USING TAXPAYERS' DOLLARS MOST EFFICIENTLY: PERSPECTIVES ON PERFORMANCE BUDGETING

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USING TAXPAYERS' DOLLARS MOST EFFICIENTLY: PERSPECTIVES ON PERFORMANCE BUDGETING

THURSDAY, SEPTEMBER 20, 2007

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

The committee met, pursuant to call, at 10:07 a.m. in room 210, Cannon House Office Building, Hon. John Spratt [chairman of the committee] presiding.

Present: Representatives Spratt, Edwards, Cooper, Becerra, Blumenauer, Berry, Boyd, Scott, Etheridge, Bishop, Ryan, Conaway, Porter, Alexander, and Smith.

Chairman SPRATT. Good morning and welcome to our hearing on performance budgeting. We have an excellent panel of government witnesses who have thought long and hard about this subject, performance budgeting. I thank them for their participation today.

Given the daunting budgetary that face us, we need more than ever to put the taxpayers' dollars to the wisest possible use. Earlier this year, the committee heard from government witnesses about efforts to combat waste, fraud and abuse in health care, retirement and tax collection.

Our budget this year made provision for additional funding to provide for what we call "program integrity" in these areas. And those program integrity funds are included in the appropriation bills that the House passed.

Today we turn our attention to another aspect of stewardship. Our question today is whether or not there are ways that we can improve the tools we use to measure government performance and effectiveness to see that we are getting the most bang for our bucks.

Performance budgeting is not a new concept. It has been undertaken by nearly every administration for the past 50 years. The most recent comprehensive initiative was the Government Performance Results Act of 1993 which is aimed at creating a framework to align performance objectives and program activities.

While the goals of the GPRA are similar to other efforts, it differs from its predecessors in one key respect. The basis for the GPRA review is statutory, explicitly linked to the budget process, and congressional involvement is mandated.

During the current administration, OMB has embarked on the development of the rating system known as Program Assessment Rating Tool, or PART. While similar in some respects to the goals of GPRA, PART has been used mostly to assist in the executive branch budget formulation. There is a wide range of views about PART. Criticism has been raised about its effectiveness, the subjectivity. And some of those perspectives will be explored today. And from OMB, GAO and CBO we have an extraordinary range of expertise.

But before turning to our witnesses, I want to yield to the Ranking Member, Mr. Ryan for any opening statements he may care to make.

Mr. Ryan.

Mr. RYAN. Thank you, Chairman, and I thank you for having this hearing. This is a very well-timed hearing and I look forward to our witnesses' testimony.

Clearly, constituents want Congress to ensure that they are running their government and spending their tax dollars as effectively and as efficiently as possible. But Congress has long struggled to define that goal, let alone even achieve it. There is simply no formula on how Congress' spending decisions are made. Policy preferences, parochial interests, both inside and outside of government, and even emotional ties, all factor into the mix. And it is notoriously difficult to come to a consensus as to which programs we think are working well and which are not. It is therefore critical that Congress has an objective means for measuring agency performance.

Today we are here to discuss several of the tools Congress has been provided to help us towards that end. And in particular, the Government Performance and Results Act and the administration's Program Assessment Rating Tool, or PART, are two good tools. Clearly there is not always going to be a direct correspondence between how well an agency performs and the amount of funding it receives.

That said, let us look at this year's PART assessment of the worst performing programs that appears to show that there is a complete disconnect between program performance and House-passed funding levels.

If you could pull up chart one, please.

Consider what has happened with our worst performing programs. OMB's recent PART analysis reviewed over 1,000 programs, 3 percent of which received a rating of ineffective, or the worst possible rating that they provide. The President's budget requested lower funding levels for these programs. But as this chart shows, the House actually gave them considerably more than the President requested. Again, there is not always going to be a direct correspondence between performance and funding levels, but it does seem that Congress is failing to take advantage of the tools we have available to guide funding decisions, at least partially, on actual agency performance.

So I think today's review of these assessment tools and how Congress might better utilize them is a particularly useful and constructive use of this committee's time. And I thank the Chairman for having this hearing.

