WASTE, FRAUD, AND ABUSE IN FEDERAL MANDATORY PROGRAMS

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

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WASTE, FRAUD, AND ABUSE IN FEDERAL MANDATORY PROGRAMS

WEDNESDAY, JUNE 18, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to call, at 10 a.m. in room 210, Cannon House Office Building, Hon. Jim Nussle (chairman of the committee) presiding.

Members present: Representatives Nussle, Shays, Ryun, Schrock, Brown, Putnam, Brown-Waite, Hensarling, Diaz-Balart, McCotter, Barrett, Garrett, Franks, Hulshof, Wicker, Spratt, Baldwin, Neal, Edwards, Scott, Ford, Baird, Davis, and Emanuel.

Chairman NUSSLE. Good morning. I would like to call the Budget Committee to order. Today the Budget Committee will hear from the General Accounting Office on its efforts to identify waste, fraud and abuse in the Federal Government. Our witness is the Honorable David M. Walker, the Comptroller General of the U.S. General Accounting Office or, as some refer to it, "the Government Accountability Office." We are trying to get that name changed for you, General. We will see how we do.

General Walker, I want to thank you for being here and welcome you back to the committee. You have been here many times and we appreciate the work that you and the GAO does on our behalf.

I have some slides I would like to go through. The first slide, as you can see from this chart, since 1995, overall government spending has increased nearly 41 percent, or at about 4.4 percent a year. This is total government spending. The second chart shows that non-Social Security mandatory programs, in particular, have grown at about 37.4 percent since 1995, about 4 percent each year. If you look at individual budget categories, overall education spending has grown at 82 percent. Veterans mandatory spending has grown at 49 percent. Medicare mandatory spending has grown at 55 percent. Medicaid has grown at 77 percent.

Now with the economic boom and the budget surpluses of the late 1990s, Congress spent very generously and government programs grew by leaps and bounds. But while these important programs expanded, we did not ask that Congress expand our oversight responsibilities at the same rate that the government was increasing these programs. As a result, we now have a government that spends at about $69,000 per second; more, certainly, than the average family makes, in many instances, in a year. Let me repeat that, the Federal Government now spends $69,000 per second. And if you look at the chart, you will see that this kind of pace has been going on when it comes to spending increases for quite some time. As it expands out, obviously, we are going to have a problem.

We have massive government agencies with massive responsibilities and obligations. As everybody in this room and everybody in America knows, it is unconscionable, but it has many different varying amounts of bureaucratic waste, fraud and abuse within its agencies. Certainly, this is not a new problem, but the question is why is it allowed to continue?

As we know from GAO reports—and there are hundreds and thousands of them, and I know that General Walker will discuss many of them today—many government agencies cannot even account for much of their own budgets. In many cases, agencies are punished if they don't spend the entire budget or if they uncover waste or inefficiencies. The more they waste, the more they get. There is absolutely no incentive to find savings. It is wrong and it needs to change.

Everyone has heard the, "if you don't use it, you will lose it" adage, that has been around for quite sometime. There is no family business in America that would operate that way, certainly no family operates that way.

We are going to focus on the mandatory or entitlement spending side of this today for many reasons. I want to show you the spending breakdown for the Federal budget. As you can see from this chart, 55 percent of overall spending is what we call mandatory. Another way to say that is it is automatic. It continues every year, not subject to appropriations, there is no built in process of review, it is automatic. It just continues typically with large annual increases in the budget. Certainly the Appropriations Committee has got to do their job. Appropriations have increased at astronomical rates as well on the discretionary side. But to just look at the discretionary side would miss over half of the budget responsibility. And as we know from General Walker, GAO reports, IG reports and elsewhere, billions of these dollars are wasted every year.

So we are holding the hearing today as another step in the process that we started back in March, when we passed the budget, that required every authorizing committee in both the House and Senate to identify means of eliminating waste, fraud and abuse within their jurisdiction by September 2 of this year. The goal we set for each committee was to find one penny on the dollar in savings for each dollar that they spend. We understand that they might find a little less, some might find even a little more, but this is a goal and I think a worthwhile starting point.

And last month, this committee joined the House Republican leadership and committee chairmen in publicly announcing our determination to change this tolerance, and we did so as a leadership and committee chairs for a reason. Oftentimes in the past, this has been an individual effort or project; one individual Member or group of Members. I think it is different when committee chairs and leadership join in this process. We stand committed and ready to do the hard work to ensure that government spends taxpayers' dollars more responsibly. I want to applaud the committees who have already begun this effort, including the House Veterans' Affairs, and Government Reform committees; both the Commerce and

Ways and Means committees have waste, fraud and abuse hearings scheduled, and I believe it is a good start.

Just last night, the Ways and Means Committee in a somewhat unprecedented way, included a title within the Medicare modernization bill that passed last night at 11:30. It was a waste, fraud and abuse title. It got very little fanfare, no discussion and actually, interestingly enough, no complaints in part because this is a bipartisan approach. As a result of the Ways and Means Medicare mark, $33 billion will be eliminated from the Medicare program that has been wasted or fraudulently applied.

So today we continue the process to help in this effort and we are going to hear from the General Accounting Office. We are also going to take a different new step. We have all heard stories of government waste in education, agriculture, Medicaid, Medicare. My own constituents have told me many stories, and yours as well, and we want to hear these stories. So today we are going to invite the American public to be part of this process. We are unveiling a link at our Web site, www.budget.house.gov., which will provide the public an outlet to report their observations of government waste.

I don't want anyone to think that, just because we are running billion dollar deficits, or that billion dollars is what we talk about often in Washington, that if you have a story that involves only $100, or $1,000, that isn't worthwhile. We want to hear it all, because all of this money adds up; the nickels and dimes become dollars very quickly. At the end of the day, we may find only $10 million or $10 billion, but every dollar that we find that is better spent is dollars that is not wasted, that is hard earned by the taxpayers.

And let me be clear, this is not a Republican or Democrat effort. This can and should be a bipartisan effort. This affects us all and all of our constituents can be part of this. We can enter into a blame game. The Democrats have evidence and charts showing how this is all a Republican plot and the Republicans have charts that can show why this is all because of the Democrats. And we can continue to go through historical efforts to show how the other party is totally to blame. That would be interesting but it would be a waste of time. And just like we should not waste money, we really don't need to waste time either. We can disagree on policy and how best to get the economy going, but we really don't need to disagree on whether or not waste within the Federal Government is something that we can work together to eliminate.

So I appreciate the work that Mr. Walker and his team continue to do in this effort. We need to pay attention to what the GAO says when their little blue books come out. We need to do more than just allow them to sit on a shelf and collect dust, and we will do that as part of this process.

Thank you. I want to turn to Mr. Spratt for any comments he would like to make.

Mr. SPRATT. Thank you, Mr. Chairman, General Walker and Mr. McIntyre. We very much appreciate not only your coming but the efforts you have put into the preparation of your testimony, because we too are interested in eliminating waste, fraud and abuse from government spending. In fact, the Clinton administration opened its administration with the National Performance Review making government smarter and cost less. By his calculation $100 billion was saved. That may be hype but nevertheless significant savings were ferreted out and implemented. We as Democrats have passed in the past and Democratic Presidents have signed into law bipartisan measures to reform government, beginning going back to acts like the Inspector General Act of 1978, which has surely paid dividends and does every day, and the Government Performance and Results Act of 1993.

We have reservations about a formalistic approach that gives percentage numbers to different committees of jurisdiction. In response to the chairman's charts, we would like to make it clear that one of the reasons those mandatory costs are going up is that a substantial component consists of the medical health care entitlements. And as the population gets older, the cost of health care goes up. We all experience that in our own individual lives. We are experiencing that collectively in our society today.

The fact of the matter is 77 million baby boomers are marching toward their retirement as we meet today. They begin retiring in the year 2008 and start drawing Medicare in the year 2011, and there is nothing we can do to make that tide recede. They are born and they are going to demand their benefits. When they do, we will eventually double the number of beneficiaries on Social Security and Medicare, and that is why we are concerned about what you are doing to the revenue base of the Federal Government. We think you are diminishing the revenue base to the point where it cannot sustain the Medicare program or the Social Security program or these programs that the population of this country come to depend upon and care deeply about.

We think as you drain away government revenues, you are also driving the deficit higher and higher. It is likely to be over $400 billion this year unless we take drastic steps to reverse the course that we are now on, likely to be over $400 billion over the next 10 years. That means $4 trillion in additional debt. I don't know if we have the chart available, but there is something we began to call the debt tax—not the death tax—that is today—the debt tax, because as we accumulate this debt you can see what happens to debt service.

We have indeed enjoyed the savings over the last 4 years. From 1997–2000, we paid off $400 billion of government debt. As a result of that and a result of the fact that the government for 8 consecutive years—the deficit was declining. We were not crowding out private borrowers. Interest rates went down. Debt service has dropped from over $250 billion to about $170 billion this year. That is a $70 [billion] to $80 billion dividend we have been able to use for other purposes or at least charge up to savings in the Federal Government. That won't last long, not at the rate we are accumulating debt today.

We are also concerned, let me say, about the scope of this inquiry. First of all, we are looking at the spending side of the ledger today. We should look at the tax side, too. We haven't had a good cleaning out of the closet, a good scrub down of the tax code since 1986. And as a result, it is full of accretions, of special interest provisions, targeted provisions that are really an embarrassment to the point they have reached today.

We have a witness today, Mr. McIntyre, from Citizens for Tax Justice, who will direct our focus on the tax code because we think there is plenty of tax expenditures that ought to be examined and reconsidered. Under expatriation provisions now, which American corporations are moving to Bermuda, buying a telephone and setting up a mailbox and claiming they are now domesticated in Bermuda. We are allowing something outrageous like that to happen and doing nothing about it. That too should be a topic of our concern.

We are very concerned—this is a worthwhile exercise and I commend the chairman for undertaking it, but I hope we don't treat this as a red herring, to divert our attention from the serious problem of accumulating deficits and mounting debt. Whatever we are able to accomplish through the efforts we undertake, there is no way the net outcome of this is going to be the eradication of the debt we are now accumulating. We have to do something else about tax policy and about spending policy other than just ferret out waste and abuse.

Having expressed all these concerns, let me say that we stand ready to work with you to define waste, fraud and abuse and to wipe it out. We welcome you, Mr. Walker, and look forward to your testimony and appreciate your efforts. And we welcome Mr. McIntyre from Citizens for Tax Justice and look forward to his testimony.

Mr. Chairman, I have a full statement which I will offer for the record.

[The prepared statement of Mr. Spratt follows:]

PREPARED STATEMENT OF HON. JOHN M. SPRATT, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH CAROLINA

We strongly support efforts to eliminate waste, fraud, and abuse from government spending. Indeed, the Clinton administration initiated the National Performance Review, which is supposed to have saved more than $100 billion. Democratic Congresses have passed and Democratic presidents have signed into law bipartisan measures to reform government, laws like the Inspector General Act of 1978 and the Government Performance and Results Act of 1993.

We do have reservations, however, about the approach taken in the budget resolution conference report. The conference report requires the authorizing committees to recommend changes in laws within their jurisdictions that would eliminate waste, fraud, and abuse, and produce budget savings totaling $132 billion in outlays over 10 years. Each committee is instructed to find savings of approximately 1 percent of the net cost of all mandatory spending within its jurisdiction. These recommendations can then be used in formulating future budget resolutions.

We are concerned that the approach taken in the conference report takes us back to the formula-driven reductions to mandatory spending included in your budget resolution and then rejected. These cuts started at $470 billion in the chairman's mark, were reduced to $265 billion before floor consideration, and have been reduced again to $132 billion. Not only has the total changed, but committees are required now just to recommend these changes, rather than to pass legislation implementing them.

The arbitrary nature of these cuts is one concern. Their scope is another. The fastest rising spike in the budget will soon be interest on the national debt. At the beginning of 2001, the Congressional Budget Office projected that the interest costs would fall below zero in 2009. Instead, by current staff estimates, net interest costs in 2011 will be $368 billion—$348 billion more than projected by the Bush administration in 2001, and $464 billion more than projected by CBO.

Another concern is that your approach does nothing to address waste, fraud, and abuse in the tax code, a problem that our second witness will address. And by focusing on reductions in mandatory spending only, you also neglect waste, fraud, and abuse on the discretionary side of the budget, as in the Department of Defense, which represents about half of all discretionary funding.

In any event, the $132 billion in savings that the plan aims to generate will not come close to solving our Nation's fiscal problems which in large measure have been created by the tax cuts passed in 2001, 2002, and 2003. In January 2001, CBO and OMB projected a $5.6 trillion surplus. But this March, CBO projected if the President's budget is adopted a total deficit of $1.8 trillion over the period 2004–13. This deficit total excludes such costs as the occupation and reconstruction of Iraq, as well as the cost of correcting the Alternative Minimum Tax. These will make the overall picture even bleaker. The $132 billion is less than 10 percent of what is needed to close even a conservative estimate of the budget gap that we face.

Finally, we are concerned that the current approach may, in the end, threaten vital services to the American people. We recognize that the instructions to the authorizing committees state that the required levels of savings should be found solely through eliminating waste, fraud and abuse. But past efforts to identify waste, fraud, and abuse such as President Reagan's Grace Commission have often identified not true waste or fraud, but rather policy changes that would, in fact, reduce benefits received by individuals or businesses. Similarly, in the past when GAO has been asked to identify mandatory budget savings, some of the options they have identified have included such steps as increasing cost-sharing for beneficiaries and revising eligibility rules.

We stand ready to work in a bipartisan way to reduce wasteful and fraudulent government spending. But this work must be done carefully and responsibly.

We welcome the Comptroller General, Mr. Walker, and look forward to his testimony, and we welcome Mr. McIntyre, and look forward to his testimony.

Chairman NUSSLE. I thank the gentleman. I need to report to Mr. Spratt and to other members of the committee that if you are worried about accumulating deficits and debt, you may want to pay attention to what happened last night on the Ways and Means Committee. The minority offered an amendment, a substitute amendment drug plan. And if you remember, the minority budget that Mr. Spratt wrote accommodated a $528 billion drug plan, which was a little more than, of course, the majority plan that passed, which was 400 billion. The Blue Dog Coalition offered a $400 billion drug plan. But last night the minority offered a $1 trillion drug plan.

So don't worry about the fact that it busted our budget, it busted both of your budgets put together. So if you are worried about deficits and debt, as I said, we can talk about blaming, we can talk about who is at fault, that is fine, we can do that, and we will get probably nowhere. Today I think we can, in a bipartisan spirit, not as a red herring, even if it is a dollar—may be a red herring to some, but it shouldn't be wasted. We are going to hear about some egregious waste that, no, totally won't eliminate the national debt, but I do think that if we don't start working on this together, there won't be much that we will be able to do together in a bipartisan way.

So I am worried about the deficit and debt as well, but I think people have got to start concerning themselves with what they are doing. And if you bust your own budget, not our budget, forget our budget, I know you didn't vote for ours. You don't want ours and that is fine, but I think it would be hypocritical to suggest that you shouldn't at least stick within the budget that you wrote, which unfortunately the majority of Democrats last night on the committee did not do. And at some point in time, I think that is what is going to come back to haunt us in the long-term. Our tax cuts fit within a budget. You didn't like it, but you proposed tax cuts in your budget.

We can keep going on this all day, but I am willing to at least move on and talk about waste, fraud and abuse today. But if you want to keep talking about national debt tax and all of this, I am going to unleash all of us and we can all have a great debate today about who is at fault and who historically—and we can go back to Reagan, Carter, Clinton and everybody else. So I would rather stick to waste, fraud and abuse, hear from the witness and start talking about how we are going to eliminate it.

Mr. SPRATT. Let me respond, Mr. Chairman. We proposed $528 billion. And further, a provision out of your budget resolution dealing with transportation; namely, the idea that if more revenues are generated they can be devoted to that particular program area than more user fees generated under the highway program and they are paid into the Highway Trust Fund, and your budget resolution allowed an increase. So we stipulated if the Ways and Means Committee came up with up to $200 billion of additional tax measures, identified to the Medicare prescription drug proposal, that could be added to the $528 billion. The net cost of the budget would still have been $528 billion. We did it frankly because we didn't think you could offer anything that was worthy of a name in the way of prescription drug coverage for less than that. And as you look at the package that is coming down the pike now, coming out of your committee last night, it appears to me that what you are proposing is that beneficiaries pay $4,000 of their own money in premiums, copayments, deductibles and a gap for the first $5,000 of coverage. So I think what is coming down validates our concern that if you are going to be for prescription drug coverage, you have to step up to the plate and pay the price.

Let us not forget you have got on the floor today a total repeal of the estate tax. In the second 10 years after the repeal is fully phased in, by our calculation, that will mean a reduction in Federal revenues of $820 billion. That will pretty well pay the cost of prescription drug coverage under even the proposal made last night.

Chairman NUSSLE. Well, let us see, 1 trillion minus 528 plus 200 is 728. You are still missing $300 billion. Again, if we want to keep having this debate, you are adding $300 billion to the national debt with your proposal, even under the best calculation of your budget. And you know we can keep having this discussion and debate all day. I would rather move to waste, fraud and abuse.

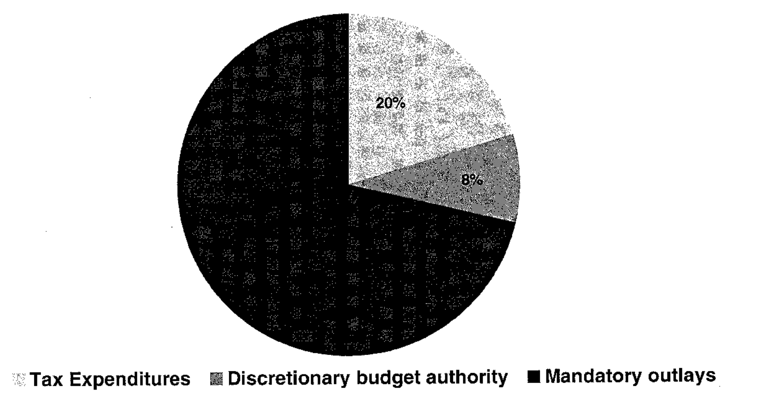
Mr. Walker, welcome, we are pleased to receive your testimony on waste, fraud and abuse and hopefully we can get to the Medicare debate on the floor this week and carry this on at some point in the future. Mr. Walker, welcome.

STATEMENT OF THE HON. DAVID M. WALKER, COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY BILL SCANLON, MANAGING DIRECTOR, HEALTH CARE; PAUL POSNER, MANAGING DIRECTOR, BUDGET AND INTERGOVERNMENTAL RELATIONS; AND SUSAN IRVING, DIRECTOR, FEDERAL BUDGET ANALYSIS

Mr. WALKER. Thank you, Mr. Chairman, Ranking Member Spratt and members of the committee. It is a pleasure to be here to talk to you about this important topic. Let me say that I believe that this hearing is a positive first step, but obviously just a first step, toward dealing with a major challenge that we all have to come to grips with in the months and years ahead. I am pleased to appear on behalf of the GAO. And, Mr. Chairman, with your permission and the committee's permission, I would like for my full thick statement to be inserted into the record. I am going to use these PowerPoint slides to touch on some highlights if that is OK.

If we can, let us go to the first slide. Next. Thank you.

Relative Reliance on Policy Tools in the Health Care Budget Function (FY 2000)



Note: Loan Guarantees account for about $5 million, or about .001 percent, of the approximately $447 billion in total federal health care resources.
Source: *Budget of the United states Government, FY 2002,* Office of Management and Budget.

It is important to note that if you look at the composition of Federal spending for fiscal 2003, including the supplemental, only 39 percent of the total Federal budget is represented by discretionary spending. By that, I mean 39 percent is represented by what you, as members, can vote on and have some control over, through the regular appropriations process; 7 percent is represented by interest on the Federal debt, which is clearly mandatory in anybody's term and 54 percent is represented by other mandatory programs. So in total 61 percent—and if you excluded the supplemental, 64 percent—would be mandatory.

Now how does that compare, because everything has to be put in context. In 1963, when John F. Kennedy was President, roughly two-thirds of all Federal spending was discretionary. It has now flipped. Roughly two-thirds of all Federal spending is now mandatory and the trend is continuing. And so mandatory programs must be part of any examination, although it is not the whole issue.

Next, please.

FIGURE 2.—EXAMPLES OF OTHER ENTITLEMENTS, MANDATORIES AND DIRECT SPENDING

- Crop insurance
- Commondity credit corporation
- Food stamps
- Child nutrition

- Federal, military, and civilian retirement
- Federal unemployment benefits
- Social Services Block Grant [entitlement to the States]
- Vaccine injury
- Veterans pension and compensation
- Payments to States from forest service receipts

I think it is also important to call attention to the range of mandatory programs, in addition to interest on the Federal debt, which is obviously mandatory, Social Security, Medicare, Medicaid, which we all know of as mandatory, there are a number of other items that are deemed to be mandatory. These include items such as crop insurance, food stamps, Federal unemployment benefits. These are in effect on auto pilot. So it is not just the big programs that we all know about talk about.

Next, please.

FIGURE 3.—TALK ABOUT 3 LEVELS OF REVIEW

- Addressing vulnerabilities to fraud, waste, abuse and mismanagement;
- Improving economy, efficiency and effectiveness;
- Reassessing what government does: fundamental re-examination of programs, policies, activities and processes.

In GAO's view there are three levels that Congress is going to have to ultimately deal with in order to address our large and growing fiscal gap. At the first level, which is the subject of this hearing, is addressing vulnerabilities to fraud, waste, abuse and mismanagement. We should have zero tolerance for fraud, waste, abuse and mismanagement, but in the largest, most complex, the most diverse, and arguably the most important entity on the face of the Earth—the U.S. Government—it will never be zero. Nevertheless, we should have zero tolerance and do whatever we can to absolutely minimize it. It will, however, never be eliminated. But even if we do everything that we can do, which we should and we must, we also need to move to the next level, improving the economy, efficiency and effectiveness of Federal programs and that won't be enough. We also have to look at reassessing what the government does, how the government does business and in some cases who does the government's business in the 21st century. Because what we now have is a building of the base over decades and we are going to have to start looking at the base. And I will come back to that.

Now the first category: Addressing vulnerabilities with regard to fraud, waste, abuse and mismanagement. In my testimony, I give specific examples based upon GAO's work in areas dealing with Medicare, Medicaid, the earned income tax credit, food assistance, DOD, improper payments, credit card abuse, student financial aid and a variety of others where there are clearly opportunities to make progress on fraud, waste, abuse and mismanagement. There is real money involved. We need to take various steps, but they in and of themselves, are not going to be enough to come close to solving our problem, but that doesn't mean we shouldn't take the necessary steps

High Risk Areas	Year Designated High Risk
Addressing Challenges in Broad-based Transformations	
Protecting Information Systems Supporting the Federal Government and The Nation's Critical Infrastructures	1997
Strategic Human Capital Management*	2001
U.S. Postal Service Transformation Efforts and Long-Term Outlook*	2001
Implementing and Transforming the New Department of Homeland Security	2003
Modernizing Federal Disability Programs *	2003
Federal Real Property *	2003
Ensuring Major Technology Investments Improve Services	
FAA Air Traffic Control Modernization	1995
IRS Business Systems Modernization	1995
DOD Systems Modernization	1995
Providing Basic Financial Accountability	
DOD Financial Management	1995
IRS Financial Management	1995
Forest Service Financial Management	1999
FAA Financial Management	1999
Reducing Inordinate Program Management Risks	
Medicare*	1990
Collection of Unpaid Taxes	1990
DOD Inventory Management	1990
Student Financial Aid Programs	1990
HUD Single-Family Mortgage Insurance and Rental Assistance Programs	1994
Earned Income Credit Noncompliance	1995
DOD Support Infrastructure Management	1997
Medicaid Program *	2003
Managing Large Procurement Operations More Efficiently	
DOD Weapon Systems Acquisition	1990
Department of Energy Contract Management	1990
NASA Contract Management	1990
DOD Contract Management	1992

* Additional authorizing legislation is likely to be required as one element of addressing this high-risk area.

