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Statement of  
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before the  
Committee on Appropriations  
U.S. Senate



on

[Lack of Controllability in  
The Federal Budget]

Mr. Chairman and Members of the Committee

I am very pleased to appear before you today. I commend the committee for addressing a most important issue--an issue that affects every citizen and one that is putting strains on the existing budget procedures--the extraordinary growth in the so-called uncontrollable portion of the Federal budget.

I have been greatly encouraged by the scope and depth of the Congress' current concern about this issue.

Nature of the "controllability" problem

I would like to start by emphasizing that I have consistently held that when viewed over a long enough period of time there are few uncontrollable programs in the Federal budget. The length of time necessary to make the necessary

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changes depends upon the willingness of the Congress and the executive branch to enact legislative changes.

The short-term "controllability" problem is traditionally represented by the OMB figures which indicate that the relatively uncontrollable part of budget outlays grew from about 59 percent in fiscal year 1967 to about 76 percent estimated for 1981. This growth largely reflects the growth of Federal entitlement programs, long-term demographic trends, and programs tied directly or indirectly to inflation. In 1981 these relatively uncontrollable outlays are estimated to be about \$503 billion.

I should add that the portion of the budget that is, from a practical point of view, relatively uncontrollable in any one year is probably even higher than the 76 percent. There are, for example, numerous operations and maintenance programs for public works and defense facilities that require special attention and funding.

In general, there are three major categories of uncontrollables identified for the current year (FY 1981) in the budget for fiscal year 1982.

--Entitlements will account for about 48 percent of the budget outlays or about \$321 billion.

These include Social Security (\$140 billion), Medicare (\$40 billion), Unemployment Trust Funds (\$23 billion), and Revenue Sharing (\$5 billion).

--Net Interest on the Debt which is estimated to be about \$67 billion or 9 percent of total outlays.

--Liquidation of prior commitments and other fixed costs--in effect the payments for goods and services obligated for in prior years or for fixed cost items--this will be about \$115 billion or 18 percent of estimated outlays.

The issue of "controllability" involves the trade-off between the need for longer term, stable commitment by the Federal Government to people who voluntarily or involuntarily participate in Federal programs and activities versus the need for the Congress to "control" the budget in both the short-term and the long-term. There is no magic formula for making this trade-off. Furthermore, the trade-offs have to be made on a program-by-program basis dealing with specific groups of people, specific sectors of the economy, and specific problems.

The growth in uncontrollables, and prospects for their continued growth, points to a critical need for the Congress and the executive branch to take budget actions with a longer time horizon in mind. In this manner, budget trends and priorities will reflect conscious choices made in a "strategic planning" type of process rather than being accepted as simply uncontrollable factors. Consideration should be given to enhancing multiyear planning and budget actions, and the organizational and procedural changes that may be required. The

Congressional Budget Act of 1974 requires that the budget include outlay estimates for five years into the future. The recent steps by OMB and the Budget Committees to include multiyear planning amounts in the budget documents and resolutions is a big step forward, though it is too early to say how effective they will be in determining future budget decisions.

We do feel that the Congress has become increasingly aware of the possibility or probability that a program that may be inexpensive at the start can get more expensive later. Indeed, increasing this awareness is one of the greatest values of long range planning. I might add that CBO's budget estimates of the long-run cost of new legislation have contributed to this awareness. A new entitlement program should not be established based solely on the argument that its' first-year costs are minimal. This longer horizon will also make it easier to show that small changes in the law that affect costs minimally in the year in which they are enacted may be compounded in succeeding years into significantly higher costs.

Another advantage of multiyear planning is that the budget becomes more controllable in the long-term. The controllable portion of a budget may look very small in any given year, but viewed over several years it becomes much greater. We believe this would encourage savings proposals that may require an initial increase in spending in order to achieve much greater savings in subsequent years.

Furthermore, I believe it is imperative that the efforts to control budget levels be a cooperative, coordinated process. This process must include the authorization, as well as appropriations and budget committees. These committees are playing an increasingly important role in the congressional budget process. Budget schedules and narratives need to be revised to emphasize the amounts that are contingent upon new authorizing legislation.

This need will be magnified further if the Congress enacts legislation to provide for a systematic review and re-authorization process as envisioned in the proposed sunset legislation. In short, we should ask ourselves whether the budget concepts and procedures established when most of the budget was controllable through the appropriations process, are adequate today.

#### Entitlements and indexed programs

I would now like to focus my remarks on that group of uncontrollables that are known as entitlements and indexed programs.

The five largest entitlement programs--by size of their estimated FY 1981 outlays--account for about \$247 billion.

They are:

Social Security	\$139.9 billion
Medicare	39.9 billion
Unemployment Trust Fund	23.5 billion
Civil Service Retirement	26.9 billion
Medicaid	<u>16.5 billion</u>
Total	\$246.7 billion

Entitlements for the most part involve support of individuals who are elderly, retired, sick, poor and/or veterans. In operation these programs are income redistribution programs, but they are intended to prevent more serious problems. The people who benefit from these programs have adjusted their personal lives to certain expected payments when they retire or become ill. It is very difficult to change the rules in the middle of the game. Therefore, any significant change must be made with sufficient lead time to allow people to change their spending and savings patterns. There are, however, changes that can and should be made. These changes can have both short and long range financial savings.