Chairman SPRATT. Mr. Ryan, we will go with Mr. Johnson first, the Deputy Director of OBM. But before we do, we have got a couple of housekeeping details. First of all, we have a request for unanimous consent for two witnesses, the statements of Mr. Barry Anderson, whom we all know, head of Budgeting and Public Expenditures at OECD, and Paul Posner, Director of the Public Administration program at George Mason. I want to take this opportunity quickly to thank both of them for their contributions to the hearing. We had asked them to submit testimony to gain a boarder spectrum of views about the subject from some of those who have thought long and hard about it. Their observations will be part of the record and will be food for thought as we deal with this matter.

[The prepared statement of Mr. Anderson follows:]

PREPARED STATEMENT OF BARRY ANDERSON, ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD)

Mr. Chairman and Members of the Committee: Thank you for giving me the opportunity to testify on the use of performance information in budgeting. I know this Committee has had an interest in the performance of Federal programs for a number of years, as I have discussed the subject many times with members and staff during my tenure as the Deputy Director of the Congressional Budget Office between 1999-2003. However, I am in a much different role now than I was then: I am currently Head of the Budgeting and Public Expenditures Division of the Organization of Economic Cooperation and Development (OECD) located in Paris. And I have been asked to submit written testimony on the international use of performance information in budgeting.

OECD countries—and other countries around the world—are under pressure to improve public sector performance and at the same time contain expenditure growth. As factors such as ageing populations and increasing health care and pension costs add to budgetary pressures, citizens are demanding that governments be made more accountable for what they achieve with taxpayers' money. An important step in this process is to gather objective information about public sector performance.[1] Performance information enables governments to measure progress towards achieving their policy and programme goals and provides details on what initiatives are working and those that are not. The central aim is to improve decision making by providing politicians and civil servants with better quality and more concrete information on the performance of agencies and programmes. In addition, this information can enhance transparency to the public and the legislature.

The introduction of performance information into the budget processes across OECD countries is a widespread, long term and evolving process. Formal performance information is taken to refer to both performance measures (outputs and/or outcomes) and evaluations. Consider the following:

- 75% of OECD countries include non-finance performance data in budget documentation;
- 40% of countries have been working on outputs for over 10 years;
- 35% of countries introduced a new initiative in this area in 2005.[2]

The 1990s witnessed an expansion of efforts by many governments to introduce performance information into their budgets as part of a process that seeks to move the focus of decision making in budgeting away from inputs (how much money can I get?) towards measurable results (what can I achieve with this money?). At first this movement led to the introduction of performance budgeting as a form of budgeting that directly relates funds allocated to measurable results. Performance budgeting has also been linked to larger reform efforts to improve expenditure control and/or public sector efficiency and performance. Performance budgeting initiatives tend to go hand in hand with performance management or managing for results. These reforms are often combined with reductions in input controls and increased flexibility for managers—in return for stronger accountability for the results—so as to enable them to decide how to best deliver public services.

PERFORMANCE-INFORMED BUDGETING

The production of performance information is not an end in itself; quite the contrary, to make difference performance information has to be actually used in the de-

[1] Curristine, T., Z. Lonti and I. Joumard (2007) "Improving Public Sector Efficiency: Challenges and Opportunities", OECD Journal on Budgeting, Vol. 7(1), pp. 161-201

[2] Curristine, T (2005) "Performance Information in the Budget process: Results of the OECD 2005 Questionnaire", OECD Journal on Budgeting, Vol. 5(2), pp. 87-131

cision-making process. As countries struggled with mechanical performance budgeting systems that some first started with, a major issue developed on what was the best way to use performance information in the budgetary process. However, whatever troubles countries encountered in using performance information, no country ever stopped using the information, although some changed their techniques as they learned what worked and what didn't.

There are different models and approaches to using performance information. As the use of performance information evolved, the majority of OECD countries began to adopt performance-informed budgeting where performance information (performance measures and/or evaluations) is used along with other information on political and fiscal priorities to inform—but not determine—budget allocations. Most importantly, it is only one factor in the decision-making process.[3] In performance-informed budgeting, there is no direct or mechanical link between measures of performance and funding. Performance information is used for planning and/or accountability purposes; that is, the Ministry of Finance (MOF) can use planned future performance to inform funding decisions and use performance results to hold agencies to account and to inform budgetary allocations. But many countries have found that performance-informed budgeting techniques are better at incorporating performance information into the budget process than mechanistic performance budgeting.

