government's performance in dealing with budget and accounting issues. That may be especially true in a week when Congress passed its 13th short-term continuing resolution for fiscal year 1996. We appear to have also, finally, reached agreement on a long-term appropriations bill to fund the government for the rest of the fiscal year -- seven months into FY 1996. Maybe we should call the Guinness Book of World Records.

I understand and support the desire to improve the budget and accounting process. In the 104th Congress, we have had trouble with every aspect of that process:

- the budget resolution
- the budget reconciliation bill
- the 13 regular appropriations bills
- the 13 short-term continuing resolutions
- the debt ceiling increase.

In the Contract with America, the majority appeared to abandon reliance on the normal budget process and demanded instead a balanced budget constitutional amendment. Then they turned to the line item veto, which gives away much of Congress' institutional power over the budget to the President. The Federal courts will now have to decide whether that procedural reform is constitutional. And on April 15th, the majority tried to give away the power of the people's elected representatives to decide tax issues by majority vote. Fortunately, the plan for a two-thirds vote to raise taxes was overwhelmingly rejected.

So now we're back to looking at budget process reform. But the bottom line in budgeting, as in all other controversial policy issues, is for Congress to be able to make decisions and to pass legislation in a timely manner. No <u>process</u> can accomplish that for us Only we can. Hopefully, the experts here today, and at the previous two hearings on this issue, will help us determine which procedural issues should move to the top of the list if Congress considers budget and accounting reforms.

While our problems go beyond process, these hearings may at the very least help us sharpen our awareness of the problems, even if the solutions do not appear obvious. This hearing will address financial management and accounting issues, which are unquestionably part of the broader universe of budget issues.

I strongly support efforts, like Senator Brown's, to promote generally accepted accounting principles and strengthen accounting standards. In fact, I have drafted legislation to do just that at the Defense Department and I would like to invite the Chairman to join me as an original cosponsor.

I am also supportive of efforts to establish a more explicit capital budget at the Federal level, since I have seen it work so well in New York City. I also believe that the current process used to consider emergency supplemental appropriations is in serious need of reform and support efforts to address this critical issue.

Mr. Chairman, I congratulate you on your continued focus on improving the budget process throughout the government. The process may need more help than we can provide, but we won't get anywhere if we don't look carefully at the issues.

Mr. HORN. Welcome.

Mr. CAMPBELL. Thank you, Mr. Chairman.

Mr. HORN. Have you had a chance to give your testimony?

Mr. CAMPBELL. No, I have not.

Mr. HORN. Please proceed.

STATEMENT OF HON. TOM CAMPBELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. CAMPBELL. Thank you Congressman Davis, Congresswoman Maloney. I am here to ask for support for a resolution which expresses the sense of Congress to use dynamic economic modeling for CBO and Joint Tax projections on revenue. And it is a very simple proposition that I put to you, because I don't recommend that we give up anything else we are doing. I don't recommend that we base our budget analysis on some economist's theory. I am asking simply that we take advantage of the state of economic science as presently available to inform the Congressional Budget Office and the Joint Committee on Taxation, and that is what my resolution does, which will be introduced today.

I draw attention to the fact that presently we are doing something in between an absolute static and what economists would call a dynamic model in order to effect correct estimates of tax policy. The perfectly static model assumes there is no change in behavior by reason of a change in the tax laws.

We know very little perhaps, but one thing we know is that is wrong. That is wrong. People will change behavior because of the tax laws.

Now, at the other end of the spectrum, one can speculate that there will be such huge beneficial effects from a tax cut or huge negative effects from a tax increase that the budget will be balanced overnight, and that is obviously absurd.

What I would like to do in my resolution, and what I would urge the committee to consider favorably, to call upon economic science to the extent it has expertise and to offer that along with the other modeling already being done, and the other static and in-between models being used by CBO and Joint Tax.

In favor of my proposal, you will find an interesting example from my home State of California and the chairman's home State of California. When I was a State senator, where I was a happy person until December 12th, I introduced this resolution, and it became the law of the State of California. And California has an even more difficult time theoretically using a dynamic model than the Federal Government because California is subject to more economic leakage than the United States. Roughly 11 percent of the GNP of the United States is involved in international trade, whereas over a third of the State of California's is, once you define "international" as anything but California.

So it is a more difficult task, yet the State of California has begun to implement just this. The Commonwealth of Massachusetts has been implementing dynamic economic revenue modeling for the last several years. They use the a model, which has its critics and detractors, but it is better than the static model. And the State of Minnesota does as well.

What I am calling upon you and our colleagues to do is to support a resolution to ask CBO and Joint Tax to take advantage of the state-of-the-art to the extent we can, and I will conclude with just a couple of observations, then I would be open to your questions as you may wish.

The observations about the traditional criticisms—to anticipate the criticism—the most common criticism is, isn't this just a cover for those that want to cut taxes and claim you will lose revenue, or the loss in revenue won't be that great? No, it is not just a cover. It is an attempt to get a more accurate estimation.

If I took a perfectly static model, I would have an inaccurate estimate of any change in tax law. I am not suggesting that we do anything unreasonable or force any conclusion. And here is why I think my case is compelling. Take history as the guide, fit the model to the data, and we know one thing for sure. The Joint Committee on Taxation has gotten it wrong, almost without exception, so much so that the Joint Economic Committee in 1991 issued its own analysis of the remarkable consistency with which the Joint Economic Committee got revenue estimates wrong.

The classic example was in estimating revenue from the capital gains tax, where behavioral assumptions are essential to properly understand effects. So the first objection that is a mask for those that want to cut taxes and pretend it has nothing but beneficial effects on the budget deficit, that is not my point of view, and I draw to the attention of the chairman and the ranking member that in my own personal life I did not support the tax cut. I, rather, supported balancing of the budget as our top priority.

So there is no smoke screen involved here. I am simply saying the present system gets it wrong, and it is time to try to get it right. Without giving up our present approach, let's look at a possible alternative.

And the second and last criticism is if this is true, why don't we do it for spending programs as well? Isn't it true that expenditure programs could have dynamic economic effects? My answer to that is, yes, amen. Let's do it. As soon as the science supports it, I would be here with a resolution calling for that as well.

It happens that the economic science is further developed in estimating the effects of the tax policy. That is all. But if a coherent economic model were to be proposed to consider the dynamic effects of expenditure, just as I today recommend be for revenue, I would support it. In other words, nothing I am putting forward today precludes that.

In conclusion, the proposal is supported by Michael Boskin and Martin Feldstein, former CEA and former Council of Economic Advisors chairman; Citizens for a Sound Economy; the Tax Foundation. I mentioned it is in practice in the State of California, Massachusetts and Minnesota, and I observe as well that I have limited the resolution to effects of $100 million or more. It may be that we should even go higher as a threshold, but it gets us to start what I think should have started many years before.

I am informed that the first meeting of an ad hoc committee of the Congressional Budget Office and Joint Tax took place this last Monday, and that eight different models are now being considered for dynamic economic modeling, according to Gary Robbins, a former Treasury official who is advising, and Dale Jorgenson, a Harvard professor who is advising. It is likely that Joint Tax and the Congressional Budget Office will come up with some model in time for the next Congress. This resolution will ensure that that process continues.

Thank you, Mr. Chairman. Thank you, Congresswoman Maloney.

[The prepared statement of Hon. Tom Campbell follows:]

TESTIMONY OF THE HONORABLE TOM CAMPBELL, M.C.
"THE DYNAMIC WAY TO SCORE TAX POLICY"

THE FEDERAL BUDGET PROCESS HEARING
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY
THURSDAY, APRIL 25, 1996
ROOM 311 CANNON

Thank you, Chairman Horn, for inviting me to testify before the Government Management Subcommittee on the issue of reforming the federal budget process, and how to make the federal budget process more manageable and responsive to the American people. It is a pleasure to take part in this important hearing.

Congress can gain valuable insight from the States in many key policy areas, and one important area is in the accurate estimation of the revenues available to provide government services in the first place. Through the sound application of an accounting device known as dynamic economic modeling, several state and local governments are providing clear and accurate insight into revenue patterns for future years. I am testifying today in support of the premise that dynamic economic modeling is a valuable means of estimating taxes and fiscal actions. In addition, this is a concept that Congress and the federal government should explore further.

The formulas now used to predict the economic impact of changes in the tax code ignore the fact that tax changes spur behavior changes. If you don't factor in these behavior changes you get phony revenue numbers and, consequently, inaccurate budget numbers. My resolution is designed to encourage the consideration of real life and real dollars back into government projections.

At the heart of this discussion is whether we should encourage growth and opportunity in our tax policy. By implementing dynamic economic modeling, one can get a better idea of the revenue effects that changes in sensitive tax policy cause. The State of Massachusetts, for example, has been using dynamic economic methods. My home state of California, it should be noted, has completed initial design and testing of a computable general equilibrium model (CGE). As a state senator in California, I took part in this process by authoring Senate Bill 1837, a bill authorizing the implementation of dynamic economic modeling techniques. This bill was passed by the California legislature and signed by Governor Wilson in 1994.

The California Department of Finance, I am pleased to say, has sent a copy of the model paper to members of Governor Wilson's Council of Economic Advisors, specifically John Cogan, John Taylor and Michael Boskin of Stanford University. I expect this model will be circulated to other academics in California and elsewhere, and am confident that these models will be excellent tools to help policymakers at the state and federal levels understand the full economic consequences of tax legislation.

Dr. Boskin, also a former Bush Administration Economic Advisor, argued last year before Congress that dynamic economic modeling is not an attempt to "cook the books" as defenders of conventional models might suggest. As Dr. Boskin added, those who claim that this is an attempt to cook the books are starting with the erroneous proposition that the "books" are now in good shape. What he acknowledged is that there are serious problems in conventional accounting and in the current presentation of information.

Let me illustrate how dynamic modeling may work. The House of Representatives Joint Economic Committee (JEC) cites a 1990 projection of Congressional Budget Office (CBO) realizations after capital gains tax rates were increased. Initial estimates of capital gains realizations showed significant gains even after a large increase in the capital gains tax rate after 1987. According to recent Internal Revenue Service data, however, actual realizations were less than half of what was projected by CBO for 1993. Instead of projected realizations of $295 billion in 1993, capital gains realizations remained stagnant at $141 billion -- an error of over 100%! In the words of the Joint Economic Committee, the higher capital gains tax rate has produced less annual real revenue in the 1990-1993 time period under the lower rate of 1985, despite a larger economy.

These are serious enough to justify exploration of policy changes in how we project revenue. At the very least, the idea of dynamic economic modeling could provide a range of revenue estimates around the number produced by the static mold.

It is time for Congress to take notice of dynamic economic modeling's implementation by States, and with the help of leading accounting firms and academics, adopt it. Ignoring the debate on alternative revenue estimating will create a bias against tax policies to create growth which are now under consideration. Good ideas which could enrich our future standard of living are at risk of outmoded economic calculations if we do not create this dialogue.

Thank you again for giving me the opportunity to testify today.

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Mr. HORN. I yield to the ranking minority member to begin the questioning.

Mrs. MALONEY. Thank you, Representative Campbell. And when did you enact the dynamic economic model in California, what year?

Mr. CAMPBELL. In 1994.

Mrs. MALONEY. 1994.

And you state they use this model to estimate revenue patterns and to estimate taxes. Will you explain for us how this device makes these estimates and how you believe it can be implemented in the Federal process?

Mr. CAMPBELL. Yes. Input/output analysis is the simplest of the three or four models, so let me try just to develop that for a moment.

You can study history in the State of California as to what revenues resulted from the change in the sales tax, and you fit a multiple regression analysis, which is let the data fit the equation.

I can't tell you off the top of my head what the coefficients might be, but I know that an increase in the sales tax will depress the purchase of particular items, and so the one prediction that isn't true is assume the exact same quantity sold with higher revenue, because there is a higher sales tax. So go back 5 years—this is the input/output analysis—and try to correlate the actual revenue with the tax levels.

Put in there as well what data you have on transient employment in our State, in California anyway, trends overall into and out of the State, and other tax levels. Hope that R-squared, which is the correlation coefficient, is high, and take it to 3 years out and watch it.

And like my legislation here, my bill in the State of California said don't give up what you are doing. No, do this as well, watch it, and if it is more accurate, had I still been in the State Senate, I would have said, I will come back in a couple of years and make it mandatory. Take what the data is, fit it, and hopefully you will get a better prediction.

Mrs. MALONEY. You are saying it should just be one of the many variables that should be considered in the budget process; that you do not have to follow necessarily what it says, but just that it be considered.

Mr. CAMPBELL. Absolutely right.

Mrs. MALONEY. It is an interesting idea. It is a good idea. Thank you.

Mr. CAMPBELL. Thank you.

Mr. HORN. Perhaps the gentlewoman would like to join me in cosponsoring Mr. Campbell's resolution.

Mrs. MALONEY. I believe I will. I will cosponsor it.

Mr. CAMPBELL. I would be happy.

Mr. HORN. Add us both. I get a finder's fee.

Mrs. MALONEY. Only on the condition that you send my office some background information on your bill, a copy of your bill in California and how it was working there.

Mr. CAMPBELL. Indeed. Out of respect for that request, if you would like, I will not make your cosponsorship public until I hear from you, if you would like to take a look at that.

Mrs. MALONEY. I would like to look at that. When you say "make it mandatory," what do you mean? The new mandatory—that you would make that this economic forecast be—right now you are in California, you must look at it, but it must not impact on the decision. When you make it mandatory, would it impact on the decision? What is the difference that you see?

Mr. CAMPBELL. I do underline the premise being that it is more accurate. If it doesn't, the heck with it, throw it out. That is what I want to do on the Federal side, too. But if it turns out to be more accurate, then what I would have done is require the Department of Revenue, which is that branch of the State government, to use this rather than the static model because it is just—if it is more accurate, we should use it.

But since I can't say that until I have studied it in vivo, not in vitro, take a look in the actual data, then I am going to wait. So that is what I would do.

Presently, though, in our State, and it may be true in yours as well, the revenue estimates are wrong. I would then require that our revenue estimates be based upon the model if it proves more accurate than the present system, but if it doesn't, I wouldn't.

Mrs. MALONEY. Thank you.

Mr. HORN. One of the famous incidents of tax stupidity was the 1986 tax bill and the excise tax on luxury yachts, which put the shipbuilding business for yachts out of business, and it went abroad. Your dynamic model, I take it, would have predicted that in terms of the levy of excise taxes, or does common sense do it?

Mr. CAMPBELL. Both.

Mr. HORN. Do we need 20 economists to tell us the obvious?

Mr. CAMPBELL. I would encourage hiring economists whenever possible.

Mr. HORN. Keep them off the unemployment lines.

Mr. CAMPBELL. Particularly academic economists, it is highly recommended.

Putting my self-interest aside, yes, you are quite right. And the way it would have is we would have looked historically—just in my answer to Congresswoman Maloney's question, we would have looked historically at what happened when you increased the luxury tax.

Elasticity of demand with respect to price is quite high on luxury goods. And so had we only taken a moment to look at recent experience on similar luxury goods, we would have been able to say, hold on a minute, we are not likely to gain the revenue.

The chairman's point is equally right. Not only did we fail to gain the revenue, but we sent the building business elsewhere with purchases then made off-shore. You can purchase your yacht in a non-American jurisdiction, then bring it into the United States jurisdiction.

So, yes, I am confident in saying so because that was one of the examples that is classic in the mistakes made of not studying elasticity of demand with respect to price. If the Joint Economic—if the Joint Tax Committee were here, they would tell you they were trying their best to do that just now, and I am pleased. But they are not going to the macroeconomic effect. Yachts, probably not a huge macroeconomic effect. Capital gains, yes. So behavior is only part of a dynamic economic model. Macroeconomic effect is a very important other part.

Mr. HORN. Let me ask you on the Consumer Price Index and its relation to a dynamic economic model. One of our problems with the Consumer Price Index is they are slow to look at the substitutional factors that have changed behavior. Behavior has changed, and thus the Index has changed, but there are still things in the Index that some of us would argue aren't relevant to what people are doing these days. And they say, we will finish doing something about it by 1997, and they want to get themselves through an election year and not face reality.

Give me, if you can, what is the relationship between the staff working on a dynamic economic model and the Consumer Price Index role within that model in terms of the broad range of things that are covered in the CPI?

Mr. CAMPBELL. It is a very fair and insightful question, and it would be the subject of a later bill. I will respond as best I can to how it will affect the CPI calculation, but I do emphasize it is not in this bill sufficient unto the day as the evil thereof. Get me better estimates from Joint Tax, and I am a happy Congressperson.

But you are absolutely right. The dynamic effect of changes in price on behavior, which this model captures, should also be captured in the CPI. The CPI model used now is called the Los Behr's Price Index, and that assumes you bought the exact same market basket today as when you measured the last CPI, when in truth the composition of that market basket has changed because relative price has changed.

And that means with 100 percent certainty—very few things I say this—100 percent certainty that the present measure of CPI is an overstatement. How much of it is an overstatement? That is hard to say. But that it is an overstatement is undebatable because the consumer as the very worst can buy the identical purchases that she or he made, but hopefully is exercising some judgment and substitutes products within the market basket and does better.

An even more difficult aspect of CPI is the quality of goods. The classic example from my district is the computer. When I did my Ph.D., I did it on a hand-held calculator. I imagine you did, too, Mr. Chairman.

Mr. HORN. I was a little ahead of you. Have you heard of where you punch cards and try to get the deck stacked up and see what happens?

Mr. CAMPBELL. I also punched cards. Chicago must not have been that much advanced. Today, of course, it is incredible the IBM 360 on which I did my dissertation has less power than the low-market laptop. And so if in your computation you have a hand-held calculator, you are totally in the Dark Ages, and you are not picking up the effect. You would have a huge drop in the price index if I put in a calculator capable of doing multiple regression analysis stepwise and an analysis of variance. That would have been $100,000 just to rent the time that I would need, and today it would be what, $250.

So there are two aspects where in the CPI is wrong. One, it doesn't take account of the changes between goods, assuming they are identical; and second, it doesn't reflect the fact the goods are no longer identical.

Mr. HORN. This has been very helpful.

Now I see in my briefing book here is a paper here by Dr. Frederick Treyz. Is that part of your testimony?

Mr. CAMPBELL. I would be happy to make it so. I didn't actually submit it as part the testimony. I would like to send it, if it is agreeable with you, and if the Chair wishes to make it part of the testimony——

Mr. HORN. I would like to. Without objection it will become part of your testimony following your formal statement.

[The prepared statement of Dr. Treyz follows:]

Testimony in Support of House Resolution on

Dynamic Economic Modeling

Dr. Frederick Treyz

Regional Economic Models, Inc.

Dynamic economic modeling can vastly improve current national tax policy by providing more accurate predictions of revenues and by providing analysis of the economic effects of tax policy. The use of dynamic scoring to achieve the goal of better revenue forecasting is a matter of sound accounting. The models should be further used to evaluate the effects of national tax policy in terms of job creation, economic growth, and state and local impacts.