There are five basic methods of change that can reduce entitlement programs once they have been enacted by the Congress:

- Eliminate the program altogether.
- Reduce the level of assistance, including placing a cap on the program.
- Change the eligibility criteria.
- Improve management efficiency of the programs.

--Change the method, frequency or basis for indexing the program.

As a general rule all these methods except management efficiency changes would require changes in the enabling legislation - a formidable task which will require the coordinated action of the authorizing committees as well as the appropriations and budget committees.

Since my time is short and because you asked me specifically to address indexing I will limit my remaining formal remarks to that one issue.

Indexing is a mechanism for adjusting Federal payments when there is a change in prices. Under an indexed program, payments increase automatically when there is inflation. Usually, the size of the payment is linked by a formula to some index of prices. For example the size of Social Security pensions is linked to the Consumer Price Index, the CPI, which is the most widely used.

In 1979 GAO issued a report analyzing the effects of indexing on Federal expenditures. The programs we studied included either an explicit indexing formula or an implicit mechanism for automatically adjusting the level of benefits when prices changed. We also looked at Federal pay since the comparability formula can produce effects similar to indexing. However, the Congress and the executive branch have more options in dealing with pay than with other indexed programs

and the major problems resulting from indexing do not occur in this area.

At the time our report was issued indexed programs represented more than fifty percent of the total Federal budget, and their share of Federal spending was increasing, a trend which has not yet been reversed. As a result the current inflation rate automatically increases Federal spending substantially even if no other change in the entitlement programs occur. We estimated that a ten percent annual rate of inflation would automatically increase Federal spending by \$15 to \$25 billion. Currently, that estimate would be even higher. We also estimated that from 1970 to 1977 inflation accounted for half of the growth in Social Security expenditures and somewhat less than half of the increase in expenditures for Civil Service and Military retirement.

Although the indexing of Federal expenditures has helped protect the benefits provided under many Federal programs, the trends which I have just discussed are deeply troubling. It is widely agreed that without restraint in the growth of Federal expenditures it will not be possible to end inflation. Since it is also agreed that an increase in defense spending is necessary, there is little prospect for achieving this restraint without some check on the programs which are indexed. This was our conclusion in 1979. It is even more apparent today.

What can be done? One step which we have recommended in the past is that the cost-of-living adjustments for Federal retirees should be made annually rather than semi-annually. This would be more consistent with the indexing provisions in other entitlement programs. Federal retirement programs are the only remaining indexed programs which adjust benefit levels twice a year. The Office of Management and Budget estimates that shifting to an annual adjustment would reduce outlays \$1 billion in fiscal year 1982.

In addition, I share the concern many have expressed concerning the housing component of the Consumer Price Index. Since this index is used to adjust Social Security benefits and Federal pensions, any shortcomings in its construction have serious budgetary consequences. We will shortly issue a report that recommends changes in the housing component of the CPI.

The main purpose of indexing is to protect the purchasing power of the benefits of Federal programs. Inflation clearly threatens the living standards of those people whose incomes are fixed in dollar terms. This is why some adjustment for inflation in the entitlement programs is appropriate. However, under current inflationary conditions, it is necessary for all groups in society to share the burden of bringing inflation under control. In the last two years declining productivity and higher prices for imported oil have lowered the real income of the average American family. Under these circumstances the

full protection of entitlement benefits is questionable. For example, does the Congress really intend that the people receiving these benefits are to be fully protected from the rising price of oil, when this protection cannot be provided to most Americans?

Clearly, the Congress faces some hard choices. Under the circumstances it may be wise to consider revisions in the indexing formulas to permit a temporary cap at less than the full adjustment as is currently possible for Federal pay increases. Needless to say the effects of such a move on needy recipients must be carefully weighed.

Inflation also has an affect on Federal revenues, which grow during inflationary times because as incomes rise, people move into higher marginal tax brackets. For example, OMB estimates that a one percentage point increase in inflation yields a \$3 billion increase in Federal revenues.

Before I finish I would like to state that in my opinion the bigger issue facing us today is inflation - we have pointed out that a piecemeal approach to solving the problem of inflation is not as desirable as a broad systematic program. We believe such a program would require that many steps be taken. Entitlements cuts are only one part of the formula.

Furthermore, change will mean sacrifices. Therefore, steps must be taken that assure such sacrifices are equitably distributed in the economy. The parties involved in making these changes, including this committee, will have to brace

themselves for the forthcoming pressures of special interest groups of all types. In addition better budget discipline requires that many of the current budget practices which are being used to escape that discipline be reexamined. Items such as off budget entities, backdoor spending reflected in permanent authorizations, use of offsetting receipts, reuse of borrowing authority and others, are all examples of a series of issues that we are recommending, in a separate study, be examined by a special task force or commission.

This completes my remarks and I would be glad to respond to any questions you may have.