Next, please.

This represents a summary of GAO's high risk list, which is not just dealing with fraud, waste, abuse and mismanagement but it is also addressing economy, efficiency, effectiveness, and it is also reexamining some of the basic roles of government. We update this list every 2 years. We are becoming more strategic about it, and we are adding items that not only have to be dealt with by the executive branch but also the legislative branch.

Next, please.

The next category is improving economy, efficiency and effectiveness, and in my testimony I note there are at least four dimensions to this. There is better targeting of existing programs, whether they be grant programs, flood insurance, the Social Security pension offset. There is consolidation of certain programs where we have too many players on the field. By definition that means you are going to have economy, efficiency and effectiveness problems such as food safety, homeland security grants, and rural housing assistance. We can also look at what we can do to achieve better cost recovery, real full absorption costing in areas like public power, child support enforcement. We also need to look at areas of cross-cutting or horizontal Federal activities where there is a tremendous opportunity for savings such as Federal real property. The Federal Government has a tremendous amount of excess real property. It is not just DOD, not just the Postal Service, it is the VA and many civilian agencies that have built up a tremendous amount of excess real property before the technology age that we need to fundamentally review and reassess because not only can we save money through not having to spend on maintenance, security and protection, but we can hopefully realize some asset recovery values as well.

The next slide shows certain key questions that need to be asked about every program and policy periodically, and these are the questions.

The next, please.

FIGURE 7.—KEY QUESTIONS

- Is the program targeted appropriately?
- Does it duplicate or even work at cross-purposes with related programs and tools?
- Is it financially sustainable? Are there opportunities for instituting appropriate cost sharing and recovery from nonfederal parties including private entities that benefit from Federal activities?
- Can efficiency be increased through reengineering or streamlining processes or restructuring organizational role and responsibilities?
- Are there clear goals, measures and data with which to track progress, benefits and costs?

And then last but certainly not least with regard to the three major categories, a fundamental reassessment of what does the government do, how does the government do business, and who does the government's business based upon 21st century realities. In reality what we have now is we have built up a number of programs, policies, functions and activities over the past several decades and the assumption is that the base is OK. The base is not OK. The base is unsustainable. Due to known demographic trends and rising health care costs, we face large and growing deficits that must be addressed. This means you are going to have to look beyond fraud, waste, abuse and mismanagement, including the mandatory programs, to economy, efficiency, effectiveness and move on to make some tough choices on the proper role of government. Just 2 weeks ago when I spoke to a group of Ph.D. economists, including some past chairs of the Council of Economic Advisers, I asked them whether they believe that we were going to grow our way out of the long-range problem, and nobody raised their hand—nobody. Tough choices will be required. We need to start with fraud, waste, abuse and mismanagement. We need to move on to economy, efficiency and effectiveness. And we ultimately have to reassess what is the proper role of government.

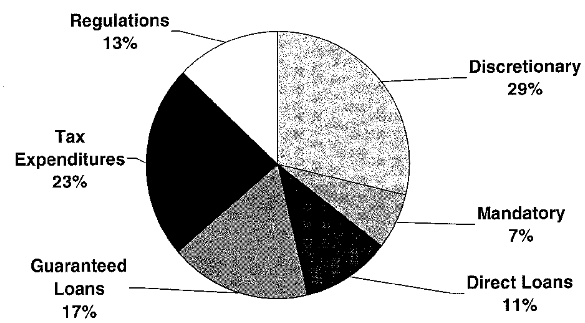
Next, please.

This is an example of the different tools that government has to achieve policy. The government has tax incentives. They need to be reexamined, too. There are a lot of tax incentives that have been in the base that may or may not make sense and may not be affordable or sustainable going forward. There are tax incentives, loan guarantees, regulations, discretionary spending, mandatory spending, direct loans.

This is an example of the education and labor budget. Namely, of all the different tools the government has in order to try to achieve a desired policy objective. I would respectfully suggest that many of those tools haven't been reviewed in years, and it is time that we do that.

Relative Reliance on Tools in the Education & Labor Budget Function (FY 2000)

Percent of Total Federal Resources for the Education and Labor Budget Function, Fiscal Year 2000



Note: Includes $41 billion in discretionary spending and about $1 billion in mandatory spending for the Iraq war supplemental Includes $11 billion in mandatory spending for the 2003 tax cut package.
Source: GAO analysis of data from the Congressional Budget Office.

Last but certainly not least, health care. I would respectfully suggest that our health care is the biggest domestic policy challenge. It is not just cost, it is access, it is quality, it is affordability, sustainability, and a variety of issues. If you look at health care in fiscal 2000—and it has gotten worse since then—72 percent represented mandatory outlays, 8 percent discretionary, 20 percent tax expenditures, over $99 billion per year in tax expenditures for health care, which is a permanent difference. Unlike pensions where people ultimately pay tax on their pensions—it is just a matter of when, and at what effective tax rate—people never pay tax on the value of their health care insurance. In addition that value is not in either the Social Security or the Medicare wage base.

So the fact of the matter is, Mr. Chairman, in summary, we face large and growing fiscal imbalances that we must address. There are three tiers, first fraud, waste, abuse and mismanagement, including the mandatory programs. We must make progress there. Secondly, economy, efficiency and effectiveness, when we have a range of opportunities. And last but not least and probably the biggest amount of money but the toughest to do is fundamentally reassessing the base on the tax and—both discretionary and mandatory—and rationalizing government for the 21st century. It is heavy lifting but it must be done. I have 10½ years left in my term. I look forward to working with you along with my GAO colleagues to try to get it done.

[The prepared statement of Mr. Walker follows:]

PREPARED STATEMENT OF DAVID M. WALKER, COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE

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Mr. Chairman, Mr. Spratt, members of the committee. It is a pleasure to be here today as you deal with one of your important obligations—to exercise prudence and due care in connection with taxpayer funds. No government should waste its taxpayers' money, whether we are operating during a period of budget surpluses or deficits. Further, it is important for everyone to recognize that waste, fraud, abuse, and mismanagement are not victimless activities. Resources are not unlimited, and when they are diverted for inappropriate, illegal, inefficient, or ineffective purposes, both taxpayers and legitimate program beneficiaries are cheated. Both the administration and the Congress have an obligation to safeguard benefits for those that deserve them and avoid abuse of taxpayer funds by preventing such diversions. Beyond preventing obvious abuse, government also has an obligation to modernize its priorities, practices, and processes so that it can meet the demands and needs of today's changing world. More broadly, the Federal Government must reexamine the entire range of policies and programs—entitlements, discretionary, and tax incentives—in the context of the 21st century.

Periodic reexamination and revaluation of government activities has never been more important than it is today. Our Nation faces long-term fiscal challenges. Increased pressure also comes from world events: both from the recognition that we cannot consider ourselves "safe" between two oceans—which has increased demands for spending on homeland security—and from the U.S. role in an increasingly interdependent world. And government faces increased demands from the American public for modern organizations and workforces that are responsive, agile, accountable and responsible.

As everyone on this committee knows well, only about 36 percent of the Federal budget—and even less if you look only at programmatic spending—is discretionary. The rest is direct or mandatory spending.[1]

In addition, we can't forget about tax incentives. I make this point to reinforce the fact that efforts to assure prudent use of taxpayer funds, efforts to guard against fraud, waste, abuse and mismanagement, and efforts to improve economy, efficiency and effectiveness cannot focus solely on discretionary appropriations but must also encompass mandatory programs and tax policy, including tax incentives.

Direct, or mandatory, spending programs are by definition assumed in the baseline and not automatically subject to annual congressional review as are appropriated discretionary programs. Nonetheless, a periodic reassessment of these programs, as well as tax incentives, is critical to achieving fiscal discipline in the budget as a whole. Moreover, such a review can help ascertain whether these programs are protected from the risk of fraud, waste and abuse and are designed to be as cost effective and efficient as possible.

As you know, the Budget Resolution directs GAO to prepare a report identifying "instances in which the committees of jurisdiction may make legislative changes to improve the economy, efficiency, and effectiveness of programs within their jurisdiction." My testimony draws in part on some of the items that will be included in that report.

Today I want to talk about program reviews, oversight, and stewardship of taxpayer funds on several levels:

- First, it is important to deal with areas vulnerable to fraud, waste, abuse and mismanagement. Payments to ineligibles drain resources that could otherwise go to the intended beneficiaries of a program. Everyone should be concerned about the diversion of resources and subsequent undermining of program integrity.
- Second, and more broadly, policymakers and managers need to look at ways to improve the economy, efficiency and effectiveness of Federal programs and specific tax expenditures. Even where we agree on the goals of programs, numerous opportunities exist to streamline, target and consolidate to improve their delivery. This means looking at program consolidation, at overlap and at fragmentation. For example, it means tackling excess Federal real property—whether at home or abroad. It means improved targeting in both spending programs and tax incentives—in some cases, spreading limited funds over a wide population or beneficiary group may not be the best approach.
- Finally, a fundamental reassessment of government programs, policies, and activities can help weed out programs that are outdated ineffective unsustainable, or simply a lower priority than they used to be. In most Federal mission areas—from low-income housing to food safety to higher education assistance—national goals are achieved through the use of a variety of tools and, increasingly, through the participation of many organizations, such as State and local governments and international organizations, that are beyond the direct control of the Federal Govern-

ment. Government cannot accept as “givens” all of its existing major programs, policies, and operations. A fundamental review of what the Federal Government does, how it does it, and in some cases, who does the government’s business will be required, particularly given the demographic tidal wave that is starting to show on our fiscal horizon.

ADDRESSING VULNERABILITIES TO FRAUD, WASTE, ABUSE AND MISMANAGEMENT

Programs and functions central to national goals and objectives have been hampered by daunting financial and program management problems, exposing these activities to fraud, waste and abuse. These weaknesses have real consequences with large stakes that are important and visible to many Americans. Some of the problems involve the waste of scarce Federal resources. Other problems compromise the ability of the Federal Government to deliver critically needed services, such as ensuring airline safety and efficiently collecting taxes. Still others may undermine government’s ability to safeguard critical assets from theft and misuse.

In 1990, GAO began a program to report on government operations we identified as “high risk.” This label has helped draw attention to chronic, systemic performance and management shortfalls threatening taxpayer dollars and the integrity of government operations. Over the years GAO has made many recommendations to improve these high-risk operations. We discovered that the label often inspired corrective action—indeed 13 areas have come off the list since its inception. For each of these areas, we focus on (1) why the area is high-risk; (2) the actions that have been taken and that are under way to address the problem since our last update report and the issues that are yet to be resolved; and (3) what remains to be done to address the risk.

In January of this year we provided an update for the 108th Congress, giving the status of high-risk areas included in our last report [January 2001] and identifying new high-risk areas warranting attention by the Congress and the administration.[2] GAO’s 2003 high-risk list is shown in Attachment I. Lasting solutions to high-risk problems offer the potential to save billions of dollars, dramatically improve service to the American public, strengthen public confidence and trust in the performance and accountability of our national government, and ensure the ability of government to deliver on its promises.

In addition to perseverance by the administration in implementing needed solutions, we have noted that continued congressional interest and oversight, such as that exemplified by this hearing today are of crucial importance. The administration has looked to our recommendations in shaping governmentwide initiatives such as the President’s Management Agenda, which has at its base many of the areas we have previously designated as high risk.

Clearly progress has been made in addressing most of the areas on our current high risk list, both through executive actions and congressional initiatives. However, many of these problems and risks are chronic and long standing in nature and their ultimate solution will require persistent and dedicated efforts on many fronts by many actors. Some will require changes in laws to simplify or change rules for eligibility, provide improved incentives or to give Federal agencies additional tools to track and correct improper payments. Continued progress in improving agencies’ financial systems, information technology resources and human capital will be vital in attacking and mitigating risks to Federal program integrity. Some areas may indeed require additional investments in people and technology to provide effective information, oversight and enforcement to protect programs from abuse. Ultimately, a transformation will be needed in the cultures and operations of many agencies to permit them to manage risks and foster the kind of sustained improvements in program operations called for. Continued persistence and perseverance in addressing the high risk areas will ultimately yield significant benefits for the taxpayers over time. Finding lasting solutions offers the potential to achieve savings, improved service and strengthened public trust in government.

I will now address some specific areas and examples from both our high risk work and other program reviews that illustrate both the problems facing us and the opportunities for congressional and executive actions to better safeguard taxpayer funds.[3]

IMPROPER PAYMENTS

Improper payments include inadvertent errors, such as duplicate payments and miscalculations; payments for unsupported or inadequate supported claims; payments for services not rendered; payments to ineligible beneficiaries; and payments resulting from outright fraud and abuse by program participants and/or Federal employees. Recently, agencies’ financial statements also have begun to identify and measure the wide range of improper payments involved in many activities throughout government. Agency financial statements for both fiscal years 2002 and 2001 identified improper payment estimates of approximately $20 billion. OMB recently testified that the amount of improper payments was closer to $35 billion annually for major benefit programs. This range may be indicative of the fact that it is hard to get a handle on the precise total. Furthermore, as significant as these amounts are, they do not represent a true picture of the magnitude of the problem governmentwide because they do not consider other significant but smaller programs and other types of agency activities that could result in improper payments. In reviewing fiscal year 2002, agency financial statements of the 24 CFO Act agencies, we found references to improper payments in 17 agencies and 27 programs. Unfortunately, not all of them provided information on the amount of such payments. In the Federal Government, improper payments occur in a variety of program activities, including those related to contractors and contract management, such as defense; healthcare programs, such as Medicare and Medicaid; financial assistance benefits, such as Food Stamps and housing subsidies; and tax refunds.

THE MEDICARE PROGRAM

The sheer size and complexity of the Medicare program makes it highly vulnerable to fraud, waste and abuse. In fiscal year 2002, Medicare paid about $257 billion for a wide variety of inpatient and outpatient health care services for over 40 million elderly and disabled Americans. To help administer claims the Centers for Medicare & Medicaid Services (CMS) contracts with 38 health insurance companies to process about 900 million claims submitted each year by over 1 million hospitals, physicians, and other health care providers. Although CMS has made strides, much remains to be done. We have recommended actions in a number of specific areas, including:

- Reducing Improper Payments: Since 1996, annual audits by the Department of Health and Human Services' Office of the Inspector General have found that Medicare contractors have improperly paid claims worth billions of dollars—$12.3 billion in fiscal year 2002 alone. CMS has been working to better hold individual contractors accountable for claims payment performance and help them target remedial actions to address problematic billing practices. Program safeguard activities have historically produced savings. In the past CMS has estimated a return of over $10 for every dollar spent in this area.
- Monitoring managed care plans: In 2001 auditors found that 59 of 80 health plans had misreported key financial data or had accounting records too unreliable to support their data, but CMS did not have a plan in place to resolve these issues.
- Improving financial management processes: Despite a "clean" opinion on its financial statements, CMS financial systems and processes do not routinely generate information that is timely or reliable and do not ensure confidentiality of sensitive information.
- Collecting debt: At the end of fiscal year 1999, over $7 billion of debt had accumulated on contractors' books as accounts receivable that were neither collected nor written off. While Medicare contractors have referred eligible delinquent debt to the Treasury for collection, CMS continues to face challenges in ensuring that contractors consistently make these referrals and is working to address this.
- Reducing excessive payments for services and products: These hurt not only the taxpayers but also the program's beneficiaries who are generally liable for copayments equal to 20 percent of Medicare's approved fee. Excessive payments have been found for
- Home health care or skilled nursing facility care: Medicare pays as much as 35 percent more than providers' costs for home health care and 19 percent more for skilled nursing facility care. Unfortunately, CMS has not adopted our recommendation that would minimize excessive payments to some home health agencies.[4]
- Medical products: Medicare's payment approaches lack the flexibility to keep pace with market changes. Payments for medical equipment and supplies are through fee schedules that remain tied to suppliers' historical charges to the program. Evidence from two competitive bidding projects suggests that competition might provide a tool that facilitates setting more appropriate payment rates that result in program savings
- Outpatient drugs: Medicare pays list prices set by drug manufacturers, not prices providers actually pay. In September 2001, we reported that in 2000 Medicare paid over $1 billion more than other purchasers for outpatient drugs that the program covers. CMS has not acted upon our recommendations in this area.[5]

Medicare excessive payments: outpatient drugs

In some cases, Medicare's payments were so high that the beneficiaries' copayments alone exceeded the purchase price available to the provider.

In 2001:

- Medicare paid $3.34 per unit for Ipratropium bromide although it is widely available for $0.77 per unit;
- Medicare paid $588 for leuprolide acetate although it was widely available at a cost of $510.

THE MEDICAID PROGRAM

Medicaid, which pays for both acute health care and long-term care services for over 44 million low-income Americans, has been subject to waste and exploitation. In fiscal year 2001, Federal and State Medicaid expenditures totaled $228 billion. The Federal share was about 57 percent, representing 7 percent of all Federal outlays. Medicaid is the third largest social program in the Federal budget (after Social Security and Medicare) and the second largest budget item for most states (after education).

CMS, in the Department of Health and Human Services (HHS) is responsible for administering the program at the Federal level, while the states administer their respective program's day-to-day operations. The challenges inherent in overseeing a program of Medicaid's size, growth, and diversity, combined with the open ended nature of the program's Federal funding, puts the program at high risk. Inadequate fiscal oversight has led to increased and unnecessary Federal spending. GAO has made recommendations in a number of areas, such as:

- Curb State financing schemes: Such schemes inappropriately increase the Federal share of Medicaid expenditures. For example, some states have created the illusion that they made large Medicaid payments to providers while in reality they only made temporary electronic funds transfers that the providers were required to return to them. In some cases, states have used Federal payments for purposes other than Medicaid. Although Congress and CMS have repeatedly acted to curtail abusive financing schemes, states have developed new variations. Each has the same result: some of the state's share of program expenditures is shifted to the Federal Government. Curbing abusive State practices is of increasing importance today since states are under budgetary pressures. Experience shows that some states are likely to look for other creative means to supplant State financing, making a compelling case for the Congress and CMS to sustain vigilance over Federal Medicaid payments.

Curbing states' exploitative practices can yield substantial savings. CMS' 2001 regulation to close one significant loophole that was being increasingly used by states to generate excessive Federal Medicaid payments, referred to as the upper payment limit, is estimated to save the Federal Government $55 billion over 10 years, and a related 2002 CMS regulation is estimated to yield an additional $9 billion over 5 years. To reduce these and other exploitative schemes and to better ensure that Federal funds were used to reimburse providers only for Medicaid-covered services actually provided to eligible beneficiaries, we recommended in 1994 that the Congress enact legislation to prohibit making Medicaid payments to a government-owned facility in excess of the facility's costs. To date, no action has been taken.

The figure below shows one state's arrangement to increase Federal Medicaid payments inappropriately.

Address inappropriate provider claims

- The improper payments that states have identified suggest that—with augmented and consistent effort—States have the potential to save Medicaid millions of dollars. An estimate of savings from cost recoveries for the State of Washington alone, for example, was over $9 million in Medicaid funds during fiscal year 2002 through its hospital and physician audits.
- Our review of certain Medicaid services provided to children through their schools also demonstrates the importance of heightened scrutiny over Medicaid expenditures. In one State alone, there were $324 million in disallowed claims involving school-based services for a 3 1/2 year period ending in fiscal year 2001. Some claims were for service not covered by Medicaid or for services provided to non-Medicaid-eligible children.

Improve Federal and State agency controls over payments

CMS does not have a sound method for states to identify areas at high risk for improper Medicaid payments. Also, in our June 2001 review, we noted that no State requested the full amount of Federal funds available for antifraud efforts due to a reluctance to put up State matching funds.

IMPROPER PAYMENTS AT DOD

Ensuring prompt, proper, and accurate payments continues to be a challenge for the Department of Defense (DOD). DOD managers do not have the important information needed for effective financial management, leading DOD to overpay contractors by billions of dollars over the past 8 years. In our past reports, we have noted that (1) contractors were refunding hundreds of millions of dollars to DOD each year for a total of about $6.7 billion between fiscal year 1994 and 2001; (2) DOD made overpayments due to duplicate invoices and paid invoices without properly and accurately recovering progress payments; (3) contract administration actions had resulted in significant contractor debt or overpayment; (4) DOD and contractors were not aggressively pursuing the timely resolution of overpayments or underpayments when they were identified; and (5) DOD did not have statistical information on the results of contract reconciliation. In May 2002, we reported that DOD has various short-term corrective actions underway that appear to be having positive results. However, cost increases, performance issues, or schedule delays have beset two of DOD's key long-term initiatives: the Defense Procurement Payment System, which is intended to be DOD's standard contract payment system, and the Standard Procurement System, which is intended to be DOD's single, standard system to support contracting functions and interface with financial management functions. GAO has recommended that DOD take a number of steps including developing controls over contractor debt and overpayments.

EARNED INCOME CREDIT (EIC) NONCOMPLIANCE

For tax year 2001, about $31 billion was paid to about 19 million EIC claimants. Although researchers have reported that the EIC has generally been a successful incentive-based antipoverty program, IRS has reported high levels of EIC overpayments going back to 1985. IRS's most recent study, released in 2002, estimated that between $8.5 and $9.9 billion should not have been paid out to EIC claimants for tax year 1999.

Administering the EIC is not an easy task. The IRS has to balance its efforts to help ensure that all qualified persons claim the credit with its efforts to protect the integrity of the tax system and guard against fraud and other forms of noncompliance associated with the credit. Further, the complexity of the EIC may contribute to noncompliance. The EIC is among the more complex provisions of the tax code, which can contribute to unintentional errors by taxpayers. In addition, unlike other income transfer programs, the EIC relies more on self-reported qualifications of individuals than on program staff reviewing documents and other evidence before judging claimants to be qualified for assistance.

Early in 2002, the Assistant Secretary of the Treasury and the IRS commissioner established a joint task force to seek new approaches to reduce EIC noncompliance. The task force sought to develop an approach to validate EIC claimants' eligibility before refunds are made, while minimizing claimants' burden and any impact on the EIC's relatively high participation rate. Through this initiative, administration of the EIC program would become more like that of a social service program for which proof of eligibility is required prior to receipt of any benefit.

According to IRS, three areas—qualifying child eligibility, improper filing status, and income misreporting (i.e., underreporting)—account for nearly 70 percent of all EIC refund errors. Although the task force initiative is designed to address each of these sources of EIC noncompliance, many of the details about its implementation are still to be settled. A significant change to the initiative was announced just this past Friday, June 13, when IRS said that its pilot effort to precertify the eligibility of qualifying children for the EIC would not include requesting claimants to show their relationship to the qualifying child. Because planning and implementation for the EIC initiative will proceed simultaneously, its success will depend on careful planning and close management attention.

Congress has already focused oversight attention on the EIC initiative and continued oversight can help ensure that the initiative balances efforts to reduce EIC overpayments with continued efforts to maintain or increase the portion of the EIC eligible population that receives the credit. Further, Congress can consider making the several definitions of children in the tax code more uniform. The differing definitions contribute to the complexity taxpayers face and complexity is widely believed to contribute to errors taxpayers make in claiming the EIC. As early as 1993 we had suggested that Congress consider changes that would have made the definitions for children more similar for several tax purposes. More recently, IRS's Taxpayer Advocate, the Joint Committee on Taxation, and the Department of the Treasury have made proposals as well.

EIC problems

• IRS estimated in 2002 that of the $31.3 billion in earned income credits claimed by taxpayers in tax year 1999, about $8.5 billion to $9.9 billion, should not have been paid.

• This level of noncompliance has remained relatively unchanged even after a 5-year effort to reduce it.

COLLECTION OF UNPAID TAXES

Collecting taxes due the government has always been a challenge for IRS, but in recent years the challenge has grown. In testimonies and reports we have highlighted large and pervasive declines in IRS' compliance and collections programs. For example, between 1996 and 2001 the programs generally experienced larger workloads, less staffing, and fewer number of cases closed per employee For the last several years, Congress and others have been concerned that the declines in IRS's enforcement programs are eroding taxpayers' confidence in the fairness of our tax system putting at risk their willingness to voluntarily comply with the tax laws. Because of the potential revenue losses and the threat to voluntary compliance, the collection of unpaid taxes is a high risk area.

