

TESTIMONY OF
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BEFORE
HOUSE WAYS & MEANS COMMITTEE

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Mr. Chairman:

My colleagues at OMB and throughout the executive branch have worked hard to present this committee and our fellow citizens with a very different budget for the Fiscal Year 2003. Before turning to the traditional subjects of totals, balances, and specific policies, let me recommend to the Committee's attention some new features which I hope will now become part of your annual expectations and deliberations.

This budget takes seriously the assessment of government performance, and its relationship to future spending. Activities where effectiveness can be proven are maintained and often reinforced; those that demonstrably fail, or can make no showing of effectiveness, in many cases are looked to as sources of funding. The days when programs float along year after year, spending taxpayer dollars with never a showing of reasonable results or return, must give way to an era of accountable government. This and all future budgets must no longer be permitted to answer only "How much?" They must also address the question "How well?"

This innovation responds to decades of calls by good government advocates. While long overdue, it is especially necessary at a time when the physical safety of Americans requires that the federal government take on many additional, expensive tasks.

In the interest of both accuracy and sound management, this budget takes a major step toward full cost accounting of programs and departments by assigning the costs of health and retirement benefits to the places where those costs are created. At long last, the true cost of these programs will be visible, and managers will have full incentive to control the costs of additional personnel. Other disguised costs, such as the future liability

associated with hazardous waste, remain and should be the object of further reforms.

The Unexpected Cost of the Recession

It has been clear for months – since September 11th to be precise – that our fiscal picture had changed in a fundamental way. The weaker economy erased \$177 billion of revenues previously expected for 2002, and \$120 billion for 2003. Additional spending to respond to the terrorist attacks in these years subtracted another \$31 billion from the surpluses we all had anticipated. Over a 10-year period, for those still professing to find use in such numbers, changed economic and technical factors reduced the surplus by \$1.345 trillion.

The recession that began in the first quarter of 2001 was the largest but not the only economic factor reducing estimated surpluses. The revised outlook for near-term productivity growth reduced the level of GDP – and hence the receipts base – throughout the budget window. Both the recession and the impact it has had on budget surpluses took us all by surprise.

As the Washington Post has noted, “2001 was a nightmare for economists,” pointing out that, almost without exception, forecasters failed to see recession or its effects coming. In our misjudgments, our economists were in large and renowned company. The good people at the CBO, and 51 of the 54 private forecasters in the Wall Street Journal survey, all missed the recession even as it was well underway. The fact that our assumptions were toward the conservative end of the forecasting spectrum did not protect us from a very large misestimate. May I add that when the nation’s economists are having nightmares, budget directors lose sleep, too. We ultimately must choose assumptions that we believe will be accurate, and it is no comfort later that the rest of the world was in error, too.

The Administration stated from the outset that it would leave room for error, particularly when it came to longer-term projections. In mapping out long-term policy proposals, our Blueprint expressly marked off over \$800 billion (15% of the total expected) as a Contingency Reserve in the event that the hoped-for surpluses did not materialize. At least as far as one can tell from the latest 10-year estimate, even this generous hedge was not enough.

The 2001 experience casts further doubt on the entire idea of 10-year budget forecasts. The attempt to see ten years out began only six years ago – prior to that time 5-year forecasts were the longest ever attempted – but already enough evidence is in hand to convict. The experiment with 10-year forecasts demonstrates that no one can reliably predict budget levels this far into the future. In fact, despite all the lamentations, this year’s 10-year baseline surplus forecast is just as big as that of 2 years ago; even after tax relief, it is the largest ever except for last year’s. If we had taken a one-year timeout from 10-year guesswork, no one would say that anything was “missing.”

Our budget extends 10-year forecasts at the top-line level, for those still determined to find them credible, but it drops them from the rest of the document. There we return to the wisdom of our predecessors by using five-year numbers, which are plenty uncertain in their own right.

A Two-front War Against Terrorism

Mr. Chairman, we present this week a budget for a two-front war. It proposes substantial increases, those the President believes necessary to deliver on the paramount duty of the federal government, to secure the safety of the American people.

Last year’s budget began the reconstruction of a neglected national defense base, and that project continues now with new urgency. The President asks Congress to support a 12% growth in base defense funding, part of this reflecting the new threats presented by a long-term terrorist foe. He also requests an additional \$10 billion, if needed, for the costs of continued hostilities at today’s levels.

Funding for the category of activities we now term “Homeland Security” will double under the President’s plan: airline security, first responders, bioterrorism, border security and preventive law enforcement, are all scheduled for major increases as recommended to the President by Governor Tom Ridge.

We have worked closely with the Office of Homeland Security to define and budget for these activities; an explanation of the definition of the Homeland Security budget is attached at the end of my testimony. We will guard

against and oppose efforts to divert funds from Homeland Security requirements or to misclassify unrelated funding under Homeland Security's priority status.