Below are examples of different approaches to include performance information in budget and management processes taken by a few OECD countries.

Australia

Australia's current performance budgeting and management framework has been in place since the mid-1990s. These arrangements arose from the budgetary reforms associated with the 1996 report of the National Commission of Audit and subsequent introduction of accrual-based outcomes and outputs policies. The current framework develops both performance measures and evaluations.

At a national level, Australia operates under a devolved financial framework. Performance management and budgeting are generally the responsibility of individual ministers and their departments and agencies. The current system concentrates on agency-level outcomes. Every department and agency within the general government sector is required to identify comprehensive and explicit outcomes, outputs, and performance measures for quantity, quality, price, and effectiveness of their activities. They are required to report on those items and any major evaluations in their budget plans (portfolio budget statements) and their end-of-year results (in annual reports).

Expenditure and programme reviews are a central feature of the Australian budget process and an area where performance information is used to inform budget decisions. Until recently, the lapsing budget measure review process was the most commonly used type of review, but the Australian government revised the review arrangements in October 2006. The new arrangements give the MOF a greater role in identifying and managing reviews in co-operation with departments. Senior ministers make decisions early in the budget process regarding which major areas of public expenditure will be reviewed in any year. In addition, there can be major reviews or departmental reports, which can be short-term and available for the next budget or more for long-term.

Canada

Over the years, the Canadian federal government has implemented numerous performance budgeting and management initiatives. The government currently uses performance information throughout the planning, measuring and assessing, and reporting phases of expenditure management.

The federal government's expenditure management framework is complex and decentralised. All major departments produce strategic plans, known as reports on plans and priorities (RPPs). These are planning documents which are submitted to Parliament detailing the strategic outcomes and planned results of each department. These documents also include information on resource requirements over a three-year period. All departments report on the results in departmental performance reports (DPRs) which set out performance against commitments in the RPP. The Treasury Board (a Cabinet committee) produces and presents to Parliament two whole-of-government reports: RPP Overview guides parliamentarians through the many RPPs each spring, and Canada's Performance does the same for the departmental performance reports each autumn.

In addition, all major departments and agencies have internal audit and evaluation units. In 2004-2005, evaluations covered approximately 10% of departmental

[3] OECD (2007) , Performance Budgeting in OECD Countries, OECD Publishing, Paris.

programme funding. The government has also sought to introduce performance information into decision making on its 750 non-statutory transfer payment programmes that are delivered through third parties and must be reviewed by the Treasury Board at least once every five years. As the programmes come up for review, departments must produce evaluations. In addition, a policy on transfer payments (June 2000) formalised the requirement for departments to develop results-based management and accountability frameworks and risk-based audit frameworks in support of the ongoing management and renewal of these programmes.

In 2005, the Treasury Board, in an effort to regain detailed programme-level knowledge, adopted the Management, Resources and Results Structure (MRRS) policy. This sets explicit requirements for departments on how to collect, manage and report financial and non-financial information at a government-wide level. These results-based structures underpin all performance planning and reporting.

After the 2006 election, the conservative government called for reform of the federal expenditure management system and greater use of performance information in support of resource allocation and reallocation decisions. In addition to the performance-based Cabinet reviews of transfer payment programmes already in place, current plans call for the commencement of a first round of strategic programme reviews to begin in the autumn of 2007. All available performance information—whether from audits, evaluations, the MRRS performance frameworks, or from annual assessments of departmental management performance—will support these reviews.

Netherlands

In 2001, the Netherlands introduced a more policy-oriented budget structure. The Policy Budgets and Policy Accountability reform aimed to provide Parliament with a more transparent budget document and clearer information about the results of government actions. This reform was an initiative of the Lower House of the Dutch Parliament.

In addition, since 1995 the Netherlands has developed a system of interdepartmental policy reviews. Policy reviews are proposed by the MOF and approved by the Cabinet and the respective line ministries. A list of proposed reviews is included in the September budget memorandum. These reviews are conducted by small working groups including representatives from the relevant line ministries, the MOF, and external experts. All reports are published and submitted to Parliament. Initially these reviews concentrated on efficiency with a mandatory 20% saving; however, as the economic situation improved the mandatory cut was abolished and the reviews focused more on institutional reform.