A key to reversing these trends and ensuring compliance with the tax laws is continuing to modernize IRS's management and systems. Such change is required across IRS. IRS needs to acquire and analyze data on noncompliance by continuing to implement the National Research Program as planned. IRS needs to reengineer it compliance and collection programs. Reengineering depends, in turn, on successfully modernizing business information systems by implementing recommended management controls. IRS needs to implement its planned centralized cost accounting system in order to strengthen controls over unpaid tax assessments. Because of their magnitude, these efforts are a major management challenge. IRS has tried to increase enforcement staffing. However, the hiring of additional staff has been delayed by factors such as unbudgeted cost increases.

Uncollected taxes

By the end of fiscal year 2002, IRS had deferred collection action on about one out of three collection cases and had an inventory of $112 billion of known unpaid taxes with some collection potential.

STUDENT FINANCIAL ASSISTANCE

The Department of Education's student financial assistance programs disburse about $65 billion annually. Education also manages a $267 billion loan portfolio. Millions of dollars in loans and grants have been disbursed to ineligible students because of internal control weaknesses. While the default rate on student loans has come down substantially, the dollars in default remain high.

Education has made progress on improving its financial management; however it needs to implement corrective actions to ensure that relevant, reliable accounting information is available. Over the years, Education has spent millions to integrate and modernize its many financial aid systems in an effort to provide more information and better service to customers—students, parents, institutions, and lenders. However Education did not have an enterprise architecture[6] and it lacked the ability to track students across programs. Education also faces challenges in maintaining program integrity, specifically ensuring that information reported on student aid applications is correct and that adequate internal controls exist to prevent erroneous and improper payments of grants and loans. To improve the integrity of the financial aid programs, Education should (1) continue to coordinate with the Internal Revenue Service to verify income information reported on student aid applications, (2) provide clear policy and guidance on the effect of using tax provisions on student aid awards, and (3) implement controls to limit improper disbursements of grants and loans.

For example, in 2001, $21.8 billion remained in default. Education's Office of Federal Student Aid (FSA) draft fiscal year 2002 performance plan specified the goals it had for default management; however, it included only limited information about the strategies to achieve those goals. Without giving additional details on its strategies for default recovery and prevention, it is not clear how FSA will determine whether it has achieved its default management goals. Finally, while Education has set up voluntary flexible agreements with four of its guaranty agencies, it is in the process of assessing whether they have been successful in lowering default and delinquency rates.

Fraud in student aid programs

• The owner, registrar, director of education, and other employees at The Training Center, a computer and travel school in Michigan, were indicted for falsifying documents to illegally obtain student financial aid. The indictment included an $875,000 forfeiture to recover the funds these individuals illegally received.

• An investigation at Beacon Career Institute in Florida (BCI) revealed a major Pell Grant case that defrauded Education of over $720,000. The former BCI administrator and other BCI officials created false documents to justify the disbursement of these grants. They were ordered to pay restitution totaling $1,778,472 and sentenced to prison.

• A former instructor at Piedmont College of Hair Design in South Carolina pled guilty and was ordered to pay restitution of $27,000 for Pell Grant fraud. Her actions caused over $300,000 in Pell Grants to be given to ineligible students.

• One individual in Los Angeles, who was convicted of student aid fraud, conducted weekly seminars for parents and students, charging $300 for the programs at which he advised and assisted them in preparing student aid applications that deliberately misstated their income or dependency status. The potential loss to the government from his actions was about $800,000.

FOOD ASSISTANCE PROGRAMS

Each day, one in every six Americans receive nutrition assistance through 1 or more of the 15 programs administered by the U.S. Department of Agriculture (USDA). In fiscal year 2002 Congress appropriated about $38.8 billion—nearly half of USDA's budget—to provide children and low-income adults with access to food, a healthful diet, and nutrition education through programs such as Food Stamps, school breakfast and school lunch programs.) USDA continues to face serious challenges in ensuring that eligible individuals receive the proper benefits from the food assistance programs administered by its Food and Nutrition Service.

In fiscal year 2001, the Food Stamp Program alone provided 17.3 million individuals with more than $15.5 billion in aid. About 149,000 authorized retail outfits accept food stamps. A program this large and this decentralized is vulnerable to problems and we have made recommendations in a number of areas, including:

Erroneous payments: USDA estimated that for fiscal year 2001 erroneous payments totaled about $1.4 billion—about $1 billion in overpayments and just under $400 million in underpayments. This is an error rate of about 9 percent.

• To deal with the complexity of the Food Stamp Program and the high error rate, the Farm Security and Rural Investment Act of 2002 contained a number of administrative and simplification reforms, such as allowing states to use greater flexibility in considering the income of recipients for eligibility purposes and to extend simplified reporting procedures for all program recipients.

Misuse of benefits

Individuals sometimes illegally sell their benefits for cash—a practice known as trafficking. In its most recent report on trafficking [March 2000] USDA estimated that about 3.5 cents of every dollar of food stamp benefits issued each year from 1996–98 was trafficked by stores—about $660 million.

• Storeowners generally do not pay the financial penalties assessed for trafficking. For example, we reported in May 1999 that USDA and the courts collected only $11.5 million, or about 13 percent, of the $78 million in total penalties assessed against store owners for violating food stamp regulations from 1993 through 1998.[7] Better use of information technology has the potential to help USDA minimize fraud, waste, and abuse in the Food Stamp Program. The Food and Nutrition Service has taken some actions to implement our recommendations, such as assisting states in the use of EBT data to identify traffickers and has other actions under way.

Other nutrition programs also suffer from fraud and abuse

• For example in fiscal year 2001 the Child and Adult Care Food Program (CACFP) provided subsidized meals for a daily average of 2.6 million participants in the care of about 215,000 day care providers and received $1.8 billion in fiscal year 2002. In response to our November 1999 recommendation[8] and reports by the USDA OIG, legislation was enacted in June 2000 to strengthen CACFP management controls and to reduce its vulnerability to fraud and abuse. As a result, the Food and Nutrition Service has intensified its management evaluations at the State and local levels and has trained its regional and State agency staff on revised management procedures.

National School Lunch Program provided nutritionally balanced, low-cost or free lunches for over 27 million children each school day in more than 98,000 public and nonprofit private schools and residential child care institutions. Past reports have disclosed that the number of children certified as eligible to receive free lunches in this program was 18 percent greater than the estimated number of children eligible for this benefit. Furthermore, in its strategic plan for fiscal years 2000 through 2005, USDA specifically identified the challenge it faces in ensuring that only eligible participants are provided benefits in the National School Lunch Program. USDA has taken some initial steps to develop a cost-effective strategy to address this integrity issue, such as pilot testing potential policy changes to improve the certification process.

Child and Adult Care Food Program

- To identify potentially fraudulent or abusive claims, reimbursement claims are reviewed, but the reviews are not foolproof. For example, one State we visited used several methods to evaluate the soundness of claims, but a State reviewer found that the reviews did not catch a $5,000 overpayment to a day care home sponsor. In this case, the claim for reimbursement had jumped in 1 month to $7,000, from an average monthly claim of $2,000.
- FNS has not effectively directed states' efforts to control fraud and abuse. In fiscal years 1997 and 1998, only 23 of FNS' 47 management evaluations directly evaluated the states' implementation of required controls over reimbursements to sponsors and providers. Almost half of these reviews found serious problems, including the failure of some states to conduct any administrative reviews of sponsors or providers.

CREDIT CARD ABUSE

We and a number of Inspectors General have identified improper and fraudulent use of purchase cards as well as control weaknesses in numerous agencies such as the Departments of Agriculture, Defense, Education, Housing and Urban Development, Interior, and the Federal Aviation Administration. Identified problems include weaknesses in the review and approval processes, lack of training for cardholders and approving officials, and ineffective monitoring. These weaknesses created a lax control environment that allowed cardholders to make fraudulent, improper, abusive, and questionable purchases. Similarly, we have found that a weak control environment contributed to significant abuse and potential fraud in the use of travel cards in the Department of Defense.

For instance, in March 2003, we reported that weaknesses in FAA's purchase card controls resulted in instances of improper, wasteful, and questionable purchases, as well as missing and stolen assets. These weaknesses contributed to $5.4 million of improper purchases. This included 997 transactions totaling $5.1 million associated with purchases that were split into two or more segments to circumvent single purchase limits. In addition, over half of the asset purchases—such as computers and other equipment—that we examined had not been recorded in FAA's property system, increasing the risk of loss or theft. As a result, FAA could not locate or document the location of over a third of the items. These missing items totaled almost $300,000. In separate internal reviews, one FAA location identified over 800 items, totaling almost $2 million, that were lost or stolen in fiscal years 2001 through 2002. Given systemic weaknesses in FAA's property controls, the actual amount of missing or stolen equipment FAA-wide could be much higher. We made a total of 27 recommendations to strengthen FAA's internal controls and compliance in its purchase card program, decrease wasteful purchases, and improve the accountability of assets in order to reduce vulnerability to improper and wasteful purchases. These included requiring centralized receiving of accountable assets and sensitive property items, improving physical security over the storage of computer related equipment, and following up on missing property items.

Poor oversight and management of travel card programs led to high delinquency rates costing millions in lost rebates and increased ATM fees. For example, as of March 31, 2002, we found that over 8,000 Navy cardholders had $6 million in delinquent debt. During the period of our reviews, over 400 Air Force, 250 Navy, and 200 Army personnel committed potential bank fraud by writing three or more nonsufficient (NSF) fund checks to the Bank of America. Also, many cardholders used their cards for inappropriate purchases, such as cruises and event tickets. Our review of Air Force travel cards, for example, found documented evidence of disciplinary actions in less than half of the cases reviewed where cardholders wrote NSF checks, or their accounts were charged off or placed in salary offset. We made several recommendations to DOD and the Air Force, including providing sufficient training to agency program coordinators to promote proper oversight of the travel card program, including effective monitoring for inappropriate transactions; reviewing the security clearances of cardholders with financial problems; and strengthening procedures for canceling cards of employees leaving the service. DOD and the Air Force concurred and said that they had actions under way to address many of them.

Purchase card abuses

- At Education, a purchase cardholder made several fraudulent purchases from two Internet sites for pornographic services. The name of one of the sites—SlaveLaborProductions.com—should have caused suspicion when it appeared on the employees' monthly statement.
- At HUD, we found improper purchases totaling about $1 million where HUD employees either split, or appeared to have split, purchases into multiple transactions to circumvent cardholder limits.
- At the two Navy units we reviewed, we identified over $11,000 of fraudulent purchases including clothing from Nordstrom, as well as improper, questionable, and abusive purchases, such as rentals of luxury cars and purchases of designer and high-cost leather goods such as leather purses costing up to $195 each.

EXAMPLES OF ABUSIVE AIR FORCE TRAVEL CARD ACTIVITY

Category	Examples of vendors	Number of transactions	Approximate dollar amount
Cruises	Carnival, Celebrity, Norwegian, and Princess	70	31,000
Gambling	Global Cash Access	79	14,000
Sports, concerts, and other events	Dallas Cowboys, Backstreet Boys, and other Ticketmaster purchases	223	31,000
Gentlemen's clubs	Cheetah's Lounge, Deja-vu Showgirls	187	32,000

HUD SINGLE-FAMILY MORTGAGE INSURANCE AND RENTAL ASSISTANCE PROGRAMS

HUD manages about $550 billion in insurance and $19 billion per year in rental assistance. The department relies on a complex network of thousands of third parties to manage their risk. We have made recommendations in a number of areas:

- *Reducing rental subsidy overpayments:* HUD estimates that rental subsidy overpayments in fiscal year 2000 were $2 billion—over 10 percent of total program expenditures. A significant portion of this overpayment is attributable to tenants' underreporting of income. We have recommended steps to improve data sharing between HUD and the Department of Health and Human Services to help identify unreported income before rental subsidies are provided.[9] HUD needs to ensure that its rental housing assistance programs operate effectively and efficiently, specifically that assistance payments are accurate, recipients are eligible, assisted housing meets quality standards, and contractors perform as expected.
- *Reduce risk of losses in the single family housing program:* HUD also needs to reduce the risk of losses in its single family housing program due to fraud, loan defaults, and poor management of foreclosed properties. Ineligible buyers sometimes fraudulently obtain loans, or loans are made on properties actually worth less than the loan amount, increasing the risk of default and losses. In addition, foreclosed properties are not always secured and maintained in a timely fashion and their condition can deteriorate, resulting in lower sales prices and limiting FHA's ability to recover its costs. HUD's IG has reported that fraud in the origination of mortgages of single-family properties continues to be the most pervasive problem uncovered by its investigations. We have reported on weaknesses in HUD's oversight of mortgage lenders and have made recommendations aimed at strengthening HUD's processes for approving and monitoring lenders and holding them accountable for poor performance.[10] We have also recommended that HUD adopt a foreclosure process more like that used by other entities to better ensure that properties do not deteriorate and that it recoups more of its losses when the houses are sold.[11] HUD needs to improve the management and oversight of its single-family housing programs to reduce its risk of financial losses.
- *Improve acquisition management and monitoring of contractor performance.* Contractors are responsible for managing and disposing of HUD's inventory of single-family and multifamily properties—properties that had a combined value of about $3 billion as of September 30, 2001. Our review of HUD's files and disbursements indicates that its oversight processes have not identified instances in which contractors were not performing as expected. Weaknesses in HUD's acquisition management limit its ability to readily prevent, identify, and address contractor performance problems. Without a systematic approach to oversight and adequate onsite monitoring, the department's ability to identify and correct contractor perform-

ance problems and hold contractors accountable is reduced. The resulting vulnerability limits HUD's ability to assure that it is receiving the services for which it pays.

Fraud in FHA Program

- A joint investigation between HUD's Inspector General and the Federal Bureau of Investigation uncovered a 20-person property flipping scheme in Chicago, IL, that resulted in 21 indictments and convictions and 12 jail sentences.
- The use of fraudulent documentation to qualify borrowers for FHA-insured mortgages had led to criminal indictments and convictions in several other communities.

HUD contractor performance oversight

In one case, HUD paid $227,500 to have 15,000 square feet of concrete replaced; however, we determined that only about one-third of the work HUD paid for was actually performed.[12]

IMPROVING ECONOMY, EFFICIENCY, EFFECTIVENESS

Important as safeguarding funds from fraud, waste, abuse and mismanagement is, I believe that for long-lasting improvements in government performance the Federal Government needs to move to the next step: to widespread opportunities to improve the economy, efficiency and effectiveness of existing Federal goals and program commitments. The basic goals of many Federal programs—both mandatory and discretionary—enjoy widespread support. That support only makes it more important for us to pay attention to the substantial opportunities to improve their cost effectiveness and the delivery of services and activities. No activity should be exempt from some key questions about its design and management.

GAO's work illustrates numerous examples where programs can and should be changed to improve their impact and efficiency. Today I want to touch on some of these areas and highlight some significant opportunities for program changes that promise to improve their cost effectiveness. I recognize that many of these will prompt debate—but that debate is both necessary and healthy.

Key questions for program oversight

- Is the program targeted appropriately?
- Does the program duplicate or even work at cross purposes with related programs and tools?
- Is the program financially sustainable and are there opportunities for instituting appropriate cost sharing and recovery from nonfederal parties including private entities that benefit from Federal activities?
- Can the program be made more efficient through reengineering or streamlining processes or restructuring organizational roles and responsibilities?
- Are there clear goals, measures and data with which to track progress, benefits and costs?

TARGETING

Our work has shown that scarce Federal funds could have a greater impact on program goals by improving their targeting to places or people most in need of assistance. Poorly targeted funding can result in providing assistance to recipients who have the resources and interest to undertake the subsidized activity on their own without Federal financing. Moreover, lax eligibility rules and controls can permit scarce funds to be diverted to clients with marginal needs for program funds.

- Grant programs: Many Federal grant programs with formula distributions to State and local governments are not well targeted to places with high needs but low fiscal capacity. As a result, recipients in wealthier areas may enjoy higher levels of Federal funds than harder pressed areas. Better targeting of grants offers a strategy to reduce Federal outlays by concentrating reductions in wealthier communities with comparatively fewer needs and greater capacity to finance services from their own resources. For such mandatory programs as Medicaid, Foster Care and Adoption Assistance, reimbursement formulas can be changed to better reflect relative need, geographic differences in the cost of services and State bases.
- Flood insurance losses: Repetitive flood losses are one of the major factors contributing to the financial difficulties facing the National Flood Insurance Program. Approximately 45,000 buildings currently insured under the National Flood Insurance Program have been flooded on more than one occasion and have received flood insurance claims payments of $1,000 or more for each loss. These repetitive losses account for about 38 percent of all program claims historically (currently about $200 million annually) even though repetitive-loss structures make up a very small por-

tion of the total number of insured properties—at any one time, from 1 to 2 percent. The cost of these multiple-loss properties over the years to the program has been $3.8 billion. One option that would increase savings would be for FEMA to consider eliminating flood insurance for certain repeatedly flooded properties.

- Medicare Incentive Payment Program: The Medicare Incentive Payment program was established in 1987 to provide a bonus payment for physicians to provide primary care in underserved areas. However, specialists receive most of the program dollars, even though primary care physicians have been identified as being in short supply. Shortages of specialists, if any, have not been determined. Moreover, since 1987 the Congress generally increased reimbursement rates for primary care services and reduced the geographic variation in physician reimbursement rates. HHS has acknowledged that structural changes to this program are necessary to better target incentive payments to rural areas with the highest degree of shortage. For example, if the program's intent is to improve access to primary care services in underserved rural areas, the bonus payments should be targeted and limited to physicians providing primary care services to underserved populations in rural areas with the greatest need.
- Social Security Government Pension Offset Provision: The Social Security Administration (SSA) administers the Government Pension Offset (GPO) provision requiring benefits to be reduced for persons whose Social Security entitlement is based on another person's Social Security coverage (usually a spouse's). The GPO prevents workers from receiving a full Social Security spousal benefit in addition to a pension from government employment not covered by Social Security. However, the law provides an exemption from the GPO if an individual's last day of State/local employment is in a position that is covered by both Social Security and the State/local government's pension system. In a recent study, we found instances where individuals performed work in Social Security covered positions for short periods to qualify for the GPO last day exemption. The practices we identified in Texas and Georgia alone could increase long-term benefit payments from the Social Security Trust Fund by $450 million.[13] In our report and testimony on this topic we presented a matter for congressional consideration that the last-day GPO exemption be revised to provide for a longer minimum time period, and the House has passed necessary legislation that is pending in the Senate.

CONSOLIDATION

GAO's work over the years has shown that numerous program areas are characterized by significant program overlap and duplication. In program area after program area, we have found that unfocused and uncoordinated programs cutting across Federal agency boundaries waste scarce resources, confuse and frustrate taxpayers and beneficiaries and limit program effectiveness.

- Food Safety: The Federal system to ensure the safety and quality of the Nation's food is inefficient and outdated. The Food Safety and Inspection Service within USDA is responsible for the safety of meat, poultry, eggs, and some egg products, while the Food and Drug Administration under HHS is responsible for the safety of most other foods. USDA, FDA and 10 other Federal agencies administer over 35 different laws for food safety. The current system suffers from overlapping and duplicative inspections, poor coordination and inefficient allocation of resources. The Congress may wish to consider consolidating Federal food safety agencies under a single risk-based food safety inspection agency with a uniform set of food safety laws.
- Grants for Homeland Security: GAO identified at least 16 different grant programs that can be used by the Nation's first responders to address homeland security needs. These grants are currently provided through two different directorates within the Department of Homeland Security, the Department of Justice, and the Department of Health and Human Services and serve State governments, cities and localities, counties, and others. Multiple fragmented grant programs create a confusing and administratively burdensome process for State and local officials and complicate their efforts to better coordinate preparedness and response to potential terrorist attacks across the wide range of specialized agencies and programs. In addressing the fragmentation prompted by the current homeland security grant system, Congress should consider consolidating separate categorical grants into a broader purpose grant with national performance goals defining results expected for the State and local partnership.
- Rural housing assistance: USDA and HUD both provide assistance for rural housing, targeting some of the same kinds of households in the same markets. The programs of both agencies could be merged, using the same network of lenders. A consolidation of these programs building off the best practices of both programs

would improve the efficiency with which the Federal Government delivers rural housing programs.

COST RECOVERY

The allocation of costs that once made sense when programs were created needs to be periodically reexamined to keep up with the evolution of markets. In some cases, private markets and program beneficiaries can play greater roles in financing and delivery of program services.

- Public Power: The Federal Government began to market electricity following the construction of dams and major water projects primarily from the 1930s to the 1960s. However, the restructured and increasingly competitive electricity industry suggests that a reassessment of the roles and missions of Federal subsidies is needed. Although the Power Marketing Administrations (PMAs) are generally required to recover all costs, in fact in some cases rates do not recover full costs incurred by the Federal Government in producing, transmitting and marketing Federal power. The Congress has the option of requiring the PMAs to sell their power at market rates to better ensure the full recovery of these costs.
- Child Support Enforcement: The Child Support Enforcement Program is to strengthen State and local efforts to obtain child support for both families eligible for Temporary Assistance for Needy Families (TANF) and non-TANF families. From fiscal year 1984–98, non-TANF caseloads and costs rose about 500 percent and 1200 percent, respectively. While states have the authority to fully recover the costs of their services, states have charged only minimal application and service fees for non-TANF clients, doing little to recover the Federal Government's 66 percent share of program costs. In fiscal year 1998, for example, State fee practices returned about $49 million of the estimated $2.1 billion spent to provide non-TANF services. To defray some of the costs of child support programs, Congress could require that mandatory application fees should be dropped and replaced with a minimum percentage service fee on successful collections for non-TANF families.

BEYOND PROGRAM DESIGN: OPERATIONAL ECONOMY, EFFICIENCY AND EFFECTIVENESS

Beyond program management, there are governmentwide areas where major savings could come from improving economy, efficiency and effectiveness. Today I would like to highlight one GAO thinks is so important that we added it to the high-risk list—the management of Federal real property.

Excess and underused property and deteriorating facilities present a real challenge—but also an opportunity to reap great rewards in terms of improved structure and savings for the Federal Government's operations. In the U.S. Government's fiscal year 2002 financial statements show an acquisition cost of more than $335 billion for the Federal Government's real property. This includes military bases, office buildings, embassies, prisons, courthouses, border stations, labs, and park facilities. Available governmentwide data suggest that the Federal Government owns roughly one-fourth of the total acreage of the Nation—about 636 million acres.

Underutilized or excess property is costly to maintain. DOD alone estimates that it spends about $3 to $4 billion per year maintaining unneeded facilities. Excess DOE facilities cost more than $70 million per year, primarily for security and maintenance.

There are opportunity costs—these buildings and land could be put to more cost-beneficial uses, exchanged for needed property, or sold to generate revenue for the government. Table 1 below highlights excess and underutilized property challenges faced by some of the major real property-holding agencies.

TABLE 1.—EXCESS PROPERTY CHALLENGES AT SOME OF THE MAJOR REAL PROPERTY—HOLDING AGENCIES

Agency	Excess and underutilized property challenge
DOD	Even with four rounds of base realignment and closures that reduced its holdings by 21 percent, DOD recognized that it still had some excess and obsolete facilities. Accordingly, Congress gave DOD the authority for another round of base realignment and closure in the fiscal year 2002 defense authorization act, scheduled for fiscal year 2005.
VA	VA recognizes that it has excess capacity and has an effort underway known as the Capital Asset Realignment for Enhanced Services (CARES) that is intended to address this issue. VA recently completed its initial CARES study involving consolidation of services among medical facilities in its Great Lakes Network (including Chicago) as well as expansion of services in other locations. VA identified 31 buildings that are no longer needed to meet veterans' health care needs in this network, including 30 that are currently vacant.
GSA	GSA recognizes that it has many buildings that are not financially self-sustaining and/or for which there is not a substantial, long-term Federal purpose. GSA is developing a strategy to address this problem. The L. Mendel Rivers Federal Building in Charleston, S.C. is a prime example of a highly visible, vacant Federal building held by GSA.
DOE	After shifting away from weapons production, DOE had 1,200 excess facilities totaling 16 million square feet, and the performance of its disposal program had not been fully satisfactory, according to DOE's Inspector General. Facility disposal activities have not been prioritized to balance mission requirements, reduce risks, and minimize life-cycle costs. In some cases, disposal plans were in conflict with new facility requirements.
USPS	The issue of excess and underutilized property will need to be part of USPS's efforts to operate more efficiently. Facility consolidations and closures are likely to be needed to align USPS's portfolio more closely with its changing business model.
State	Although States has taken steps to improve its disposal efforts and substantially reduce its inventory of unneeded properties, it reported that 92 properties were potentially available for sale as of September 30, 2001, with an estimated value of more than $180 million. State has begun the disposal process for some of these properties. State will also need to dispose of additional facilities over the next several years as it replaces more than 180 vulnerable embassies and consulates for security reasons. Security also has become a primary factor in considering the retention and sale of excess property.