The current tax modeling of the Joint Committee on Taxation, the Office of Tax Analysis and the Treasury holds all macroeconomic variables constant. Thus, even when behavioral adjustments to tax policy are considered, the economic effects are still treated as a zero-sum game. Yet, some of the most pressing economic problems that our country faces are greatly affected by the way the government goes about collecting taxes, and ignoring these effects means that we are not grappling with the problems of unemployment, economic readjustment, and the budget deficit.

State governments, primarily California, Minnesota, and Massachusetts, are leaders in using dynamic models for revenue forecasting and tax policy analysis. Minnesota and Massachusetts have implemented their policy analysis using the Regional Economic Models, Inc. (REMI) economic model. This allows them to evaluate the differences among various tax instruments, such as sales, profits, and income taxes. The macroeconomic feedbacks of these policies allows better revenue forecasting. Addiconally, even in the case of alternative revenue-neutral tax policies, the dynamic economic model provides a basis for evaluating the policies for reasons of earnings and employment growth.

Mr. CAMPBELL. Mr. Chairman——

Mr. HORN. I think it is a very helpful sheet.

Mr. CAMPBELL. One caveat, if I could, in Dr. Treyz's testimony, the reason I did not make it part of my own, I understand the Commonwealth of Massachusetts is now engaged in reconsidering the model by Dr. Treyz's company, the Regional Economic Model, Inc. That to me is healthy, good, you ought to try it. If it needs improvement, go to something better. But because of that, I did not wish to rely lest an opponent wishes to say, but Massachusetts is now moving away from Dr. Treyz's model.

Mr. HORN. It is without objection.

Well, I thank you. It is always good to see a Member with a high level of intelligence thinking new thoughts. Maybe we can change some of the ways we do business in analysis prior to making a decision. Thank you for coming.

Mr. CAMPBELL. Thank you, Mr. Chairman.

[The prepared statement of Hon. Hank Brown follows:]

STATEMENT OF SENATOR HANK BROWN

submitted to

The Subcommittee on Government Management, Information and Technology of the House Government Reform and Oversight Committee

March 27, 1996

I would like to begin by thanking Chairman Horn for convening these hearings. Budget process reform and financial management reform are both essential if this government is to be worthy of its taxpayers. I'm very pleased to participate in these efforts.

The past several months have dramatically illustrated the flaws in our budget process. In the past, Washington's addiction to spending has made it impossible to enact even limited reform of federal programs. The current system obscures pork-barrel spending and encourages quiet tax increases. It has allowed congresses to promise balanced budgets that are never delivered. Real attempts at fiscal discipline have been thwarted through obfuscation and phoney estimates.

Wasteful spending and demagoguery have no trouble capitalizing on weaknesses in the budget process. Opponents of sensible budgets rely on rosy economic assumptions that are generated by the creative use of baselines. In recent months we have seen how baseline projections in major entitlement programs can be used to make a modest limits in projected growth sound like cuts in important benefits. Clearly reform of the budget process must begin with honest figures. Comparisons must be made with the prior year's spending -- not an imaginary forecast.

Currently 48 of 50 states have balanced budget requirements (35 of these are constitutional while the other 13 are statutory). Twenty-one states also have spending limits, such as limiting growth in appropriations to the level of increases in population and inflation, or to a fixed percentage of estimated revenue. Eight states have legislative supermajority voting requirements for revenue increases. These are all possibilities for exerting fiscal discipline at the federal level.

Even the best fiscal intentions are undermined by a lack of uniform accounting standards. Budget process reform will be hollow unless it is accompanied by financial management reform.

Consider the stunning lack of information available to the President and Congress as they set the budget. They are-under informed at every level. There is, for instance, no such thing as a financial statement for the Federal Government based on generally accepted accounting practices. It would be impossible to generate because there is no uniform financial management system for the government. The Federal Government has more than 253 separate financial management systems. The result is that government agencies are unable to account for billions of taxpayers dollars.

Overhead costs offer one disturbing example. Federal agencies spend more than 100 billion taxpayer dollars each year on overhead costs, but there is no accounting system to keep track of these expenses. In fact, the government doesn't even have a definition of "overhead cost."

The lack of accounting standards causes fiscal chaos in even the largest federal departments. In just two years the Department of Defense paid vendors $29 billion that could not be matched to supporting documentation to determine if payments were proper. Recently the General Accounting Office has been unable even to assess financial statements of the Internal Revenue Service because of serious accounting and internal control problems, including over $90 billion of transactions that had not been posted to taxpayer accounts.

The government needs a clear, consistent, comprehensive set of accounting standards. This would permit meaningful audits and force Federal agencies to compile and report costs in the same manner from one fiscal year to the next and make one agency's financial statements comparable to another's.

Taxpayers deserve honest, disciplined, accountable government. Budget process and financial management reform are essential if we are going to have that kind of government. The benefits of such reform include not only a return of citizen confidence in their government, but a much healthier and more robust economy from which all Americans will profit.

Mr. HORN. Our next panel is panel two: Dr. Jesse W. Hughes, associate dean, College of Business and Public Administration, Old Dominion University. Dr. Hughes is representing the American Accounting Association.

Old Dominion is one of America's great urban universities. I am glad to see a member of the faculty here from Old Dominion. We have a tradition in the committee a Member of Congress gets sworn in, because when a Member misleads you, you never listen to him anymore.

[Witness sworn.]

Mr. HORN. You have a very fine and thorough statement. That immediately becomes part of the record, but if you could look us in the eye and summarize it in 5 minutes so we could get a dialog going, then ask questions and get a dialog going, we would appreciate it.

STATEMENT OF DR. JESSE W. HUGHES, ASSOCIATE DEAN, COLLEGE OF BUSINESS AND PUBLIC ADMINISTRATION, OLD DOMINION UNIVERSITY, REPRESENTING AMERICAN ACCOUNTING ASSOCIATION

Mr. HUGHES. I certainly appreciate the opportunity to appear before your subcommittee, Mr. Chairman. And I would like to just say the preceding testimony presented the positions very well, and so it looks like you are getting an academic approach somewhat to the issues.

I would like to mention that I have had 20 years working for the Federal Government as a controller systems analyst, so I think I bring an academic perspective, as well as the practical perspective, to the testimony.

On behalf of the American Accounting Association, we certainly appreciate the opportunity to express our views. We have approximately 700 members throughout the world. We work strictly with governmental accounting issues, in their teaching, research and service. So, now we are able to bring it down to the grass roots level in our classrooms.

I have not had the opportunity to coordinate my testimony with the other key members of the association, so the views I express here are strictly my own.

I would like to applaud the efforts of the subcommittee in looking at financial reforms throughout the Federal Government, and the efforts that Congress has made over the past few years have certainly been noteworthy, especially that being the Chief Financial Officer's Act, which acted as the springboard for the Federal Accounting Standards Advisory Board. The actions that the Board has made since passage of the CFO Act in 1990 have been especially beneficial, and we have had the opportunity of testifying before that Accounting Standards Setting Board—Accounting Advisory Board, let me correct that, over the past 5 years.

We need at this point to legislate some of those policies to ensure that they continue to be in place. The essence of my comments, then, are as follows: We should adopt full accrual accounting systems to ensure that current taxpayers pay for the services that they receive and the costs of these services are not passed on to future generations. Further, a mechanism should be established to reconcile our accounting numbers with the System of National Accounts to ensure that there is consistency between the numbers reported nationally and those reported worldwide.

In the academic community we attempt, of course, to establish a conceptual framework on which we can build. In the private sector, as far as accounting concepts are concerned, we utilize the capital maintenance concept, which attempts to measure how well off we are at the end of a period versus what our position was at the beginning of that period, and the difference, of course, we call profit or loss.

In the public sector we are not fortunate enough to be able to apply the capital maintenance concept. In lieu thereof, I have proposed a standard of living maintenance concept, which, in essence, says we measure how well off we are in our standard of living at the end of a period versus what our position was at the beginning of that period, and typically we measure using the gross domestic product and the growth then in that gross domestic product from one period to the next.

The computation of the gross domestic product is clearly defined in the System of National Accounts; however, there are extensive differences between the accounting numbers that we generate and the numbers that are generated in the System of National Accounts. Attached to my testimony is a reconciliation that the General Accounting Office had done back in the early 1980's, and you can see on that reconciliation the extensive adjustments that are made and the difference between the accounting numbers and the numbers that are reported in the System of National Accounts.

Someplace, somehow, the accountants and the economists have to work closer together to ensure that there is comparability between those numbers and that there is greater auditability in the numbers that are reported both in the accounting system and the System of National Accounts.

It seems to us there are four key questions that are asked, the first being, where do your funds come from, what did the governmental unit do with them, or how extensive was the surplus or deficit? We do a very good job of that by a statement of cash-flows.

Where we do not do a good job is in determining what public services we are providing today and if we will be able to maintain or increase the level of service without changing the tax rate. To be able to answer that question, we need a full accrual accounting system and a full set of financial statements.

The third question is how much debt do we have, and will we be able to repay it without cutting back on the public services provided or increasing the tax rates? To be able to do that, we need a statement of fiscal health, and we have no such statement in the system at this point in time, although the Federal Accounting Standards Advisory Board has recommended a statement of current service assessment.

I note that my period for introductory comments has expired. I would be most happy to answer any questions that you might have.

[The prepared statement of Mr. Hughes follows:]

Jesse W. Hughes, Ph.D., CPA, CIA, CGFM
Associate Dean
College of Business and Public Administration
Old Dominion University

A Conceptual Framework for Government Accounting

Mr. Chairman and members of the Subcommittee. On behalf of the American Accounting Association, we appreciate the opportunity to express some of our views relative to government financial reform. Within our Association, we have approximately 700 members worldwide who devote their primary energies to teaching, research, and service in the government financial arena. Even though I am speaking on behalf of the Association, the views expressed are my own since I have not had sufficient time to coordinate with other key members of the Association.

We applaud the efforts of Congress in recent years to pass laws that permit the Federal government to become more fiscally accountable to their constituents. Especially noteworthy is the Chief Financial Officers Act of 1990, which served as the springboard for the Federal Accounting Standards Advisory Board (FASAB). We have had the opportunity on many occasions to testify before FASAB on critical issues and to work with them on resolving these issues. The accounting standards recommended by this Board have laid the foundation for better accounting procedures at the national level, and their efforts should be recognized and supported. However, there is a need to legislate the policies associated with these financial reforms.

Much has been said and written about budgeting, especially balanced budgets, separate capital budgets, and the line-item veto. However, today I would like to limit my remarks to accounting and financial reporting. The essence of my comments are as follows:

We should adopt full accrual accounting systems to insure that current taxpayers pay for the services that they receive and the costs of these services are not passed on to future generations. Further, a mechanism should be established to reconcile our accounting numbers with the System of National Accounts to insure that there is consistency between the numbers reported nationally and those reported worldwide.

Conceptual Foundation

Downsizing, rightsizing, reinventing, reengineering!!! These are all terms that are being used frequently in the private and public sectors. Yet, we do not have a conceptual base on which to make good decisions in the public sector. This makes it difficult to prepare for good accounting systems as we enter into the 21st century.

In the private sector, we use the "Capital Maintenance" concept. This means that attempts are made (through the measurement of income) to determine if the firm or individual is "as well off" after a period of operation as it was at the beginning of that period. Any difference between the beginning and ending amounts indicates that we have made a profit or loss for the period. Thus, we can match our expenses for a product against the revenue generated from that product to determine the profit or loss associated with each product. This concept can be applied to those business-type operations in government, such as revolving funds, stock funds, etc.

However, in the public sector, we can not apply the "Capital Maintenance" concept (except for business-type operations) since the value of capital (i.e., owner's contribution) to be maintained is difficult to define. Nor are we in the business of maximizing profits. Rather, in the public sector, we are more concerned with a "Standard of Living Maintenance" concept. This means that we want to maintain (or increase) our standard of living from one period to the next. Traditionally, change in the standard of living is measured by the percent change in the per capita gross domestic product (GDP) between the periods being compared. GDP is comprised of the following spending categories: consumption, investment, government, and net import/export. Thus, the impact of government spending can be readily identified in the computation of GDP. We attempt to maximize the quality of services delivered against the costs for providing that service.

The computation of GDP is clearly defined in the System of National Accounts. This system was initially implemented in the 1930s and, over time, other definitions of financial terms for this system have been developed to assure that comparisons are valid between states and countries. Further, in the public sector, we are interested in matching the costs of services to the revenue generated to determine if there is a gain or loss during the period. This matching principle is known as "interperiod" or "intergenerational" equity. This means that taxpayers pay for the public services that they receive today, and that expenses for those services are <u>not</u> passed on to their children and grandchildren. For example, the liability associated with social insurance programs should be fully accrued (and the expense recognized in the period when the service is performed) in order to pay for the pensions of covered workers when they become eligible.

Key Questions

Providers and users of public services are concerned with the following basic questions:

1. From where did the funds come, what did the governmental unit do with them, and how extensive was the surplus or deficit? These questions can be readily answered by a Statement of Cash Flows or Statement of Source and Application of Funds (dependent upon whether the accounting system is cash or near cash). In general, most systems are sufficiently adequate so that we can answer these questions with a high degree of accuracy. Since budgets are maintained on a cash or near cash basis, a comparison between budget and actual should be included in this statement.

2. What public services are provided today and will we be able to maintain that same (or increased) level of services in future years without an increase in the tax rate? In order to answer these questions, a full accrual basis of accounting is needed. Today, only those governmental activities that have clearly defined end products and are maintained on a business-like manner (i.e., trust and revolving funds, enterprise funds, etc.) use the full accrual basis. Some of these units are being privatized. Few governmental units accrue their pension or other post employment benefits. Consequently, the costs of employees who provide services today are passed on to future generations for payment. Extensive modification of our accounting systems will be needed in order to answer these questions. A full set of financial statements (Balance

Sheet, Statement of Change in Net Assets and Statement of Revenues and Expenses) is needed to provide the necessary information for decision making.

3. How much debt do we have and will we be able to repay it without cutting back on the public services provided or increasing the tax rate? Question two must be answered before we can accurately answer this question. But accounting systems must be developed to permit us to provide answers to this question on the level of fiscal stress so that the governmental unit is not forced into bankruptcy. Thus, a Statement of Fiscal Health is needed that will provide this information.

4. How do we compare to other governmental units with similar characteristics? This principle of "selective comparability" states that governmental units will compare their activities to those of other governmental units with similar characteristics, in order to determine if changes are needed in taxing and spending policies. Many governmental units have developed systems to provide for some degree of financial comparability on a cash or near cash basis. However, the systems for comparing measures of productivity have not yet been fully developed. As these systems are being developed, a Statement of Performance Measurement is needed to provide the desired information.

Future Needs

The basic foundation used to answer these questions must be developed further. Financial measures used in the private sector are fairly well defined, but measures in the public sector are evolving and need to be more clearly specified. The first question on cash flows is well developed and does not need many further refinements. However, the need for full accrual accounting systems is extensive and much effort will be exerted during the next century in this area.

The increasing sophistication of government managers and the computer resources available to them will permit future accounting systems to provide answers to these questions. Consequently, the will of the people must be exercised in order to enact laws that permit accounting systems to be developed to answer these questions. Let us look at the systems to be developed in the 21st century in order to answer the last three questions. The levels of government are looked at separately even though, over time, the accounting systems for these levels of governmental will converge.

State and Local Governments.

Key indicators will be developed that will permit governmental units to readily determine their financial condition. In the U.S. today, these indicators are maintained on a cash or near cash basis, such as long-term debt to funds available to pay that debt (typically no less than 5 percent) or to some measure of wealth (i.e., no more than 10 percent of assessed property value).

Some states within the U.S. have developed uniform accounting systems on the modified accrual basis of accounting that permit comparisons between the local governments within their boundaries. It is presently difficult to make comparisons between local and state governmental units in different states due to significant differences in aid provided by the Federal and state governments to the local governments within their jurisdiction. These differences are dictated by legislative mandates, and uniform state laws for allocation of financial resources are not anticipated in the future.

National Governments.

The System of National Accounts has been developed to permit comparative analysis of economic data between national governments on a uniform basis. This system has been refined by the European Economic Community where three convergence ratios are used to determine if countries desiring to join meet their criteria. These ratios are as follows: Deficit/GDP less than 3 percent, Debt/GDP less than 60 percent, and an inflation rate no greater than the inflation rate of the three best performing member countries by more than 1.5 percent. The objective of the European System of Central Banks is to maintain price stability while sustaining non-inflationary growth and a high level of employment.

The System of National Accounts has also been refined by the Office of Economic Cooperation and Development. This System of National Accounts will continually be refined to assure more auditability of the data, thereby giving more reliability to the comparisons. The more informed citizens will come to rely on the annual economic growth in GDP for the economic health of their national government, much to the same extent that shareholders in a publicly held company rely on the audited profit figures to report on the soundness of their investment.

Partnerships between the private and public sector are also very important to the well-being of a country. Analysts will be able to look at the contributions of each segment in the computation of GDP to determine which are contributing more strongly to the economic growth of a nation, much in the same manner that a privately held company looks at its product lines to determine which are most profitable.

Accounting systems developed for national governments will link more closely with the System of National Accounts, thereby permitting the rollup of the data in local, state, and federal systems into the System of National Accounts. This will provide more accurate comparisons between the ratios of long-term liabilities to GDP, etc. At the present time, extensive and difficult reconciliations must be made between the accounting numbers and those reported in the System of National Accounts. An example of the reconciliation for deficit is attached. Accountants and economists must work more closely to correct these problems.

All Levels of Government.

At the micro level, performance measures will be developed to assist operational units to measure their degree of efficiency and effectiveness. Much work has been done in this area by the U.S. Government Accounting Standards Board (GASB). One major objective of GASB is to provide more complete information about a governmental entity's performance than can be provided by the traditional financial statements and schedules. It is believed that this objective can best be accomplished if the performance information is reported as part of the general purpose external financial reports (possibly in a separate report). It is anticipated that the information would focus on the relationships between service efforts (input) and service accomplishments (outputs and outcomes).

Extensive work has also been done on performance measures by the U.S. Federal Accounting Standards Advisory Board and other national bodies. However, much more must be done at all levels in order to standardize the definitions for valid comparisons between governmental units.

As performance measures are developed, they will need to be used in the future allocation of resources. Thus, line item budgets, program budgets, and performance budgets will have to be linked to the accounting systems that are reporting actual results. Further, tax expenditures (i.e., tax relief to a special group that would otherwise be subject to tax) will need to be linked to the accounting system as part of the decision making process.

The desire for balanced budgets is readily recognized, but these are short-term solutions to long-range needs. We should be developing strategic cost management systems that will permit us to plan for our financial needs at least ten years into the future. This may dictate that capital budgets are separated from operating budgets in the appropriation process. Further, the capital budgets may need to recognize the investment in human capital (i.e., education and training), in addition to the investment in physical capital (i.e., infrastructure).

In the future, key indicators will be reported on the full accrual basis of accounting. For example, long-term debt will be measured against the level of equity accumulated to repay that debt. To be solvent, that ratio should be at least 1:1 as it is in the private sector. Some countries (i.e., Australia and New Zealand) have already implemented full accrual accounting systems for government.

