

THE BUDGET CRISIS: FINDING A WORKABLE SOLUTION

BY

CHARLES A. BOWSER

COMPTROLLER GENERAL

OF THE UNITED STATES

PREPARED FOR DELIVERY AT

THE ROTARY CLUB

SAN FRANCISCO, CALIFORNIA

FEBRUARY 17, 1987

I would like to talk to you today about one of the most serious problems facing our federal government--the staggering budget deficit and the need to revamp our entire budget process to bring the federal deficit under control.

Back in the early 60s when I was a young accountant with Arthur Andersen & Co. in Chicago, I had the opportunity to hear a speech by Senator John McClellan of Arkansas at the Chicago Executive Club. I remember well Senator McClellan's prediction that the federal budget would soon reach the \$100 billion dollar mark. Now, some 20 years later, we are faced with a budget of one trillion dollars and a federal deficit of more than \$220 billion.

The consequences of our failure to control the budget have, in my view, become horrendous for our nation and indeed for the world. I believe that a bipartisan effort by the legislative and executive branches is essential to finding a workable solution.

In the next few minutes, I will hit you with a lot of numbers. But each of these numbers has a vital impact on

individual lives and on the economic strength and welfare of our nation. It is a frightening story, but one that needs to be told and understood by every American citizen.

THE STATE OF THE BUDGET

To begin, let me recall that, in each of the last four fiscal years, from 1983 through 1986, the deficit has hovered around \$200 billion. In 1986 it set a new record--\$221 billion.

I believe the roots of the problem can be traced back to the early 1970s when two things helped lay the foundation for our present situation. First, we indexed a variety of programs just as we were entering a period of rapid inflation. This drove benefits up much more rapidly than anyone expected. When wages failed to keep pace because of slow economic growth, payroll taxes had to rise substantially, adding to later pressures for tax relief.

Second, at the end of the Vietnam War, we reduced our defense budget, creating the need to rebuild later. We began the rebuilding from 1976 through 1981 when defense outlays rose by 75 percent, from \$90 billion to \$158 billion. From 1981 through 1986, they rose by another 75%, to \$275 billion. Thus, for the 10-year period as a whole, defense spending tripled.

We also cut taxes. Federal revenues dropped from 20 percent of GNP in 1981 to about 18.5% in 1986. That is about \$65 billion in taxes we did not collect.

And we did not face up to what we had done. The rate of growth of domestic programs slowed dramatically, but the reduction

was far less than was needed to pay for both the tax cut and the defense program.

In addition, we pursued a restrictive monetary policy. This was essential to bring inflation under control, but it triggered a recession which further eroded revenues. It also caused interest rates to rise dramatically, helping to more than quadruple federal interest costs from \$30 billion in 1977 to around \$135 billion in 1986.

These factors together turned a modest but vexing problem into a succession of \$200 billion deficits and a doubling of the federal debt in five short years.

WHAT PRICE ARE WE PAYING?

Our nation's budget has been out of control for several years in a way that we usually think is reserved for mismanaged economies in unstable or backward countries. Yet most of our people are living relatively comfortably (provided you are not a heavily indebted farmer or a worker in heavy manufacturing or the oil and gas industry).

If you happen to be one of the lucky ones who has been doing reasonably well for the past eight or ten years, why should you care?

You should care, if for no other reason, because of self-interest. This failure of budgetary policy at the federal level has a price. Every taxpayer is paying some of that price today and will be paying a lot more in the years to come.

Take the cost of interest on the debt. The \$135 billion we paid last year in net interest on the federal debt did not buy us

a thing--except the privilege of paying it again this year. It didn't buy a single tank or airplane, it did not pave a mile of highway or replace a single obsolete bridge, and it didn't pay the salary of a single FBI agent or air traffic controller. Instead, it was a transfer of income from the average taxpayer to the holders of government bonds. And many of those people live in Japan and other overseas countries.

These interest costs come off the top of our federal budget, just as taxes and the mortgage payment come off the top of the family budget. Each year's deficit adds to next year's interest bill and to the portion of the budget which cannot be spent on the things our government needs to be doing.

Another part of the price is a nation which will grow more slowly than it would otherwise. We will go on paying that price for a long time to come.

In the 1960s our economy grew at an average annual rate (above inflation) of almost 4%. So far in the 1980s, it has been only 2.4%. That is an awfully important difference. Thousands of lost jobs are involved.

It translates into a lot of factories not built or modernized, unemployed people not put to work, and services not provided to the poor, the hungry, and the homeless. It also translates into lower tax revenues, further compounding the deficit problem.

The budget deficit is not the only reason for our present low growth rate. Clearly, the need to wring inflation out of our economy is a major factor. But the deficit is a significant

impediment to future growth. I believe the deficits of the early 1980s caused the Federal Reserve to pursue a more restrictive monetary policy than would otherwise have been needed. In addition, many reputable economists believe--and I agree with them--that our problems in international trade and finance, which have direct effects on our domestic economy, cannot be solved until we bring the deficit under control.