If the Federal Government is to more effectively respond to the challenges associated with strategically managing its multibillion dollar real property portfolio, a major departure from the traditional way of doing business is needed. Better managing these assets in the current environment calls for a significant paradigm shift to find solutions. Solutions should not only correct the long-standing problems we have identified but also be responsive to and supportive of agencies' changing missions, security concerns, and technological needs in the 21st century. Solving the problems in this area will undeniably require a reconsideration of funding priorities at a time when budget constraints will be pervasive.

Because of the breadth and complexity of the issues involved, the long-standing nature of the problems, and the intense debate about potential solutions that will likely ensue, current structures and processes may not be adequate to address the problems. Thus, as discussed in our high-risk report, there is a need for a comprehensive and integrated transformation strategy for Federal real property. This strategy could address challenges associated with having adequate capacity (people and resources) to resolve the problems. The development of a transformation strategy would demonstrate a strong commitment and top leadership support to address the risk. An independent commission or governmentwide task force may be needed to develop the strategy. We believe that OMB is uniquely positioned to be the catalyst for identifying and bringing together the stakeholders that would develop the transformation strategy, drawing on resources and expertise from the General Services Administration, the Federal Real Property Council, and other real property holding agencies. For example, OMB could assess agency real property activities as part of the executive branch management scorecard effort. Congress will need to play a key role in implementing the transformation strategy's roadmap for realigning and rationalizing the government's real property assets so that the portfolio is more directly tied to agencies' missions. Without measurable progress and a comprehensive strategy to guide improvements, real property will most likely remain on the high risk list.

REASSESSING WHAT GOVERNMENT DOES

I have talked about the need to protect taxpayer dollars from fraud, waste, abuse and mismanagement and about the need to take actions improving the economy, efficiency and effectiveness of government programs, policies, and activities. However, to meet the challenges of today and the future, we must move beyond this to a more fundamental reassessment of what government does and how it does it.

In part this requires looking at current Federal programs—both spending and tax—in terms of their goals and results. Why does the program/activity exist? Is the activity achieving its intended objective? If not, can it be fixed? If so, how? If not, what other approaches might succeed in achieving the goal/objective? More fundamentally, even if a program/activity is achieving its stated mission—or can be "fixed" so that it does so—where does it fit in competition for Federal resources? Is its priority today higher or lower than before given the Nation's evolving challenges and fiscal constraints?

It also requires asking whether an existing program, policy, or activity "fits" the world we face today and in the future. It is important not to fall into the trap of accepting all existing activities as "givens" and subjecting new proposals to greater scrutiny than existing ones undergo. Think about how much the world has changed in the past few decades and how much it will change in future years.

One example of a disconnect between program design and today's world is the area of Federal disability programs—a disconnect great enough to warrant designation as a "high risk" area this year. Already growing, disability programs are poised to surge as baby boomers age, yet the programs remain mired in outdated economic, workforce, and medical concepts and are not well positioned to provide meaningful and timely support to disabled Americans. Disability criteria have not been updated to reflect the current state of science, medicine, technology and labor market conditions. Using outdated information, agencies—primarily SSA and VA—risk overcompensating some individuals while undercompensating or denying compensation entirely to others. Although Federal disability programs present serious management challenges and can be vulnerable to fraud or abuse, the overarching and longer-term challenge is to design a disability system for the modern world.

We should be striving to maintain a government that is effective and relevant to a changing society—a government that is as free as possible of outmoded commitments and operations that can inappropriately encumber the future. The difference between "wants," "needs," and overall "affordability" and long-term "sustainability" is an important consideration when setting overall priorities and allocating limited resources.

Finally, any reassessment of Federal missions and strategies should include the entire set of tools the Federal Government can use to address national objectives. These tools include discretionary and mandatory spending, loans and loan guarantees, tax provisions, and regulations. If we are evaluating Federal support for higher education, we need to look not only at spending but also at tax preferences. The same thing is true for health care. The figure below shows Federal activity in health care and Medicare budget functions in fiscal year 2000: $37 billion in discretionary BA, $319 billion in entitlement outlays, $5 million in loan guarantees, and $91 billion in tax expenditures.

Government must operate in the context of broader trends shaping the United States and its place in the world. These include:

- National and global response to terrorism and other threats to personal and national security.
- Increasing interdependence of enterprises, economies, civil society, and national governments—a.k.a globalization.
- The shift to market-oriented, knowledge-based economies.
- An aging and more diverse U.S. population.
- Advances in science & technology and the opportunities & challenges created by these changes.
- Challenges and opportunities to maintain & improve the quality of life for the Nation, communities, families & individuals.
- The increasingly diverse nature of governance structures and tools.

In addition to the above trends, growing fiscal challenges at the Federal, State, and local levels are of great concern. Furthermore, rising health care costs and other health care related challenges (e.g., access, quality) are of growing concern crossing all sectors of the economy and all geopolitical boundaries.

Government leaders are responsible and accountable for making needed changes to position the Federal Government to take advantage of emerging opportunities and to meet future challenges. Focusing on accountable, results-oriented management can help the Federal Government operate effectively within a broad network that includes other governmental organizations, nongovernmental organizations, and the private sector.

CONCLUDING REMARKS

There is a Chinese curse that says, “May you live in interesting times.” We clearly do. I would prefer to see this not as a curse, but as a challenge and an opportunity.

Tackling areas at risk for fraud, waste, abuse and mismanagement will require determination, persistence and sustained attention by both agency managers and Congressional committees. Large and complex Federal agencies must effectively use a mixture of critical resources and improved processes to improve their economy, efficiency, and effectiveness, Congressional oversight will be key.

In view of the broad trends and long-term fiscal challenges facing the Nation, there is a need to fundamentally review, reassess, and reprioritize the proper role of the Federal Government, how the government should do business in the future, and, in some instances, who should do the government's business in the 21st century. It is also increasingly important that Federal programs use properly designed and aligned tools to manage effectively across boundaries work with individual citizens, other levels of government, and other sectors. Evaluating the role of government and the programs it delivers is key in considering how best to address the Nation's most pressing priorities. Periodic reviews of programs in the budget, on the mandatory and discretionary sides of the budget as well as tax preferences, can prompt a healthy reassessment of our priorities and of the changes needed in program design, resources and management needed to get the results we collectively decide we want from government.

Needless to say, we at GAO are pleased to help Congress in this very important work.

ATTACHMENT I.—GAO'S 2003 HIGH–RISK LIST

2003 High-risk areas	Year designated high risk
Addressing Challenges In Broad-based Transformations	
Strategic Human Capital Management[1]	2001
U.S. Postal Service Transformation Efforts and Long-Term Outlook[1]	2001
Protecting Information Systems Supporting the Federal Government and the Nation's Critical Infrastructures	1997
Implementing and Transforming the New Department of Homeland Security	2003
Modernizing Federal Disability Programs[1]	2003
Federal Real Property[1]	2003
Ensuring Major Technology Investments Improve Services	
FAA Air Traffic Control Modernization	1995
IRS Business Systems Modernization	1995
DOD Systems Modernization	1995
Providing Basic Financial Accountability	
DOD Financial Management	1995
Forest Service Financial Management	1999
FAA Financial Management	1999
IRS Financial Management	1995
Reducing Inordinate Program Management Risks	
Medicare Program[1]	1990
Medicaid Program[1]	2003
Earned Income Credit Noncompliance	1995
Collection of Unpaid Taxes	1990
DOD Support Infrastructure Management	1997
DOD Inventory Management	1990
HUD Single-Family Mortgage Insurance and Rental Assistance Programs	1994
Student Financial Aid Programs	1990
Managing Large Procurement Operations More Efficiently	
DOD Weapon Systems Acquisition	1990
DOD Contract Management	1992
Department of Energy Contract Management	1990
NASA Contract Management	1990

Source: GAO

Notes: [1]Additional authorizing legislation is likely to be required as one element of addressing this high-risk area.

ATTACHMENT II.—SELECTED REPORTS REGARDING SPECIFIC EXAMPLES CITED IN TESTIMONY

Erroneous payments, Misuse of benefits, Child and Adult Care Food Program (CACFP), National School Lunch Program:

Food Assistance: WIC Faces Challenges in Providing Nutrition Services. GAO–02–142. Washington, DC: December 7, 2001.

Food Stamp Program: Better Use of Electronic Data Could Result in Disqualifying More Recipients Who Traffic Benefits. GAO/RCED–00–61. Washington, DC: March 7, 2000.

Food Assistance: Efforts to Control Fraud and Abuse in the Child and Adult Care Food Program Should Be Strengthened. GAO/RCED–00–12. Washington, DC: November 29, 1999.

Food Stamp Program: Storeowners Seldom Pay Financial Penalties Owed for Program Violations. GAO/RCED–99–91. Washington, DC: May 11, 1999.

Credit Card Abuse:

Purchase Cards: Control Weaknesses Leave the Air Force Vulnerable to Fraud, Waste, and Abuse. GAO–03–292. Washington, DC: December 20, 2002.

Government Purchase Cards: Control Weaknesses Expose Agencies to Fraud and Abuse. GAO–02–676T. Washington, DC: May 1, 2002.

FAA Purchase Cards: Weak Controls Resulted in Instances of Improper and Wasteful Purchases and Missing Assets. GAO–03–405. Washington, DC: March 21, 2003.

HUD Single-Family Mortgage Insurance and Rental Assistance Programs:

U.S. General Accounting Office, Financial Management: Strategies to Address Improper Payments at HUD, Education and Other Federal Agencies, GAO–03–167T (Washington, DC: Oct 3, 2002).

U.S. General Accounting Office, Strategies to Manage Improper Payments: Learning from Public and Private Sector Organizations, GAO–02–69G (Washington, DC: October 2001).

U.S. General Accounting Office, Major Management Challenges and Program Risks, Department of Housing and Urban Development, GAO–01–248 (Washington, DC: January 2001).

U.S. General Accounting Office, HUD Management: HUD's High-Risk Program Areas and Management Challenges, GAO–02–869T (Washington, DC: July 24, 2002).

U.S. General Accounting Office, Financial Management: Coordinated Approach Needed to Address the Government's Improper Payments Problems, GAO–02–749 (Washington, DC: Aug 9, 2002).

DOD Improper Payments:

U.S. General Accounting Office, Financial Management: Coordinated Approach Needed to Address the Government's Improper Payments Problems, GAO–02–749 (Washington, DC: Aug 9, 2002).

U.S. General Accounting Office, Department of Defense: Status of Achieving Key Outcomes and Addressing Major Management Challenges, GAO–01–783 (Washington, DC: June 25, 2001).

Grant Programs:

Formula Grants: Effects of Adjusted Population Counts on Federal Funding to States. GAO/HEHS–99–69. Washington, DC: February 26, 1999.

Medicaid Formula: Effects of Proposed Formula on Federal Shares of State Spending. GAO/HEHS–99–29R. Washington, DC: February 19, 1999.

Welfare Reform: Early Fiscal Effect of the TANF Block Grant. GAO/AIMD–98–137. Washington, DC: August 22, 1998.

Public Housing Subsidies: Revisions to HUD's Performance Funding System Could Improve Adequacy of Funding. GAO/RCED–98–174. Washington, DC: June 19, 1998.

School Finance: State Efforts to Equalize Funding Between Wealthy and Poor School Districts. GAO/HEHS–98–92. Washington, DC: June 16, 1998.

School Finance: State and Federal Efforts to Target Poor Students. GAO/HEHS–98–36. Washington, DC: January 28, 1998.

School Finance: State Efforts to Reduce Funding Gaps Between Poor and Wealthy Districts. GAO/HEHS–97–31. Washington, DC: February 5, 1997.

Federal Grants: Design Improvements Could Help Federal Resources Go Further. GAO/AIMD–97–7. Washington, DC: December 18, 1996.

Public Health: A Health Status Indicator for Targeting Federal Aid to States. GAO/HEHS–97–13. Washington, DC: November 13, 1996.

School Finance: Options for Improving Measures of Effort and Equity in Title I. GAO/HEHS–96–142. Washington, DC: August 30, 1996.

Highway Funding: Alternatives for Distributing Federal Funds. GAO/RCED–96–6. Washington, DC: November 28, 1995.

Ryan White Care Act of 1990: Opportunities to Enhance Funding Equity. GAO/HEHS–96–26. Washington, DC: November 13, 1995.

Department of Labor: Senior Community Service Employment Program Delivery Could Be Improved Through Legislative and Administrative Action. GAO/HEHS–96–4. Washington, DC: November 2, 1995.

Flood Insurance Losses:

Flood Insurance: Information on Financial Aspects of the National Flood Insurance Program. GAO/T–RCED–00–23. Washington, DC: October 27, 1999.

Flood Insurance: Information on Financial Aspects of the National Flood Insurance Program. GAO/T–RCED–99–280. Washington, DC: August 25, 1999.

Flood Insurance: Financial Resources May Not Be Sufficient to Meet Future Expected Losses. GAO/RCED–94–80. Washington, DC: March 21, 1994.

Medicare Incentive Payment Programs:

Physician Shortage Areas: Medicare Incentive Payments Not an Effective Approach to Improve Access. GAO/HEHS–99–36. Washington, DC: February 26, 1999.

Health Care Shortage Areas: Designations Not a Useful Tool for Directing Resources to the Underserved. GAO/HEHS–95–200. Washington, DC: September 8, 1995.

Social Security Pension Offset Provision:

Social Security Administration: Revision to the Government Pension Offset Exemption Should Be Considered. GAO–02–950. Washington, DC: August 15, 2002.

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END NOTES

[1] While Social Security and Medicare are the largest direct spending or mandatory programs, this category also includes such others as farm price supports, insurance programs, food stamps, TANF block grants to the states, Federal civilian and military pension and health.

[2] U.S. General Accounting Office, High-Risk Series: An Update, GAO–03–119 (Washington, DC: January 2003).

[3] Attached to this testimony is a list of selected GAO reports related to the specific examples cited.

[4] U.S. General Accounting Office, Medicare Home Health: Prospective Payment System Will Need Refinement as Data Become Available, GAO–HEHS–00–9 (Washington, DC: April 7, 2000); and Medicare Home Health: Prospective Payment System Could Reverse Recent Declines in Spending, GAO–HEHS–00–176 (Washington, DC: Sept. 8, 2000).

[5] Medicare: Payments for Covered Outpatient Drugs Exceed Providers' Cost, GAO–01–1118 (Washington, DC: Sept. 21, 2001).

[6] Enterprise architecture is an institutional blueprint that defines in both business and technology terms the organizations current and target operating environments and provides a transition roadmap.

[7] U.S. General Accounting Office, Food Stamp Program: Storeowners Seldom Pay Financial Penalties Owed for Program Violations, GAO/RCED–99–91. (Washington, DC: May 11, 1999).

[8] U.S. General Accounting Office, Food Assistance: Efforts to Control Fraud and Abuse in the Child and Adult Care Food Program Should Be Strengthened, GAO/RCED–00–12. (Washington, DC: Nov. 29, 1999).

[9] U.S. General Accounting Office, Benefit and Loan Programs: Improved Data Sharing Could Enhance Program Integrity, GAO/HEHS–00–19, (Washington, DC, Sept. 13, 2000).

[10] U.S. General Accounting Office, Single-Family Housing: Stronger Oversight of FHA Lenders Could Reduce HUD's Insurance Risk, GAO/RCED–00–112 (Washington, DC: April 28, 2000).

[11] U.S. General Accounting Office, Single-Family Housing: Opportunities to Improve Federal Foreclosure and Property Sales Processes, GAO–02–305 (Washington, DC: Apr. 17, 2002).

[12] U.S. General Accounting Office, Financial Management: Strategies to Address Improper Payments at HUD, Education and Other Federal Agencies, GAO–03–167T (Washington, DC: Oct. 3, 2002).

[13] We calculated this figure by multiplying the number of last-day cases reported in Texas and Georgia (4,819) by SSA data on the average annual offset amount ($4,800) and the average retirees life expectancy upon receipt of spousal benefits (19.4 years). This estimate may over/under estimate costs due to the use of averages, the exclusion of inflation/cost-of-living/net present value adjustments, lost investment earnings by the Trust Funds, and other factors that may affect the receipt of spousal benefits.

Chairman NUSSLE. I thank you, General Walker, for your testimony. Would you give us some examples that you find most egregious within this category? You have provided us with a long list of examples, but I was hoping that you would pull out a few that you thought were, in your opinion, from your experience, the most egregious examples of waste, fraud, abuse and mismanagement.

Mr. WALKER. Let me give you some examples. Whether or not they are egregious is in the eye of the beholder, but they all involve a lot of money, so I think that is the common denominator. There are several dimensions in Medicare. And to put it in proper context, Medicare's improper payments last year were estimated to be a little over $13 billion. That is a lot of money. It is important to note that not all improper payments represent waste, fraud, abuse and mismanagement. In some cases it is a situation where we paid twice and we ultimately recover down the road, but shouldn't have paid twice. Now that $13.2 billion roughly is way too high, but it is also down from about $24 billion several years ago. We are making some progress but we have a ways to go.

As you can imagine, given the amount of money in Medicare and given the fact that most of Medicare is administered by third parties, there are tremendous opportunities for gaming and that is an area we need to stay on top of.

Another example is we are not getting the best deal on Medicare. You would think Medicare would be getting the best prices. We are not always getting the best prices that one would expect we would get given the size of the purchaser we are. The Federal Government is not always going after people for debt collection either.

On Medicaid: Medicaid represents a high risk area and is on a high risk list along with Medicare. Medicaid is a tremendous financial burden for States. It is probably one of their biggest and fastest growing financial burdens. States are trying to come up with innovative ways to increase their Federal payment. Some would call them schemes, and we constantly have to be vigilant to make sure that we are fighting against schemes that result in the Federal Government paying more than it should.

Earned income tax credit, several billion dollars a year with regard to the earned income tax credit. Now in fairness, this is a dual issue. For one thing, it needs to be streamlined and simplified. It is just way too complex and we need to streamline and simplify it so people who are truly deserving of getting the unearned income tax credit can do so. On the other hand, we also need to have more aggressive enforcement to make sure that only those individuals who are truly eligible for the benefit receive it.

Food assistance: In the food stamp programs and the school lunch programs, there is evidence that there are significant instances where individuals who are not eligible to receive benefits. Again, we want to make sure that the people who are eligible receive those benefits, but we got to have adequate transparency and appropriate enforcement and accountability mechanisms to make sure those who are not eligible in fact do not receive the benefits.

So I am focusing Mr. Chairman, right now on the fraud, waste, abuse and mismanagement because that is the subject of this hearing. We have specific examples and I have several of my managing directors here who can drill down as far as you want to go on any of these topics.

Chairman NUSSLE. I was amazed at—the travel card issue is just amazing. The examples of cruises being purchased, you know Carnival cruises, Celebrity cruises, Norwegian, Princess cruises. Again, these aren't going to add up to the national debt, but it is just amazing that this kind of thing continues to go on.

Is there a common denominator that you find in these programs? In looking at these programs, are there common characteristics that are part of these programs that possibly one reform or another might help us? Do they tend to be more health programs? Do they tend to be—I guess I am looking for a common denominator and maybe you are not able to put it in that kind of a general term.

Mr. WALKER. Well, there are certain common elements I would say. First, I think we have to recognize that when you are talking about fraud, waste and abuse, the greatest opportunities are where the most money is. The other thing we can say is that for any system to work, whether it be a health care system, a corporate governance system, or weapons acquisition system, you really have to have three elements. You have to have incentives for people to do the right thing, transparency to provide reasonable assurance that people will do the right thing because somebody is looking, and appropriate accountability, which includes enforcement mechanisms with swift and sure penalties if people do the wrong thing.

I would respectfully suggest that in health care we don't have the right incentives, transparency, and accountablity. We also don't have them in certain other areas, such as earned income tax credit. And I think part of the other problem it that a lot of these areas are very complex. There are pages and pages of rules and regulations. Anybody who, even in a good faith effort, is trying to comply, might find it extremely difficult to comply.

Thirdly, I would say another common element, at least in the case of health care, is that most of the claims administration work is being done by third party intermediaries. Since most of the work is being done by third party intermediaries, we don't have adequate transparency about who is getting paid for what. And the user of the services, the beneficiary, may not necessarily even see the bill. They don't even know who is getting billed for what. So we don't have adequate checks and balances with regard to certain of these activities. So I think there are certain common elements.

I would be remiss, given that I am from GAO, if I didn't talk about needing to make sure these agencies and programs, including the Medicare claims administration contractors, have appropriate internal controls in place to provide for the appropriate checks and balances. These internal controls minimize the possibility of improper payments in the first instance, rather than having to try to go back and recover after the money is already gone.

Chairman NUSSLE. Thank you, General. David Walker has to leave by noon and we have a lot of good bipartisan interest in this hearing, so I am going to limit my time to the 5 minutes. I have other questions, but I know other members do as well.

Mr. Spratt.

Mr. SPRATT. Let me direct your attention, General Walker, to one particular provision on page 8 of your presentation about outpatient drugs. You state there Medicare pays less prices set by drug manufacturers, not prices that providers actually pay. In September, 2001, we reported that in 2000, Medicare paid over $1 billion more than other purchasers in outpatient drugs that the program covers. CMS has not acted upon our recommendation, and you footnote that to a study which was September 21, 2001. No response at all. Any explanation as to why they wouldn't try to negotiate downward the prices?

Mr. WALKER. I could have Bill Scanlon, who is our Managing Director for Health Care, say what the latest status is. Let me give a comment now. First, we are supposed to be getting best price and we are not always getting best price. CMS is absolutely overwhelmed. They have more than they can say grace over. We could be making recommendations for CMS, as we could the IRS and others, probably about every week. Bill, where do they stand on this, please?

Chairman NUSSLE. Identify yourself for the record, too.

Mr. SCANLON. My name is Bill Scanlon, Managing Director for Health Care.

CMS has taken some action to try and eliminate some of the disparities that existed between what the different contractors were paying for drugs. As General Walker indicated, we have delegated a large portion of the Medicare program to private contractors and there was some variation in of the payment rates they were offering, which was a source of excessive payment. But beyond that, we are still operating with the same system that we had in place in 2001, in which we were paying the prices that drug manufacturers post but no one necessarily pays.

Mr. SPRATT. Isn't it a fact that the Veterans Administration more or less dictates or administers the prices it will pay?

Mr. SCANLON. The Veterans Administration operates under statute that provides for a Federal supply schedule price. What the Congress has done is to use the leverage of the Medicaid program and said that if a drug manufacturer wants to sell its drugs to Medicaid beneficiaries, then it has to agree to Federal supply schedule prices, which are the best price that the drug manufacturer offers any purchaser. The Veterans Administration, DOD, and public hospitals all get that price.

Mr. SPRATT. And it is substantially lower?

Mr. SCANLON. Much, much lower.

Mr. SPRATT. Couldn't we save billions then if Medicare did the same thing?

Mr. SCANLON. We need to think about how Medicare differs from the Veterans Administration in terms of the delivery of drugs, but we can save billions by taking into account what the market prices are that drugs are available for and have Medicare pay based on those prices.