The concepts associated with activity-based costing and total quality management systems will be refined over time and replaced by new concepts not yet identified. However, the end objective will remain the same (i.e., those financial assessment systems necessary to assure that cost beneficial values are added by the services provided).

Conclusion

It is anticipated that the following areas will drive accounting for governments in the 21st century:

1. The role of government accountants will change from being a reporter of information to that of an adviser on the use of the information for decision making.

2. The advancing state of technology will permit accountants to deliver the right piece of information, in time, to support a critical decision.

3. Changes in organizational structures and the elimination of many managerial levels will provide for a more team oriented approach to decision making, with the accountant as a key member of that team.

4. Accountants in government will need more training on social skills in order to function effectively as a member of a cross-functional team or to play a facilitator's role. Further, the accountants will need expert financial analysis skills, advanced literacy in information systems, and highly effective communication skills.

5. Accountants will need to hone their skills to be able to differentiate between core management information (which will be GAAP-driven) and dynamic management information (which will be dictated by the circumstances for rapid decision making).

We must avoid the temptation to do accounting for accounting's sake. Rather, we must understand clearly the purpose for which we are developing our accounting conceptual framework for governments. Only through the interaction of numerous knowledgeable individuals, agencies, and organizations can we hope to establish the kind of framework that will permit the effective and efficient measurement of government activities by accountants during the 21st century. This will be difficult to accomplish in the political arena where the future is so uncertain. Yet, we owe it to future generations to keep trying.

Attachment 1

RECONCILIATION OF DEFICIT MEASURES*

	1984	1983
Excess of Expenses over Revenues	$215.1	$232.0
Less:		
Increase in actuarial liab. for pension, retirement, and disability plans	60.9	79.9
Depreciation	37.8	23.4
Contingent liabilities for guarantees and insurance programs	1.1	(0.6)
Other accrual adjustments	24.1	28.5
Unrealized loss (gain) on gold revalue	15.0	(0.6)
Plus:		
Capital Outlays	102.3	90.5
Net loan disbursements	6.3	15.3
Seigniorage**	0.5	0.5
Budget Deficit	$185.3	$207.7
Less:		
Coverage differences (outlays)		
Geographic	5.0	4.9
Other	0.2	0.3
Financial transactions (outlays)		
Net lending	18.2	14.5
Other	(0.1)	(0.3)
Net Purchases of land (outlays)		
Outer Continental shelf	(3.5)	(7.5)
Other	0.1	0.1
Timing differences		
Corporate income tax	(1.5)	3.3
Federal and state unemployment insurance tax	(0.4)	1.5
Withheld personal incomes taxes and Social Security contributions	0.2	0.1
Excise taxes	(0.7)	0.9
Other receipts	—	0.5
Plus:		
Coverage differences (receipts)	1.8	1.4
Timing differences		
Purchases of goods and services	2.2	0.8
Other outlays	(1.7)	(2.3)
Net miscellaneous	0.2	—
Nat. Income and Product Accounts Deficit	$170.3	$189.3

*Billions of dollars
**Difference between face and metal value of coins manufactured.
Source: A Joint Study by the Office of the Auditor General of Canada and the United States General Accounting Office, *Federal Government Reporting Study: Detailed Report* (GAO/AFMD-86-30B), Appendix C-U.S. 54.

Mr. HORN. Let me ask, when I was getting out of high school in 1949, the first Hoover Commission reported, and as I recall, it recommended accrual accounting. Now, what is your feeling as you look back in history why the Federal Government has never really done much with accrual accounting, and where are we now, and how would you explain what has happened?

Mr. HUGHES. You and I are about the same generation, so we have had the opportunity over the years to see many changes. The Hoover Commission had made the recommendation, the General Accounting Office had adopted Title II, which required a full accrual accounting system, but it has never been fully implemented in the Federal Government, nor has it been implemented at the State and local level. We use a modified accrual basis of accounting.

At the State and local level, the Governmental Accounting Standards Board has recommended a full accrual set of accounting standards. However, that has hit difficulty in adoption and is now being revisited. It is anticipated at the State and local level that we will have a full accrual, as well as a modified accrual basis of accounting, so we will have dual-purpose financial statements.

That is not necessarily bad. If we look at the private sector, we have a statement of cash-flows as well as a full accrual set of financial statements. For some reason in the public sector we have always said we need either a statement of cash-flows or the full accrual set of financial standards accounting standards. And in the private sector we use both.

Why don't we attempt to do it in the public sector? I am not advocating that we abandon a statement relative to the cash-flows. It does give useful information. But in addition to that, we do need the statement of standards on a full accrual basis so we can ensure that the services that we use today, the cost of those services are not passed on to future generations. For whatever reason, it has not been adopted at the national level. Through your efforts, hopefully, it will be accomplished.

Mr. HORN. What was the basic reason it wasn't adopted? Was it a political reason; was it just organizational lethargy? What was it?

Mr. HUGHES. Whenever you move to a full accrual basis of accounting—let me just give you the experience that we are encountering at the State and local level. As soon as we adopt a full accrual statement basis of accounting, the fund balance is impacted because we at that point recognize extensive liabilities that are not recognized in the financial statements at this point in time. The fund balance is what is available to the State and local governments for future appropriations.

So if at one fell swoop we record those liabilities that we have, but have not recognized on the financial statements, we, to a large extent, eliminate the fund balance that we have available.

So politically it is not very encouraging to the political bodies to go ahead and wipe out the fund balance and eliminate their leverage that they have for implementing those areas where they feel they might have the most need.

Mr. HORN. Is it a matter that you feel the political areas just don't want to scare the constituents with the extent of what this program is all about and let's just hide the cash cow in there with taxes bringing in revenue every year? Let's just spend it out every year and think we are only dealing in fiscal years?

As you all know, we have trillions of dollars in unfunded liabilities. We talk about dividing the national debt among our grandchildren. Let them try to divide the trillions and trillions of unfunded liabilities with our grandchildren, then we will really know what life is like.

Mr. HUGHES. They have deliberated that in the area of social insurance programs. What do you do to recognize the liability associated with social insurance programs?

Mr. HORN. Would you say any of our social insurance programs are actuarily putting money away during the working years for possible use in the retirement years?

Mr. HUGHES. That's right. Not to the degree that they should. I am 62 this year and so fortunate enough to hit the age when I am eligible for Social Security payments. There is nothing on the financial statements that say there is a liability set aside to recognize that liability for any services I might have provided during my lifetime.

I am also a retired military. There is nothing—there is no liability on the books to recognize that the services I performed in the past for the Government are recognized in the financial statement. So we have tended to ignore those liabilities even though they are real. There is a day of reckoning.

When I start drawing Social Security—I am already drawing my military retirement—and so it is on a pay-as-you-go basis. Consequently, at some point in time that catches up with you, and our children and grandchildren have the obligation to repay those debts for the services—we have lived very well during our lifetime. So there is a sense of guilt associated with that because we know that our children and grandchildren will not be as fortunate.

Mr. HORN. In your standard-of-living criteria as I listen to you, it is primarily economic criteria you are looking at. How about looking at psychological criteria? Would this be legitimate when you are determining what the standard of living is? How do you feel?

Mr. HUGHES. The difficulty there, of course, is establishing a surrogate to measure that psychological——

Mr. HORN. Well, you go out and ask them, just as a market surveyor would do, and you can get an intensive factor on the scale. You can sort of isolate where did they feel they were if you want to have a continuing panel to start. Treat them like they did the Termin kids 60 years ago as followup, a feeling of life in general. Wouldn't that be as good as most economic models?

Mr. HUGHES. My background being accounting, we tend to deal with hard numbers a little bit more extensively and like to have those numbers a little more auditable. It would be very difficult for somebody like me to support the soft numbers, if you will.

Mr. HORN. So you seem to be against an I-feel-your-pain index. That is what politicians do. We look at the 1980 election. Do you feel you are better off if you vote for the incumbent, but if not, vote for the challenger? People say, yes, both of us are working now. We are working. As the one lady said when the President said, "I have created millions of new jobs," and, "yeah, I hold three of them;" that is the way our economy is.

Mr. HUGHES. I would like to say that some of the other national governments have moved forward in this area, of course. New Zealand, Australia have adopted a full accrual basis of accounting. I would not necessarily recommend that we duplicate their effort. I think the work of the Federal Accounting Standards Advisory Board has been exemplary in that area. And they have recommended a set of financial statements that I think will be very beneficial.

If we look at the European Union and their convergent ratios that they use to be able to join the European Union, we find that the ratio of debt to gross domestic product should be no more than 60 percent. Our debt exceeds that level, as does——

Mr. HORN. How do we get the magic number of 60 percent? I listen to the people that are constantly trying to tell us—and this has been going on for 40 years. It is not recent, but it gets more recent when you try to pin somebody for the responsibility—that, gee, what are you worried about? This budget is only X percent of GNP. In other words, go back to bed and quit bothering us, when you raise the question of how you pay for it.

So our happy folks that like running up the national debt, they just say don't worry about it, just this percent of GNP. And look at Europeans. They have a higher percent of GNP in some areas. We all know during the Second World War we had a tremendously high percentage of GNP, and the same in the Civil War. Should that bother us if we have a high percent or low percent of GNP? Is it even a legitimate index, that is what I want to know?

Mr. HUGHES. Nobody knows at this point. A number of European member countries have adopted it as a target. In the analysis that I do with the Office of Economic Cooperation and Development, which is headquartered in Paris, almost all the countries have a debt to GNP ratio less than 60 percent.

Mr. HORN. What I am curious about as one who did study economics and accounting in relation to economics, which I found a very intriguing type of course to take, when you get to 61 percent of GNP, what happens? I mean, do drums start beating, does lightning come down and hit you if it doesn't happen at 61? What happens when you get to 62 percent of GNP or 58 percent? So that is what I am asking. They come up with these things simply because they can count them, unless they can tell me what the effect on the rest of the economy and the stock market is.

Mr. HUGHES. It is only a target ratio. You need to have some indicator. As for the private sector, our current asset to current liability—our current ratio should be at approximately 2 to 1. If you don't have a 2 to 1 ratio, are you bankrupt? No. It is the ideal ratio we typically deal with in the classroom.

Mr. HORN. We deal with a lot of things in the classroom, but I mean are they—there are some probabilities of behavior when this ratio gets skewed one way or the other. When do we worry? Unemployment, we can know. When do we worry?

The old story is if you are unemployed, it is a depression; if I am not unemployed, it is a recession. You sure know when people do feel pain and people have no longer purchasing power, and where we had one-third of the Nation that was unemployed in the early 1930's, we didn't really figure a way out of it.

The Second World War was our way out of it. I think every economist or historian and political scientist would probably agree with that statement. The question I am looking at is, "What guidance does government get out of some of these ratios to indicate that we should do something different?"

We sort of have a concept based on the family or the firm or whatever, that it is wrong to have all this debt hanging over our grandchildren, great-grandchildren, great-great-grandchildren. We will maybe try to reduce it by a trillion or two. That is why I am curious when these formulas come up; are they really worth anything?

Mr. HUGHES. That is why I am advocating a statement of fiscal health so we can establish some target ratios we can work toward. Maybe 60 percent is wrong. Maybe it should be 40 percent. Maybe it should be 80 percent, but at least it is a target number out there.

Mr. HORN. It is a target, but again, I don't see what we are doing that has changed. I see more value, frankly, in a psychological survey of unhappiness, and you could have jobs all around you, and if some people are unhappy, their behavior is going to change politically certainly because they are unhappy. And I think we are not looking at some of the factors such as the stress on a family when both people are working or the whole family is working, all the little kids, something out of Dickens, in a way, where all the little kids are out in a sweatshop. That would concern me a lot more than some of these percentages-of-debt ratio to GNP.

I don't even know if we have got GNP too well-organized except we have done it, and we think we have something that tells us, gee, when this sector is going up and when the other is going down maybe.

So anyhow, I think you have made a very interesting presentation, and I agree with you on accrual accounting, and I think it would be wise if we slowly moved there first. We have got to get them to do a balance sheet, and 1997 is the target, as you know, for the Chief Financial Officer to do that. We know the Pentagon can't make it and the IRS can't make it. The first Secretary never bit the bullet. Sad, but nobody seems to have bit it either since.

Mr. HUGHES. I appreciate the opportunity to appear before the subcommittee, and if there is anything we can do to help you achieve your objectives, we would be more than happy to do so.

Mr. HORN. You have been helpful to us, and we appreciate that help, and we thank you for coming.

Now, we will proceed with panel three. We have Morgan Kinghorn, Jr., director of Coopers and Lybrand Consulting; Ms. Diane Dudley, partner of the federal practice of KPMG Peat Marwick, accompanied by Richard Roberts, a partner with KPMG Peat Marwick. If you would rise and raise your right hands.

[Witnesses sworn.]

STATEMENTS OF C. MORGAN KINGHORN, JR., DIRECTOR, COOPERS AND LYBRAND CONSULTING; AND DIANE DUDLEY, PARTNER, FEDERAL PRACTICE, KPMG PEAT MARWICK LLP, ACCOMPANIED BY RICHARD ROBERTS, PARTNER, KPMG PEAT MARWICK LLP

Mr. KINGHORN. I believe, as I think everyone on this panel does, and as the discussions I have heard, that it is time for fundamental reform in our budgeting processes. This morning I would like to contain my remarks to three key elements of budget and financial management reform.

One is changing the structure of the information that we get out of both those processes; second, leveraging the existing improvements that have been made primarily in financial management and bringing those improvements to the entire budgetary process; and third, linking financial and budgetary information more closely to the core operations of the agencies you have oversight for.

First, one of our managers recently took a tour of the Pentagon with relatives, and what he recalled to me was that the tour guide basically discussed the miles of hallways, the number of people working in the building, the number of computers, the magnitude of paper used, the number of Xerox machines, all in an attempt to describe what was going on in the Pentagon, but obviously there would have been more going on in the Pentagon. These descriptions were inputs on the things we use to accomplish work, and that tour could be anywhere. It could have been anywhere in the IRS. Where I worked, you'd get a similar story if you wanted to visit. What does this have to do with financial management reform? I think it has a lot to do with it. If you read the President's budget, any President's budget, it is like a tour of the Pentagon. It contains exactly the same kind of descriptions.

There are class descriptions for people: One for equipment, one for hallways and offices, one for rent, one for furniture, another one for travel, and there are hundreds of these object and subject classes, and essentially that is what the Federal Government's budget is based on, hundreds of inputs which after you leave the building, it doesn't tell you much about what is going on in the building.

Further——

Mr. HORN. I want to interject that you are absolutely correct. That has been the scourge of congressional budgeting for 100 years, and I have got to tell you, when I was doing my book on the Senate Committee on the Appropriations back in the 1960's, some of the old-timers on the committee had been around in the 1930's.

One of the great leaders of the Second World War, who has never really had a decent biography, was the head of the services of supply for the whole Army, which was most of where the war was being conducted. And he was a young major at Fort Myer, and had to come up and testify before a congressional committee.

As he told the story himself, he said he knew how many nails were in the project, he knew how many boards, he knew how many acres and everything else, so he goes into this typical House Appropriations Subcommittee, just fill them with all these facts of the nails, the boards and so forth, and finally one of the old members of the committee looked at him and said, "Why are we doing it?"

And the major was absolutely stunned. No one had ever told him why they were doing it, and there he was. He had mastered it.

And I remember the Subcommittee on State Justice, I testified before it 30 years ago as head of a Federal agency part-time, and that is all they asked you. That is all they cared about. They didn't really care are we getting results, are we doing what the goal did, but that has been the culture, in a sense, that we have had on the House side. Now we are trying to change that, and you are going to help us do that, so continue.

Mr. KINGHORN. You have just stolen my statement here. I believe we must change how we deal with budgets in this way and base their presentation and their formulation much more importantly on the underlying business processes, not the inputs, not the object classes, and draw relationships of those processes within the organizations to products or services to be delivered to the citizens. This will allow you and others, including the agencies themselves, to make choices on investment or disinvestment based on the quality or timeliness of a particular product.

The current budgetary structure has little to do with effect of the budget structure. It has lost contact with the organization which it supports, and I think for the last several years the pace of this disassociation has only been growing. Budgets today are not only dead on arrival, they are dead on type of formulation, and there are informal investigations going on in agencies trying to formulate budgets with an end product that is not particularly useful.

The second point I wanted to make is try to—things have been done in the financial management arena, bringing them more related to budgetary structure. I believe the statutory authorities and administrative initiatives that could be enacted could bring a more consolidated framework that ties better financial management in budgetary managements. For example, of the ones in the United States that have just been passed, all of them have one element for performances of measurement. It is confusing. There needs to be a single framework. You could bring those frameworks together in a consolidated fashion.

The bottom line of all this should be to integrate more effective financial management there to do environmental protection. I think the first plans and objectives—much of this is going to really be an agreement between the executive and the legislative branches ahead of time, at least on the overall framework. You are never going to get an agreement on everything, but hopefully most of it.

Second, you then develop performance measures, strategic plans that were going on in the field, not just at national offices. You find the tactical means to do it, and finally you tie all that together with really holding people accountable. And you cannot have performance-based budgeting unless you have such a framework.

Finally, linking agencies to budgetary and financial management, that worked in the Federal Government. You heard about the compliance, about the time that budgets take, and that can be the glue that holds it together.

However, now budgets do not link to basic program operations. I lived through zero-based budgeting, as many people in this room probably did. It was an interesting concept because it did get management to focus on the cost of their programs for the first time. I was at EPA at the time.

Program managers finally realized that there was something that went into their programs, and that was money. It didn't last when the flavor of the month went away, so they published the first manager cost accounting standards ever for the Federal Government. They were designed to link in a very simple direct way to program operations.

One of them suggested approaches, and in what I believe should have been a recommended approach would be an organization to use basically a relatively new technique called activity-based management. First, understand their business processes, and once you do that—and most managers, including myself, did not understand our business processes. From there you can build your strategic objectives, your measurements, and then hold yourself to the table.

Bottom line is whatever we do to make better, stricter financial managements, we need to focus on improved information. Anything you can do in terms of systems or financial statements is going to help unless the underlying issues associated with getting rid of the traditional way of presenting budgets is ended.

Last year a CFO officer and program manager did a study on how well the CFO Act was being implemented. We started a major investment to publish a book this fall on the CFO Act and really the role of financial managers. One thing is clear from everything we have done in both instances is that the financial manager wants and needs to be at the table and bring in more strategic chiefs or the agency heads. I really do believe the continued interest of this subcommittee and the interest of the Appropriations Committees will bring about that transformation.