United Kingdom

The United Kingdom first introduced the comprehensive spending review in 1998 and repeated the exercise in 2000, 2002, 2004 and 2007. This biennial approach aims to reallocate money to key priorities and to improve the efficiency and delivery of public services. After a review of existing departmental spending, each department develops a three-year spending plan and a public service agreement (PSA). The Treasury negotiates with ministries regarding their key performance targets for the next three-year period and these targets are included in their public service agreements. PSAs contain measurable targets for a whole range of government objectives. The current agreements mainly focus on outcome targets, although there are still a few output targets. In addition to the PSA, each department produces a technical note stating how the targets will be measured and a delivery plan explaining how it plans to achieve the targets. The technical note is published but the delivery plan is not.

The PSA also states who is responsible for the delivery of the targets—usually the relevant secretary of state. In contrast to Australia, Denmark, and Sweden, this is a top-down, centrally-driven performance system. The development and evolution of the PSA framework has been led by the Treasury. All performance agreements and ministerial targets are agreed with the Treasury. Performance information is discussed as part of the spending review negotiations between the Treasury and ministries, although there is no automatic link between results and resource allocation.

In the United Kingdom, key objectives and targets are integrated into the decision-making process at a high political level. There is a special cabinet subcommittee on public services and public expenditure, which is chaired by the Chancellor of the Exchequer. This committee discusses progress against targets and key strategic objectives and challenges.

THE BENEFITS AND CHALLENGES OF THE USE OF PERFORMANCE INFORMATION IN THE BUDGET PROCESS

Countries have reported a number of benefits from the use of performance information:

• It generates a sharper focus on results within the government.

• It provides more and better information on government goals and priorities, and on how different programmes contribute to achieve these goals.

• It encourages a greater emphasis on planning—especially when part of a medium term expenditure framework—and acts as a signalling device that provides key actors with details on what is working and what is not.

• It improves transparency by providing more and better information to parliaments and to the public. (Twenty-four out of 30 OECD countries provide information on performance results to the public.)

• It has the potential to improve the management of programmes and efficiency.

Advocates claim that the provision of objective performance information facilitates better decision making for the efficient use of resources, programme management, central resource allocation, and expenditure prioritisation. In sum, supporters claim that the use of performance information in budgetary decision-making can contribute to budgetary goals of improving productive efficiency, allocative efficiency, and even aggregate fiscal discipline.

Despite these reported benefits, OECD countries continue to face a number of challenges with the development and use of performance information in the budget process including:

• how to improve the use of performance information in budgetary decision-making;

• how and if performance information should be related to resources;

• how to improve the measurement of activities;

• how to improve the quality of information; and

• how to get politicians to use performance information in decision making.

Country experiences have shown that the existence of a procedure to integrate performance information into the budget process is a necessary but not sufficient condition to ensure its use. Other factors influencing use include the quality of the information, the institutional capacity of the MOF and the spending ministries, and the political and economic environment.

OECD GUIDELINES ON DESIGING AND DEVELOPING BUDGET SYSTEMS THAT USE PERFORMANCE INFORMATION

Despite these challenges, countries are not discarding the use of performance information, but continue to evolve new approaches to using the information. The OECD has developed general guidelines for countries as they adopt and evolve initiatives to improve the use of performance information in budgeting processes. Some important factors to consider in this respect are:

• There is no one model of performance budgeting; countries need to adapt their approach to the relevant political and institutional context.

• A whole-of-government planning and reporting framework is important.

• Performance information should be integrated into the budget process.

• Designing government-wide systems that automatically link performance results to resource allocation should be avoided. Such automatic linkages distort incentives, ignore the underlying causes of poor performance, and require a very high quality of performance informaiton that is rarely available.

• Meaningful and accountable performance information requires reliable output and outcome data that are continuously updated.

• Timely and straightforward assessments of performance information should be carried out independently of the spending departments and be supported by external expertise.

• The support of political and administrative leaders is vital for implementation.

• The staff and resource capacity of the ministry of finance and spending ministries is critical.

• Reform approaches need to be adapted to evolving circumstances.

• It is important to develop incentives to motivate politicians and civil servants to change their behaviour. Regardless of the type of performance information (evaluations or performance measures), consideration needs to be given to whether and how it will be used by decision makers. It is a matter not just of process, but also of having the right incentives to motivate decision makers to use the information.