Mr. SPRATT. Let me read you a provision that is in the prescription drug bill coming to the House floor shortly called noninterference. In carrying out its duties with respect to the provision of qualified prescription drug coverage to beneficiaries under this title, the Administrator may not, one, require particular formulary; two, interfere in any way in negotiations between PDP sponsors and drug manufacturers, wholesalers or other suppliers of outpatient drugs; and, three, otherwise interfere with the competitive nature providing such coverage through sponsors and organizations.

Does that mean the Federal Government would have to tie its hands and not use the clout of 40 million Medicare beneficiaries and negotiate downward prices?

Mr. SCANLON. It actually would tie the hands of the government less than today. Right now, the statute requires that the government pay on the basis of a price called the average wholesale price, which I indicated was not a price. The provision in the prescription drug bill would allow the operators of these drug plans the leverage to negotiate their prices. They will probably do better than we are doing today.

Mr. SPRATT. But they could do still better if they did what the Veterans Administration does, right?

Mr. SCANLON. That certainly is the case. When you are using the leverage of the entire Medicaid population and the Medicare population you do have incredible leverage. You need to be sensitive to the fact that the deal that you are going to get when you bring in a lot more consumers is not going to be as good as the deal that the Veterans Administration is getting today.

Mr. WALKER. Let me touch on that if I can. Part of the problem that we have is that government tends to look in silos. VA wants to get the best deal it can get. DOD wants to get the best deal it can get. The government is paying—actually, as we all know, government has no money, government is a clearinghouse. So if the taxpayers are paying, then we need to figure out how we can act more collectively so we can leverage our purchasing power. What that might mean is that the government and the taxpayers get a better deal in the aggregate, but maybe each agency doesn't get the same deal and some won't get quite as good a deal as they are getting right now. On the other hand in the aggregate we are better off. We need to start acting that way, in the collective best interest of the country, of the taxpayers rather than everybody trying to maximize their own deal.

Mr. SPRATT. So Medicare should use the collective clout of 40 million beneficiaries to negotiate prices with drug suppliers, wholesalers and manufacturers?

Mr. WALKER. Well, I would say that we need to use the collective power of Medicare, Medicaid, civilian health care, military health care, et cetera, which is a lot more than 40 million in order to get the best deal possible.

Mr. SPRATT. Thank you very much.

Chairman NUSSLE. Mr. Schrock.

Mr. SCHROCK. Thank you, Mr. Chairman. Thank you, General, for being here. This is the topic I am not sure we are going to get our hands around and I have been sitting here thinking the many minutes we have sat here and it is $69,000 a second, and that is overwhelming to think about. And when I look at the list you have here on some of the things they are spent on, and I know that I am a big supporter of DOD but I am just getting a little tired of some of the things that are going on over there as well, that we have to get our hands around this.

I noticed you had here—this sheet you provided us, the high risk list. And apparently there were some issues for managing large procurement operations more efficiently. And they said they apparently tried to change some of that in 1992, DOD contract management. I am here to tell you that it is not working. It is an absolute disaster. I don't care what they said they fixed in 1992. It is not working. DOD financial management I am not sure is working. Systems modernization, whatever. But when we come up with some of these programs to change it, it doesn't change, I think what is the point. How can we get our hands around it? And I read all these things. And if I worked for somebody—if I had people working for me who took credit cards and went to Cheetah's Lounge and Deja Vu Showgirls, I would fire them so quick it would make your head spin. I don't care whether they are civil servants or not, they would go. But are we keeping these people around? Are we getting rid of them? Are we trying to get them to pay back their visit to Cheetah's Lounge, wherever the devil that is?

Mr. WALKER. We and the IG are trying to follow up to find out what type of action is being taken. I think it is important to note that with regard to the cards issue, there are two sides of this coin. Clearly this is an example of fraud, waste and abuse for which we should have zero tolerance, and we need to be serious about dealing with offenders. At the same time, I think we also have to recognize that when we went to the purchase card system, we actually saved the taxpayers a lot of money in the aggregate because we eliminated a lot of paperwork and a lot people who pushed papers to be able to do that.

So yes, we need to have zero tolerance, but we don't want to taint the fact that we saved a lot of money by using purchase cards.

Mr. SCHROCK. I understand. I don't know if it is Mr. Spratt who said it or not, but I too am concerned about the offshore businesses and what is going on there and I don't know how we get our hands around it. I was part of the group that went to that press conference where we said we were going to reduce the budgets by 1 percent, and I think if we can't there is something horribly wrong with this government, if we can't cut it by 1 percent. But what I am afraid is they will cut meat instead of the fat; instead of trying to figure out where the waste, fraud and abuse is, that they won't do that. They will pick something that really needs to be done, and I don't know how you prevent that from happening.

And in the past—I will tell you when I was in the Navy, and I have told this story a million times and people are going to get sick hearing it—I ran an operation in California and it got to be September time frame and the comptroller from my organization back at the Pentagon would call and say you have X number of dollars left. You darn well better spend it. I don't care what you spend it on, you better spend it, because if you don't you want get a plus-up next year. What nonsense is that? And I said I can't do that. He said you have to do it. I didn't and they didn't like it very much. I am here, so it didn't hurt me too bad. But that attitude goes on and on everywhere in government. How do we get our hands around that?

Mr. WALKER. Let's take DOD, for example, we have had a number of exchanges with regard to acquisitions. DOD is No. 1 in the world in fighting and winning armed conflicts. They are the global gold standard. Nobody is even close. So we are an A-plus in effectiveness. We are No. 1. DOD is a D in economy, efficiency, transparency and accountability, in part because they have not really focused enough efforts in building the basic management infrastructures that are necessary no matter who the Secretary of Defense is, and no matter who the President is.

So we end up having a lot of waste, economy, and efficiency problems. I will give you two examples on DOD. In our view, DOD should absolutely have to follow commercial best practices with regard to contracting and weapons system's, both the design and acquisition, unless there is a clear and compelling national security reason not to. They don't do that. In form they do, in practice they don't. That is billions. In addition to that, believe it or not, we have something called the Prompt Payment Act, which says if we don't pay contractors on a timely basis we have to pay them penalties. On the other hand, if we overpay them and they don't tell us and they benefit from that overpayment for months or years, they don't even have to pay us interest. We need to think about how we can level the playing field on some of these things as well.

Mr. SCHROCK. In the Pentagon—and I am not trying to pick on the Pentagon. Believe me, I worked there for a number of years, so I know some of the problems. They have certain people that are going to be there forever and ever. They see the uniform people come in and say we don't like them. We will just wade them out because in 2 years they are gone. They see the political appointees come in and they know they are only going to be there as long as the President is in office. And it just keeps getting worse and worse and worse. And I think that is what Secretary Rumsfeld is trying to get his hands around. He is getting pinged on a lot about it, but I think he is trying to get his hands around it. I am not sure how he ever does that.

Chairman NUSSLE. I thank the gentleman, and I would like to take the Chair's prerogative to welcome State Representative Willard Jenkins and his wife Kay from Iowa.

Mr. Emanuel.

Mr. EMANUEL. I would like to welcome him as well. First of all, I appreciate doing this hearing and your time in this and your perspective that you got to look at this from an aerial perspective, which is both on the waste, fraud and abuse side as well as on the economy and efficiency standard. First, I got two parts, one on the waste, fraud and abuse and then on the economy and efficiency. But my own view is that since we are now going to be in Iraq for a good time, I would hope your agency is looking at how we are spending our dollars, and there are two stories that come to mind.

Last week the New York Times ran a story that we give people in Iraq $20 a day for no-show jobs who aren't showing up. I am from Chicago. We think we know something about no-show jobs. And there was an American official there in the article of the New York Times who said who could quibble with that. I would like to raise my hand. I could quibble with that. So I hope as we spend our time and resources in Iraq that you guys are going to spend your time looking at how we are spending our dollars.

And I also bring your attention to a story over the weekend by AP that showed that Halliburton, which got a no bid contract which was originally set for $77 million is now running at $184 million. That is for a no bid contract. So I don't know if it gets the label waste, fraud or abuse. I would hope that given that we are now on the ticket for $1.67 billion in Iraq, with the dollars going and it is only going to continue over the next 10 years, that your agency continues to look at how we spend our dollars in Iraq and make sure that not only are we getting the most out of it but that you are a watchdog because that should not become a bottomless pit to our operation.

Second, to the issue of efficiency and economy, and I know this hearing is on the waste, fraud and abuse area, but as we are debating the prescription drug benefit and on the health care area, I look forward to the day in which we got free market principles, as it relates to the pharmaceutical area, as it relates to the area of our patent laws and the frivolous lawsuits pharmaceutical companies impose on generic companies that prevent generics. Wall Street Journal did a story last week that generics are bringing down the price of drugs and also bringing down health care inflation, that we could then get generics to market quicker, we would actually control costs. We would not have a captive market that allowed pharmaceutical companies to participate in frivolous lawsuits.

Second, if our consumers were allowed to import from—like we do cars, steel, wheat, meat, other products, from Germany, France, England, other major industrial nations, we are—our consumers are paying and also the government as an agent is paying 30–300 times more than for the same drugs that people overseas are paying in Europe. And if we had the free market principle operate in that area, we would bring down the cost of drugs.

And finally in the area of taxes, there isn't a single cancer drug or AIDS drug that hasn't been developed with U.S. taxpayer dollars, and yet we get no return on our investment. I worked in the investment area. The IR return on equity in the private sector is 30 percent. We don't even get 10 percent in this country. You know in the private sector world when you don't get a return like that you are called dumb money. And we treat the taxpayer money—no drug today in cancer, AIDS or any area is not developed without U.S. taxpayer backed research.

I am not just talking about on the R&D scale. I am talking about directly out of NIH and so when we look at efficiencies and economy, we need to start looking, and allowing the free market principles to start operating in the pharmaceutical area. I would hope also your agency would begin to look at that area, give recommendations to how we can get the most out of our tax dollar.

Mr. WALKER. Let me address both topics. First Iraq: We are on the case. I announced about 2 months ago in front of the Armed Services Committee that under my own authority as Comptroller General that we were going to be doing work with regard to general contracting activities in Iraq, not targeting specific companies, but while nobody is off the radar screen, looking at all major activities, and we are doing that. We have two people in Iraq right now. We expect we will end up having more people come in periodically to do work in a range of areas, and we will be staying on the case. We are also coordinating our activities with the Inspector Generals of the Department of Defense and AID because we don't want to be duplicating efforts.

I might also add for the record that our son Andy, who is a Marine Corps company commander, just came back from Iraq.

Mr. EMANUEL. Thank you for his service.

Mr. WALKER. Thank you.

Secondly, on the drug issue, that is an example of the need for targeting. We already have a $5.8 [trillion]–$5.9 trillion gap between promised benefits and funded benefits under Part A of Medicare. That is just Part A, not Part B. So there is going to have to be targeting for prescription drugs no matter what because we already have a huge hole that we have to fill up.

You made a good point about drug costs here. Our son lived in Yuma, which is right on the border with Mexico. People regularly went right across the border and bought the same exact drug for a big percentage discount from what people in Arizona bought it for. My personal view is there are a range of issues. They are very complex. It is probably our No. 1 domestic policy challenge, and we are on that case as well.

Mr. EMANUEL. Thank you. I see my time is up. Thank you, Mr. Chairman.

Chairman NUSSLE. Thank you.

Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman, and thank you, General Walker, for coming and giving us such good insight on what is happening. It is a real refreshment to hear somebody who really has concern. I guess my point is not a question but what can we do in the legislature to help enforce some of the items that you have discovered?

Mr. WALKER. Well, first, I think it is critically important to conduct active and ongoing oversight of all major programs, policies and activities. We have a fiduciary obligation to the taxpayers to do that.

Secondly, I think Congress needs to relook at all of GAO's matters for consideration that require legislation, and ask "why not."

Thirdly, I think the departments and agencies need to be held accountable as part of the oversight process for why they have not adopted GAO recommendations. Fortunately, 79 percent of the recommendations that we made 4 years ago have been adopted, but 21 percent haven't. Furthermore there are some areas where I think legislation is going to be necessary. For example, the imbalance between the fact that we have to pay penalties when we don't pay on time, but if we overpay somebody they don't even have to pay interest. I mean that is something that is going to take legislation. Those are a few examples.

Mr. BROWN. We mentioned about the high cost of medicine, and Gil Gutknecht who is member of this committee, and has been a big proponent of trying to find some equity in resolving the differences between Europe and Mexico and Canada, I guess, and the prices of medicine here. Do you have any recommendations along those lines that we might be able to get something moving rather than just keep talking about it?

Mr. WALKER. Well, we are doing work right now in that area. We are doing a great deal of work on health care because I believe that is our biggest domestic challenge. Basically what is happening is we are paying for most of the world's pharmaceutical R&D. Most of the world has price controls on prescription drugs. I am not saying that is good or bad. It is just a fact. As you know, there are pros and cons to price controls. We have had experience in our country with them. But the simple fact of the matter is that most of the rest of the world has price controls. We don't, and the effect of that is we have more innovation in prescription drugs in this country than anywhere in the world, but we also pay more than our fair share of the R&D for those drugs.

One out of the box thought that I will throw out, is that we have all kinds of multilateral negotiations to deal with issues where there is a global benefit. Why aren't we engaging in some type of multilateral efforts to figure out how we can avoid undercutting innovation with regard to drugs have a more equitable allocation of associated costs on a global basis. I don't even know if that is on anybody's radar screen, but it is an important issue.

Mr. BROWN. What would it take for us to get there? We all know the problem. What is the solution?

Mr. WALKER. Well, let me think a little bit more on it and I will get back to you. I wish I had performance based comp.

[The information referred to follows:]

MR. WALKER'S RESPONSE TO MR. BROWN'S QUESTION REGARDING GLOBAL PRESCRIPTION DRUG PRICING

Consideration of a global prescription drug pricing agreement would involve a thorough understanding of the complex price controls and regulations in other countries as well as pharmaceutical pricing practices. Most pharmaceutical companies are large corporations that pursue global research and marketing strategies. The economies of drug pricing in multinational markets are exceedingly complex, and nation-specific controls on prices or spending are only one of several factors these companies take into account. Multinational agreements on pricing may be an important tool to ensure equitable contributions to drug research and development, although they would require careful evaluation to prevent potential unintended consequences.

Chairman NUSSLE. Ms. Baldwin.

Ms. BALDWIN. Thank you, Mr. Chairman. I would like, if you could, for you to briefly recap or summarize the factors that get a program on the high risk list. And I have follow-ups, so just a summary would be ideal.

Mr. WALKER. There are quantitative factors and there are qualitative factors that deal with whether or not somebody is on our high risk list. And I might add that this is on our Web site, which is www.gao.gov. It is a process that we went through about 3 years ago that included involving comments from the executive branch agency so that they thought we were being fair about this. On the quantitative side generally it has got to involve something that is a billion dollars or more at risk. Now a billion dollars is real money. Obviously we are concerned about things below that, but it has got to involve at least a billion dollars or more in money. On the qualitative side it has to deal with safety, security, service delivery, a variety of other factors, and it is all laid out in detail on that Web site.

So we have criteria not only as to how you get on, but we also have criteria as to how you get off, which generally means that you have demonstrated a commitment. You have a plan. You have made substantial progress. You are not done yet, but we are convinced that you are taking it seriously. You have made enough progress. You have enough of a plan to where we believe ultimately you can be successful and that as a result sometimes programs and/or operations come off.

Ms. BALDWIN. Again, for clarity, your high risk list includes both mandatory and discretionary spending programs?

Mr. WALKER. That is correct. It includes both mandatory and discretionary. And it also includes both tax and spending. For example, the earned income tax credit is on there.

Ms. BALDWIN. And for further clarity, your presentation started with the three levels of inquiry vulnerable for abuse, fraud, the promise of efficiency, economy, effectiveness, et cetera. Can you be in a high risk category for any of those levels, or is it just relating to the abuse, fraud and waste?

Mr. WALKER. It can relate to one or all three. Quite frequently it is several of the elements. My personal view is that if you look quantitatively, the biggest money is in the third element, the second biggest money is in the second element, the least money is in the first element, which is fraud, waste, abuse and mismanagement. There is big money in all three.

However, I think the other thing that you have to consider is the confidence of the public in government operation to the extent that the public sees things that they view as fraud, waste and abuse, even though it may not be as much money as economy, efficiency and effectiveness or the last tier, that can undermine public confidence and you can't really put a price tag on that.

Ms. BALDWIN. Well, I appreciate the point you have just made that the big money is in level three, and you know, so on, working backwards. Because as you know, the budget resolution section 301 requires the authorizing committees of this Congress to identify changes in law by September 2 of this year that would require or would result in a reduction of mandatory spending to eliminate fraud, waste and abuse. So we are talking about all three levels, one that probably will produce the lesser of the three levels, and we are only talking about the mandatory programs, not the discretionary programs.

I sit on the Judiciary Committee in addition to this committee, and the mandatory spending under the oversight of the Judiciary Committee includes compensation for radiation exposure, the September 11 funds for victims, witnesses and expenses at trials, public safety officer death benefits and independent counsel. Are any of those on your high risk list as being particularly vulnerable for waste, fraud or abuse?

Mr. WALKER. Not at the present time.

Ms. BALDWIN. OK. Are any of them likely to be added to that list before September 2 when we are to report back on changes in law?

Mr. WALKER. No. But I think it is also important to note that we only issue our high risk list every 2 years. The most recent was January of this year. We won't issue another one obviously until January 2005. So no, we won't have added the areas you mentioned.

Ms. BALDWIN. Thank you.

Chairman NUSSLE. Thank you.

Mr. Wicker.

Mr. WICKER. Thank you very much and I appreciate you being with us. Two questions: Mr. Spratt mentioned during his opening remarks the initiative of the Clinton administration right at the beginning of their term headed by Vice President Gore and opined that the savings might have been in the hundreds of millions of dollars. Have you had a chance to look back over that? Did we call it reinventing government? Something like that. And have you had——

Mr. WALKER. National Performance Review. It was focused on reinventing government. We have issued reports on it and it probably won't be a surprise that it saved more money than some argue, but not nearly as much as was claimed. So that is kind of the story of life. It is somewhat in the middle.

Mr. WICKER. And what would that figure be and are we continuing to realize savings from it or did we sort of drop that?

Mr. WALKER. I will be happy to provide for the record or provide to you directly a copy of the report that we issued. I don't recall the details off the top of my head. But this is a never ending process. This is something where we can never be off the case. In addition, it is not just the executive branch, but also it is the legislative branch. There has to be active and ongoing and assertive oversight, and candidly I don't think Congress has done enough of that.

Mr. WICKER. I think you are right. The latest report that you are talking about, when was it issued?

Mr. WALKER. Oh, it was issued early in the current administration, I believe. But I will provide the exact date for the record.

Mr. WICKER. Do you recall if the National Performance Review dealt mostly with discretionary spending or did it get on over into the mandatory, which are the big ticket items?

Mr. WALKER. I believe it dealt with both, but it was primarily discretionary. But again I will provide more information for the record.

[The information referred to follows:]

MR. WALKER'S RESPONSE TO MR. WICKER'S QUESTION REGARDING THE NATIONAL PERSFORMANCE REVIEW

GAO issued several products on the National Partnership for Reinventing Government, also known as the National Performance Review (NPR). We are providing a copy of a May 4, 2000, testimony on Management Reform: Continuing Attention Is Needed to Improve Government Performance, GAO/T–GGD–00–128. This testimony summarizes much of GAO's work on selected aspects of the NPR viewed from a governmentwide perspective. Our work on selected NPR initiatives, as well as our other related work on Federal management issues, suggests an overriding theme, as we discussed at this hearing today—successful reinvention is not an end—state, but rather an ongoing process that seeks continuous improvements in performance, efficiency, and effectiveness. We are also providing a copy of our July 1999 report on NPR's Savings: Claimed Agency Savings Cannot All Be Attributed to NPR, GAO/GGD–99–120. In that report, we found that some savings were overstated because OMB counted savings twice, and two of the estimates were reported incorrectly, resulting in claims that were understated.

NPR encompassed a wide range of different initiatives during the years it existed. NPR's efforts ranged from focusing on specific agency reforms to major crosscutting efforts, such as those to downsize the Federal Government and to streamline acquisition and regulatory processes, and included recommendations on both mandatory and discretionary programs. For example, NPR recommended the Department of Health and Human Services pursue options to ensure that adequate investments are made to avoid unnecessary payments from the trust funds and that the National Aeronautics and Space Administration (NASA) improve its contracting practices. Although progress has been made in many of the areas that NPR focused on, more needs to be done. Both the Medicare program and NASA contract management, for example, have been on GAO's high-risk list since its inception in 1990 and continue to experience problems that must be resolved. Our work examining governmentwide management reform efforts points to the importance of combined efforts by agencies and executive branch leadership along with support and oversight from Congress.

Mr. WICKER. OK. I appreciate that, and I look forward to it.

My second line of questioning is concerning government payments for medical mistakes. For example, if an employee of a hospital administers the wrong medicine, causing harm to a patient, it is my understanding that if that patient is a Medicare recipient, Medicare pays for the wrong medicine that was administered first and then pays the cost of correcting that bit of medical malpractice. If a Medicare recipient goes in for an amputation and the physician amputates the wrong foot, for example, then Medicare would pay to go back in and pay to amputate the right foot. Have you looked into this, and do you have any idea how much we are spending as a Federal Government to correct medical errors?

Mr. WALKER. Dr. Bill Scanlon just confirmed my understanding. You are correct. Medicare does pay for it. We have not looked into it historically. That may be an area that either we or the IG for Health and Human Services ought to look into. As you might imagine, probably the area where we have the biggest supply and demand imbalance for request for work versus resources to do it is health care. But part of that is the way that Medicare is designed. It pays for services. And you know, you are putting your finger on a good point because it is not just the cost. Obviously in a couple of the examples that you gave, I would imagine there would be a lot of litigation associated with the error because of the personal harm done as well.

Mr. WICKER. Well, and I think probably we are too litigious, and I voted for legislation to correct that and to sort of get the pendulum swinging back in the other direction. But I think there is no question that malpractice exists just as lawsuit abuse exists, and it just seems to me that there ought to be some way, where when it is clear that the provider itself has caused the damage, that the provider should not benefit monetarily from correcting that at the expense of the taxpayers. So I hope we will look into that.

Mr. WALKER. Well, I think it is an area worth looking into. I think the key is what you just said, "when it is clear." How do you define that? In a circumstance as clear as the one that you posited, I think all reasonable people would agree, we shouldn't be paying twice. The question is, where do you draw the line.

Mr. WICKER. I guess the first question would be how to start quantifying that. Maybe I have identified a problem that is so small that we don't need to look at it, but I frankly doubt that.

Mr. WALKER. Well, one of the things I will do when we go back is to find out whether or not things like the example that you gave activities, would be deemed to be an, "improper payment." It would be interesting just to know that because CMS should observe the radar screen, no doubt about and then determine what, if anything, should be done legislatively. If it takes legislation or whether something can be done administratively.

Mr. WICKER. Thank you very much.

Chairman NUSSLE. Mr. Edwards.

Mr. EDWARDS. Thank you, Mr. Chairman. Mr. Chairman, let me first just say to you I welcome a hearing on cutting waste, fraud and abuse. I think it is important. I don't think Congress has carried out its responsibility as well as it should regarding oversight, and I hope this will lead authorizing and appropriating committees into doing more oversight. I would also hope, Mr. Chairman, that considering since this committee last met we have had the deficit estimate soar and since our responsibility is to oversee the budget, considering that we now face the largest deficit in American history, that this committee could also have a hearing in the near future regarding the implications of $400 [billion] and $500 billion deficits over the next several years, where we could focus on spending taxes as well as waste, fraud and abuse.

Mr. Walker, I would like to ask you this question. Perhaps Dr. Scanlon will need to come up. I will leave that to you. Is there a way we can determine or has there already been a study by the GAO to determine how much the government could save, how much taxpayers would save if all government expenditures for prescription drugs were paid at the Canadian level for those products?