We must understand what is actually happening today. When we borrow money from other countries, we spend it by importing more than we export. The nation as a whole is consuming more than it is producing. We are living well, for now, by borrowing the output of other people's factories, mines, oil wells, and financial institutions.

When we have to pay back what we have borrowed--even the interest charges--we must consume less as a nation than we produce. Just as we are benefitting from other people's labor today, others will be able to claim a portion of the fruits of our labor in the future. The longer we try to postpone it, the higher the price we must pay in the end.

WHAT MUST WE DO?

This brings me back to the crux of the matter--the budget deficit. What must we do and how can we do it?

The first thing we must do is face reality. The deficit is an urgent problem and we must deal with it. We must also be realistic. There are no easy, painless ways of cutting the deficit, nor can it be done overnight.

To understand why it is so difficult to cut spending, you need to think about what makes up our budget. In fiscal year 1986, we collected \$769 billion in revenues. Interest on the debt took the first \$135 billion, leaving about \$635 billion to spend on programs. Almost \$275 billion of that went to the military, and another \$10 billion went for defense-related foreign assistance, leaving about \$350 billion to cover everything else before we had to begin borrowing.

Let's look at the rest of the budget for a moment and see what would have been required to reach a balance. We spent \$200 billion on Social Security; \$70 billion on Medicare; and another \$90 billion on other benefits for retirees, veterans, and the unemployed. Then let's stop, because we have now spent every dollar we raised in taxes. In fact, if we hadn't spent another dime, our budget would have had a \$10 billion deficit.

But the fact is that there were a lot more dimes to be spent on programs and services which many citizens consider essential. First, I would like to add the \$7 billion it took to run the IRS, because otherwise we would have had a hard time collecting any taxes at all. Then let's include the \$5 billion it took to run our beleaguered Federal Aviation Administration. And what about the Justice Department and the federal court system? That cost us another \$5 billion or so, primarily for the Federal Bureau of Investigation, the Drug Enforcement Administration, the Immigration and Naturalization Service, and the prison system.

Do you think we should stop here, with a deficit of about \$30 billion? You might, but a lot of other people wouldn't. The

farm price support program took \$25 billion and the highway program another \$14 billion. Are you ready to abolish the National Aeronautics & Space Administration, another \$7 billion? What about the \$1 billion we spent on various food safety programs, such as the Food and Drug Administration, or the \$5 billion we spent on medical research at the National Institutes of Health and the Centers for Disease Control? Do you think we should close the national parks and forests to save the \$3 billion they cost to operate last year? If you think we should protect all these programs, you should also understand that we have now built a budget with a deficit approaching \$85 billion, and I haven't even mentioned the \$55 billion or more we spent on major welfare programs, or the \$8 billion in assistance to college students.

The list of things which people want to keep in the budget could be a lot longer than this. I am not trying to defend these programs. Many could operate more efficiently, and some need basic reform. GAO has always been at the forefront of efforts to make these improvements. Last year alone, for example, our recommendations led Congress and the executive branch to save or redirect almost \$20 billion. But we have to be realistic. Improved efficiency alone will not solve our \$200 billion problem.

To solve this problem without new taxes, and without touching Social Security or the defense buildup, you would have to eliminate most of the other functions of our federal government. I don't think the American people would permit that, but in recent

years the people and their political leaders seem to have forgotten that if you want programs, you must pay for them.

If we're going to solve this problem, we must all be willing to compromise. Right now, we just don't collect enough taxes to pay for all of our programs.

We must be prepared to take a hard look at the defense budget. The defense program must not be gutted, but neither can we continue the pace of the past seven years. The Defense Department cannot manage that rate of growth efficiently, and the public will not support it. Over the years, we have heard a lot about the futility of "throwing money" at social problems. I think we have become equally careless in how we spend money on defense. And the upward pressure on defense spending will continue. We now face the rising costs of operating and maintaining the new weapons that are pouring out of the plants.

We must be prepared to negotiate on the entitlement programs, especially Social Security and Medicare. Our growing population of retirees deserves protection--particularly those in the lowest income group. But retirees as a whole must share some of the burden of reducing the deficit. A modest constraint on cost-of-living adjustments for Social Security beneficiaries could make a significant contribution, particularly if coupled with meaningful controls over Medicare costs. Such constraints will be difficult, but they are essential, particularly if we enter another period like the 1970s, with wages not keeping pace with accelerating inflation.

We must lower our expectations about how much government can do about some problems. The abuse of drugs is a very serious problem in our society--one we would all like to see solved. But I'm not sure we know enough about how to solve it to spend another \$1.5 billion per year wisely. Similarly, our farmers face very real problems. But I'm not sure our farm price supports help enough to be worth the \$25 to \$30 billion we will spend on them this year, up from \$4 billion in 1981.

And we must be prepared to negotiate and reason together on taxes. We can and must hold tight on spending. But recent experience shows that the public will not accept the cuts needed to solve the problem exclusively on the spending side of the budget.