If you mention the word "accounting," as we have done today, the program managers run for the doors. Most analysts spend 70 percent of their time collecting data and 30 percent analyzing how would we all benefit if those percentages were reserved. The Federal manager is now able, partially with your help and request. What does he bring to that table? The same budget process innovation to provide you and the agency more information to make in-depth decisions.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Kinghorn follows:]

Mr. Chairman and Members of the Subcommittee:

I am C. Morgan Kinghorn, a Director with Coopers & Lybrand Consulting in McLean, Virginia. I am honored to appear again before the Committee, this time on the critical issue of budget and financial management reform. Prior to my joining Coopers & Lybrand last August, I was a public servant in the Federal government for over 25 years with all of my experience in budgeting and financial management. Like the disjointed business processes of most organizations that develop over time, the multitude of budget and financial management statutes have been piecemealed for years. I believe that it is time for fundamental reform of our budgeting processes and a time for leveraging that reform with the excellent transformations already occurring in financial management.

This afternoon I would like to contain my remarks to three key elements of budget and financial management reform:

(1) changing the structure of financial and budgetary information and reporting;

(2) leveraging the existing financial and budgetary statutes into a more comprehensive and useful structure; and

(3) linking financial and budgetary information to core operations.

Changing the Structure of Budgetary and Financial Management Information

One of our managers recently took a tour of the Pentagon with some relatives. What he recalls was the speech that the tour guide gave in which he discussed the miles of hallways, the number of people working in the building, the amount and kind of building materials used in construction, the electricity usage, the number of offices, the number of computers -- all in an attempt to describe the unique size and character of the building. These descriptions describe inputs -- the things that we use to accomplish work. And the tour could be in just about any building in this City.

But what does this have to do with financial and budgetary reform. Unfortunately, I believe a great deal. Reading the President's Budget is like a tour of the Pentagon. It contains exactly the same kind of descriptions -- as do the congressional budget justifications: object class inputs: one for people; one for the cost of hallways and offices; another for office furniture; another for travel; another for equipment, including computers.

Furthermore, when Congress reacts to budgets and makes reductions what do we generally do: we again focus on inputs: a 10% across the board cut on travel; or a 5% reduction in FTE. This is financial management by amputation.

I believe we must change how we deal with budgets and base their presentation on the underlying business processes and the relationship of those processes within organizations to products or services that are delivered to a customer on the part of an organization or to a citizen, your constituency. This will allow choices to invest or disinvest in programs to be based on the impact to the customer because there will be an understanding of what drives costs and related inputs associated with particular products or services. Short of outright elimination of entire organizations, which generally does not occur in this town, this approach will permit organizations and their oversight and appropriators to focus on strategic elements of their operations in terms of effectiveness, efficiency, and value.

In addition, the current budgetary structure often has little to do with how agencies are operating day to day. In effect, the budgetary structure has lost contact with the organizations it should reflect and the pace of this disassociation is gaining speed. Today, budgets are not only dead on arrival they are dead at the time of formulation. We have organizations whose business horizons are multi-year who do not even have budgets for the current year baselined. We need to get more out of the budgetary process than presentation fodder for OMB or the Congress. The budgetary process must become a more integral means to improve and change core business operations. Many, if not most agencies portray their budgets both to OMB as well as the Congress in formats that are often different and have little connection any longer to the actual way the organizations are being restructured or managed. If the budget and financial information structures do not represent current reality than how is anyone to hold the organizations accountable for what commitments were made.

Leveraging the Existing Financial and Budgetary Statutes into a more Comprehensive and Useful Structure

As the Chairman and Members of this Subcommittee are well aware, there has been an entirely new financial management framework created in only the last five years. The CFO Act, GPRA, GMRA all provide needed "cover" and support for leadership in financial and budgetary management. They are additive, however, to other operational requirements for internal controls, stewardship reports, element of the National Performance Review, as well as performance agreements between the President and many Departments.

As an individual who has spent his entire career in financial management, I welcomed these statutes and administrative directives. But at some point a blessing can become a curse. I believe these statutory authorities and administrative initiatives need to be put into a consolidated framework that can assist in preventing duplicate effort. Furthermore, a new comprehensive approach will help ensure improvements are implemented more effectively. For example, each of these statutes has a requirement for performance measurement; there only needs to be a single performance framework. The bottom line should be to integrate more effectively financial management into the basic program operations of public entities:

- a focus first on the development of strategic plans and objectives that are agreed upon between the executive and legislative branches; while it is likely impossible to reach agreement on all strategic objectives, it is critical to have concensus on most of them;
- the development of performance measures that link those strategic plans and objectives to tactical day-to-day operations; we do need to focus on more strategic outcomes (how many college graduates are gainly employed five years after graduation -- not just how much grant or loans money is given out) but we also need to have tactical measures linked to operations in the field;
- and the accountability for achieving those objectives based on the measurement of the outcomes promised for delivery. We need primarily a reward system for those organizations attempting to pull this all together.

There are many organizations that have successfully begun to use this management framework: The Patent and Trademark Office; Customs; Internal Revenue Service; Social Security Administration; the General Services Administration. We need to construct a comprehensive statutory support framework that ties these existing financial and budgetary initiatives into a more comprehensive approach that is linked to the core operations of Federal departments and bureaus.

Linking Financial and Budgetary Information to Core Operations

Agencies continue to invest heavily in budgetary and financial management processes. Anyone who has worked in the Federal government has heard the complaints about the budget process and how long it takes, how much work it involves, and the relatively small payoff it has over the long run. The real fact is that the budget process of an organization is the glue that holds organizations together. However, those processes do not link budgetary and financial information to the core operations -- program operations -- of most federal organizations.

Zero-based budgeting, a process whose intensity helped give me gray hair as well as forced me to begin taking blood pressure medication some eighteen years ago, did have one important result: program managers learned about budgets and some of the costs of their programs. It was the first time that I had seen program managers working hard at understanding a simple fact that their program operations were supported by a variety of inputs -- tax dollars. Unfortunately, the costs of ZBB were very high for very short term payoffs. Its essential problem was that it still focused on inputs and focused attention on the artificial dividing of those inputs into a variety of program levels. It had no lasting value because it did not provide information to program managers that helped them change how they did their business. When the "flavor of the month" went away, nothing was left in it place.

The Federal Accounting Standards Board last year published the first managerial cost accounting standards ever for the Federal Government. These were designed to link financial information directly to program operations through an understanding of the full costs of program operations. One of the suggested approaches -- and I believe the recommended approach - would be for organizations to use a relatively new technique to the public sector called activity based management.

Activity based management requires program managers to first understand their own business processes. This is a fundamental issue and one that surprises program manages themselves: they often do not know why many of their business processes were created. In fact, like many of the financial and budgetary statutes over the last 75 years, many program business processes were created piecemeal to resolve an issue of the day or year. Managers must then define their products and services which are a result of those business processes and then array full costs to those processes in relationship to product and services.

They must also then determine the "drivers" of those costs -- ie., why are costs incurred and how can those costs be influenced. Such a process can provide full costs, information on the value added of individual business processes, and the time it takes public officials to deliver a product or service. Most important, instead of focusing on inputs, program managers, OMB, Members of Congress can begin asking questions about the full cost of a business process, the time it takes an organization to deliver a service to a citizen, and the value added of those business processes to customers.

And program managers, using the same financial information, have more than input data: they know which processes work well, which work less well; they know what drives their costs and they can then begin to take action to reduce cost through reduction in non-value added work or investing in technology that will reduce high cost processes where appropriate. Instead of everyone focusing on the numbers of people working in an organization; or the travel dollars; or equipment money we could focus on key elements of cost, the time it takes to deliver a product. For example:

- the value added of the business processes that the IRS uses to deliver an installment agreement requested by a taxpayer;

- the time it takes for Social Security Administration to respond to an inquiry;

- the cycle time of an FDA process to review a drug for approval to sell.

new drug.

So, I believe as part of the new financial management framework we need to ensure that there is a better linking of financial information that we are generating through all these new statutes to program operations. The following chart shows how this approach can help transform the nature of information.

Traditional vs. Process View of Cost

Object Class View
Budget Reports Branch

Salaries & Benefits	$1,242,044
Travel Expenses	3,349
Space Rental & Phones	131,448
Printing & Reproduction	92,684
Contractual Services	600
Training	6,045
Health Units	2,818
Supplies	841
Equipment	1,319
Total	$1,481,148

Process View
Budget Reports Branch

Compile Agency Data (2108)	$50,906
Perform File/System Admin.	204,542
Verify STAR Data	144,862
Create MTS Camera Copy	66,535
Print & Distribute MTS	102,405
Prepare Treasury 2108	19,818
AR Appendix Camera Copy	92,378
Print & Distribute AR Appendix	1,215
Create AR Camera Copy	14,121
Print & Distribute AR copies	13,457
Manage Human Resources	102,920
Perform Admin. Functions	89,874
Attend Training	23,154
Perform Special Projects	358,537
Perform Agency Reporting	178,493
Provide Training	21,913
Total	$1,481,148

Conclusions

The bottom-line is that whatever we do to better structure financial management we need to focus on improved information, its use by program officials, a strategic structure to frame performance measurement, and a reward system that is just that: rewards those who try and sometimes succeed to develop performance measurement and provide useful financial management information by which we can all make more informed choices about public programs. Last year, Coopers & Lybrand in conjunction with the Association of Government Accountants, completed a major survey of Chief Financial Officers, Inspectors General and program managers that dealt with the advantages and disadvantages of the CFO Act's implementation. Just recently, we have held extensive interviews with many CFO's and focus groups with a number of Deputy CFOs and financial managers throughout the government. Our firm will be publishing a major book this fall on the evolving role of the financial manager in helping to manage the public purse: one thing is very clear from all of these inputs -- that the financial manager wants and needs to bring a more strategic presence in supporting their Secretaries, their Bureau Chiefs, or the Agency Heads. The continued interest of this Subcommittee and an expansion of that interest to members of Appropriations Committees will be essential in continuing to bring about this transformation. Today, if you mention the word "accounting" or financial management, most program managers snicker. Most analysts spend 70% of their time collecting data, and 30% analyzing it. How would we all benefit if those percentages were reversed? The Federal financial manager is now at the table: the question is, what does she bring to that table? The same old tired budget processes or reforms that will help change how government operates. To the extent this Subcommittee can help arm those financial leaders with more consistent and focused tools and authorities we can get on with actually using all the financial and budgetary data that we produce.

Thank you Mr. Chairman for the opportunity to appear before you this afternoon.

Mr. HORN. We thank you, Mr. Kinghorn. You have been a great help to this subcommittee, and we appreciate your volunteer service of getting a lot of people together with our staff to educate us in some of the things that are going on.

One of the things that has always concerned me as an executive, for almost two decades I had to run a large organization. I tried to get from the very beginning the analytical group that one could monitor to see if progress was made, and it seems to me, one, I have had experience with a number of Federal agencies on a part-time basis. They were more likely to pick something they could count because it had numbers, had quantity, and you could see if it is here and the pile is this high or that high. That bothered me because it had nothing to do with what we are trying to accomplish.

How do we get agency people, and what can consulting firms do with the sort of model-type of basic questions? Because there are some things we need to ask of every human organization. There are others we need to tailor what we ask, obviously, with regard to whatever that mission is of that organization.

What do you see happening there? Are we coming up with some basis units that we ought to measure as to the success of the organization? I realize you cannot do that without the goals being the ones you look at. How close are we to achieving our goals?

Mr. KINGHORN. I think there are two views on that. One is I think there are some excellent measures you can use. I am very strong in activity-based management because I saw how it can work. How long does it take that organization to deliver a particular product to their customer? You can, if you wish to compare the same kinds of businesses like Veterans Affairs and Defense hospitals; you can begin to use that cycle time under similar kinds of delivery of products to compare.

I think you can certainly use it to compare inside and see if they are basically responsive to the customer. That is another consistent factor you can get with activity-based management, the value added to the customer, if you look at your business process and measure it.

And, finally, cost those three kinds of things that can be consistent with all agencies. After that, you look at your business processes, which do become unique. You have both the value of the comparative information outside and a great deal of information internally to measure the quality of that business process.

Mr. HORN. One of the things that I just spent the morning in another committee working it over with your ex-agency, the IRS——

Mr. KINGHORN. I am glad to be here today.

Mr. HORN [continuing]. Is on the debt they haven't collected. The first thing got my ire up, was they said we have $100 billion in debt that we can't collect. Well, the question was did you ever try, and so forth and so on. Do you have any words of wisdom of measuring tools we ought to have there other than did you collect the debt or didn't you?

Mr. KINGHORN. Actually, we began to implement it in the western-based region, primarily, in the IRS. We looked at an installment agreement, and we worked with the program staff in the western region and found out very simply it is not just IRS. The cycle time for citizens to get an installment agreement, which is something we presume they want—they are not able to pay full tax. Let's do an installment, and we all agree to it, and it took an inordinate amount of time.

Mr. HORN. How inordinate?

Mr. KINGHORN. Try on an average a year.

Mr. HORN. A year.

Mr. KINGHORN. Most of that time the ABM system told them it was in the coup—maybe the tax.

One of the things they began to do was come up with some recommendations. In effect, to eliminate a lot of what is very concrete. It is real to the program office. They are the ones who came up with the recommendation. They also, through the efforts of installment agreements, full costs, not just partial costs, they know the full cost of installment, agree that kind of information can be developed. The question is their incentive. Under the current structure of government, for people to use, it takes a risk to use it, then be rewarded. When do you use it?

Mr. HORN. In the debt collection bill I put in, it will be part of the omnibus appropriations bill. We have a reward to the agency of 5 percent or so, which they can spend on new computers or whatever it is to help in debt collection, because I think it is a national scandal. And now people are talking about $200 billion in Government generally uncollected, most of which is IRS. If you don't move in fast on these, pretty soon people say, who did you say I owed that debt to?

Mr. KINGHORN. Time is the essential factor.

Mr. HORN. Right. That is why we are trying to get them to use private debt collectors. Let the Government have a crack at it for 30 days. If you can't do it, let's get people who are professionals in the field.

Well, that is very helpful testimony.

Mr. HORN. We now have Diane Dudley, accompanied by Richard Roberts, both of KPMG Peat Marwick.

Welcome, and please go ahead.

Ms. DUDLEY. Good morning, Mr. Chairman. I am Diane Dudley. With me is Richard Roberts. We are partners at KPMG Peat Marwick, a global accounting and management consulting firm. We do a significant amount of audit and consulting work with Federal agencies. Thank you for providing us the opportunity to appear before your subcommittee to discuss Federal financial management.

Considerable progress has recently been made, largely as a result of the CFO Act, the Government Performance and Results Act, and the Government Management Reform Act. However, more is yet to be done to realize the results promised by this existing legislation, such as informed decisionmaking, performance and accountability.

We believe the legislative foundation is sound, and the strategy is appropriate. It is the implementation of the existing financial management requirements that needs attention. We see an enormous amount of energy being spent on tracking and reporting data and feeding it into systems, but it is rare to hear financial managers say that these reports are being relied on to actually manage the agency's business, let alone achieve desired results.

We recommend four areas of highest impact for this subcommittee's attention. First, Congress and financial managers need to receive and use meaningful financial information. With full implementation of the CFO Act, GPRA and GMRA, the Federal Government will be preparing financial statements, strategic plans, performance reports and accountability reports.

Taken together, these reports are intended to communicate successes and progress in achieving the results Congress intended when budget authority was provided. The Authorizing and Appropriations Committees should ask for these audited financial statements and performance reports and then use them when establishing each agency's budget.

Financial statements and performance reports are valuable and worthwhile efforts; however, the current reports do not present information particularly useful to program managers. They need timely data at the program level to monitor progress and manage for results. Then program managers must be able to analyze and use that financial data to make better program decisions. The current budget process and prior legislation focused financial management on ensuring spending within appropriation limits. Therefore, agencies maintain two separate and often uncoordinated accounting and reporting processes, one to track budget execution and another to present accrual-basis financial statements.

Unfortunately, appropriations often do not directly correlate with agency management structures or programs. Nevertheless, the information for the budgetary accounting system is often the only information that agency heads and program managers actually use to determine the financial status of their operations.

The usefulness of financial information for program management will only be improved when there is a direct link between financial statements and the budgeting reports. This will require aligning the budget accounts that provide resources for programs with the accounting and reporting in those programs and training program managers in how to analyze financial, not just budget, data.

Our second recommendation is to continue emphasizing the CFO function. Reduced budgets and downsizing have put tremendous pressures on the resources allocated to financial management functions. As agency financial managers implement existing legislation, they will need to continue to build more effective financial organizations with the strong leadership needed to produce reliable information and measure the cost of providing services.

Many financial managers below the CFO do not have the requisite skills in financial accounting principles or financial appropriation. Training as a means of leveraging experienced financial managers will be more important than ever. Such training must be done right. KPMG has learned from experience that training must be focused, pertinent and timely.

But training can only accomplish so much. Financial management requires a level of sophistication that may not exist in the Federal Government. So hiring from the outside will be needed in many agencies. Congress can help strengthen Federal financial management through continued emphasis on the role of financial management operations and funding for qualified personnel and training.

Third, investments must continue to be made in ADP systems that support improved financial management. The Federal Government has been investing heavily in updating and replacing its principal core financial systems. Accelerating this momentum is critical to overall improved financial management. Implementing systems requires significant effort and funding, and it is difficult to maintain this focus with agency reorganizations, work force downsizing and budget reductions. In addition, the systems implementation cycle is too long. Many current system efforts require 5 or more years from inception to completion. Long implementation periods typically result in systems that are antiquated from the start.

One way to obtain systems faster is to increase the use of outsourcing. This can be accomplished through shared systems, cross-servicing and outsourcing through the private sector. For example, the Small Business Administration contracts with Treasury FMS for its accounting system. And on a larger scale, the U.S. Department of Defense provides numerous successful examples of cross-servicing outsourcing and centers of excellence to deploy critical expertise. Off-the-shelf software solutions are also available and should be continued to be emphasized.

Finally, reporting requirements need to be consolidated. Congress must consider what can be done to simplify existing reporting requirements and guidance and relieve the perceived and often real problem of too much reporting and compliance responsibility with too few good financial managers in place. In this regard, we commend the subcommittee on its efforts to draft the Omnibus Budget Act. This, among other things, would simplify and consolidate reporting.

Combining the various reporting requirements into a single report product like the accountability report that OMB is currently piloting at six agencies would be a good way to communicate financial results. The accountability report will show the degree to which an agency has met its goals and at what cost.

In closing, we believe that the financial management strategy Congress has set forth through legislation is sound and that overall progress is being made.

The focus moving forward should be on implementation, getting results and adding value.

[The prepared statement of Ms. Dudley follows:]

Testimony
Ms. Diane Dudley
Partner, Federal Practice
KPMG Peat Marwick LLP
Before the U.S. House of Representatives
Committee on Government Reform and Oversight's
Subcommittee on Government Management, Information and Technology
April 25, 1996

Opening remarks.

Good afternoon Mr. Chairman and members of the subcommittee. I am Diane Dudley; with me is Richard Roberts. We are partners at KPMG Peat Marwick LLP (KPMG). My 15 years of experience includes 7 years auditing federal agencies and organizations. Mr. Roberts' experience includes 17 years providing financial management consulting support to federal agencies.