Mr. WALKER. I am sure we haven't done a study on that.

Mr. EDWARDS. Wouldn't it be possible, you know, say pick the top five or 10 most used drugs and fairly quickly be able to come up with some type of number?

Mr. WALKER. We could take a look at that from an illustrative standpoint to be able to demonstrate how much that might show.

[The information referred to follows:]

MR. WALKER'S RESPONSE TO MR. EDWARDS' QUESTION REGARDING CANADIAN PRESCRIPTION DRUGS

COMPARISON OF CANADIAN AND U.S. PRICES FOR SELECTED DRUGS

Prices for drugs covered by the Ontario Ministry of Health and Long-Term Care in June 2003 are on average about 13 percent less than what a U.S. cash-paying customer (without any insurance coverage) would have paid in April 2002 for 2 commonly used generic drugs and 54 percent less for 10 commonly used brand name drugs. (See attachment.) The U.S. cash-paying customer price represents the average of what an individual without insurance coverage would pay at 36 pharmacies GAO surveyed, but payments for individuals with insurance coverage in the United States would typically be less than the cash-paying customer price. Based on our review of three plans participating in the Federal Employees' Health Benefits Program (FEHBP), the average retail price negotiated by pharmacy benefit managers on behalf of the FEHBP plans in April 2002 would be about 58 percent below the cash-paying customer price for the 2 generic drugs and 19 percent below for the 10 brand name drugs.[1] Thus, the Ontario Drug Benefit payment to pharmacies for the 2 generic drugs was on average significantly higher than the FEHBP payment, whereas the Canadian payment for the 10 brand name drugs remained on average significantly lower than the FEHBP payment. (See table 1.)

TABLE 1.—COMPARISON OF U.S. CASH–PAYING CUSTOMER PRICES, 3 FEHBP PLANS' RETAIL PAYMENTS, AND ONTARIO DRUG BENEFIT PAYMENTS

[In U.S. Dollars]

Drug description	U.S. cash-paying customer prices (April 2002)	Percent below cash-paying customer price	
		3 FEHBP plans' average retail payments (April 2002)	Ontario drug benefit payments (June 24, 2003)
Average of 2 generic drugs	10.53	4.38 (−58.4%)	9.12 (−13.4%)
Average of 10 brand name drugs	79.79	64.94 (−18.6%)	36.96 (−53.7%)

Source: GAO survey of 36 pharmacies in California, North Dakota, and the Washington, DC area; 3 FEHBP plans; and the Ontario Drug Benefit Formulary.

ATTACHMENT.—COMPARISON OF U.S. CASH–PAYING CUSTOMER PRICES AND ONTARIO DRUG BENEFIT PAYMENTS FOR SELECTED DRUGS

[In U.S. dollars]

Drug[1] (strength, number of capsules or tablets)	U.S. cash-paying customer price,[2] April 2002	Ontario drug benefit payment,[3] June 24, 2003[4]	Ontario drug benefit payment as percent different from U.S. cash-paying customer price
Generic[5]			
Atenolol (50 mg, 30)	11.60	13.30	14.7%
Furosemide (40 mg, 30)	9.47	4.95	47.8%
Average of 2 generic drugs	10.53	9.12	13.4%
Brand Name			
Celebrex (200 mg, 30)	87.63	35.13	59.9%
Celexa (20 mg, 30)	76.89	35.13	54.3%
Fosamax (70 mg, 4)	76.31	33.43	56.2%
Lipitor (10 mg, 30)	74.02	43.63	41.1%
Lotensin (20 mg, 30)	36.26	23.71	34.6%
Norvasc (5 mg, 30)	50.45	35.86	28.9%
Paxil (20 mg, 30)	91.76	43.39	52.7%
Premarin (0.625 mg, 30)	27.32	7.71	71.8%
Prevacid (30 mg, 30)	140.90	53.35	62.1%
Zocor (20 mg, 30)	136.37	58.21	57.3%
Average of 10 brand name drugs	79.79	36.96	53.7%

Source: GAO survey of 36 pharmacies in California, North Dakota, and the Washington, DC area; 3 FEHBP plans; and the Ontario Drug Benefit Formulary.

[1] The three FEHBP plans we reviewed were Blue Cross and Blue Shield, the Government Employees Hospital Association, and PacifiCare of California. We previously reported that for the 4 generic drugs we reviewed the average retail price negotiated with the pharmacy benefit manager for the FEHBP plans was 47 percent below the cash-paying customer price and for the 14 brand name drugs reviewed the retail price for the FEHBP plans was 18 percent below the cash-paying customer price. Of the drugs included in the FEHBP study, 2 generic drugs and 4 brand name drugs did not have comparable equivalent information in the Ontario Drug Benefit Formulary. See U.S. General Accounting Office, Federal Employees' Health Benefits: Effects of Using Pharmacy Benefit Managers on Health Plans, Enrollees, and Pharmacies (Jan. 10, 2003, GAO–03–196).

Notes: [1] Drugs were selected based on 4 generic drugs and 14 brand name drugs GAO reported on in Federal Employees' Health Benefits: Effects of Using Pharmacy Benefit Managers on Health Plans, Enrollees, and Pharmacies (Jan. 10, 2003, GAO–03–196). These 18 drugs were among the drugs with the highest expenditures or number of prescriptions dispensed based on data reported by the three Federal Employees' Health Benefit Program plans we reviewed. Of the drugs included in the study, 2 generic drugs and 4 brand name drugs did not have comparable equivalent information in the Ontario Drug Benefit Formulary.

[2] Cash-paying customer prices represent the average prices for customers without any insurance or other third party coverage at 36 pharmacies surveyed in April 2002 by GAO in California, North Dakota, and the Washington, DC metropolitan area.

[3] The Ontario Drug Benefit price is based on the ingredient cost found in the Ontario Drug Benefit formulary plus a 10 percent markup and a $6.47 (Canadian dollars) dispensing fee included in the Ministry of Health and Long-Term Care's payment. See Ontario Drug Benefit Act, http://192.75.156.68/DBLaws/Regs/English/960201—e.htm, downloaded on June 23, 2003.

[4] Canadian dollars were converted to U.S. dollars based on an exchange rate of 0.736161 as of June 24, 2003. See http://www.xe.com/ucc/convert.cgi, downloaded on June 24, 2003.

[5] For generic drugs, the Ontario Drug Benefit payments were the same regardless of manufacturer. Thus, we did not match Canadian and U.S. manufacturers for the generic drugs.

Mr. EDWARDS. OK. I would appreciate that. Let me go to what I consider the biggest waste in the Federal Government and that is interest on the national debt. In your chart, Mr. Walker, you showed 7 percent of the government goes to interest on the national debt, and I consider that waste because it doesn't buy one college student a college loan or a Pell Grant. It doesn't train one Army soldier, it doesn't pave one highway. Could you tell me when you add net interest on the national debt? Would you define for me the difference between gross interest on the debt and net interest on the debt? Are you subtracting interest income when you use the 7 percent number? And if you do, that would really mean that we are going to continue to bring in interest income. It would really mean the debt payments, the interest from the debt, the debt tax is really greater than 7 percent of the budget.

Mr. WALKER. I believe that is correct, and we will also provide those numbers. I think the key is that obviously we are not getting anything for interest on the debt now. And part of the question is what caused the debt to arise? What was the nature of the activity that caused it to rise? Then I think you would have to say whether or not there is any value, but clearly based upon our simulations it is large and growing and it is part of the——

Mr. EDWARDS. I want to be sure we are not underestimating the already incredibly high cost to taxpayers, and it is a cost. It is an expenditure, one of the largest five expenditures in the Federal Government. I want to be sure we are not underestimating the cost of interest on the debt by using the definition of net interest, and I would welcome further information on that in the days ahead.

[The information referred to follows:]

MR. WALKER'S RESPONSE TO MR. EDWARDS' QUESTION REGARDING NET INTEREST ON THE FEDERAL DEBT

Gross interest is all interest paid by the government, including to governmental trust funds.

Net interest is the net flow of interest payments to people and entities outside the Federal Government. It is gross interest minus interest paid to trust funds and minus a relatively small amount of interest received by the Federal Government.

For 2002, the relationship between the two figure was as follows:

BREAKDOWN OF FEDERAL DEBT

	Billions of dollars
Gross interest	333
Less interest received by trust funds	−153
Less interest received	−8
Net interest	171

Source: Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2004–2014." Figures may not add due to rounding.

The amount paid in interest is a function both of the amount of outstanding debt held by the public and interest rates. In its January 2003 ''Budget and Economic Outlook,'' CBO reported that the average maturity of outstanding marketable debt has remained fairly constant, fluctuating between 5 and 6 years since 1985. At the same time, there have been some changes in the types of securities issued. Treasury has discontinued 30-year bonds and introduced a 4 week bill. As a result, the average maturity of outstanding debt has fallen from a little over 6 years in December 2000, to 5½ years in September 2002. CBO also reported that interest-sensitive Treasury bills with a maturity of one year or less accounted for about 28 percent of all marketable debt.

Mr. EDWARDS. Let me ask you this. Is most of our national debt funded on a short-term basis now compared to 10 or 20 years ago?

Mr. WALKER. It is clearly a shorter term than it was. And of course we had a period of time where we thought we were going to pay it all off, and that didn't happen.

Mr. EDWARDS. So if we assume, as Mr. Greenspan has said, that massive borrowing by the government will drive up interest rates, that will also drive up the cost of our borrowing to pay for the interest on our national debt. Has the GAO done any kind of analysis to assume if, for example, the long-term interest rates, the treasury bill interest rates went up 2 percentage points what that would mean in extra expenditures by the taxpayers to pay for interest on the national debt?

Mr. WALKER. We haven't, but it is a very easy calculation to do. Let me also clarify my understanding of what this 7 percent is—it is interest on debt held by the public. As you know, there is a substantial amount of debt that is held by so-called trust funds which in reality aren't trust funds. They are really accounting devices. This 7 percent is just on debt held by the public.

Mr. EDWARDS. And the interest on the debt, that 7 percent, one of the largest five programs in the Federal Government would actually go up dramatically if interest rates went up perhaps two full percentage points over the next couple of years because of our massive deficit spending, is that correct?

Mr. WALKER. It would go up, but probably the biggest threat is the size of the deficits that we are undertaking right now.

Mr. EDWARDS. You could make some assumptions, make an assumption if interest rates go up 1 percent, 2 percent or 3 percent how much that would mean in extra costs to the taxpayers for paying for that wasteful program, the interest on the national debt. I assume that could be just a simple mathematical calculation.

My time is up. I thank you, Mr. Walker.

Mr. WALKER. Thank you.

Chairman NUSSLE. We are expecting votes on the floor in the next 10 to 15 minutes, three of them, so we are going to need to adjourn at that point. Unfortunately, we are not going to be able to keep the hearing going because there will be three votes in a row.

Mr. Shays.

Mr. SHAYS. Thank you. First, Mr. Walker, let me thank you for the extraordinary work of the GAO. It is an invaluable tool and if there is any message in what I think we have learned in the last few years, it is to take the reports of the GAO and act on them. And I am pleased that we are beginning to try to get the authorizing committees, besides the Budget Committee and the appropriators, to look at this legislation, look at your reports, because much of it is mandatory spending that requires authorizing changes.

I want to just first respond to the issue of the national debt. I believe the national debt is a crucial way of concern and the interest we pay on the national debt, and I believe the reason why you are seeing members on our side of the aisle focus on this issue is to reduce the debt by getting the economy moving again. It is a fact that the biggest contributor to the national debt is the decline in revenues, or the slowing of revenues. And if we could get revenues up to where they were in previous years, we would have no deficits and our national debt wouldn't keep increasing. So we are focusing our effort on looking at waste, fraud and abuse and getting this economy moving again.

Let me just focus on two areas of waste, fraud and abuse that just bug the heck out of me and I don't hear it spoken of much on the other side of the aisle. One is something that I call, that is referred to as the earned income tax credit, which to me is a surprising word because I don't know what is earned about this tax credit. It is paid to people who pay no taxes. We understand from reports that you have done that the earned income tax credit, that $9.3 billion, or nearly 30 percent of the total $31.3 billion claimed by taxpayers is erroneous. Is that number still a fact? It has been the last 5 years.

Mr. WALKER. It is a realistic estimate on the percentage basis. Unfortunately, the IRS hasn't updated it, but they have taken a number of different steps to try to deal with it. We assume that it probably hasn't changed much.

Mr. SHAYS. So for these individuals who pay no income tax, they pay other taxes but pay no income taxes, we are looking at nearly one-third of all of the so-called earned income tax credit being given out erroneously. How do we deal with it? What do we do about it?

Mr. WALKER. Well, I think there are two dimensions. First, I think one of the things that this is intended to do is to encourage and reward individuals who actually work and who are actually earning income and coming off of the welfare rolls, and that is something on which I think there probably can be bipartisan consensus, that we want to try to get people off of welfare into work. Also recognizing that we have some perverse incentives in our Federal system. As you are going to find out in a forthcoming report, one could argue that the best health care coverage we have is Medicaid, which is welfare for the indigent. So we have some perverse incentives. I think there are two answers.

First, we need to streamline and simplify so that we can more effectively communicate who is eligible and who is not eligible for the earned income tax credit. Complexity is a problem. Second, the IRS needs to enhance its enforcement activities. But we have to have a balance. On the one hand, we want people who are eligible for the credit to be able to get it. On the other hand, we do not want people who are not eligible to benefit from it. It is a combination of simplification and enforcement.

Mr. SHAYS. But the bottom line is nearly $10 billion is being paid out erroneously to people who do not qualify, and it seems to me this committee and other committees need to pay attention to that.

Let me just ask you about food stamps, another important program. It is a program that is supposed to help those with the least income. According to reports that we have from your department, we have a 9 percent error rate; in other words, $1.4 billion is paid erroneously. Now, in this case one billion represents an overpayment and $400 million an underpayment. And in either case, that is wrong, correct?

Mr. WALKER. That is correct. I mean we want people that are eligible to get the benefits. But the ones that aren't shouldn't.

Mr. SHAYS. And so what should we be doing here? How can we make sure that we don't have waste, fraud and abuse in the food stamp program?

Mr. WALKER. I would like Dr. Posner to come up for a second if it is OK. He is one of our experts with regards to the details here. Is that alright, Mr. Chairman?

Chairman NUSSLE. Yes. Please identify yourself for the record.

Mr. POSNER. I am Paul Posner, managing director for our work on budget and intergovernmental programs.

Basically there are a number of things that have been done over the years to address this. One is——

Mr. SHAYS. There is a red light on, and so I know other members have very little time, so real quick.

Mr. POSNER. OK. One is to give more incentives to the States to do a better job in pursuing this kind of thing. The other is electronic benefits transfers to reduce trafficking in food stamps, which will really improve oversight of a real abuse in the system. But the incentives to the States are really important.

Mr. SHAYS. OK. Thank you. I am sorry for the need for the short answer. Thank you.

Chairman NUSSLE. Thank you.

Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman. Can I get the other one? This chart shows how we have been budgeting. The chairman is very reluctant to talk about how we got to where we are, but I think it is instructive because you see all the red ink being run up during the Reagan and Bush administrations. The green part is what happened in——

Chairman NUSSLE. Will the gentleman yield just briefly?

Mr. SCOTT. I yield.

Chairman NUSSLE. All I am suggesting—all I was suggesting is that there are probably two sides to the story. That is all I was suggesting. I know I have a side. I know you have a side. I just thought it was maybe not necessary to go into that today is all I was suggesting.

Mr. SCOTT. Reclaiming my time.

Chairman NUSSLE. Please.

Mr. SCOTT. I understand why you don't want to go into it. I just want to say that as a Member on this side, we voted for the green and we voted against the red. So when we start talking about which was the Democratic plan and these amendments, some of these amendments are dealing with the mess that has been created, the best good faith effort. But if you want to know what the Democratic plan is, look at the green.

Now, the next chart is what this mess puts us in. That green sloping line is what General Walker referred to as we were going to pay off the national debt. That was what the projection was when this new administration came in. The red is the interest on the national debt we are going to pay. The blue, just to put things into perspective, is the defense budget.

Now, General Walker, you have pretty well disparaged the idea that we are going to grow ourselves out of this mess and said these are tough choices. Is the fact that one-half of the 2001 tax cut—if it had been that same amount of money had been allocated to the Social Security problem—that we could have solved the Social Security problem with that amount of money?

Mr. WALKER. Candidly, based upon GAO's long range budget simulations which we do twice a year, if we can enhance economic growth that will help. The gap is too great in the long term to grow our way out of the problem. Therefore, tough choices are going to have to be made with regards to tax policy, including tax incentives, spending policy, and regulatory policy. You are not going to avoid that, and quite frankly,we need to get on with it.

Mr. SCOTT. Thank you.

EITC, how much would it cost to fix the problem?

Mr. WALKER. How much would it cost to fix it? I think you are making a good point here, Mr. Scott. In some cases in order to fix the problem you have to spend a little bit of money, you have to spend to save. And there could be a net savings once you do that. This also ties to one of the things I think we need to be thinking about in the budget process which is how to look at discounted present value as well as annual cash flow since sometimes the latter can cause us to do some unusual things.

Mr. SCOTT. About how much would it cost to fix the problem?

Mr. WALKER. I apologize. I do not have that number readily available, and I don't know that we do either but I will check and see.

[The information referred to follows:]

MR. WALKER'S RESPONSE TO MR. SCOTT'S QUESTION ON HOW MUCH IT WILL COST TO "FIX" EIC

How much will it cost to "fix" the Earned Income Credit (EIC) compliance problem?

The estimated cost of fixing the EIC compliance problem continues to evolve and an overall estimate remains unknown. IRS has received a dedicated appropriation for many years that is intended to help it reduce the level of EIC overpayments while maintaining the program's fairly high participation rate. These appropriations totaled about $875 million between 1998 and 2003. However, the most recent IRS compliance study found that EIC overpayments for tax year 1999 totaled between about 27 to 32 percent of dollars paid out, or between $8.5 and $9.9 billion. For fiscal year 2004, IRS has asked for a total of $251 million, including about $151 million for the activities supported by the long-standing special appropriations plus $100 million for a new EIC initiative intended to address the major sources of noncompliance errors in claiming qualifying children, income misreporting, and filing status errors. A joint Department of the Treasury/IRS task force estimated that the cost of the dedicated EIC appropriation for years between 1998 and 2003 represented about 0.5 percent of the total EIC tax credits paid to taxpayers each year. When considering the new initiative for fiscal year 2004, we estimate this will increase to 0.8 percent.

Whether the continued special appropriations and the additional funding for the new initiative will be sufficient to result in significant reductions to the EIC's compliance problems remains to be seen because IRS is only in the planning or testing phases of the new initiative. Expansion of the new initiative will depend on results of testing over the next year, but data will not be available for some time. We are preparing a report on the portion of the new EIC initiative dealing with errors in claiming qualifying children. The report is due in late July.

In addition, it should be noted that Congress has enacted three pieces of legislation since 1999, which could potentially improve compliance rates. However, the effect on EIC compliance has been estimated for only one of the statutory changes-a change that required the custodial parent with the highest income to claim a qualifying child. This study, prepared by Treasury, indicated that the new rule would have eliminated about $1.4 billion of the tax year 1999 EIC overclaims.

Mr. SCOTT. The gentlelady from Wisconsin mentioned some Judiciary Committee programs. In education, we have got student loans, school lunches and rehabilitation. In education, where do we save money on those programs or are any of those programs? Or on your high risk list?

Mr. WALKER. We have specifics laid out in the testimony, and there are specific recommendations that we have made in the past that we think you should consider in order to be able to save money.

Mr. SCOTT. What about veterans' benefits? The gentleman, my colleague from Virginia, mentioned the problem that if you cut veterans benefits, you may be disqualifying people that are in fact eligible. How do you save money with veterans benefits?

Mr. WALKER. Well, veterans benefits frankly are like most other entitlement programs. You want to make sure the people who are truly entitled to benefits receive them but that those who aren't, don't. There is more that has to be done, for example make sure we are not paying dead people.

Mr. SCOTT. Can we do that by cutting administrative expenses?

Mr. WALKER. It is more complex than just how much money there is. It is how the money is used.

Mr. SCOTT. What is so complicated about sanctioning those who abuse credit cards? I mean, has anybody ever gone to jail for trying to charge a personal cruise on a government credit card and passing the expense off to the government?

Mr. WALKER. To my knowledge, no. But the IG and us are following up on what DOD is doing.

Mr. SCOTT. So how is that any different? I mean why is this complicated? Why is it any different than just vouchering the cruise to the Federal Government? Just going to Office Depot and buying a computer and charging, taking it home and charging it off to the government? I mean that is theft. What is so complicated about that?

Mr. WALKER. Well, I think the point you are making with which I would agree is that when we find clear examples of abuse and illegal activity, we need to take specific actions. There must be penalties that are paid to dissuade those who would try to take advantage of this system from doing so.

Mr. SCOTT. Thank you, Mr. Chairman.

Chairman NUSSLE. I thank the gentleman.

Mr. Garrett.

Mr. GARRETT. Thank you. Just a couple of questions. One of your points seems to be that if you want to save money, you want to go after the big programs first. And Medicare, you are talking about $12 billion, and that comes out in my little computations around 5 percent of the program, roughly. We are looking now depending on the bill before us at a prescription program of either $400 billion, $600 billion or now maybe $1 trillion. If all things hold true on the average of setting up new programs going forward, if the 5 percent figure holds true, are we looking at around a $20 billion possibility for waste, fraud and abuse in this new program we are about to pass in one form or another?

Mr. WALKER. There is little question in my mind that preventing fraud, waste and abuse will be a challenge in any prescription drug program. There is also no question in my mind that one of the things Congress has to do is have more concrete debate on the long term discounted present value—the long-term cost of any new legislation that is considering on either the spending or the revenue side. Today you do not have that. We have a big hole. Congress debates 10-year numbers but our biggest problem does not start until after the baby boomers retire.

Mr. GARRETT. Can you provide us this committee or myself with what the real figure is, I guess, going forward under our proposal as far as what the real costs will be when we hit that date?

Mr. WALKER. That is CBO's job. One of the things we have recommended is that when you anticipate big, long-term numbers, especially when the cost starts going up after the 10-year period, then separate calculations be done of the long-term fiscal exposure. I don't know whether or not CBO has done that or not, but I think that would be important.

Mr. GARRETT. I mean, I saw one figure in the paper and I don't know where they got it, not from CBO, about $3.8 trillion. I am going forward on that, so——

Mr. WALKER. Well, I think we have to recognize that we already have a $5.8 [trillion]–$5.9 trillion gap on Part A of Medicare alone. That doesn't count Part B and that obviously doesn't count prescription drugs.

Mr. GARRETT. Right. And so this is just adding to that. One of the questions that my constituents had, and I am a new guy here so I have a hard time answering this, is when we say, well, we are not responsible for some of this because now we are—almost over half is on the mandatory side and we have no control over that. And they of course say, well, you are in Congress, I thought you had control over everything. My understanding, correct me if I am wrong, there is a number of programs which are in that category, which come under the authorized programs, right, that have been authorized in the past but have not been reauthorized. And yet we continue to pay on those programs. Is that how it works?

Mr. WALKER. I am looking to my budget people real quick. This is Dr. Susan Irving, who is in our budget area. I want to make sure we get you a correct answer and right answer.

Ms. IRVING. Mr. Chairman. I am Susan Irving, Director of Federal Budget Analysis.

The issue of unauthorized programs that still continue to receive funding is largely in the discretionary area of the budget. Every year CRS and CBO put out a list of unauthorized but appropriated programs. And in the past it has been held that the act of appropriation means the Congress implicitly authorizes the activity. For most of the mandatories, it is kind of a direct spending. That is the spending flows directly from the authorizing legislation. Social Security is the obvious example. The amount of money that goes out is a function of the eligibility rules and the payment benefit calculations. You do have control. You can change those, but not on an annual basis through the appropriations process.

Mr. WALKER. And that is the point. Congress ultimately has the authority to act on what is mandatory as well as discretionary programs. It just hasn't always.