Winning our two-front war is not optional, and will be expensive. As in other times of national conflict, tradeoffs will be required. Other priorities will have to stand aside for a time, lest we commit the "guns and butter" mistake of the Viet Nam era. We propose a very reasonable level that allows spending not related to the war or homeland defense to grow by around 2%.

Within this "Rest of Government" category the President proposes \$355 billion of spending. It must be noted that the activities it encompasses have enjoyed rapid funding increases during recent years, growing by an average annual rate of more than 8% since 1998.

Within this enormous sum, it is both possible and desirable to increase high priority programs of proven effectiveness, and this budget recommends many such increases. Dozens of programs across the government are scheduled for growth based on demonstrated results.

Measuring Performance and Delivering Results

For decades, good government advocates have called for systematic measurement of government's performance, and its reflection in the allocation of resources. In 1993, Congress passed the Government Performance and Results Act (GPRA), which was intended to implement this reform, but this mandate has been virtually ignored. The President's budget for 2003 responds to Congress' instruction, differentiating where the facts are available between programs that work and those that do not.

Many programs of proven effectiveness are strengthened, by shifting funds from those which can make no proof of performance. NSF, WIC, Community Health Centers, and the National Weather Service are among the best performers, based on clear targets they have set and hard data that says these goals have been met or surpassed.

A serious attitude toward performance is long overdue, but takes on special urgency at a time when the demands of national security assert a heavy

claim on our resources. We hope the findings of this budget will trigger interest in performance assessment, and bring forth much new information about that large majority of programs for which we have no useful data at all.

Restoring Economic Growth

This budget funds a two-front war, but takes aim at a third priority as well, the struggling American economy. The President urges the Congress to act, and act quickly, on a jobs and growth package like that which passed the House but was blocked in the Senate just before Christmas.

There are some encouraging signs of recovery, but the President is not satisfied to leave matters to chance. Government cannot “manage” the economy, but it should do what it can, and the President wants to act on a stimulus measure that might accelerate and strengthen recovery. While adding this action to his other budget proposals would likely make 2003 a year of a small deficit rather than a year of small surplus, the President favors the tradeoff in favor of jobs and growth. Past the short term, it is only rigorous economic growth that can restore surpluses in any event.

Conclusion

In sum, we should count our national blessings. Despite simultaneous war, recession, and emergency, we are in a position to fund the requirements for victory, plus a stimulus package, and still be near balance. The deficit we project will be the nation’s smallest in times of recession since the early 1950s.

Interest costs to the federal government will continue to decline; interest payments will fall below 9¢ of each budget dollar for the first time in 22 years. Despite everything, the outlook is promising for balance in the year after next, and for a return to large surpluses thereafter.

The President’s proposals thus do what must be done, while protecting our fiscal future. It is a privilege to submit them for the committee’s review.

The Homeland Security Budget

To develop the homeland security budget, the Office of Homeland Security and the Office of Management and Budget (OMB) identified those activities that are focused on combating and protecting against terrorism and occur within the United States and its territories. Such activities include efforts to detect, deter, protect against and, if needed, respond to terrorist attacks.

As a starting point, funding estimates for these activities are based on data that has been reported since 1998 in OMB's *Annual Report to Congress on Combating Terrorism*, and include combating terrorism and weapons of mass destruction (WMD), critical infrastructure protection (CIP), and continuity of operations (COOP).

In addition, homeland security includes funding for border security (i.e., Immigration and Naturalization Service's enforcement and detention activities, Customs' enforcement activities, Coast Guard's enforcement activities, the Agricultural Quarantine Inspection Program, and State's visa program) and aviation security.

Since homeland security focuses on activities within the United States, estimates do not include costs associated with fighting terrorism overseas; those costs are captured within the war on terrorism abroad category.

The budget uses the Combating Terrorism Report's definitions for combating terrorism and WMD preparedness, CIP, and COOP. Combating terrorism includes both antiterrorism (defensive measures used to combat terrorism) and counterterrorism (offensive measures used to combat terrorism), and includes the following five categories of activities as they directly relate to such efforts:

- law enforcement and investigative activities;
- preparing for and responding to terrorist acts;
- physical security of government facilities and employees;
- physical protection of national populace and national infrastructure; and
- research and development activities.

CIP is defined as efforts associated with enhancing the physical and cybersecurity of public and private sector infrastructures, especially cyber systems that are so vital to the nation that their incapacitation or destruction would have a debilitating impact on national security, national economic security, and/or national public health and safety.

COOP refers to the capability of federal agencies to perform essential functions during any emergency or situation that may disrupt normal operations.

As the Office of Homeland Security develops a comprehensive national strategy to secure the United States from terrorist threats or attacks, it may refine the definition used to establish the boundaries of this category.