Thank you for providing us the opportunity to appear before this Subcommittee to discuss federal financial management. Eight years ago, our firm provided testimony on this issue, and included several recommendations on how to improve financial management within the federal government. Considerable progress has been made since that time in ways that are consistent with many of our recommendations. For example, Congress passed the CFO Act that established clear accountability for government-wide and agency-level financial leadership, emphasized the importance of effective financial systems, and established requirements for audited financial statements. Such recent legislation as the Government Performance and Results Act of 1993 (GPRA) and the Government Management Reform Act of 1994 (GMRA) further challenge agency managers to use financial management to improve performance by linking financial results and data much more clearly to program objectives.

We applaud these initiatives and believe they have set the federal government in the right direction on the path toward meaningful improvements in financial management. However, more is yet to be accomplished if Congress and the American public expect to realize the results promised by existing legislation.

As Congress moves forward, it must ensure that achieving the key outcomes of effective federal financial management—informed decision making, performance, and accountability — are emphasized, rather than simply compliance with processes and requirements. To accomplish this, it is critical to align budgets, programs, and reporting; continue investments in technology and training; and make sure the information is used effectively. We are not here to recommend far-reaching, expensive alternatives to what currently exists. Instead, we believe the legislative foundation is sound and the strategy is appropriate. It is the implementation of the existing financial management requirements that needs attention.

Managers' greatest need, regardless of their businesses or activities, is for information—information with which to make informed and supported decisions that affect their management of people, operations, and programs. We see an enormous amount of energy being spent on tracking and reporting data, and feeding it into systems that are producing reports required by and for oversight functions. But, it is rare to hear federal managers say that these reports are being relied upon to actually manage the agency's business, let alone achieve desirable outcomes. If the current government financial management infrastructure is not satisfying this basic need, we must examine the existing process and the legislative requirements that drive it.

We believe there are many things that can be done to continue the momentum and build on the progress being made. We recommend four areas of highest impact for the Subcommittee's consideration:

- Federal managers must have, and know how to use, financial information as part of their decision-making process. This will require aligning the budget accounts, that provide resources for programs, with the accounting and reporting of those programs, and training program managers in how to analyze financial, not just budget, data.

- Congress and federal agencies must continue emphasizing the CFO and the financial management function. This includes continued funding for staffing and specialized training in federal accounting and reporting.

- Investments must continue to be made in the systems that support improved financial management. There is an urgent need for systems with the capabilities to integrate reporting and compliance requirements, as well as decision-useful outputs, throughout the federal government.

- Existing financial management reporting should be consolidated and simplified. This can be done without jeopardizing oversight. In this regard, we commend this Subcommittee on its efforts to draft the Omnibus Budget Act.

Financial managers need to receive and use meaningful financial information. With full implementation of the CFO Act, GPRA, and GMRA, the federal government will be preparing department and government-wide financial statements, strategic plans, performance reports, and accountability reports. Taken together, these reports are intended to communicate successes and/or progress in achieving the results Congress intended when the agencies/programs were established and budget authority provided.

It sounds great—but is all of this required annual reporting really going to help manage programs better? The answer is "no." The current audited financial statements are presented at a level too high to reflect program operations. Program managers need timely data at the program level, in addition to historical financial organization-based information, to monitor progress and manage for results. Financial and performance information that is collected and reported through required systems and processes must provide greater insight to agency operations and assist managers in making better decisions. Therefore, current reporting must be supplemented by program-level reporting that is distributed to managers on a more frequent basis. Then, program managers must be able to analyze and use that financial data to make better program decisions. It is a lack of analysis training, as well as a lack of useful program-level information, that is the largest obstacle to improving management of federal programs

The current budget process and prior accounting and budget legislation focused financial management on ensuring spending within appropriation limits. Therefore, agencies maintain two separate, and often uncoordinated, accounting and reporting processes—one to track budget execution and another to present financial statements that conform primarily to accrual basis accounting concepts. The budget accounting system has been developed over decades and tracks congressionally-approved budget amounts, by appropriation. Unfortunately, appropriations often do not directly correlate with agency management structures or programs. Nevertheless, the information for the budgetary accounting system is often the only information agency heads and program managers actually use to determine the financial status of their operations. Because of the disconnection between appropriations and programs, most federal managers are not using complete financial information that could show the full cost of a program, thereby adversely affecting management decisions.

The usefulness of financial information will only be improved when there is a direct link between financial statements and the budgeting reports. This link will not be feasible until the budget is formulated, enacted, and executed consistent with each agency's organization. Only then will accounting systems be operated to report accounting data consistent with an agency's organizational structure, so agency management can take responsibility for reported information. The basis of reporting may continue to differ between budgetary (essentially the obligation basis) and the accrual basis, but reconciliation will be possible, and reports on both bases can be available for agency and program managers to use. Changes may be needed to both budget and accounting structures, to ensure that all costs attributable to a program are readily identifiable—and identified—with that program.

This is not to say that valuable information is not being obtained from the process used to produce financial statements. A recent survey of government financial managers, program managers, and Inspectors General show consensus that the process of preparation and audit of agency financial statements has been highly useful in highlighting control and process weaknesses, providing realistic assessments of agencies' finances, and improving the usefulness and reliability of financial information. The audit of an agency's financial statements also provides completeness and credibility to other data generated by that agency's information systems, including program information. Audits also help in identifying and disclosing the complete costs of running the government, including providing an early warning of future costs that will require consideration in the budget process.

Overall, the process an agency goes through to get an audited financial statement is a good one, and very similar to what the commercial sector does. The difference lies in the usefulness of the report. In industry, financial data is reported, analyzed, disseminated, and used to evaluate and direct operations organization-wide. Within government, there is a tremendous amount of energy exerted in the reporting and collection process, but little in the analysis—thus minimizing its value and usefulness to the organization as a whole. Financial statements themselves, unless read and understood, do not provide value or direction to the program manager charged with developing budget projections, resource requirements, and eventually, with evaluating the progress of his or her program.

Finally, both the CFO Act and the GPRA address developing and reporting performance measures. It is widely accepted that the use of performance measures increases accountability and improves management for results. However, some agencies have established only general, financial-related performance measures. These agencies have not yet developed measures specific to key programs that could be used to evaluate operational performance. Agencies must determine what programs are expected to accomplish, develop effective means to measure those programs, and pay attention to what the measures are saying.

The task at hand—transforming the government from a compliance-based organization into a performance-based organization—may seem overwhelming. Essential in this process is ensuring that federal managers have meaningful and useful financial information. To this end, we present the following recommendations for your consideration:

- Congress must reexamine both the budget structure and budget basis, in an effort to align budgets, programs, accounting, and financial reporting. A common structure and timing for budgeting, reporting, and performance measurement, that is meaningful at the program level, must be developed and implemented.

- The Authorizing and Appropriations Committees should ask for audited financial statements and performance reports, and use them when establishing each agency's budget.

- Agencies must develop performance measures that show how effective and efficient they are at meeting their objectives. Each agency must establish a manageable number of performance measures specifically relevant to its major programs and reward those who meet or exceed their goals.

- The program management focus must evolve from data collection and manipulation to information analysis. Providing the most complete and comprehensive information to program managers is not an end to the process. It is rather the point at which a manager can begin to react intelligently to the results, understand the reasons behind apparent performance problems or opportunities, and develop strategies for dealing with them. To do this, program managers will need training in financial analysis and performance measurement techniques.

Because analysis techniques are the skills that most program managers currently lack, federal agencies may consider outsourcing the program analysis function. KPMG, for example, has supported the U.S. Department of Defense in program analysis for many years. However, such outsourcing must be done correctly to ensure proper integration of the analytical findings, so that the institutional knowledge is still retained within government. Ultimately, it may be more beneficial to the government to retain these analytical functions and outsource detail-oriented processing of data.

Continue emphasizing the CFO function.

The structure provided by the CFO Act and the heightened awareness of the importance of financial data has helped federal management strengthen general and financial management operations throughout government. For instance, there is now a broader understanding of financial management, more emphasis on improving systems, and increased control consciousness. However, reduced budgets and downsizing have put tremendous pressure on the resources allocated to financial management functions. It is extremely important that Congress continue to emphasize the role of the agency CFO and continue funding financial management operations.

As agency financial managers implement existing legislation, they will need to continue to build more effective financial organizations with the strong leadership needed to produce reliable information and measure the costs of providing services. Agency financial operations must be properly structured and adequately supported to provide the people, processes, and organizational infrastructure necessary for the generation, analysis, and distribution of useful, reliable, and timely financial information and reports.

Effective CFO's need to have authority over budget formulation and systems development as well as accounting and financial reporting. The CFO's scope of authority needs to be increased in a few agencies to include the areas of budgeting and ADP systems. Maintaining a separate budget function enforces the incorrect notion that financial results are less important than budgetary reporting. OMB has reported that some of the agencies with the poorest financial management are the those that have kept the budget function separate from the CFO's responsibilities.

In addition to continuing to strengthen the role of the CFO, federal financial management organizations require experienced accounting and financial reporting managers. Developing and maintaining integrated accounting and financial management systems, as well as preparing reliable and useful reports, requires specialized skills. Many financial managers below the CFO do not have the requisite skills in financial accounting principles or financial statement preparation. Downsizing, retirements, and in some cases, redeployment of financial personnel to program management or systems development positions has resulted in the loss of experienced federal financial managers.

Leveraging experienced financial managers across federal organizations is essential. Training, as a means of accomplishing this, will be more important than ever. The federal government has always recognized the importance of training its people, but may not be providing the right training at the right time. KPMG has learned from experience that training must be: focused on core competencies; a mix of functional (e.g., accounting principles and financial reporting) and industry training (e.g., specific to the agencies' activities); pertinent and timely; and tied to individual responsibilities, performance evaluations, and goal-setting.

The federal government should follow industry's lead in developing "just in time" training and leveraging those who have been trained, to fully benefit from the training resources expended. Once trained, professionals must be given the opportunity to apply their newly acquired skills and knowledge in their daily functions. Current inhibitors to effectively implementing new skills include outdated systems, and supervisors and staff that are unwilling to change old ways.

Training done right can provide the highest payoff to an organization's performance—done wrong, it wastes time and drains resources—not to mention the affect of inadequate training on morale.

But training can only accomplish so much. Federal agencies need a strong cadre of financial management personnel to achieve the results of current legislation. Financial management requires a level of sophistication that may not exist in the federal government, so hiring from the outside will be needed in many agencies.

Congress can help strengthen federal financial management through continued emphasis on the role of financial management operations and funding for qualified personnel, training, and outsourcing initiatives, where necessary.

Capable systems are critical to effective financial management.

The federal government has been investing heavily in updating and replacing its principal core financial systems. Much of this activity has been focused on meeting the requirements published by the Joint Financial Management Improvement Program (JFMIP) and adopted by OMB, and compliance with the CFO Act. To date, many agencies have implemented compliant systems and the federal Standard General Ledger. Effective, modern financial information systems are the enabler, if you will, to collecting, reporting, and disseminating useful information across the organization.

Accelerating the momentum of financial system replacement or modernization is critical to overall improved financial management. There are still a large number of agencies that have not improved their systems. Others are designing or developing systems that may not address the requirements resulting from implementing the program performance reporting called for by GPRA or the accounting methods and reporting specified by new Federal Accounting Standards Advisory Board (FASAB) pronouncements. Some government financial systems are still not capable of producing auditable financial statements.

Despite the need for financial system improvements, several conditions in the current environment work against federal agencies' ability to take advantage of the systems and technology currently available. For example:

- Implementing systems requires significant effort and funding, and it is difficult to maintain this focus with agency reorganization, workforce downsizing, and budget reductions. The leadership and skill base depletion resulting from downsizing and attrition also adversely affects federal agencies' ability to lead or manage systems projects. Smaller agencies are particularly hard hit.

- The cumbersome and complex system of budgetary and proprietary accounting provides a barrier to both efficient system development and to attracting new personnel to maintain them.

- The systems implementation cycle is too long. Many current systems efforts require five or more years from inception to completion. Long implementation periods typically result in systems that are antiquated from the start, increasing the risk of failure and inhibiting the ability to obtain the benefits of rapidly changing technologies. Smaller projects must be deferred until the larger project is completed.

- Agencies must consider how to coordinate implementation of performance reporting required by GMRA with financial reporting. The emphasis on core financial (accounting) systems is required for a solid foundation of fiscal control, reporting, and auditability. However, GPRA will overlay nonfinancial requirements on the new accounting infrastructure. Unless these two components are well integrated, there will likely be substantial duplication of systems, reporting, and effort.

It is clear that improvements need to be made in federal financial management systems and the implementation process. There are many areas that need to be addressed—particularly important, is that systems should be devised and implemented on a more integrated basis. Financial systems improvement efforts must incorporate greater creativity, nimbleness, and flexibility. To avoid duplication of effort and better utilize dwindling resources, financial systems should reach beyond accounting in their scope and incorporate both cost and performance information. In trying to meet budgetary accounting needs, the current model too often overlooks cost and performance needs. Yet, a balanced and integrated approach is essential if management data is to be consistent, reliable, timely, useful, and reconcilable across the entire management spectrum. It is the cost and performance data, if available with analytical tools at operational levels that promises the greatest gains in overall management improvement.

The lead time for acquiring and fielding systems must also be shortened. The system development cycle must include both near-term and long-term objectives and results. By taking this perspective, federal financial management systems will yield faster tangible gains and have a better chance of capitalizing on the rapid advances in technology. The traditional five-year plan should be considered only as the basis for strategy. The plan should require components that are more tactical. The plan should also emphasize both near-term results and use of emerging technologies.

Financial management systems is another area that can benefit from greater use of outsourcing of common functions. As information demand increases and the skill base shrinks, agencies should look for ways to minimize the resources needed to fill their system needs. This can be accomplished through shared systems, cross-servicing, and outsourcing to the private sector. The increased use of outsourcing will relieve agencies of many routine operations and allow them to better focus on mission-specific, specialized operations. This is particularly important for smaller agencies where specialized skill sets are difficult to maintain. For example, the Small Business Administration contracts with the Treasury FMS for its accounting system. On a larger scale, the U.S. Department of Defense provides numerous successful examples of cross-servicing, outsourcing, and centers of excellence, to better deploy critical expertise.

Off-the-shelf solutions should continue to be emphasized, particularly for software, as a cost-effective solution to help agencies obtain new technology. For example, procuring systems from the GSA's FMSS schedule of core software that complies with JFMIP requirements has resulted in millions of dollars of savings by avoiding common requirement programming. The use of off-the-shelf products will enable agencies to reduce overall development and maintenance costs. Then agencies should be able afford more effective expenditures on enhancing systems to meet specialized needs.

Reporting requirements need to be consolidated.

Legislation such as the CFO Act and GPRA and the concepts and accounting principles recommended by the FASAB provide an excellent framework for financial reporting and provide a common goal of managing by results. Existing statutes and standards could provide agencies with information with which they can improve performance versus producing reports simply to comply with legislative requirements.

Consolidation of the reporting requirements in a single document would simplify the often overlapping requirements. Congress must consider what can be done to simplify existing reporting requirements and guidance, and relieve the perceived—and often real—problem of too much reporting and compliance responsibility with too few good financial managers in place. In this regard, we commend this Subcommittee on its efforts to draft the Omnibus Budget Act, that among other things, would simplify and consolidate reporting. For resulting reports to be more useful, the Omnibus Budget Act must also address the budget structure and align budgets with programs. As previously discussed, only then will agencies be able to manage for results.

We agree with the overall streamlining of the reporting concept. Combining the various reporting requirements into a single report product, like the Accountability Report, that OMB is currently piloting at six agencies, would be a good way to communicate financial results. The Accountability Report is intended to show the degree to which an agency met its goals, at what cost, and whether the agency is meeting its mission.

Accountability Reports would be helpful to Congress for allocation decisions and to agencies to understand the need for and to drive organizational and operational change. Simplified reporting would help agencies meet requirements, without jeopardizing the important oversight function. The report would also be helpful to demonstrate the value created through taxpayer funding—the return on the public investment—both tangible and intangible.

Closing remarks.

Overall, progress is being made to improve federal financial management. But the opportunity to do more still exists. We must build on the momentum that recent successes from the CFO Act, GPRA, and GMRA have produced. I leave you with these concluding thoughts:

- The financial management strategy Congress has set forth through legislation and guidance is sound. The focus moving forward should be on implementation—getting results and adding value.
- Achievement of results comes when goals, strategies, and tactics are aligned for informed decision making. Congress must align the requirements and objectives of budgets, accounting, performance measures, and reporting.
- The CFO function and audited financial statements are the enablers for reliable information, controls, and relevant processes.
- Training for program and financial managers must be relevant and timely, and must be able to be put to use without unnecessary constraints.
- The design and development of integrated financial and performance systems must be expedited so that a common reliable data base will serve financial, programmatic, and oversight needs.
- Streamlining required reports will simplify the often overlapping requirements and result in a more informative product.

Mr. HORN. Thank you for that very excellent statement. You both have made very fine statements.

Mr. Roberts, would you like to add anything after listening to all of this?

Mr. ROBERTS. No. I agree with all of it, sir.

Mr. HORN. You agree with it all of it. OK. I think I do, too.

Now, let me put it this way to all three of you: If you could wave your wand, and what your wish was in this area could be gratified, what is the one thing that you would like to have done first that would be significant and make a difference?

Ms. DUDLEY. Well, I guess I will begin to address that question. I think that the most important thing that can be done is to reexamine the budget structure and the budget basis in an effort to align budgets with programs.

Mr. HORN. Now, I have mentioned in several hearings, and I have felt this way for about 30 years since I first looked at it, that when the President pulls together his budget, OMB has essentially five broad-gauge divisions that review it based on programs. A message comes up here, and sometimes the President holds press conferences and all. Roosevelt used to call the press in, and they actually knew what was in his budget. No President since Roosevelt, to my knowledge, can really make that statement. But he would brief them and didn't have anybody around to help him.

But what happens, it comes up here, and we rip the President's unified budget apart. It is not particularly unified except that it goes through one office down there. And we parcel it out to 13 subcommittees, to the Committee on Appropriations, and we do something like it on the Senate side. There is a few differences in jurisdiction between some of the subcommittees and so forth and so on.

So what we have is fragmentation personified. Instead of trying to get a holistic look at the budget as to what the President thinks is the most important thing the executive branch ought to be doing, people elected him to make those decisions, and obviously if he needs our authority to do it, he ought to be asking for it. But the first place is, how does a President get hold of the executive branch? Not that anybody is paying particular attention to running it. I think Eisenhower might have been the last President that really cared about those things. But nevertheless, we have got a President. We have got an executive branch. We are the Congress.

And the question is: How can we work together to solve some of these overwhelming problems that you are describing which really don't turn a lot of people on? You have got to be a real groupie like the people in this room that either wandered in out of the heat or something.

But what do you think on how we might solve that problem of a little unity between the two branches? As we look at a government that comes up from a broad area of government, and obviously if we can agree on the units of measurement, that is one thing that is a real plus.

I have been trying to get OMB and CBO to agree on their economic data assumptions. I don't understand, frankly, why they can't do that. I realize people play political games at both ends of the avenue, but I would just like the professionals to sit down and say, hey, we ought to agree that these are the factors going in here.