Mr. GARRETT. Right. So on the authorized ones, which are within the discretionary category, the courts are saying that we are basically authorizing them all over again just by the fact that they appropriate the dollars. But we have the authority actually—right now NASA and a few other ones people say have not been reauthorized, but we just continue to do it. And I see that NASA is one of the programs in here that you highlight. Not that I am picking on NASA. But I saw that in here as I thumbed through.

So these are things that we have the ability to control through the authorization process and also through the mandatory process but we opt not to do it is the record.

Mr. WALKER. Congress has not done it. The area on the list is NASA contract management.

Mr. GARRETT. Right. Thanks a lots.

Chairman NUSSLE. And just for the gentleman's information, the CBO does have that information and per Mr. Spratt's request we will be holding a hearing on the long-term implications of a number of these programs. That will be one of the next hearings that the Budget Committee holds.

Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman. Since we are about to have votes, Mr. Walker, I will try to be brief and I have to ask you about something that my friend from Connecticut, the vice chair, was asking you about earlier. He asked you about what I think if you listen to the administration, one would believe is an epidemic of irresponsibility among poor people in this country. If you listen to the administration or the inference of my friend from Connecticut's question, one would think that there is this huge problem with people who are getting foods stamps or who are getting school lunches or who are getting the earned income tax credit engaging in fraudulent behavior. I have no doubt that there is some level of fraudulent behavior that goes on with those groups. But what very much concerns me is that frankly I don't see the same level of attention and scrutiny being directed to folks who are engaged in corporate avoidance, for example. I had a chance to look at your high risk series book last night and it is an interesting piece of work. I am sure you will correct me if I am wrong, but as I looked through it I don't see a single reference to a corporate avoidance tax gain. Did I miss one or is there one in here?

Mr. WALKER. No, we don't have that on here. Frankly——

Mr. DAVIS. Let me ask you another question since we are running low on time. You have heard of something called sale in, lease out. You have heard of that?

Mr. WALKER. I am not an expert on it. I have heard about it.

Mr. DAVIS. OK, and you have heard it is a kind of corporate tax avoidance game and you haven't taken an effort to become an expert on that either, have you?

Mr. WALKER. Not to this point in time.

Mr. DAVIS. And it is not referenced in your high risk series book, is it?

Mr. WALKER. That is correct. It is not.

Mr. DAVIS. You have also heard that occasionally there is a problem of some consulting firms marketing tax shelters that deal with inflated patent valuations. You have heard that is a problem that exists?

Mr. WALKER. Yes.

Mr. DAVIS. Is there a reference to that in your high risk series?

Mr. WALKER. We are doing work on tax.

Mr. DAVIS. Is there any reference to that in your high risk series book?

Mr. WALKER. It is not, but in fairness our high risk series started out more narrowly focused, and as time goes on it is broadening and may well—those types of items may well come out in the future ones.

Mr. DAVIS. OK. Can you tell me if there is a single corporate tax avoidance scheme reference in your high risk series book?

Mr. WALKER. By the way, we do have one item on the high risk list that these——

Mr. DAVIS. Is that in your high risk series book?

Mr. WALKER. Yes. Collection of unpaid taxes.

Mr. DAVIS. Is there a reference to "corporate" unpaid taxes in your high wrist series book?

Mr. WALKER. It is just "unpaid taxes," period. It doesn't make any difference what type.

Mr. DAVIS. OK. And I will represent to you that I have read that section. There is no reference for—the word "corporate" is not contained in it. Do you disagree with that?

Mr. WALKER. I haven't read it lately so——

Mr. DAVIS. Do you get the point I am making?

Mr. WALKER. Oh, I understand your point.

Mr. DAVIS. OK.

Mr. WALKER. I only need to hear it once.

Mr. DAVIS. And since I have got a little bit of time left I do want to leave you with this observation, Mr. Walker. One thing that I do think enormously frustrates a lot of people in this country, and regardless of what party we come from, a lot of our constituents are people who are frankly not making a lot of money. They are people who are earning between 10 and $25,000 a year and we recognize that, yes, some of those people are engaged in fraudulent conduct. But I think it must be enormously frustrating and disheartening to them when they hear the administration focusing only on their irresponsibility whereas some of the wealthiest people in this country are doing things that could potentially cost us a lot of money and, frankly, we don't have the kind of laser focus on them.

Mr. NEAL. Mr. Davis, would you yield for a second?

Mr. DAVIS. No. I don't have a lot of time left, so I apologize.

Mr. NEAL. It would be helpful to your argument.

Mr. DAVIS. Well, let me finish my point. We have got a little bit of time left. The point that I want to make to you, Mr. Walker, is this is what frustrates a lot of people, in my opinion, before I yield to my friend from Massachusetts, that when the Republican administration wants to find a way to save money they tend too look in very particular places.

I would be happy to yield to my friend from Massachusetts.

Mr. NEAL. Thank you, Mr. Davis. Let me just ask you this quick question, Mr. Walker. Do you believe that Tyco is a Bermuda based company?

Mr. WALKER. In form but not in substance. And let me say this. I think it is important to respond. No. 1, I think if you look at a number of my speeches and a number of GAO's work, you will find that we have been very much on the case in trying to highlight that more attention needs to be paid to the tax side; to preferences and incentives, and some of these abuses. We have also said that more needs to be done with regard to IRS enforcement. It is one thing to provide service and that means enforcement on all aspects of the tax code. And I think you will also see that I have said a number of times and GAO has products noting a number of concerns with regard to not only tax abuse but also failures in corporate governance and accountability under the current systems.

Mr. DAVIS. Briefly reclaiming my time since I have a little bit left, the concern though, Mr. Walker, is you and your agency draft the high risk series book. Even when you chose to talk about tax avoidance the word "corporate" doesn't even surface on the pages that you all drafted. That is the omission that concerns some of us, that the fixation is on one end of society and not the other one.

Thank you, Mr. Chairman.

Mr. WALKER. Well, I will go back and look at that to make sure. But the fact of the matter is if it isn't expressly noted who the individuals are, that is inappropriate because it is across the board, and let me make clear to you, it is across the board.

Mr. DAVIS. I agree.

Chairman NUSSLE. We have time for one more inquiry, and then we are going to have to recess for votes. Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you, Mr. Chairman. You know, one of the things that comes to mind is that with all these problems, if this is no accountability to those that are, you know, signing off or making the decisions, then nothing is ever going to happen. And Mr. Schrock asked the question what happens to those people that make those bad decisions that create the fraud or that sign off on the fraud, and I believe that your answer was really not much, right?

Mr. WALKER. We are following up to see what actions were taken. We are willing to make sure that there is appropriate accountability because the only way you are going to dissuade further abuse is if you have swift and effective accountability.

Mr. DIAZ-BALART. Because, Mr. Chairman, as you know, with your direction and your assistance after speaking with you, and with your blessing, many of us, the Republican freshmen, we created a working group to combat waste, fraud and abuse, and some of the things that we have been able to find in a very short time span is really scary. Such numbers—the numbers are amazing. Even Medicare, $13.3 billion, or housing subsidy programs, $3.3 billion, or supplemental security income, $2.6 billion or unemployment insurance or disability insurance. And these are funds that are being frankly misused or wasted by the Federal Government and therefore are not going to those that really do need the assistance, which is why those programs were set up in the first place. So we have created this working group. And not only—so I want to kind of use this opportunity, Mr. Chairman, to kind of throw in a plug. We are going to use this working group not only to highlight some of these horrendous misuse of taxpayers' money, not only is it robbing the taxpayer, it is also not going to those that truly need it. But also hopefully come up with some ideas that we can help this committee and others to try to show some possible solutions. I think one of those has to be accountability, and until we have some serious accountability to those that are making the decision, until jobs are on the line, I don't think that anything is ever going to change.

Mr. Chairman, so I want to thank you for this opportunity and I know we have very little time because we have to go vote. But thank you.

Mr. WALKER. I would respectfully suggest that Congress is part of the accountability mechanism as well. What kind of oversight you exercise and what do you do with regard to appropriations?

Mr. DIAZ-BALART. Absolutely.

Chairman NUSSLE. Congress has oversight responsibility that it has not been utilizing. It needs to. One of the ways that it does that is through the General Accounting Office, as an arm—nonpartisan arm—of the United States Congress. Mr. Davis has brought up a couple of items that I have no doubt, knowing that you, Mr. Walker, and others with GAO, when you get ideas you are all over it like a big dog on a piece of steak. So I have no doubt that you will do that in this instance as well. You do not work for the administration. I think you have demonstrated that independence in many ways both from Congress as well as from the administration, and we appreciate it.

This is a start. We could go on all day, I know, for a number of reasons, but this is a good start. We appreciate the time you have spent with us today. We know that your time is limited. You are going to have to leave by noon and our votes will not be completed by that time. So at this point in time we will dismiss you and begin with the second panel when we reconvene the hearing.

Mr. WALKER. Thank you, Mr. Chairman. I need to go start chewing on the steak.

Chairman NUSSLE. Go do it. Thank you. And with that we will recess subject to the call of the Chair following the third vote on the floor. [Recess.]

Call the committee back to order. This is the hearing on waste, fraud and abuse in Federal mandatory programs. We will resume now with the second panel, Robert S. McIntyre, who is the Director of Citizens for Tax Justice. We welcome you, Mr. McIntyre, to the committee. Your entire testimony will be made part of the record, and we are pleased to hear your testimony and have you summarize that testimony at this point. Welcome.

STATEMENT OF ROBERT S. MC INTYRE, DIRECTOR, CITIZENS FOR TAX JUSTICE

Mr. MCINTYRE. This is my first visit to the Budget Committee, despite working on tax issues for the last quarter of century or so. So I appreciate the opportunity. Our group, Citizens for Tax Justice, advocates for government fiscal policies based on two rather simple principles: One, that the government ought to raise enough money to pay for the programs that it enacts and, secondly, that it ought to do so in a fair and progressive way. Until recently, these weren't particularly controversial propositions.

Over the years, we have worked with members of both parties in the Congress and the White House to try to achieve these goals and often with some success. These days, however, the idea of raising enough money to fund the government and raising it fairly puts us somewhat in disagreement, I think, with the current management in the Congress and the White House.

This year, fiscal year 2003, the latest estimates show that the on budget deficit will be $570 billion or more. That means that $1 out of every $3 that the government spends on everything but Social Security will be financed with borrowed money. This is the highest level of borrowing to fund on budget spending since World War II, nosing out an almost as high number in President Reagan's first term, before he and I became allies. Faced with this very dire fiscal situation, which shows no sign of abating, it is very appropriate that this committee is starting to look at ways to stem the flow of red ink. We are happy if we can help in that effort.

The focus here is on mandatory spending, an area which is one of the most important ones to look at. I haven't heard much, though, except for the earned income tax credit, about tax provisions that are part of the mandatory spending system, and that is what I wanted to focus on today.

Every year, the Joint Committee on Taxation and the Treasury Department put out lists about the total amounts of mandatory tax entitlements. The latest numbers from the Joint Tax Committee indicate that we will see $843 billion worth of those programs this year, and that will rise to $915 billion by fiscal 2007. That is more than the total of all discretionary appropriations. These are mandatory programs embedded in the tax code, and I must say those numbers are actually low. They leave out corporate tax shelters. They understate the tax benefits of accelerated depreciation. They assume sunsets will happen that probably won't. For a number of reasons the number is probably closer to $1 trillion in tax-based mandatory spending.

Of course, lots of these programs are probably things the government would do whether it did it through the Internal Revenue Service or a regular government agency. But many of them aren't, and I want to focus on the ones that almost surely aren't, the large business subsidies that are embedded in our tax code that are benefiting industries from oil, nuclear, ethanol, drug manufacturing, you name it, more than 75 of them listed in the Joint Tax Committee list. I have a very strong feeling that if any of these were proposed as direct spending programs out of the Commerce Department or the Environmental Protection Agency or whatever other agency would have jurisdiction, that their chances of passing the Congress would be something close to zero. So I think they need some more scrutiny because they are so similar to regular spending programs.

We have had a concerted attack on these kinds of programs under President Reagan, who in the 1986 Tax Reform Act scaled way back on these subsidies for the very simple reason that they were perceived, correctly, I think, by the administration and by the

Congress, as wasteful, as violative of our free market principles and as economically harmful in the long run.

But things have changed since then. I know you hear from business lobbyists day in and day out about how horribly cruel we are to our corporations when it comes to taxes. The fact they can say that with a straight face suggests that they have had some very serious training, because as is well known if you just read the papers, many of our biggest companies are paying nothing at all in taxes. Overall, our taxes on corporations are now just about the lowest in the world as a share of the economy. Only Iceland is slightly lower. How can they be complaining about high taxes when they are the lowest in the world? I don't know how they get away with that.

The reason that our corporate taxes have become so low, at least in recent years, has nothing to do with tax rates, but to an explosion in the mandatory subsidies in the tax code. Recently, for instance, the Congress in 2002 and 2003 passed a vast expansion in tax breaks for depreciation write-offs, $114 billion in 2002 and then another $60 billion this year. The combination of these changes, almost $180 billion in added corporate subsidies, has not received the attention that it needs. In fact, if the sunsets are not honored, and certainly the lobbyists don't want them to be honored, these programs, just the ones adopted in the last 2 years, will cost over $400 billion over this decade. So that is one area you ought to look at.

I mean, wouldn't it make sense if we want to tax our businesses on their profits that we tax them on what they actually make, not on some figment of their accountants' imagination? Why do we want a system that taxes some companies at much higher rates than others just depending on the mix of their investments?

A second area that I think you ought to look at is international. Our multinational companies have as their goal to pay as little taxes as possible. One way they try to do it is to tell the Internal Revenue Service that they made their profits offshore. In recent years, the accounting firms have come up with ways for companies to take their U.S. profits and make them all of a sudden magically appear in Bermuda, Barbados, Liechtenstein, or some other place where they are not taxed. As a result of that, most people who have looked at it think that we are probably losing to these subsidies something in the order of $50 [billion] or $60 billion annually just from companies avoiding, or I think in many cases evading, their tax responsibilities to the United States.

There are ways to address this issue. They are not on the table in the Ways and Means Committee except to expand them, but there are steps that could be taken that would save average ordinary taxpayers tens of billions of dollars a year. I think it is something you ought to look at.

Finally, as I said before, there are many industry-specific subsidies in the code benefiting this industry or that for whatever political reason they were put in. I wonder why you would be supporting these programs, if you have any belief at all that businesses ought to make business decisions and that the government shouldn't be running sort of a quasisocialist state. Clearly because free market principles and these subsidies are so inconsistent with one another.

So the bottom line is that on-budget revenues this year are going to be about 11½ percent of GDP. That is the lowest level since before World War II, and it is almost a quarter below the level in fiscal 2000. This drop in revenues explains most of the enormous deficits we face. And the vast expansion in tax based subsidy programs explains quite a lot of that. Of course the income tax rate cuts and so forth explain a lot of it, too.

It seems to us that this committee and the Congress ought to look at tax based spending programs the same way you look at anything else. There is no real distinction except artificial bookkeeping differences. Let me give you an example.

Suppose the earned income tax credit were not refundable, but instead poor families could sell their tax breaks to better off families and get the money that way. That would show up as a reduction in taxes rather than as spending, but it wouldn't be a different program. If you think that is out of the blue, remember that corporations day in and day out sell their excess tax breaks to companies that can use them. That makes the corporate subsidies, whether it is the low income housing credit or accelerated depreciation or whatever, in essence refundable. And yet, well, they don't get the attention. So it seems to us that if this committee is serious, and I hope you are, in trying to reduce our government's unsustainable borrowing, then curbing unwarranted tax based entitlement programs, especially the expensive tax subsidies for corporations that fail to serve economic purposes and cost hundreds of billions of dollars should be very high on your agenda.

Thank you very much.

[The prepared statement of Mr. McIntyre follows:]

PREPARED STATEMENT OF ROBERT S. MCINTYRE, DIRECTOR, CITIZENS FOR TAX JUSTICE

Recent projections from the Congressional Budget Office indicate that in fiscal 2003, the onbudget Federal deficit is likely to exceed $570 billion. That means that $1 out of every $3 that the Federal Government spends outside of the self-funded Social Security system will be paid for by borrowing. This will be the highest share of on-budget Federal spending financed by deficits since World War II.

Faced with this dire fiscal situation, which shows no sign of abating in the future, it is entirely appropriate that this committee is searching for ways to stem the torrent of red ink.

In seeking to reduce the enormous rise in Federal borrowing, however, one important area has been largely off the radar screen of the majority party in Congress: the many mandatory Federal programs embedded in the tax code and administered by the Internal Revenue Service.

As the Joint Committee on Taxation points out: "Special income tax provisions * * * may be considered to be analogous to direct outlay programs, and * * * are similar to those direct spending programs that are available as entitlements to those who meet the statutory criteria established for the programs." (Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2003–07, Dec. 19, 2002)

The Joint Committee on Taxation's most recent compilation of these tax code-based spending programs, issued last December, found a total of $843 billion in such programs in this fiscal year alone, rising to $915 billion by fiscal 2007. That's more than the total amount of discretionary appropriations.

It should be noted that even these enormous figures for tax-based spending are substantially understated. They do not include the recently enacted increases in tax-based spending in the 2003 tax bill. They assume that various sunsets on old and new tax-based spending programs will be honored. They use a statistical trick to greatly understate the tax code's largest official corporate tax subsidy, accelerated depreciation. And they do not include the huge and growing cost of the burgeoning abusive corporate tax shelters that Congress and the Bush administration have so far chosen to encourage or at least tolerate.

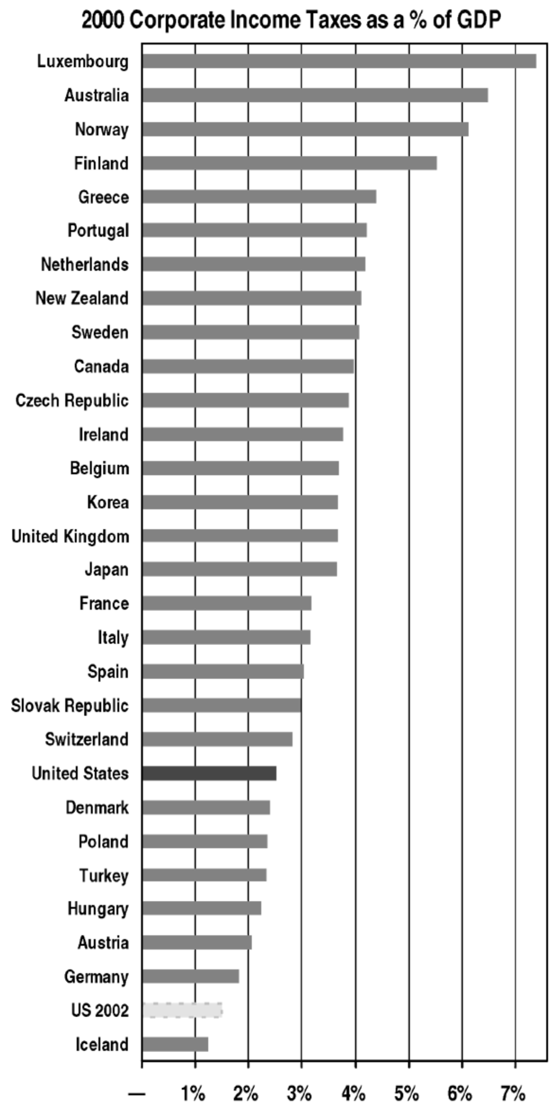
To be sure, some tax-based spending programs serve important needs that would doubtless incur significant Federal costs if they were run by government agencies other than the IRS. In my testimony today, I want to focus on what I see as the most objectionable and fastest growing area of wasteful tax-based spending programs, those that are designed to subsidize various corporate activities. There are more than 75 of these "mandatory" corporate subsidy programs, benefiting activities such as oil drilling, insurance, nuclear power, commercial real estate, equipment purchases, drug manufacturing, ethanol production and so on.

In President Reagan's second term, he strongly criticized corporate tax subsidies as wasteful, inconsistent with free market principles and harmful to economic growth. At Reagan's instigation, the subsidies were sharply cut back in 1986. But in recent years, corporate tax subsidies have made a striking comeback, and are now costing ordinary taxpayers close to $200 billion annually. They should be prime targets for reexamination in the effort to bring the budget back into balance.

OUR LOW, LOW CORPORATE TAXES AND HIGH, HIGH CORPORATE TAX SUBSIDIES

Contrary to the constant whining that members of Congress hear from corporate lobbyists, corporate income taxes in the United States have fallen so much over the past few decades that they now are virtually the lowest among the world's developed countries. Here are a few salient facts, taken from the Organisation for Economic Cooperation and Development's October 2002 comparison of taxes among its member countries:

- In 1965, U.S. Federal, State and local corporate income taxes were 4.1 percent of our gross domestic product, compared to 2.4 percent of GDP in the other OECD countries.
- But by 2000, U.S. corporate income taxes had dropped to 2.5 percent of GDP, while corporate income taxes in the other OECD countries had risen to 3.4 percent of GDP. That placed us 22nd among the 29 reporting OECD countries.
- In 2002, the last year for which full Federal, State and local figures are available, U.S. corporate taxes plummeted to only 1.5 percent of our GDP. That's below the most recently reported corporate tax levels in any other OECD country except Iceland.
- Looking only at the U.S. Federal tax system, corporate income taxes have fallen to only 1.2 percent of the GDP this year and last—69 percent below their 3.8 percent share of GDP in the 1960s.



This sharp drop in corporate tax payments in the United States in recent years has not been caused by a lower statutory corporate tax rate, but rather by an explosion in congressionally enacted tax subsidies and a wave of corporate tax sheltering activity. As a result, most of the profits that corporations report to their shareholders are never reported on their tax returns. In fact, it appears that this year corporate taxes as a percent of U.S. profits will fall to well under 15 percent probably only about a third of the statutory corporate rate of 35 percent.

RECENT LEGISLATION HAS VASTLY EXPANDED TAX-BASED CORPORATE SUBSIDIES

In early 2002, Congress enacted the largest corporate tax reduction in a generation, primarily by greatly expanding the amount that companies can write off for wear and tear on their equipment. This $114 billion expansion in business tax subsidies was defended as a supposed "stimulus" to our ailing economy, and was supposed to "sunset" in the fall of 2004, then to be followed by partially offsetting big corporate tax increases in future years. But last month, the 2002 "depreciation" tax subsidies were extended and increased (and the bill initially passed by the House would have provided an even longer extension).

The combination of the 2002 and 2003 corporate tax changes is expected to increase business tax subsidies by a total of $178 billion in fiscal 2002–04. For corporations, that will cut income tax payments by 25 percent over that period. And if the revised "sunset" date is waived after the end next year, then the cost of these programs will exceed $400 billion over a decade.

Under current depreciation rules, the profits generated by equipment investments often aren't taxed at all. Instead, many investments enjoy "negative" tax rates, that is, they are more profitable after tax than before. A whole industry has risen up to help companies with excess tax subsidies to sell the excess to other companies, typically through leveraged leasing deals, thereby making the tax subsidies essentially "refundable."

On its face, the asserted purpose of the recent corporate "stimulus" bills seems sadly misdirected. For the past few years, our economy has faced serious excess capacity: businesses can make more products than consumers want to buy. Oddly, Congress and President Bush concluded that rather than trying to boost demand, the answer to the over-capacity problem was to try to encourage even more overcapacity. Not surprisingly, this nonsensical strategy hasn't worked. By the end of 2002 the Business Roundtable reported that more than 80 percent of its members planned no added investment although they were surely happy to take the money for doing what they would have done anyway.

Yet confronted with the abject failure of the previous effort at economic stimulus, Congress 1and the President have not admitted their mistake. Instead, they concluded that throwing good money after bad was the best policy and included even bigger corporate depreciation subsidies in the 2003 tax bill.