CONCLUSIONS

Previous incarnations of performance budgeting in many countries began with expectations that were unrealistic, thus ensuring disillusionment when the predicted results failed to materialise. It is important from the outset to manage expectations in terms of the length of time it takes for the reforms to produce results. There are no quick fixes. A long-term approach and patience are necessary as countries go down this road. Some countries estimated that it took 3-5 years to establish a government-wide performance measurement framework. There can be expectations that performance budgeting will create an environment of rational decision-making and will enable governments to financially reward good performance and punish bad. While this may be a simple and appealing idea, it does not take account of the fact that budgetary decision-making takes place in a political context, or that the issues and context surrounding budget decisions are complex. In most cases such an approach is not desirable. The more realistic expectation is that countries will engage in performance-informed budgeting.

In the governments of OECD member countries, a great deal of the annual budget process remains incremental and inputs still play a key role. Results information will never completely replace inputs. There is a trend towards reforms that are, however, slowly shifting the thinking of decision makers at all levels—politicians, the MOF, spending departments and agencies, and the general public—towards a greater focus on results, and there is a clearer understanding of the need to see public policy and government actions in terms of achieving results. Despite the challenges encountered, countries are continuing to move forward with reforms to improve the use of performance information in budgetary decision-making. As long as citizens demand results from their governments for their tax dollars, there will be a continuing need for performance information.

In addition, before we proceed to testimony, we welcome—I have got it, I would like to ask unanimous consent that all members be allowed to submit an opening statement for the record at this point.

Without objection, so ordered.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF HON. ADRIAN SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Good morning and thank you, Chairman. I am so pleased we are holding this hearing today.

We have an obligation to exercise accountability and fiscal responsibility in government spending. As this Committee plans for future federal budgets, the ideas and information expressed to us today are of utmost importance.

While we address the many fiscal challenges we face, we must assess the value of the information available to us. This hearing will give us the opportunity to explore "performance-based budgeting." The models and results of "performance-based budgeting" could serve as a valuable tool for setting our spending priorities. Too often in Congress, we debate, vote on, and pass—and in some cases regrettably so—legislation about which we have no measure of its efficacy. And Mr. Chairman, that just has to change.

Financial discipline is one of my greatest concerns. By serving on this Committee, my goal is to add fiscal restraint to the budget process. Congress must promote policies which will make government programs better, more efficient, and more sustainable for the long-term. Commonsense tells us this can only be achieved with an accountability system in place. Adding accountability to the budget process will combat waste, fraud, and abuse while we work to control the growth in government and restrain spending.

I appreciate the Committee for holding this hearing as an important step to meeting our goals.

Chairman, I look forward to continuing to work with you, and I thank you for your time.

Chairman SPRATT. Let me welcome my witnesses this morning and say that if you have prepared written statements, we will treat your witness statements as made part of the record. You can summarize them as you please, but the floor is yours.

STATEMENTS OF CLAY JOHNSON III, DEPUTY DIRECTOR FOR MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET; DAVID M. WALKER, COMPTROLLER GENERAL OF THE UNITED STATES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE; AND PETER R. ORSZAG, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Chairman SPRATT. We will proceed first with Mr. Johnson. Thank you very much for coming. We look forward to your testimony.

STATEMENT OF CLAY JOHNSON III

Mr. JOHNSON. Chairman Spratt, Ranking Member Ryan, members of the committee, thank you for having me. We all want the Federal Government to be effective. We want to spend money on programs that work. We want not to spend money or waste money on programs that don't work or can't be made to work. And we want to get what we pay for. We all want to be held accountable for this. We are here to do this work. In fact, I think we should all publicly declare that we want to be held accountable for this.

To do this, to deliver on this, for every Federal program we must have clear outcome goals and we must know how we are performing relative to those goals. We can't manage programs unless we know what we are trying to manage to.

Today, every Federal program, and therefore every Federal agency, has better outcome goals and more information about its performance than ever before. It is very good information. It is not perfect, nor will it ever be perfect. Performance information, by its very nature, we will get smarter and smarter about—as we learn more and more about programs and develop ways to capture relevant performance information. But this information is very, very good. It is subjective, it is consistent with the information we have for like programs. It is appealable by those who disagree with it, and it is reviewed for accuracy and quality on a regular basis.