Now if you have got another bunch, fine, we will give you your five looney factors, and you will give us your five looney factors, but can't we agree on some basic things that most people that are semiobjective would say, yeah, that is right. That ought to be a measurement of our strength of our economy. That is the one you would pick.

How about you, Mr. Kinghorn?

Mr. KINGHORN. I think I would follow a path similar to what you just mentioned. I mentioned in my testimony in terms of some kind of agreement between Oversight and perhaps Appropriations with the Departments on what their objectives are. And let me give you the EPA as an example, and I know EPA is in difficult times right now, but I spent 10 years of my life there. It probably had 27 authorizing statutes. No one in that agency, including myself, could possibly figure out what was a priority of anything. Every committee had their own priority. There were competing priorities. You cleaned up solid waste, and you fouled up the air. So that is sort of an extreme example.

But most agencies, except a few—Treasury doesn't—have authorizing legislation. And I would see somehow as an agreement, perhaps in a year, but hopefully multiyear, because we would like to do some multiyear work here, there would be an agreement between the executive branch and the appropriate committees at the very high level. I don't think you want to micromanage. But what is EPA? What is IRS, the objectives? I think IRS has some objectives.

And once you formulate that agreement, at least people understand what the target is. And then if you wish to, you can work out, obviously, some more detailed involvement in the outcomes to get to those strategic objectives.

Right now many agencies have a multitude of objectives and they are going to have that, but I think it takes a discussion between the executive branch and Congress. We do it in authorizing legislation, but it is still very disjointed. What is that agency about? What is Customs about? Can we get an agreement on that? And from there build an understanding of the business processes rather than the inputs that you have to manage to get to those objectives. So if you don't get it, you can ask some questions rather than just simply say how many people do you throw at this? Why is your business process not working? Why are you not collecting revenue? What is there in that business process?

Unless you understand that business process fundamentally, you are never going to fix it. You will go back and scream at people and tell them to be more productive in the field. It doesn't work.

Mr. HORN. I think one of the things we could do is try to be helpful on where we are coming from. Not that one Congress can bind another, we can't, but we, in spelling out the purposes for legislation or the goals, ought to be a little more precise. What do we mean by that? Usually this is wonderful, colorful preamble stuff that wants to make people cry and weep and start marching along, and, you know, storm-the-Bastille-type language.

Mr. KINGHORN. That's because it is always a compromise. But I don't think we can afford to have generic preambles to legislation anymore. I really don't.

Mr. HORN. Right. And we need to really get more specific. The Poverty Program of 1965 is a good example, where you tried to talk about how do you target an area, and what are the evidence of success? Some was a success. Some wasn't.

Mr. KINGHORN. Correct.

Mr. HORN. We need to deal with that.

Well, any other suggestions this panel has?

Mr. ROBERTS. My only comment would be tying these all together, really having more—better financial information for the user, and that gets back to the things we talked about. Why are we doing this? And helping the user have better information, which ties to better financial systems.

Mr. HORN. Well, the real tough one, as you know, is to relate the financial cost to how we are achieving that particular goal.

Mr. ROBERTS. Absolutely.

Mr. HORN. As I look at your chart in here on traditional versus process view of cost, the process view doesn't tell me too much either unless you either did it or didn't do it. That I can understand. But I think the Oregon benchmark procedure makes some sense. You try to see how far along the trial of achievement of those goals are, and if there is some blockage there, maybe that helps you identify it and deal with it.

It isn't always money. It is just sometimes human organization isn't organized in clean lines to make the proper decisions, like your IRS example. There is no excuse for not telling that taxpayer, you could do it by computer just on a general thing; yes, give us 15 percent as a start or whatever over this time period, and not have the year go by, and that is lost time.

Mr. KINGHORN. Mr. Chairman, another thing you could do at your next IRS hearing, let them know ahead of time you would like to talk about their implementation of activity-based management and what they found out in terms of how they should improve their business process. That would provide an incentive for people in the organization who are trying to bring that nationwide.

Mr. HORN. Good. We will definitely do that because we are getting back to that.

Well, we thank you all for coming. That is very helpful and very solid statements, and we appreciate it.

Mr. KINGHORN. Thank you, Mr. Chairman.

Mr. HORN. Now. Last but not least, we have our fellow scholar of public administration, specialist with the Congressional Research Service, Ronald Moe.

[Witness sworn.]

STATEMENT OF RONALD MOE, SPECIALIST, CONGRESSIONAL RESEARCH SERVICE

Mr. HORN. Mr. Moe affirms that for one of many times.

So please proceed, Ron.

Mr. MOE. Mr. Chairman, thank you for inviting me to testify before your committee on the Omnibus Budget Act of 1996, and specifically to analyze Section 2 and 6 of the act which provides for the reorganization of the present Office of Management and Budget in two equal separate offices, an Office of Budget and an Office of Federal Management.

Both offices would be in the executive office of the President, and both directors would report directly to the President.

A review of the provisions of the Omnibus Budget Act suggests two things to my mind. First, this omnibus bill offers ample evidence of the ambitious mandate and work schedule of this subcommittee and its chairman. While the bill directs its attention to many subjects and proposals under the general heading of "budget reform," much of this legislation—legislative attention is focused on what might more accurately be titled "management reform." And second, this omnibus bill provides a strong argument favoring the creation of an Office of Federal Management.

What this bill reflects is the committee's attempt to somehow get a grasp on a subject field that has become fragmented and unglued over time. Up to approximately three decades ago, the executive branch was managed by a Presidential/congressional partnership. This partnership, through the proper design of organizations, missions, work forces, sought to provide direction and accountability to the vast and varied enterprise known as the executive branch.

Management of this enterprise was achieved principally through the use of 100 or so general management laws. Many of these laws remain well-known to you, such as the Administrative Procedure Act, the Budget and Accounting Act, the Government Corporation Control Act; while others, equally important, are of lesser visibility, such as the Miscellaneous Receipts Act and Anti-Deficiency Act.

It was through the passage and periodic revision of these laws, in part to ensure a minimum of overlapping, that the management of the Government of the United States was judged to be in reasonably good shape.

Over the past 30 or so years, for a variety of reasons, not the least being a lack of interest by recent Presidents, management at the executive branch has become fragmented, uneven, and in some cases little more than budgetary controls. Whole departments and agencies have become essentially hollow, with intentional reliance upon private contractors for the performance of basic functions.

An increasing number of quasi-governmental bodies are being created, exempt from many, if not most, of the general management laws. Throughout this process, the management side of OMB has been permitted to atrophy until in 1994 it was eliminated altogether, leaving only residual elements performing narrow statutory functions.

Contrary to the arguments espoused by the National Performance Review and other advocates of various forms of entrepreneurial management, the agencies of the executive branch are not like private corporations and cannot be organized or managed like private corporations. The governmental and private sectors are unalike in their essentials, and it is from this distinctive character that the proper and distinctive management principles follow.

The distinguishing characteristic of governmental management, contrasted to private sector management, is that the actions of governmental officials must have their basis in public law, not in the pecuniary interests of private entrepreneurs or owners or in the fiduciary concerns of private managers. And this point is critical, for when the sectors are blended or meshed in some fashion, you also change the fundamental lines of legal accountability, the managerial culture and its internal incentives, and the relationship of this unit and activity to the citizenry.

The Omnibus Budget Act is an example of extensive congressional involvement in the detailed direction of executive management, and if it were passed in its entirety would constitute a major general management act with literally hundreds of dos and don'ts for agency management.

Now, congressional involvement in the detailed direction of executive management is not aberrational behavior nor is it part of some political strategy employed by an imperialistic Congress. Under the Constitution, it is Congress that is the co-manager of the executive branch. It is Congress that properly determines the mission, structure, financing, human resources, policies, procedures and ultimately the incentive parameters in which managers function within governmental institutions.

The interests of Congress and the President, however, are not necessarily at odds or confrontational. Indeed, there is a high degree of congruence of institutional interests in managing the executive branch. The most important single element in this cooperative exercise are the general management laws, which provide the overall direction and rules for the executive branch viewed in its totality. These laws are the glue which keeps the naturally disparate parts of the executive branch tied together as a whole. The quality of the general management laws, therefore, will largely determine the quality of institutional management.

As the central managerial capacity of the executive branch has deteriorated, Congress has moved into the void and passed numerous additional management acts, such as the Paperwork Reduction Act, Inspector General Act, Chief Financial Officers Act, Government Performance and Results Act, and we could go on.

These latter acts, each supported and justified on its own definition of a problem with little consideration of its probable impact on other related general management laws, have cumulatively come to constitute a burden upon not only the agency and program manager, but upon this committee as well.

In the absence of a comprehensive management theory or an institution in the executive branch responsible for keeping the general management laws clean and creative, management issues will naturally tend to be approached on a case-by-case basis with bits and pieces finding their way into law.

The critical role of general management laws for management and the work of this committee is not found in their control aspects, but in the creative elements which permit at once accountability, flexibility and coherency. The original purpose of this committee, created after the first Hoover Commission in the forties, was to provide an ongoing, not episodic, congressional focus on management and capacity-building. Its counterpart was to be the management side of the old Bureau of the Budget, and after 1970 the Office of Management and Budget. Today, this team approach has been largely abandoned by recent Presidents, with the executive branch now rejecting the central management agency approach altogether in favor of each Department agency, corporate body and ancillary unit operating on its own definition of management.

Thus, recently, the President signed an appropriation bill which effectively exempted the Federal Aviation Administration from most elements of Title 5, meaning, in effect, the jurisdiction of this committee and many general management laws that you oversee. And this is only the opening wedge.

For Congress and this committee to properly perform their constitutional responsibilities to assure that standards of accountability and conduct for the performance of the citizens' affairs are met, there must be a central management agency in the executive branch capable of administering the general management laws and to be held accountable for this administration by this committee.

Without such an agency, we face the specter of an executive branch consisting of several hundred quasi-governmental bodies, each with their own managerial laws, personnel and compensation systems, and many effectively run by and for their contractors.

The establishment of an OFM would provide the President and the Congress with the institutional authority and capacity to maintain quality general management laws while permitting flexible exceptions to these laws and encouraging innovative experiments with an accountable system overseen by this committee.

Three principal objections are raised to the establishment of an OFM. One, it would simply be another agency, one that it is not needed because budget analysts are now providing the general management role in the executive branch.

Second, central management units are not employed in progressive private corporations and thus ought not be employed in the executive branch.

And, third, President and Congress should get out of the management business and leave it to professional managers.

Each of these objections deserve, but will not receive here, a detailed response. Suffice it to say, management interests which tend to have long-term investment perspective have never, and I believe will never, be properly addressed within the budget context, a context which tends to be both short-term in perspective and control-oriented. Private corporate management does not need a central unit because the management essentially decides for itself its mission, its resources and its practices.

The Federal Government, however, does require such an agency, because it is by law that its mission, resources and practices are determined. Because the Government is large, varied and subject to provisions of law not applicable to private corporations, for example, the Administrative Procedure Act, there is need for its activities to be coordinated and overseen on a comprehensive basis.

In conclusion, the Omnibus Budget bill is symptomatic of a larger challenge facing this committee, namely the progressive disaggregation of the executive branch and the increasing numbers of management laws being passed by Congress, each justified on its own terms, but collectively approaching incoherency.

The ability of this committee to continue and enhance its work toward bringing us a Federal Government that is both innovative and accountable will depend in large measure on how soon and in what manner the Office of Federal Management is created.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Moe follows:]

STATEMENT BY RONALD C. MOE
CONGRESSIONAL RESEARCH SERVICE

HOUSE COMMITTEE ON GOVERNMENT REFORM
AND OVERSIGHT
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION AND TECHNOLOGY
OMNIBUS BUDGET ACT OF 1996

APRIL 25, 1996

Mr. Chairman, thank you for inviting me to testify before your Committee on the Omnibus Budget Act of 1996, and specifically to analyze Section 216 of the Act which would provide for the reorganization of the present Office of Management and Budget (OMB) into two equal, separate offices; an Office of Budget and an Office of Federal Management. Both Offices would be in the Executive Office of the President and both Directors would report directly to the President. It is appropriate at the outset to note that the opinions expressed here are my own and do not represent those of my employer, the Congressional Research Service.

A reading of the provisions of the Omnibus Budget Act of 1996 offers ample evidence of the ambitious mandate and work schedule of this Subcommittee and its Chairman. While the bill directs its attention to many subjects and proposals under the general title of "budget reform," much of this legislative attention is focused on what might more accurately be titled "management reform." The present OMB, reflecting in part the philosophical perspective of the National Performance Review (NPR), accepts as its fundamental organizational and operational premise that the budgetary process and management issues are inseparable and that in fact management is properly subsumed under budgetary priorities and practices.

The NPR Report in 1993[1] rejected earlier recommendations to rebuild OMB's management capacity[2] and implicitly proposed that OMB cease to have a separate management component altogether. A subsequent OMB

[1] U.S. Executive Office of the President, National Performance Review, *From Red Tape to Results: Creating a Government That Works Better and Costs Less* (Washington: U.S. Govt. Print. Off., 1993).

[2] National Academy of Public Administration, *Revitalizing Federal Management: Managers and Their Overburdened Systems* (Washington: National Academy of Public Administration, 1983). U.S. Congress, House, Committee on the Budget, *Management Reform: A Top Priority for the Federal Executive Branch*, Committee print, 102st Congress, 1st session (Washington: U.S. Govt. Print. Off., 1991)

reorganization ("OMB 2000 Review")[3] largely implemented the NPR suggestion by integrating the staff of the General Management Division with existing budget analysts into five Resource Management Offices (RMOs) structured along budgetary, functional lines. Insofar as designated management functions remain in OMB, they are located in much reduced statutory elements of the agency (e.g., Office of Federal Procurement Policy). The integration (critics argue that a better term would be "subordination")[4] of management functions and personnel within the larger budgetary side of the agency is permanent and represents recognition that a "reinvented government" is one where general management laws are no longer viewed as constituting the basis for a politically accountable executive branch.

In defending the 1994 reorganization of OMB, then OMB Director, Leon Panetta, stated: "Critics of these recommendations may say the effort to 'integrate' management and budget will end in merely bigger budget divisions, whose management responsibilities will be driven out by daily fire-fighting on budget issues. . . . We believe this criticism is based on a false premise that 'management' and 'budget' issues can be thought of separately."[5]

The question arises: Is the premise that budget and management issues are inseparable a valid premise? There is a substantial body of opinion contending, on the contrary, that not only are budget and management separable in theory, they should be separate in practice. In fact, critics of the current OMB and the integration of management issues and personnel into budgetary processes argue that management values and issues can only be addressed properly if management is institutionally separate from the budget. The experiment with an integrated OMB is judged by many to be a failed experiment and that today critical management and institutional issues are being addressed in a perfunctory way or not at all.

The distinctions between the budgetary and management cultures are genuine. The budgetary culture necessarily and properly has a short-term perspective in which future resource allocation measured in financial terms is critical. It is a highly politicized process which emphasizes control mechanisms. The crucial variable in the budgetary process is annual "scoring" which crudely imposes limits on agency management to meet macro-financial objectives.

Management, on the other hand, properly defined, is a culture that operates with a long-term perspective and seeks to maximize the capacity of institutions

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[3] U.S., Office of Management and Budget, "Making OMB More Effective in Serving the Presidency: Changes in OMB as a Result of the OMB 2000 Review," OMB Memorandum No. 94-16, March 1, 1994.

[4] Alan Dean, Dwight Ink, and Harold Seidman, "OMB's 'M' Fading Away," *Government Executive*, 26(June 1994): 62-64.

[5] Leon Panetta, quoted in "Executive Memo: OMB Management Merger," *Government Executive*, 26(April 1994), p. 8.

to perform their statutory mission. Thus, management may seek to "invest" in management choices by making long-term, prospective choices. The principal tool of Federal management is the 150 or so general management laws which assist or diminish, depending on the conceptual quality of the laws, the capabilities of agency management. Immediate budgetary interests and contraints are necessarily influential, but they are only one of the factors that are critical in the management equation.

Unfortunately, in the view of many scholars of governmental management, when budget and management institutions and personnel are combined, short-term budgetary values and priorities necessarily displace longer-term management values and priorities. Long-term management issues and proposals often lack immediate political appeal and thus the intellectual capital so necessary for institutional growth and creativity is sacrificed to the appeal of a short-term, immediate "savings."

The net result of years of stressing budgetary over management values is evident in the myriad management issues included in this single Omnibus Budget Bill. Whole major fields of governmental activities are today essentially "unmanaged" from a central managerial perspective. Government corporations and enterprises are being created *sui generis* with little central review in the executive branch to insure conformance with statutory and customary standards of organization, operations and accountability. Today, for instance, Performance Based Organizations (PBOs) are being promoted by OMB notwithstanding the absence of clear statutory authority to create such bodies and the absence of criteria and standards for financial accountability agreed to by Congress. Increasingly, the management of the executive branch is disaggreated, disjointed, and simply foresaken to promote budgetary objectives.

Committee Report: Making Government Work

This Committee, increasingly aware that no one seems to be minding the store, held a series of hearings over the last two years to determine the nature of the problem and to recommend ways and means to address the future of management of the executive branch. The Committee's December 1995 report, *Making Government Work: Fulfilling the Mandate for Change*,[6] offered a number of concrete recommendations to improve the management capacity of the Federal Government. Recommendations one and two are of special importance to this Committee and deserve additional attention and analysis. The first recommendation was: "Strengthen the President's role as chief executive officer of the executive branch." The second recommendation, building upon this call for enhancing the President's authority and responsibility for overall management, provides that there be established in the Executive Office

[6] U.S. Congress, House, Committee on Government Reform and Oversight, *Making Government Work: Fulfilling the Mandate for Change*, H. Rept. 104-435, 104th Congress, 1st session (Washington: U.S. Govt. Print. Off., 1995).

of the President an Office of Federal Management reporting directly to the President.

These two recommendations provide the key to building the institutional capacity of the executive branch to meet the management challenges of the future. Of equal importance, although not directly evident from the wording of the recommendations, is that the implementation of these recommendations is also critical to enhancing the capacity of Congress to meets its responsibilities as co-manager of the executive branch. My intention in these remarks is to address three issues:

(1) Congress and the use of general management laws as the principal tool to hold the President and the executive branch accountable for their actions.

(2) The need for Presidents to recommit themselves to performing their proper role as chief manager of the executive branch.

(3) The establishment of an Office of Federal Management in the Executive Office of the President as a crucial element in providing sustained attention to management issues.