The public wants an adequate defense and it wants an adequate social insurance system for its retirees and disabled citizens. But the public also demands that government care for the veterans and the poor, that it have an effective FBI and IRS, and that flying on an airline be safe. It demands safe, efficient highways with bridges that don't collapse. We are misleading the American public if we go on pretending that those services can be provided at the present level of taxation.

Sometime soon, we must begin talking about how much additional revenue is needed and how it will be raised.

HOW DO WE REACH A SOLUTION?

Can our political system deal with these issues? I think so, but we haven't done it yet.

Last year, Congress and the President enacted the Gramm-Rudman-Hollings approach for reducing the deficit. The threat of automatic cuts was supposed to force the political leadership to make the "big decisions."

It didn't work out that way. To give credit where credit is due, I think the pressure of the deficit targets did cause Congress to be very tight last year. But we didn't deal with the big issues. Instead, we dealt with big gimmicks--the blue smoke and mirrors that legislators have been talking about.

The Gramm-Rudman-Hollings deficit target for 1987 is \$144 billion. The law allows a \$10 billion leeway, so the "real" target is \$154 billion. In early October, there was great elation that the target had been "met." As a person who was involved in that process, let me tell you that the target has not been met, and will not be met.

Some of the "savings" that Congress and the President used to reach the target are not really savings at all--at least not the way you and I would use that term.

For example, Congress decided to raise money through the sale of loan assets. This would actually make the problem worse next year because of the loss of future income. This effect might be compounded by the way the Administration has planned to conduct the sales. The resulting low prices may require even more loans to be sold, further depleting future income.

Other "savings" are nothing but accounting tricks. A revenue sharing payment was made early so it would be booked in

fiscal year 1986. Some military pay will be booked in 1988 by slipping a payday from September 30 to October 1.

The cash deficit for 1987 will be a good deal above the \$154 billion target. OMB and CBO are now estimating it to be around \$175 billion and that looks optimistic to me. Without the gimmicks, the number would be even higher.

Why do we keep trying to paper over the deficit problem? Mostly, it is the natural reluctance to face difficult and painful political choices involving basic disagreements over national priorities. But that reluctance is greatly intensified when the estimates and forecasts keep suggesting that continuing current policies will lead to a solution.

HOW CAN WE TRUST THE NUMBERS?

When our political leaders do not know what the real numbers are and cannot trust the numbers they are given, it becomes much easier to duck the issue. I believe that is one of our basic problems. It is unrealistic to expect a politician to vote for program cuts or tax increases that may cost him or her the next election when previous attempts to be courageous didn't solve the problem.

Also, too many people still believe the problem will go away if we just wait for the acceleration of economic growth. They believe that the economic boom and the tax revenues it will produce is just around the corner. If you are tempted to go along with them, let me remind you that New York City and the Penn-Central Railroad engaged in the same sort of thinking and lived to regret it.

Clearly, this is a matter of deep concern to me. I don't think we can solve the problem of the deficit--and keep it solved--until our political leaders are dealing with numbers they trust and in which we can all be confident. If we are to have numbers we can trust, we need a basic overhaul of our financial management structure at the federal level.

Our federal accounting systems are in terrible shape. The basic structure was laid out in World War II, and many of the systems are built around 1950s vintage concepts and computers. The systems are highly inefficient and, despite the enormous cost of operating and maintaining them, they still don't produce the reliable, timely data needed for deciding policy or managing day-to-day operations.

The budget process is in equally bad shape. Our history of unrealistic economic forecasts has been well-documented. But the budget process itself adds to the problem. It is incredibly burdensome, complex, and repetitive, and consistently produces a misleading picture of the future. Congress' problems in producing a budget are obvious, because Congress must operate in the open. But I can assure you from my own experience that the executive agencies have equal difficulty in developing a budget.

I am convinced that it doesn't need to be this way. For several years the General Accounting Office has been urging the President and Congress to start on a basic rebuilding of our financial management structure and suggesting some ways in which it could be done. Some of our ideas were reflected in the President's State of the Union message. I am hopeful that the

Administration and the Congress can resolve their problems this fiscal year and reach a workable solution.

CONCLUSION

In summary, getting--and keeping--control over the deficit and the budget requires several things. First, we must know where we are. That means having a modern financial management system producing numbers we can trust and understand. It also means building realistic budgets around credible economic forecasts.

Second, we must recognize both the price we must pay for tolerating this huge debt, and the fact that the price will continue to rise the longer we live this way.

Finally, our political leaders must be willing to work together in developing a politically feasible and sustainable strategy combining reasonable restraints on spending with appropriate revenue increases until we work our way out of the problem.

And I do mean work; this problem will not solve itself.

As responsible citizens, it is our duty to insist that the problem be solved and to accept our share of the cost. Our government can live within its means, provide the services the American people demand, and build the basis for a healthy economy in the future.

These expectations are not unreasonable. We can meet them if we decide to do it. The longer we wait, the harder the task will be.

As for myself, I have great faith in the American people and the American system of government. When enough influential

citizens--such as you--are convinced of the seriousness of this problem, I know we will solve it.

Thank you.