And by the way, Chairman Spratt, let me add that it is not separate and apart from GPRA. It is very consistent with GPRA. It is a more refined way of dealing with—in our opinion, dealing with program performance. It is more information with which to comment and report on how programs are performing. But it is not something totally different. Because we have this information, we can now, and only now, link managers' evaluations to the performance of the programs. We can more formally focus every manager and employee on the desired outcomes of the program they work on, which means we can more purposefully and intelligently pursue the goal of greater effectiveness.

In fact, we are going to talk here about the use of this information in the budgeting process. But I believe the most important, most valuable use of this quality goal and performance information is to help managers and employees cause programs to be more effective.

But in addition to helping programs be more effective, we can also use this information to make smarter budget appropriation decisions, which is the subject of this hearing. We can, for instance, invest more in programs known to be effective and less in those that are known not to work. We can decide not to create and fund new programs that duplicate existing programs, especially if they are not known to work. We can decide to increase funding for a less effective program only if its managers have a plan to fix it. And we can look at our spending by key indicator or strategic goal or desired outcome, across all agencies, to more intelligently debate relative spending levels and how to invest effectively and efficiently to accomplish our goal.

None of this is possible without good goals and good information about how we are performing relative to those goals. This is not something that is nice to have; this is something that we must have for you all to do your work and for us to do our work to drive behavior and performance in the executive branch.

I look forward to working with you and answering any questions you have at the end of this hearing. Thank you very much for having me here.

Chairman SPRATT. Thank you, Mr. Johnson.

[The prepared statement of Clay Johnson follows:]

PREPARED STATEMENT OF HON. CLAY JOHNSON III, DEPUTY DIRECTOR FOR MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET (OMB)

Since and even before enactment of the Government Performance and Results Act (GPRA) in 1993, Congress and the Executive Branch have been trying to discern just what we're getting for the tax dollars we spend and how to get even more. The first step is to have good information about what works and what doesn't.

GPRA implementation in the 90's laid a strong foundation for strategic and performance planning in the Federal Government. It required agencies to set goals and report on whether they were achieving them. This was the beginning of a candid assessment of government's performance, but any connection with the budget was remote. At the time, the Government Accountability Office (GAO) found that, although most agencies (30 of 35 reviewed) defined some type of relationship between the program activities of their proposed budgets and the performance goals in their annual performance plans, most plans did not explain how spending on the program would help it achieve performance goals.[1] More importantly, managers reported to GAO that their agencies were not well-positioned to answer the question of whether their programs produced real results.[2]

With that constructive criticism in mind, the Administration developed a tool—the Program Assessment Rating Tool—to assess performance at the program level and use the information to identify ways to help programs improve. Using the performance goals and information developed to implement GPRA, agencies and OMB assessed the available evidence and asked of every program:

- Is its purpose clear and is it well-designed to achieve that purpose?
- Does it have clear, outcome-oriented long-term and annual goals with aggressive targets?
- Is it well managed?
- Does it achieve its goals?

Over the last six years, agencies and OMB have assessed more than 1000 programs that total $2.6 trillion in spending. These assessments show that 78 percent of the programs assessed are considered "performing." Fifty percent of programs received the impressive ratings of Effective or Moderately Effective. Only 3 percent were demonstrably Ineffective.

Is the information valid and reliable? Yes. The questions asked are those a reasonable person would ask to assess a program's performance. There are clear, written rules that guide what evidence is required to get a "yes" answer to a PART question.[3] Agencies and OMB agree on the right answer based on the available evi-

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[1] Government Accountability Office, "Performance Budgeting: Initial Experiences Under the Results Act in Linking Plans with Budgets." GAO/AIMD/GGD-99-67 (April 1999).

[2] Government Accountability Office, "The Government Performance and Results Act: 1997 Governmentwide Implementation Will be Uneven." GAO/GGD-97-109 (June 1997).

[3] Office of Management and Budget, "Guidance for Completing 2007 PARTs." Program Assessment Rating Tool Guidance No. 2007-02 (www.omb.gov/part/fy2007/2007—guidance—final.pdf) (January 29, 2007).

dence. Then all PART questions are reviewed by experts in the PART process to ensure they are consistent with the rules. Agencies then have an opportunity to appeal questions to a high-level appeals board of a selection of agency chief operating officers. All of these factors contribute to the validity and reliability of PART information. We will continue every year to improve the quality of program goals, the consistency of PART answers, and the accuracy of performance information.