The present Administration has invested much of its political capital in the effort to "reinvent government," a term that is short-hand for a broad-based exercise to re-orient the organization, management, and culture of the executive branch to more closely resemble that of a large, private corporation. While couched in the rhetoric and values currently popular in business schools, reinventing government is also an exercise in changing the political relationships between the Congress and the President, the President and the agencies, and the executive branch and the public. As Vice President Al Gore stated in the report of the National Performance Review (NPR); "Chief Executive Officers -- from the White House to agency heads -- must ensure that everyone understands that power will never flow through the old channels again. That's how GE did it, that is how we must do it as well."[7]

The entire reinventing government exercise, including much of what comes under the general heading of financial systems, is based on the proposition that government and business are alike in their essentials and thus subject to the same generic behaviorial principles of management as taught in schools of business. If private businesses are moving away from central accountability and toward downsizing in personnel; then government should do the same. But what if the proposition that business and government are alike and subject to generic behavioral principles is wrong? And what if the current trend toward organizational disaggregation and weakened central managerial accountability

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[7] U.S. Executive Office of the President, National Performance Review, *From Red Tape to Results: Creating a Government That Works Better and Costs Less* (Washington: U.S. Govt. Print. Off., 1993), p. 68.

are wrong? What will this mean for Congress and its responsibility to oversee the management and operations of the executive branch?

"Reinventing government" is not the simple, non-political "good government" exercise portrayed by some of its promoters. It is a very political exercise with major implications for Congress as an institution and for this Committee. As Don Kettl of Brookings has observed:

> First, 'reinventing government' seeks the transfer of power from the legislative to the executive branch. In the Vice President's report, Congress is notable principally for its rare appearance. When it does appear, it is usually as an unindicted co-conspirator responsible for undermining effective management. The NPR criticizes Congress for micromanagement and for unpredictable budgetary decisions. Almost all of what the NPR recommends, in fact, requires that Congress give up power.[8]

It is my judgment that while the NPR, and the entrepreneurial management philosophy upon which it is based, has provided some useful insights and results at the programmatic level, at the higher level of government management theory, it is fundamentally flawed. Rather than being largely alike, the private and the governmental sectors are fundamentally unalike, each having a distinctive character, and it is the differences rather than the similarities that must provide the foundation for federal government management values and objectives. *The distinguishing characteristic of governmental management, contrasted to private management, is that the actions of governmental officials must have their basis in public law, not in the pecuniary interests of private entrepreneurs and owners or in the fiduciary concerns of corporate managers.*[9]

Thus, the purpose of agency management is to implement the laws passed by Congress as elected representatives of the people. Management of the executive branch, both in terms of process and behavior, is ultimately dependent upon Congress and the law. It is Congress that determines the mission, structure, financing, human resources, policies, procedures and ultimately the incentive parameters in which managers functions within governmental institutions. Scholars and practitioners are increasingly coming to the conclusion that the quality of the institutional and managerial laws has deteriorated in recent decades resulting in decreased capacity of governmental agencies to perform their basic functions in an accountable and effective manner.

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[8] Donald F. Kettl, "Beyond the Rhetoric of Reinvention: Driving Themes of the Clinton Administration's Management Reforms," *Governance*, 7(July 1994), p. 309.

[9] Ronald C. Moe and Robert S. Gilmour, "Rediscovering Principles of Public Administration: The Neglected Foundation of Public Law," *Public Administration Review*, 55(March/April 1995), p. 138.

In the private sector, there are compliant boards of directors which only occasionally challenge the policies and decisions of corporate management, but they can in no way be compared to the supervision provided agency management by Congress and its committees. Repeatedly, outside "CEOs" brought in to "reinvent" or "reengineer" this program or that agency along private sector lines are shocked to find that they must meticulously obey laws and regulations and are answerable to Congress for their actions. This congressional involvement is not aberrational behavior nor it is a political strategy employed by an "imperialistic" Congress. Because of Congress's immense legislative powers to organize and direct the orientation, even the very existence of every aspect of executive branch management, Congress has the potential -- frequently realized in contemporary practice -- to be a veritable co-manager of policy and program implementation.

Congress and the Utility of General Management Laws

The shared interests of Congress and the President as co-managers of the executive branch are real and continuing. The most important single element in this cooperative exercise are the general management laws which provide the overall direction and rules the President enforces throughout the executive branch. These laws are the glue that keeps the naturally disparate parts of the executive branch tied together as a whole pursuing the same general direction for administering the laws passed by Congress. The quality of the general management laws, therefore, will largely determine the quality of institutional management.

There are approximately 150 general management laws operative today, a number that varies according to the breadth of definition used.[10] General management laws are those cross-cutting laws regulating the activities, procedures and administration of all agencies of government. General management laws come in various guises and may be dramatic in their impact, as is the case with the Budget and Accounting Act; Administrative Procedure Act; Government Corporation Control Act; Inspector General Act; and Freedom of Information Act, or they may be of relatively low visibility (although visibility is not necessarily equatable with importance), such as the Miscellaneous Receipts Act; Federal Advisory Committee Act; Federal Tort Claims Act; and Anti-Deficiency Act.

The purpose of the above general management laws, plus a host of similar acts, is to shift the focus of deliberation and review to the general rather than the specific or exceptional. The politics of general applicability is a politics where Congress, the President, and the central management agencies have the authority, resources, and leverage to keep the natural centrifugal forces of administrative practices within understandable and accountable limits. That is,

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[10] The operative word with respect to general management laws is "agency" as defined in Title 5 of the United States Code. All entities of the Federal Government are considered to be agencies of the United States and therefore are covered by all provisions of the U.S. Code, except where exempted either by class of organization or individually in their enabling statute.

the laws and regulations apply to all agencies with the supplicants for exemption carrying the burden of proof. Exceptional politics occurs when there are not applicable general management laws or those that exist have become cumbersome or obsolete through extraneous amendments.

In the arena of exceptional politics, where the management of each agency tends to be viewed *sui generis* and is the sum of exceptional circumstances, interest groups and agency leadership have the advantage in making policy and in agency management. The logical end result of an executive branch functioning under a culture of exceptional politics and administration is an executive branch that is disaggregated and largely unaccountable to both Congress and the President, especially the latter, for its activities. We are closer to this logical end of exceptional politics than is generally appreciated even by otherwise sophisticated observers of the governmental scene.

In recent years a number of additional central management laws have been enacted, each supported and justified on its own definition of the problem with little or no consideration of its probable impact upon other related general management laws. The typical agency head today, for instance, has to contend with such complex financial management laws as the Federal Managers Financial Integrity Act; Prompt Payment Act; Government Performance and Results Act; and Chief Financial Officers Act, as well as directives from OMB, Office of Personnel Management, Office of Federal Procurement Policy, Office of Information and Regulatory Analysis, Office of Federal Ethics, and the list goes on.

The plethora of management acts has been a major contributing factor in the fragmentation of executive management and the increase in involvement by Congress in detailed management issues. In the absence of a comprehensive management theory or an institution in the executive branch responsible for keeping the general management laws clean, creative, and unduplicative, management issues will naturally tend to be approached on a case-by-case basis with bits and pieces finding their way into law, usually accompanied by the phrase: "notwithstanding any provision of law to the contrary," the following shall occur.

At the same time that additional general management laws are being passed, one upon another, each arguably necessary at the time of passage, but collectively approaching incoherence, the institutions responsible for overseeing the administration of these laws have been both intentionally and unintentionally weakened.

Retreat of the Managerial Presidency

Presidents since the 1960s have retreated from their management role and responsibilities preferring instead to concentrate on their political responsibilities. In the past, this presidential retreat was offset in part by the retention and reliance upon a "neutrally competent" management capacity in the Bureau of the Budget (after 1970 titled the Office of Management and Budget).

The character of OMB was intentionally altered in the 1970s by "politicizing" its leadership.[11] Recent Presidents have sought not so much to manage the executive branch through properly conceptualized management laws and trained professional managers as to control government politically through short-term political appointees placed deep within agencies and through the budgetary process.

The sheer number of political appointees today coupled with the extraordinary political constraints in effect respecting their selection places obvious limits on the quality of agency management.[12] Under the best of circumstances it is difficult to imagine major long-term commitments to management improvement by short-term appointees whose personal agenda often run counter to those of the White House and agency interests.[13]

As the institutional capacity for management declined in OMB, both absolutely and relative to congressionally initiated management, greater reliance by the President and his aides came to be placed upon the budget as the premier management tool. While the new "management paradigms" being promoted today espouse a more decentralized, more entrepreneurial agency management culture, in practice they promote greater control through the budgetary process and through implementation by budget analysts. Thus, the Government Performance and Results Act passed in 1993 and hailed as the vehicle to implement the new, business-oriented public management paradigm, is subsumed for implementation under the budgetary process and will be centrally implemented and controlled by budget analysts through OMB Circular A-11. As much of the executive branch as possible will be placed under relatively stringent performance agreements with "performing" managers rewarded by private sector financial standards and "non-performing" managers penalized personally and the agency penalized in budgetary terms.

The "reinventing government" exercise was intentionally not assigned to the management side of OMB. The decision by Vice President Gore, supported by the President, was to displace the traditional, legally based management theory and OMB staff through the use of ad hoc, non-statutory, non-institutionalized bodies under the direction of the Vice President's political staff. The NPR staff, a counter-OMB if you will, consisted mostly of private consultants and mid-level detailees from the departments. The NPR staff, however, not only wrote the

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[11] Hugh Heclo, "The OMB and the Presidency -- The Problem of 'Neutral Competence'" *Public Interest*, 38(Winter 1975): 80-85. Richard Nathan, *The Administrative Presidency* (New York: John Wiley and Sons, 1983). Terry M. Moe, "The Politicized Presidency," in John E. Chubb and Paul Peterson, eds., *The New Direction in American Politics* (Washington: The Brookings Institution, 1985): 235-71.

[12] Paul C. Light, *Thickening Government: Federal Hierarchy and the Diffusion of Accountability* (Washington: The Brookings Institution, 1995).

[13] National Commission on the Public Service ("Volcker Commission"), *Rebuilding the Public Service* (Washington: National Commission on the Public Service, 1989).

various reports and publicity sheets, they wrote some of the Executive Orders signed by the President as well.

The objective of the reinventing government exercise was not to rewrite and update the general management laws, but to change the governmental sector culture to more closely resemble that of a large, private corporation. The management element in agencies is to be the key focus in a reinvented government. Their titles are to reflect their private sector counterparts, thus there will be vice presidents (the Tennessee Valley Authority already has over 25 vice presidents) and chief executive officers, not administrators and directors. Their compensation packages are to more closely resemble those of the private sector. Risk-taking is to be encouraged at all levels. The general approach to organizational management and personnel systems is to promote legal and financial exceptionalism and organizational disaggregation. Agencies will be encouraged to "spin off" activities by establishing Employee Stock Ownership Plans (ESOPs) and contracting with these new firms to perform the functions formerly performed employees and officers of the United States. The Office of Personnel Management has taken the lead by creating an ESOP to perform its employee investigating services retaining only a few Federal employees to oversee the contractors.[14] Insofar as there is to be administrative coherency, it will be through the internal, executive branch budgetary process.

The presidential retreat from hands-on managerial responsibilities for the executive branch, coupled with inattention to the currency and integrity of general management laws, and finally what appears to many critics as the downgrading of the career professional management corps in favor of "contract" executives and third-party contractors generally, constitutes a major historical shift in the administration of the executive branch, a shift that this Committee is addressing by this hearing.

Establishment of an Office of Federal Management

Throughout the 1970s and 1980s, there was an implicit policy of disinvestment in the management side of government generally and OMB in particular.[15] This decline in management capacity in OMB was striking and a contributing factor, in the view of some in Congress, to the major instances of mismanagement and scandals of the last two decades.[16] Although there

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[14] Stephen Barr, "OPM, in a First, Act to Convert An Operation Into a Private Firm," *Washington Post*, April 14, 1996, p. A-4.

[15] Charles A. Bowsher, Comptroller of the United States, "The Emerging Crisis: The Disinvestment in Government," Webb Lecture, National Academy of Public Administration (2 December 1988).

[16] U.S. Congress, House, Committee on the Budget, *Management Reform: A Top Priority for the Federal Executive Branch*, Committee print, 102d Congress, 1st session (Washington: U.S. Govt. Print. Off., 1991). U.S. Congress, Committee on Banking, Housing and Urban Affairs, HUD/MOD Rehab Investigating Subcommittee, *Final Report and Recommendations*, Committee print 124, 101st Congress, 2d session (Washington: Govt. Print. Off., 1990). Ronald C. Moe, "The

have been repeated recommendations from many sources, most recently from this Committee, to strengthen the management capacity of OMB or more directly, to create a separate Office of Federal Management, Presidents and Directors of OMB have thus far shown little interest.

Organization and staffing of agencies should be reflective and supportive of their mission. In the case of the proposed OFM, a Director would be appointed by the President, subject to confirmation by the Senate, with the remaining key officials selected principally from the senior career service. The OFM would have a regular support staff for the Director plus a number of operating offices, each headed by career or non-political officers. These offices would be delegated responsibilities by the Director for performing functions OFM by law. These offices, however, would not be established separately by law as is now the case with the Office of Procurement Policy (41 U.S.C. 404); the Office of Information and Regulatory Affairs (P.L. 96-511, Executive orders 12291 and 12498); and the Office of Federal Financial Management (31 U.S.C. 501).

The establishment by law of subunits within an agency weakens the authority of the agency head to the degree that authority is assigned directly to a subordinate of the agency head. The Hoover Commission, in 1949, addressed this problem directly by stating:

> Under the President, the heads of departments must hold full responsibility for the conduct of their departments. There must be aclear line of authority reaching down through every step of the organization and no subordinate should have authority independent from that of his superior.[17]

It is appropriate for Congress, in agreement with the President, to stipulate the functions of the OFM, the general structure of the agency, and the types of authorities to reside in the agency head Beyond this point, however, it is probably wise to leave the President discretion organize the OFM as he deems appropriate for the mission at hand. Although this is not the forum for providing details on an "ideal" OFM structure, several suggestions are worth mentioning.

Among the operating units to be considered for an OFM would be the offices of organizational management and design; legislative clearance; financial management systems; federal procurement policy; regulatory affairs; federal personnel policy; program design and evaluation; and management development. The heads of these eight offices (and there could more or less than this number) would report to the Director of OFM. the purpose would be to have a

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HUD Scandal and the Case for an Office of Federal Management," *Public Administration Review*, 51(July/August 1991): 298-307.

[17] U.S. Commission on the Organization of the Executive Branch of the Government, First *Hoover Commission Report* (New York: McGraw-Hill, 1949), p. 24.

horizontal organizational structure without the layering of political associate directors. Several current executive branch coordinating groups could be continued under the auspices of OFM. These might include, but not be limited to, the President's Council and Integrity and Efficiency and Financial Officers Council. The approximate number of career civil service personnel necessary to staff the several OFM offices and functions would be approximately 250, many of whom would be transferred from the present OMB.

The organization of OFM would support the mission of the agency, which is to provide a comprehensive and integrated approach to managing the executive branch. Such an OFM would not be a confederation of statutorily based, semi-independent sub-agencies, each with its own authorities, agendas, and constituency, as is now the case with the remnants of the management side of OMB.

Federal Management As Capacity Building

The emphasis and incentive structure of the OFM would be very different from that present in the current OMB. Management principles and practices would not be viewed as simply an extension of budgetary priorities and procedures. Prospective management seeking to build both the capacity and accountability of agency management would be the highest objective. Many of the most vexing governmental management problems today are the result of poor organizational and program design. Thinking in a thoughtful manner about the proper and achievable objectives for agencies and programs and then organizing to reach those objectives is an all too rare activity today. Many hundreds of millions of dollars are spent annually on the offices of inspectors general, internal and external audits, and congressional hearings and investigations to ferret out alleged misdeeds. Yet, very often little or nothing is invested in organizational design and management incentives at the outset of an agency or progam.

The proposal for an OFM is a reflection of what its supporters believe is the failure of the OMB experience. The problem is not one of intentions or incompetence but one of two incompatible missions being forced upon one agency. Budget priorities will always tend to displace management priorities.

What is needed today is competent government, not necessarily big government. Measured in terms of money spent, our government is already big and growing. Measured in terms of personnel and management capacity, however, the Federal Government has been getting smaller and weaker. There is no more complex social organization than the Federal Government. Its responsibilities are enormous and the demands it faces are insatiable. It is fashionable today to say that the president should stay clear of management problems as much as possible. This argument is faulty. Presidents do not have a choice. They are "hired" by the people of the United States to manage their government. Presidents, however, must conduct their managerial leadership within the laws set by Congress. Both institutions have common responsibilities which have to be met.

One of the important favoring the proposed separate Office of Federal Management is that it serves the interests of Congress as well as the President. The need for Congress and the President to think prospectively, to design laws and institutions in such a way that problems can be addressed in advance in a responsible and creative manner, is a powerful argument in favor of an institution committed to this way of thinking about management. To build competent government requires a long-term commitment by both the President and Congress, a commitment lasting over several presidencies and one transcending partisanship and political philosophy. Such a commitment can only be met with strong institutional support, the kind of support that will be possible, although not assured, with a new, independent, presidentially oriented Office of Federal Management.

STATEMENT OF RONALD C. MOE
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AND OVERSIGHT
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION AND TECHNOLOGY

OMNIBUS BUDGET ACT OF 1996

APRIL 25, 1996

Mr. Chairman, thank you for inviting me to testify before your Committee on the Omnibus Budget Act of 1996, and specifically to analyze Section 216 of the Act which would provide for the reorganization of the present Office of Management and Budget (OMB) into two equal, separate offices, an Office of Budget and an Office of Federal Management. Both Offices would be in the Executive office of the President and both Directors would report directly to the President. It is appropriate at the outset to note that the opinions expressed here are my own and do not represent those of my employer, the Congressional Research Service.

A reading of the provisions of the Omnibus Budget Act suggests two things to my mind. First, this Omnibus bill offers ample evidence of the ambitious mandate and work schedule of this Subcommittee and its Chairman. While the bill directs its attention to many subjects and proposals under the general heading of "budget reform," much of this legislative attention is focused on what might more accurately titled "management reform." Second, this Omnibus bill provides a strong argument favoring the creation of a Office of Federal Management.

What the bill reflects is the Committee's attempt to somehow get a grasp on a subject field which has become fragmented and unglued over time. Up to approximately three decades ago, the executive branch was managed by a presidential/congressional partnership. This partnership, through the proper design of organizations, missions, and workforces, sought to provide direction and accountability to the vast and varied enterprise known as the executive branch. Management of this enterprise was achieved principally through the use of one hundred or so general management laws. Many of these laws remain well known, such as the Administrative Procedure Act, the Budget and Accounting Act, Government Corporation Control Act while others enjoy lesser visibility, such as the Miscellaneous Receipts Act, and the Anti-Deficiency Act. It was through the passage and periodic revision of these laws, in part to insure a minimum of overlapping, that the management of the government was judged to be in reasonably good shape.

Over the past thirty or so years, for a variety of reasons, not the least being a lack of interest by recent Presidents, management of the executive branch has become fragmented, uneven, and in some cases little more than budgetary controls. Whole departments and agencies have become essentially hollow with intentional reliance upon private contractors for performance of basic functions. An increasing number of quasi-governmental bodies are being created exempt from many, if not most, of the general management laws. Throughout this process, the management side of OMB has been permitted to atrophy until in 1994, it was eliminated altogether leaving only residual elements performing narrow statutory functions.

Contrary to the arguments espoused by the National Performance Review and other advocates of various forms of entrepreneurial management, the agencies of the executive branch are not like private corporations and cannot be organized or managed like private corporations. The governmental and private sectors are unalike in their essentials and it is from their distinctive character that the proper and distinctive management principles follow.