OFFSHORE CORPORATE TAX SHELTERING SCHEMES HAVE PUSHED CORPORATE SUBSIDIES STILL HIGHER

The fact that Congress was so eager to extend its obviously failed corporate "stimulus" program illustrates just how hard it is to eliminate tax-based spending programs once they are placed in the tax code. But while the justification for the recent corporate "stimulus" legislation is shaky in the extreme, Congress's tolerance of the wave of abusive offshore corporate tax shelters that have emerged in recent years is even worse.

By way of background, the traditional goal of U.S. corporate tax policy is to tax companies whether American or foreign-owned on the profits that they earn in the United States. We give a full tax credit for taxes paid on profits earned abroad, that is, actually earned abroad. For their part, corporations try very hard to make their U.S. profits appear to be foreign on paper, in order to avoid paying taxes to any country. In recent years, major accounting firms have designed an array of abusive tax shelters that have hugely expanded such paper profit shifting.

Everyone has heard about the dozens of American companies that have chosen to renounce their American citizenship and reincorporate in Bermuda or other tax haven countries to avoid paying taxes on their U.S. profits. In the face of public outrage, only a few politicians are willing to publicly defend this unpatriotic practice.

But the Bermuda tax avoidance scheme is only the tip of a vast iceberg of corporate offshore tax sheltering all designed to shift U.S. profits, on paper, outside the United States. Congress and the President have failed to act to curb these abuses, which all together are costing the Treasury and ordinary taxpayers on the order of $50 billion or more a year.

Earlier this year, the Senate version of the 2003 tax cut bill proposed to take a few small steps toward curbing the Bermuda loophole, "Enron-style abuses," and other indefensible corporate tax shelter subsidies. But even these modest changes were rejected out of hand by the House.

In fact, the chairman of the Ways and Means Committee has made it clear that he favors a vast expansion in subsidies for offshore tax sheltering. Last year in H.R. 5095, he proposed $83 billion in additional subsidies to encourage offshore tax avoidance, only slightly offset by the $14 billion in temporary tax shelters curbs he felt forced to propose in response to public outrage over the Bermuda loophole.

Of course, some may argue that there should be no taxes on corporate profits, or on any kind of investment income for that matter, and that only wages should be taxed. That indeed is the apparent opinion of the Bush Treasury Department, along with many antitax groups and some members of Congress. But even if one has that goal totally mistaken in my view setting up a tax system that encourages avoidance and evasion by the unscrupulous at the expense of honest corporate and individual taxpayers is indefensible.

CURBING CORPORATE ENTITLEMENTS

The agenda for corporate entitlement reductions is a long one. Let me quickly highlight a few areas that ought to be given a very hard look:

• **Excess depreciation write-offs.** Beyond enforcing the sunsets on the 2002 and 2003 misdirected "stimulus" bills, Congress could go considerably further in curbing unwise depreciation tax subsidies. If our goal is to tax corporations on what they really earn, then tax deductions for depreciation ought to be based on a reasonable approximation of actual wear and tear, not used as a hidden subsidy that distorts investment behavior and interferes with fair competition. In addition, depreciation write-offs on debt-financed investments could be disallowed, either completely or at least partially, as the corporate alternative minimum tax used to do before it was gutted in the 1990s.

• **Multinational tax subsidies.** There are many steps that could be taken to curb our current array of wasteful, if not perverse, tax subsidies for multinational corporations. For one thing, we don't have to let a mail drop in Bermuda turn an American company into a foreign corporation. Instead, Congress could follow the lead of countries such as Germany, Japan, and the United Kingdom, and treat any ostensibly "foreign" corporation whose shares are mostly owned by Americans as American. Going beyond the specific Bermuda loophole, we could take on offshore corporate tax sheltering generally. One important step would be to scrap an antiquated rule that lets U.S. companies indefinitely "defer" reporting their foreign profits on their U.S. tax returns. As noted above, it's not that we want to tax actual foreign earnings: We give companies a full tax credit for the taxes they pay to foreign governments when and if they report the foreign income to the IRS. But deferral opens up the door to other scams that companies use to shift their American profits on paper to tax-haven countries, and our current anti-abuse rules are too weak. Eliminating deferral would stem these abuses and hugely simplify the corporate-tax laws to boot. That's exactly what the Kennedy administration unsuccessfully proposed back in the early 1960s, and what both the House and the Senate passed in the mid-1970s unfortunately not at the same time.

Congress could also consider scrapping our unworkable rules that require the IRS to examine billions of fictitious intracompany transactions, and instead adopt a combined-reporting system that allocates taxable corporate profits among countries based on a straightforward formula. Under this approach, a corporate tax would apply once and only once, rather than only occasionally as is too often the case under current law.

• **Industry-specific subsidies.** Using the tax code to favor particular industries and/or investments that make no economic sense in the absence of a subsidy (such as ethanol) is almost always bad policy. As part of corporate entitlement reform, Congress should consider clearing out the array of narrow interest business subsidies that were they not hidden in the tax code, would have stood almost no chance of being enacted in the first place.

CONCLUSION: ELIMINATE THE DOUBLE STANDARD

This year, on-budget Federal revenues are expected to fall to about 11½ percent of GDP, the lowest level since before World War II, and about a quarter below the 15.9 percent level in fiscal 2000. This drop explains most of the enormous deficits we face this year and in the future. Of course, the recently enacted reductions in personal tax rates and the phase-out of the estate tax explain much of this decline. But the vast expansion in tax-based subsidy programs, particularly the hundreds of billions of dollars annually for corporations, looms very large as well.

Despite artificial bookkeeping differences, it seems obvious that programs should be evaluated on the same terms whether they are run by a regular government agency or by the IRS through the tax code. To do otherwise would elevate form over substance, and make responsible budgeting difficult or impossible.

So if this committee is seriously interested in reducing our government's unsustainable borrowing binge, then curbing unwarranted tax-based entitlement programs, especially the many expensive tax subsidies for corporations that fail to serve any worthwhile economic or social objective, should be high on the agenda.

Chairman NUSSLE. Thank you.

Mr. Scott.

Mr. SCOTT. Thank you, Mr. McIntyre. The previous witness pretty well disparaged the idea that we are going to grow our way out of this mess. Do you agree with that?

Mr. MCINTYRE. The idea that cutting taxes increases revenues is a nice thought, but it has been tried before. Remember under President Reagan when we were going to pay for the defense buildup with the revenues generated by the tax cuts? A few trillion dollars in increased debt later, they figured out that was a bad policy and we reversed it. In fact, we managed to balance the on-budget budget for several years in the late 1990s. So repeating that failed strategy seems to me to be, you know, foolish.

Mr. SCOTT. Could you put the deficit chart up? So you agree with his disparaging remarks?

Mr. MCINTYRE. I do agree with his disparaging remarks. I probably would state them even more strongly.

Mr. SCOTT. This is the interest on the national debt that we were going to pay—the interest on the national debt in red that we were going to pay in the defense budget. If we look at that chart and the increasing interest on the national debt and the Social Security deficit looming after 2017 and the full, as you have suggested, 10-year cost of all the phased in tax cuts and the President's statement when he came in office that said that Social Security needs reform but not in such a way that will adversely affect the benefits for those on retirement or those near retirement, opening up the question of what about everybody else, how do you reconcile that statement, this chart, the Social Security deficit in any way that does not include a repeal of Social Security?

Mr. MCINTYRE. Well, we have big problems with Social Security due to the budget deficits that we are running. As you pointed out, it is not too long from now when Social Security taxes will not be enough to fund the program and Social Security will start to have to ask the government to pay back the money that Social Security lent it. And if the government has a huge national debt and huge interest payments, it won't be able to afford to make those payments back to Social Security. That is one very important reason why we should be trying to get the budget back into balance and maybe into surplus when the economy recovers so we will have the resources to pay the Social Security commitments that we have made.

Mr. SCOTT. And if we don't do something drastic, is it fair to assume that we will not be able to afford Social Security?

Mr. MCINTYRE. I suppose they could eliminate the Defense Department instead, but something has to give, yeah.

Mr. SCOTT. One analysis was that in terms of tough choices, the tax cut that the top one percent got in 2001 would be enough money; if instead of spent on a tax cut, if it had been spent on Social Security, it would have increased the surplus in Social Security such that we could have paid Social Security for 75 years without reducing benefits. Do you agree with that calculation?

Mr. MCINTYRE. Well, it is sort of contingent on the sunset in 2010. But ignoring the sunset, that is right. By 2010 half of the 2001 tax cut will go to the wealthiest people and that will continue thereafter. And the size of the tax cut if it is extended is about double the Social Security problem. So yes.

Mr. SCOTT. Is there any chance we might solve this problem by tightening up the abuse of credit cards?

Mr. MCINTYRE. No.

Mr. SCOTT. Is there any chance that we might solve this problem by cutting back on waste in student loans, school lunches, veterans benefits or veterans pensions?

Mr. MCINTYRE. You could eliminate all those programs and you wouldn't solve this problem.

Mr. SCOTT. You mentioned tax fairness. Can you make a statement how fair the abolition of the estate tax would be while this is going on?

Mr. MCINTYRE. Well, as you know, the estate tax is mainly paid by just a handful of very large estates. Some of them were listed in today's Washington Post, the Hallmark Card family and the Mars Candy family, the ones who have been pushing hardest for repeal of the tax. For 98½ percent of Americans there is no estate tax. So it was one of our most progressive taxes and one that was an extraordinarily good deal for the vast majority of Americans.

Mr. SCOTT. When you talk about the foreign taxes, would you cure that by changing the foreign taxes from a credit to a deduction?

Mr. MCINTYRE. Actually, no. I mean our goal on international is to try to tax companies on the money they make in the United States. We don't try to tax them on their legitimate foreign profits. We do try to stop them from artificially shifting profits offshore to avoid taxes on what they make here. So the foreign tax credit says, look, if you pay tax to France or Germany we are not going to tax you again. Fair enough. But if you shift your profits to Bermuda, we are not going to honor that, and shouldn't honor that. The chairman of the Ways and Means Committee wants to honor it. If we crack down on the abuses and say we want to measure your profits fairly in the United States and that is what you pay tax on, just by getting rid of the offshore tax shelters, I am confident could raise $50 billion a year.

Mr. SCOTT. Thank you, Mr. Chairman.

Chairman NUSSLE. Thank the gentleman.

Mr. Spratt.

Mr. SPRATT. By your calculation what is the effective corporate tax rate today?

Mr. MCINTYRE. Well, my calculation in 2002 was that it was about 15.4 percent. Since then, Congress has adopted even larger corporate tax breaks. So I would think it is less than 15, probably in the ballpark of 12 or 13 percent right now, about a third of the statutory rate.

Mr. SPRATT. How much of that is attributable to the ability of American multinational firms to move their earnings or allocate their earnings overseas and outside the jurisdiction of the United States?

Mr. MCINTYRE. Well, if corporations paid taxes on all of their U.S. profits at the 35 percent rate, they would be paying more than double what they are paying now, something in the order of about $280 billion. The recent tax legislation on depreciation has cut that by about $50 billion a year. Offshore sheltering cuts it by another 50. And then there are other items in the tax code that cut it down the rest of the way. So of the total drop in the effective rate, well, a little more than a sixth is due to offshore shelters.

Mr. SPRATT. Would you explain to us exactly how a company declares that Bermuda is its headquarters and is now domesticated in another country and most of its earnings accrue and are allocated to that country rather than this one?

Mr. MCINTYRE. Well, I will tell you why they bother. We have rules in the tax code that have been there since the Kennedy administration that try with limited success, but some, to restrict a company's ability to use tax havens. But those rules only apply to American companies. If a company, say Price Waterhouse Coopers Consulting, which was planning to do it last summer, can reincorporate itself as a foreign corporation, say in Bermuda, and then shift part of its operations to Liechtenstein and some of it to Barbados on paper, our rules that stop them from doing that shift out of the United States don't work very well. Bermuda was sort of an elegant way to get around the rules that Congress set up to stop these kinds of abuses. Unfortunately, in the current Ways and Means Committee, the chairman believes that these abuses are good.

Mr. SPRATT. Now in your testimony you indicate that Germany, United Kingdom and Japan have all taken steps to clamp down on this tax avoidance scheme. Have they redefined what is a domestic corporation, what is a foreign corporation?

Mr. MCINTYRE. Basically their rule is that if you are owned by Germans, you are a German company. We could do the same thing here. If you are an American-owned company you are American, even if you happen to plant your flag on an atoll in the Pacific or in Bermuda.

Mr. SPRATT. You indicate one of the problems is allowing firms which haven't actually paid taxes to a foreign entity which they can claim as a credit against U.S. income, but also they defer—even if they haven't paid the taxes but have deferred them, they can treat the deferral as having paid foreign taxes on income allocated to some other jurisdiction?

Mr. MCINTYRE. Deferral says that the companies doesn't pay taxes on their foreign profits, foreign in quotes here, until they repatriate them, which is basically never. The problem with deferral primarily is that it makes it too easy for companies to shift their profits to tax havens. Deferral is not an issue if you are paying taxes in Europe to real countries, because the foreign tax credit would shelter your profits anyway. So when John Kennedy proposed what became the anti-tax haven rules, he actually proposed to get rid of deferral entirely because it was the clean and elegant solution. Unfortunately, the Congress wouldn't go that far.

Mr. SPRATT. Is this definitionally hard to accomplish?

Mr. MCINTYRE. No. The European countries have great interest in going along with it, by the way, if we took the lead. They are concerned that the kind of avoidance we are seeing here now is starting to spread to their countries.

Mr. SPRATT. We could have some sort of tax treaty with the western European countries who want to combat this tax avoidance scheme?

Mr. McINTYRE. There would be a great deal of interest. There also might be interest in working out a simple formula approach to allocating profits among countries, so that at that point the corporations would lose incentive to try to shift it around because it is either going to be taxed by France or by us.

Mr. SPRATT. When profits earned allegedly abroad are brought back to the United States and invested here, are they taxed at that point?

Mr. McINTYRE. Almost never. They are virtually always sheltered by the foreign tax credit. And in fact there are easy ways to bring the money back here and invest it here without technically repatriating.

Mr. SPRATT. So repatriation doesn't catch up with the tax liability?

Mr. McINTYRE. I think I have read about 4,000–5,000 annual reports over the last 20 years and the boilerplate is always the same in the tax footnote. Our company has X billion dollars of profits on which taxes are deferred because they are overseas. We never expect to pay any taxes on them. If we do repatriate them they will be sheltered by the foreign tax credit. I think they have a rubber stamp for that one.

Mr. SPRATT. Thank you very much for your testimony and the efforts you put in coming here today. I appreciate it.

Chairman NUSSLE. I ask unanimous consent that all members be given 7 days to submit statements and other matter for the record. I should have done that at the beginning and I did not. Without objection, so ordered.

There are also others who wish to put in statements in the record today and without objection, there are a number of other statements that I know needed to be submitted so we will do that by unanimous consent as well.

[The prepared statement of Mr. Barrett follows:]

PREPARED STATEMENT OF HON. J. GRESHAM BARRETT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH CAROLINA

Mr. Comptroller General, first I'd like to welcome you here and thank you for your testimony today. As a taxpayer before coming to DC as a Representative I understood that if Washington, DC received the money they would spend it. This idea has been reinforced in my mind since arriving in Washington just 6 months ago. The amount of taxpayer money that is wasted is inexcusable. The American people have a right to know what is happening to their money in DC.

We can't ask taxpayers, businesses and State and local governments to cut back and not do the same on our level. As Comptroller General of the GAO, I'm sure you are aware of the magnitude of this problem, but I'd like to take a moment to list just a few examples for the American people.

The GAO reported: "Since 1996, annual audits by the Department of Health and Human Services Office of the Inspector General have found that Medicare contractors have improperly paid claims worth billions of dollars." Last year, improper payments in the Medicare Fee-for-Service Program totaled $13.3 billion, or 6.3 percent of the program. Let me say that again because it's astounding—last year, improper payments in the Medicare Fee-for-Service Program totaled $13.3 billion.

With regard to student financial aid the GAO says: "Millions of dollars in loans and grants have been disbursed to ineligible students because of internal control weaknesses. Further, while default rates have fallen, the amount of defaulted student loan dollars has remained high."

I along with several other members of this committee have made a commitment to hold government accountable. Sometimes we come up here and forget it's not Monopoly money we are talking about—it's the money of the hard working American people.

We are determined to find and eliminate waste, fraud and abuse at all levels of the Federal Government—we have asked each committee, as well as each Cabinet Secretary and down throughout the agencies, to really look at how they are spending the taxpayer's money.

I know the GAO is often referred to as the watchdog of the Federal Government, so I look forward to listening to your testimony today and I look forward to any suggestions or recommendations you may have.

[The prepared statement of Associated Builders and Contractors, Inc. follows:]

PREPARED STATEMENT OF ASSOCIATED BUILDERS AND CONTRACTORS

Associated Builders and Contractors (ABC) appreciates the opportunity to submit the following statement for the official record. We thank Chairman Nussle (R–IA) and Ranking Member Spratt (D–SC) for addressing the problem of wasteful Federal spending programs. It is our hope that today's hearing, entitled "Waste, Fraud, Abuse in Federal Mandatory Programs," will shed light on just how inefficient, fraudulent and outdated the Davis-Bacon Act has become in today's economy.

ABC is a national trade association representing more than 23,000 contractors, subcontractors, material suppliers and construction-related firms in a network of 80 chapters. Our member firms employ close to one million craft professions across the country. Our diverse membership is bound by a shared commitment to the merit shop philosophy of awarding construction contracts to the lowest responsible bidder, regardless of labor affiliation, through open and competitive bidding. With more the 80 percent of the construction industry made up of merit shop contractors, ABC is proud to be their voice.

ABC has long advocated the repeal of the Davis-Bacon Act as a way to reduce government spending and improved efficiency and cost effectiveness of Federal contracting. The Davis-Bacon Act is a Depression-era relic enacted in 1931. Today, it functions as a system rife with waste, fraud and abuse, which translates into significantly inflated costs for Federal construction. Because of the law's outdated restrictions, Davis-Bacon has been demonstrated to inflate construction costs by at least 5 to 15 percent, and up to 38 percent, above what projects would have cost in the private sector. The unnecessary costs are directly passed on to the customers—the American taxpayer—who are forced to fund this wasteful program. According to the Congressional Budget Office (CBO), repealing Davis-Bacon would save taxpayers over $10 billion dollars over 10 years. These savings would guarantee more construction for the dollar for important public projects, such as schools, roads, bridges, low-income housing, hospitals, prisons, and more.

The Davis-Bacon wage process has been proven to be inaccurate and biased and used a tool to defraud taxpayers. In Oklahoma, extensive fraud was uncovered whereby numerous falsified wage forms were submitted to the U. S. Department of Labor, citing phony projects and workers with grossly inflated wages in order to increase the mandated wages for public projects. In 1997, a Department of Labor Inspector General's report confirmed that two-thirds of the wage surveys were inaccurate. In January 1999, a General Accounting Office (GAO) report found errors in 70 percent of the wage forms, frequent undetected errors, and that the high proportion of erroneous data "poses a threat to the reliability" of prevailing wage determinations. One very recent illustration of the current wage survey process's inability to accurately determine "prevailing" wages for a region is a recent wage determination for several counties in Pennsylvania which increased the Davis-Bacon wage rates for several categories by more than 300 percent. Upon further investigation, it turns out the association representing the vast majority of contractors in the area did not even receive the survey and that several "luxury" projects, which were otherwise anomalies in the area, significantly distorted the real wage picture. As a result of this gross wage distortion, the construction of new affordable housing projects and other government-financed projects are threatened, along with the jobs of construction workers who would be working on these projects.

Davis-Bacon also raises costs by vastly reducing competition. The extensive and overly burdensome paperwork and compliance requirements associated with the Act makes it nearly impossible for smaller businesses to compete. The Act also requires that companies follow outdated union job categories, providing yet another inefficient compliance hurdle contractors must abide by. When competition is reduced, costs increase significantly.

Under its current application, Davis-Bacon does not provide for the use of "helpers," a commonly used job category in the private sector. Former Federal Reserve Board Governor Lawrence Lindsay commented, "These restrictions (to not allow helpers) impede inner city development in two ways: they drive up the cost of construction and they tend to deprive local residents of job opportunities." Not only does the inflated cost in inner city development prevent the use of the local labor, it impacts the general public for whom the projects are designed. For example, the increased costs greatly decrease the benefit of low-income housing. One study found the Act reduces the number of minority workers in the construction industry by 25,000 per year; another study showed that in states with little Davis-Bacon laws African American employment in construction is less than half that in states without the law. With presently no allowance for helpers, a business has one of two choices in filling unskilled labor positions. A firm can a) hire only skilled labor, thereby having highly qualified workers performing menial tasks or b) hiring unskilled labor which means that workers with few to no skills will be paid the same wage as a "veteran" worker. This diminishes moral among higher skilled laborers with the knowledge that they are paid the same wage as unskilled labor.

The Davis-Bacon Act, through the waste, fraud, and abuse that is inherent in the system, ends up costing the American taxpayer upwards of a billion dollars every year. The Federal Government cannot, and should not, attempt to determine "prevailing" wage rates for construction, or for any other sector of the economy. The outdated and abused Davis-Bacon law should be repealed so that the free market can be allowed to work for public contracts, as it does in private construction. If the Federal Government is looking for ways to reduce waste, fraud and abuse in Federal spending, it need not look any farther than elimination the Davis-Bacon Act.

ABC appreciates this opportunity to submit comments on such a vital issue. We look forward to continuing a constructive dialogue on how to increase efficiency and value in Federal Government spending

[Letter submitted for the record by the Independent Budget:]

LETTER SUBMITTED FOR THE RECORD BY AMVETS, DISABLED AMERICAN VETERANS, PARALYZED VETERANS OF AMERICA, AND VETERANS OF FOREIGN WARS

THE INDEPENDENT BUDGET,
June 17, 2003.

DEAR CHAIRMAN NUSSLE AND RANKING MEMBER SPRATT: On behalf of the co-authors of The Independent Budget, AMVETS, Disabled American Veterans, Paralyzed Veterans of America, and Veterans of Foreign Wars, we are writing to express our concern as you proceed to investigate proposed additional "savings" from veterans' benefits and services based on what is assumed to be waste, fraud and abuse within the Department of Veterans Affairs (VA).

We were pleased that the Budget Committee abandoned its proposal to cut $28 billion in veterans' mandatory and discretionary spending over a 10-year period in the fiscal year 2004 Concurrent Budget Resolution. However, we are concerned that this Committee is proceeding to require committees such as the Committee on Veterans Affairs to report arbitrarily established recommended mandatory spending cuts in the amounts of $342 million in fiscal year 2004 and $3.9 billion over 10 years.

We are certainly no friends of waste, fraud, or abuse. We believe that any waste, fraud, and abuse should be identified as part of an ongoing effort by the VA and remedied by the VA and the Committees of jurisdiction. Because of the very nature of any such savings, we do not believe that they can be identified as a rhetorical goal. We are concerned that any such savings, identified in this forum, will not be used to improve the provision of benefits and services to veterans. To set a target that is arbitrary could very well mean that the mandated target might very well not be met, and that real benefits will need to be cut to reach such a goal. These would be real cuts affecting real people, veterans, their families, and survivors.

At a time when veterans are waiting months to receive earned health care benefits, and years to receive other benefits they have earned, we respectively ask this Committee, as well as the VA and the Committees of jurisdiction, to work together to provide the VA with the stable resources it needs to provide the benefits earned by the men and women who have answered our Nation's call to duty and to sacrifice.

Sincerely,

RICK JONES,
National Legislative Director, AMVETS.

JOSEPH A. VIOLANTE,
National Legislative Director, Disabled American Veterans.

RICHARD B. FULLER,
National Legislative Director, Paralyzed Veterans of America.

DENNIS CULLINAN,
National Legislative Director, Veterans of Foreign Wars of the United States.

Chairman NUSSLE. I will let you deal with Chairman Thomas. I think you have misstated his position. He can stick up for himself, but just for the record I think there is as with many things another side of the story here. We appreciate your brief testimony on the subject of the hearing today and we thank you for that. And if there isn't any further business to come before the committee, we will stand adjourned.

[Whereupon, at 12:45 p.m., the committee was adjourned.]

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