The distinguishing characteristic of governmental management, contrasted to private sector management, is that the actions of the governmental officials must have their basis in public law, not in the pecuniary interests of private entrepreneurs and owners or in the fiduciary concerns of private managers. This point is critical, for when the sectors are blended or meshed in some fashion, you also change the fundamental lines of accountability, the managerial culture and its internal incentives, and the relationship of this unit and activity to the citizenry.

The Omnibus Budget Act is an example of extensive Congressional involvement in the detailed direction of executive management and if it were passed in its entirety would constitute a major general management act with literally hundreds of detailed "do's" and "don'ts" for agency management. Congressional involvement in the detailed direction of executive management is not aberrational behavior, however, nor is it part of some larger political strategy employed by an imperialistic Congress. Under the Constitution the Congress is the co-manager of the executive branch. It is Congress that properly determines the mission, structure, financing, human resources, policies, procedures and ultimately the incentive parameters in which managers function within governmental institutions.

The interests of Congress and the President, however, are not necessarily at odds or confrontational. Indeed, there is a high degree of congruence of institutional interests in managing the executive agencies. The most important single element in this cooperative exercise are the general management laws which provide the overall direction and rules for the executive branch viewed in its totality. These laws are the glue which keeps the naturally disparate parts of the executive branch tied together as a whole. The quality of the general management laws, therefore, will largely determine the quality of institutional management.

As the central managerial capacity of the executive branch has deteriorated, Congress has moved into the void and passed numerous additional general management acts, such as the Paperwork Reduction Act, Inspector General Act, Chief Financial Officers Act, Government Performance and Results Act, to name only a few. These latter acts, each supported and justified on its own definition of a problem with little consideration of its probable impact upon other related general management laws, have cumulatively come to constitute a burden not only on the agency and program manager, but upon this Committee as well.

In the absence of a comprehensive management theory or an institution in the executive branch responsible for keeping the general management laws clean and creative, management issues will naturally tend to be approached on a case-by-case basis with bits and pieces finding their way into law, usually accompanied by the phrase: "notwithstanding any other provision of law to the contrary," the following shall occur.

The critical role of general management laws for management, and for the work of this Committee, is not found in their control aspects, but in their creative elements which permit at once accountability, flexibility, and coherency. The original purpose of this Committee, created after the first Hoover Commission in the 1940s, was to provide an on-going, not episodic, congressional focus on management and capacity-building issues. Its counterpart was to be the management side of the old Bureau of the Budget and after 1970 the Office of Management and Budget. Today, this team approach has been largely abandoned by recent Presidents with the executive branch now rejecting the central management agency approach in favor of each department, agency, corporate body, and ancillary unit operating on its own definition of management. Thus, recently, the President signed an appropriation bill which effectively exempted the Federal Aviation Administration from most elements of Title 5, meaning in effect the jurisdiction of this Committee and many of the general management laws you oversee. And this is only the opening wedge.

For Congress, and this Committee, to properly perform their Constitutional responsibilities to assure that standards of accountability and conduct for the performance of the citizens' affairs are met, there must be a central management agency in the executive branch capable of administering the general management laws. Without such an agency, we face the specture of an executive branch consisting of several hundred quasi-governmental bodies, each with their own management laws, personnel and compensation systems, and many effectively run by and for their contractors.

The establishment of an OFM would provide the President and Congress with the institutional authority and capacity to maintain quality general management laws while permitting flexible exceptions to those laws and encouraging innovative experiments within an accountable system overseen by this Committee.

Three principal objections are raised to the establishment of an OFM.

(1) It would simply be another agency, one which is not needed because budget analysts are now providing the general management role in the executive branch.

(2) Central management units are not employed in progressive private corporations and thus ought not be employed in the executive branch.

(3) President and Congress should get out of the management business and leave it to professional managers.

Each of these objections deserves, but cannot receive here, a detailed response. Suffice it to say: Management interests, which tend to have a long-term investment perspective, have never, and I believe can never, be properly addressed within the budget context, a context which tends to be both short-term in perspective and control oriented. Private corporate management does not need a central unit because the management essentially decides for itself its mission, its resources, and its practices. The Federal Government, however, does require such an agency because it is by law that its mission, resources, and practices are determined. Because the government is large, varied, and subject to provisions of law not applicable to private corporations, e.g., Administrative

Procedure Act, there is need for its activities to be coordinated and overseen on a comprehensive basis.

The Omnibus Budget bill is symptomatic of the larger challenge facing this Committee, namely the progressive disaggregation of the executive branch and the increasing numbers of management laws being passed by Congress, each justified on its own terms but collectively approaching incoherency. The ability of this Committee to continue and enhance its work toward bringing us a Federal Government that is both innovative and accountable will depend, in large measure, on how soon and in what manner an Office of Federal Management is created.

Mr. HORN Well, we thank you.

I had forgotten that in your background you have won the Louis Brownlow award four times for the outstanding article in public administration. That is a great honor. The Brownlow award is the Nobel Prize of public administration. So I commend you on that and the expertise in institutional memory you have on this subject from long study and involvement.

What are the keys to building the institutional capacity of the executive branch, besides a separate Office of Management? What else do you see doing?

Now, I look on the Chief Financial Officers Act, the Inspector General Act, the Government Performance and Results Act, all as helpful devices. I don't know—from some of your comments, I wasn't quite sure you felt the same way that I did on that, not that you have to.

Mr. MOE. The Office of Federal Financial Management is a necessary, but not sufficient element in the proper management of the executive branch. It provides the ability to build up intellectual capital among generalists so that these separate, specific laws, each with their own supporting fraternity of managers and individual agendas, are somehow brought into a coherent whole so that you, as the chairman of the subcommittee, can ask one person, how do these various important laws relate to one another?

One of the difficulties is when you have these major laws that have divided the management function into various parts, each of these groups is intent on maximizing the influence of their own specific theoretical agenda, none of which is incorrect by itself, but in toto invokes a maximum cost on the individual program manager. Today there really is no integration of all of these fundamental concepts at any one place in the executive branch.

So when I say there is a disaggregation of management, what I am saying is that we have lots of different groups with their own individual general management laws that are going in different directions, quite frankly.

Mr. HORN. Well, you raise a very good point. Let's go back to the Hoover Commission when they suggested there ought to be generally a career professional as Assistant Secretary for Administration originally, or Management, whatever you call it. And then one of my concerns now is we have a few that have taken on the Chief Financial Officer function in their role as Assistant Secretary for Management, which, frankly, I don't think you can do justice to the Chief Financial Officer function holding both jobs, but I realize good people can disagree on some of those things.

Now, think back and share with this subcommittee. Those offices, when they were created, were designed to put together the traditional Brownlow, POSDCORB-type staffing functions, if you will, in the—and to help pull all of those pieces together, integrate them, which is your home here, and be there between different administrations, and advise whoever is secretary who is setting the goals or addressing the current concerns of the President and the Department on how to go about pulling all of those pieces together to carry out the mission to achieve some of those goals. Where did that all go wrong, or did it? Does it work in some places today?

Mr. MOE. You are a political scientist. I will give you 2 seconds of history on that.

We oscillated four times in our history amongst basic values in our political system. We first had the Federalist view of what administration was; namely, that it was to be a professional, essentially nonpartisan, activity. And then we had the Jacksonians come in, and they came in with a notion that we should have political leadership. The Progressive era, which is the question of the Hoover Commission and all these that you are raising, reflected a return in large measure to the notion that a large government requires quality professional leadership and not that much political involvement, except at the policy level.

But we have returned with a vengeance in the last 30 years to the Jacksonian model, where the highest value—it is truly believed by Presidents that come into office of both parties that loyalty is the highest value, and they have put political appointees four levels down into the department, all of whom change.

When foreigners come, like the gentleman I was with yesterday from New Zealand, and look at our Government, they say, I don't understand it. You are trying to copy some of our things. We have no political appointees in any of our administrative positions, and we can't believe that you do. And I said, look, we have 2,000 of them. I mean, we run our Government as an amateur government.

Now, do you want one person in a Department to, in essence, have this as their top professional position?

Well, it is hard to say that one position is going to fundamentally alter a Department. I would say that the complete turnover at administrative times, and even the large turnover whenever we change Secretaries, unless you have some continuity, you end up asking all the same questions again. And an Under Secretary or a higher administrator for the general management issues, it seems to me, is an absolute fundamental must for a properly run Department. That will not solve all your problems, but it is a necessary first step. Because, you know—you and I know that 90 percent, maybe 95 percent, of the issues that come before the management of a Department or agency are not partisan issues.

Mr. HORN. Right.

Mr. MOE. You need to take care of those 95 percent of the issues. When you have all political appointees at the top, you have no one who is committed to a 10-year management change. And yet we are asking them to make 10-year management changes, and we have no management structure that is designed for it.

The management structure is designed for rapid turnover, OK? Persons who do not have—are not trained as managers of the public sector, for the most part. It is a rough way to run the world's largest system, and no one else would do it this way but us.

Mr. HORN. As I recall, President Hoover, acting in his role as chairman of the Hoover Commission, encouraged that both parties bring their people into government at a junior level. Thinking back, my first job in Government was assistant to the Secretary of Labor under President Eisenhower. There were two of us in his immediate office.

I look at these offices since Eisenhower, and I have watched them with each administration. It has nothing to do with, as you suggest, party or ideology. It is just that the creep of political appointees and the overconfusion of wrecking the lines of communication boggle the mind. I don't see how——

Mr. MOE. There is little central management of the executive branch today.

Mr. HORN. Right. It is chaos.

Mr. MOE. It is an empirical fact.

Mr. HORN. Yes, I agree with that.

Mr. MOE. It is astonishing that we have allowed it to deteriorate it to the point that it has. When someone comes and says to you that there is a President's Management Council, they should recognize that that is a nonstatutory, noninstitutional body of political appointees who got together and chat.

Mr. HORN. Like going to a psychiatrist.

Mr. MOE. It doesn't have an institutional staff with a long-term commitment and requirement to all of these laws.

When you pass all of these laws like GPRA, it is like process management to replace the absence of institutional capacity, and yet really no one is going to be watching GPRA closely. You know, the fellow from New Zealand said it is not likely to succeed because we do not have a system for which this is built into it.

The political appointees do not have a commitment to it when they walk into office. They will be learning about it for the first time. So we have a disconnect between our management needs and our management personnel and capacity. And we overcome this in large measure through the use of third parties, contractors, so that our Government is increasingly becoming dependent on its contractors, and this is a serious problem.

Mr. HORN. Who were some of the great managers that you have seen and either read about—let's start with Franklin Roosevelt's era up. I mean, who were the ones who really made a difference when they took over a particular slot? And why did they succeed and others not succeed?

Mr. MOE. Well, I don't have a pantheon of heroes and heroines in an administration. I would say that the last serious President interested, as President, that is, in management as I have been describing it here would be Dwight Eisenhower.

Mr. HORN. Yes.

Mr. MOE. Since you are a political scientist, I would say that the beginning of our decline of management, as I have been defining it, is actually Richard Newstadt's book.

Mr. HORN. Yes, I agree.

Mr. MOE. Richard Newstadt's book had as its thesis that Presidents who believed that the management of government should be by laws were old-fashioned and that Presidents in the future should be heroic figures that run government in large measure as a personal activity out of their White House. And beginning with Kennedy, who accepted that premise, all the way through—and Richard Nixon embodied it with the administrative management approach, namely, you don't—the reason you have a Congressional Budget Office is that the Newstadtian approach to the President, for example, says you don't need to go to Congress all the time to get approval. We have enough authority on our own to do this. We are going to emphasize our internal authority, and that is what the current NPR is doing. They are doing as much as they can, going up to the very edges, maybe over, in promoting various of their management proposals without coming to you in advance and saying, this is part of a larger program. Would you give us your approval? We need these laws changed and so forth. It is this attitude that you are not in a partnership anymore that is sort of the overarching philosophical problem we have.

You can't get a partnership by saying, we like each other. It is—a working partnership is where the general management laws come in. No general management law should be passed, you see, until both of you have talked about it, both the Congress and the President, at considerable length because you both live by it. It is your tool to ensure that they are operating in an accountable way.

Conversely, they should ensure that that law permits them to develop the capacity of their managers to perform the functions.

It is this absence of the proper partnership that is traceable intellectually back to the sixties that is the root cause that you have in front of you a genuinely omnibus bill that has an incredibly wide variety of subjects that are being considered in one bill.

We shouldn't be at this point. I do not believe this is a healthy way to go about it. Thank goodness you are doing it now, but nonetheless, ideally, you wouldn't be doing this—this committee wouldn't be doing this every year.

Mr. HORN. Hopefully.

Mr. MOE. Hopefully.

Mr. HORN. Hopefully.

Well, I think—let's take the space agency now. Remind me, their great administrator they had about 30 years ago and for which we have a lecture named in the National Academy of Public Administration, it just escapes me now.

Mr. MOE. Jim Beggs.

Mr. HORN. Yes, Jim. Here was a person most respected as a manager who came in, was no rocket scientist, as the saying goes, but he knew how to manage and pull together the pieces of an agency, focus their attention, and he knew how to relate to Congress.

Now, that made him probably one of the most successful managers that ever hit Washington. Or am I wrong on that?

Mr. MOE. No. You are absolutely correct.

Notice what the rule was here, however, and this was during Eisenhower's time. OK? Now, we didn't have as much general management laws, maybe 100. Maybe we have 250 now. But when they set up NASA, it was a deliberate decision to look at the general management laws and ask for some specific exemptions. For example, they were permitted exemptions in the area of compensation for certain types of civil employees. They didn't do this on their own. They came up, it was discussed in Congress, and because there was a high degree of trust, Congress said, we give you this discretion.

It is—trust is the point of the realm. And when the executive branch in the case of Beggs, who was a professional—he knew he was going to be around for a long time, he knew what his mission was, he could come up and say, I need this to get the job that you want done; particularly if you give me the trust, I will not abuse it.

You will find it—well, we find it at CRS, when we are asked to go back. Why is it that Congress is involved in what someone will call micromanagement in some area? Almost invariably, there is a story, and the story is abused trust. Because it is very difficult for Congress. It will give trust to a particular person in the executive branch, but 5 years from now they have an entirely different new staff up at the top who don't remember why this trust was given, and they decide to go to the edge of this trust, and Congress responds by restricting it, or micromanaging.

And so that it—the Office of Federal Management has, as its unseen objective, a development of trust, because it will have a long-term perspective. And if it sees one of its agencies going out of line and risking that trust that Congress has given it in discretion over personnel or compensation, it should be the one that comes in and stops it. But it no longer has that capacity to do that. And so, therefore, it all comes back to this committee and other committees. It is an unfortunate situation.

The fact that private corporations do not have similar organizations is not a valid analogy, because, as I pointed out in my—in my testimony, they aren't run by laws. They are essentially run by managers who decide what that mission is going to be, and what resources they are going to have, and who's going to be there. They don't need to have that.

But we are run by laws. And we are run by more laws every year, all of which made sense when you passed them, but when you have 250 of them, you—they become a burden in and of themselves. And so that's why we have to train a new generation of generalists who see the big picture and give you the kind of advice that you need to do your job better. We do not have these generalists anymore.

Mr. HORN. Yes. I agree with you completely. I have watched what was BOB, it became OMB, eaten away as they moved in political layers lower and lower, where you have the blind leading the blind.

Mr. MOE. Yes.

Mr. HORN. I mean, they are nice people. They all have their Ph.Ds, et cetera, but what gets me is I look at the schools of public administration, there aren't too many schools of public administration anymore. They are all policy studies. They don't know how to run anything——

Mr. MOE. That's correct.

Mr. HORN [continuing]. The people they are turning out.

Mr. MOE. You see, there are two fundamental philosophies, and one of them is that governmental sector management and private sector management are alike in their essentials. That is the fundamental premise of the NPR.

Therefore, the Government should be run like a large corporation, and they always pick General Electric for some reason.

And there is the other school, which is the Brownlow school, OK, is that they are fundamentally distinctive because one is run for the benefit, ultimately and properly, of its owners and the fiduciary interests of those who—the managers, and the Government is run in order to implement the laws passed by Congress. That is the purpose of an agency. That is what GPRA and these other acts have to be very careful about, when you measure process, but you forget what the outcome is.

It really says, well, Congress should be concerned with the outputs, input and outputs.

What Congress does best is be concerned with the outcomes. And this—these distinctions are very, very important, because what the NPR has done essentially is to dismantle the historic capacity of the executive branch to be centrally managed.

It has essentially gutted OPM, and so now the question is, what do we do in the future when we have had this dominant position that government and business are alike? As I say, that is now the dominant philosophy. That is why there are very few schools of public administration. Because if the governments are all supposed to be run like businesses, then you better go to business schools—they pay better, their professors better—why bother to go to a school of government management?

Mr. HORN. I have had city managers, Governors, police chiefs all tell me, hey, I am going to get my staff out of the business school because the public administration schools have just off—they are on a tangent with the glamour of policy studies.

I told that to a new dean of a school of a major university that has had a zilch public administration program for the last 50 years. They are now creating a school. I said, I don't see that you are doing much more public administration, but I guess you are still titillating people with the fact they can make policy. But they don't understand why policies fail because they can't administer them, don't even have the slightest idea how they administer them.

Well, this has been interesting as always to see you. Thank you for coming over. Your statement is a good one.

And when you get some more ideas on how we convince the powers that be here and there, because they are the ones fighting it downtown right now, the separation of budget and management, so that we can get an Office of Management which has an institutional memory, which has people that are professionals that can serve Presidents regardless of party, which is what the old Bureau of the Budget did in the 1920's, 1930's and 1940's.

Mr. MOE. Correct.

Mr. HORN. Yes. They had a crew that could serve people regardless of party, regardless of ideology. They were the institutional memory of the Government. That has been an eroded capacity.

So I don't think I am just talking nostalgia or anything, but it is true as I look at it. And Professor Light's book, "Thickening Government," certainly is a great tome in terms of what has happened, as you say, since Eisenhower. The title makes you laugh when you think somebody from the Prussian chancellery got in here.

We have this nonsense on the Hill with the chief of staff of an office. Utter baloney. You know, the Legislative Reorganization Act of 1946 said you have got an administrative assistant. Now they are all chiefs of staff, or they are chancellor—what are they? Counselor to the Secretary now. Good grief. You know, it really gets to me.

But let me thank those that put the hearing together, and let me thank you, Ron, for coming over; the majority staff headed by J. Russell George, our staff director/general counsel; and the gentleman to my immediate left, Harrison Fox, professional staff member, who, with Anna Miller, another professional staff member, put this together; Andrew Richardson, our clerk; and the minority staff, Mark Stephenson, professional staff member; Liza Mientus, professional staff member; and Josh Sabo, legislative assistant to Representative Kanjorski. And we thank our official reporters, Katie Stewart and Mindi Colchico.

With that, the hearing is adjourned.

[Whereupon, at 12:30 p.m., the subcommittee was adjourned.]

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