As part of our ongoing effort to ensure PARTs reflect the most accurate picture of a program's performance, agencies and OMB over the next several months will systematically review all of the assessments to ensure the program goals are clear and outcome-oriented; the performance information is valid; and the program improvement plans are aggressive.

GPRA required public planning and reporting. PART results, the evidence on which they are based, the results each program achieves, and the amount of money spent and requested for each program, are all posted on ExpectMore.gov. We must continue to be candid about how well (or not) programs are performing and what we are doing to improve if we want to hold programs and agencies accountable for achieving outcomes that matter to the American people.

We want to incorporate performance information into budget justifications so Congress finds that it is a valuable factor in the decision-making process. Finding the best way to do this remains a challenge. The report accompanying the FY 2008 Financial Services and General Government Appropriations Bill criticized agency budget justifications for being "filled with references to the [PART], drowning in pleonasm, and yet still devoid of useful information." [4] [I'm sure the Members of the Committee know this, but I had to consult the dictionary to find that pleonasm means "the use of more words than are necessary to express an idea; redundancy."] But the Labor, Health and Human Services Appropriations Bill cites the Department of Education's Budget Justification as a model.[5] Education's budget justification integrates performance information in three different ways:

- A separate 25-page Performance Budget tab displaying budgets, programs, and key performance measures by strategic plan goal;
- A detailed discussion of performance information—both GPRA and evaluation—in each program justification; and
- References to performance information and PART in the program account narratives.

Education's budget staff has briefed every agency on its justification, and OMB has encouraged others to emulate it, provided they consult with appropriators first. In an effort to encourage greater use of performance information in Congressional decision-making and address a helpful recommendation from GAO, agencies now also brief their House and Senate appropriations and authorizing committees each year on completed and planned PART assessments.

Of course, it was never our goal, nor should it ever be, to make decisions mechanically based on performance information. It is not true that a program's budget should be cut just because it is not currently achieving results. Such a program may require additional resources in order to improve. Likewise, just because a program is achieving results does not mean it warrants an increase in funding. Such a program may have outlived its usefulness.

In some cases, poor performance has been the basis for a request for additional resources. For instance, the National Park Service Facilities Maintenance was unable to demonstrate results when it was first assessed in 2002. The program then began using a facility condition index to assess the state of its facilities and prioritize investment decisions for addressing identified deficiencies. Use of the index also helped the program provide a better justification for additional resources. This program has received funding increases and is steadily improving the quality of its facilities. Additional funding for the Earned Income Tax Compliance Program was proposed to improve its efforts to reduce improper payments. Improper Payments in this program are estimated at between 23 and 28 percent of total program payments.

Our ultimate goal is to make programs work better. We believe that making information about a program's performance more of a factor in all deliberations about the program will help it and other programs become more effective.

We have more information about what works and what doesn't today than ever before and we are always working diligently to improve its quality. Performance in-

[4] United States House of Representatives Committee on Appropriations, Report Accompanying the FY 2008 Financial Services and General Government Appropriations Bill, House Report 110-207 (June 2007).

[5] The Departments of Labor, Health and Human Services, and Education FY Appropriations Act for FY 2006, Public Law 109-149, Section 107.

formation for both agencies and programs is available to the public on *ExpectMore.gov.* We can and must make greater use of this information in our deliberations about programs, including funding and other issues affecting program performance. I look forward to working with Congress, especially Members of this Committee, to find ways we can be ever smarter about spending the taxpayers' money.

Chairman SPRATT. Now, General David Walker, the Comptroller General of the United States.

STATEMENT OF DAVID M. WALKER

Mr. WALKER. Thank you, Chairman Spratt, Ranking Member Ryan. I am pleased to be here today to discuss performance budgeting as a way to help the government meet the pressing challenges of the 21st century by prompting a much needed and long overdue review of Federal activities and programs.

The Federal Government is in a period of profound transition. It faces a range of challenges and opportunities that can enhance performance, ensure accountability and better position the Nation for the future. A number of overarching trends, including the Nation's long-term fiscal imbalance, drive the need to reexamine what the Federal Government does, how the Federal Government does business, and who does the Federal Government's business.

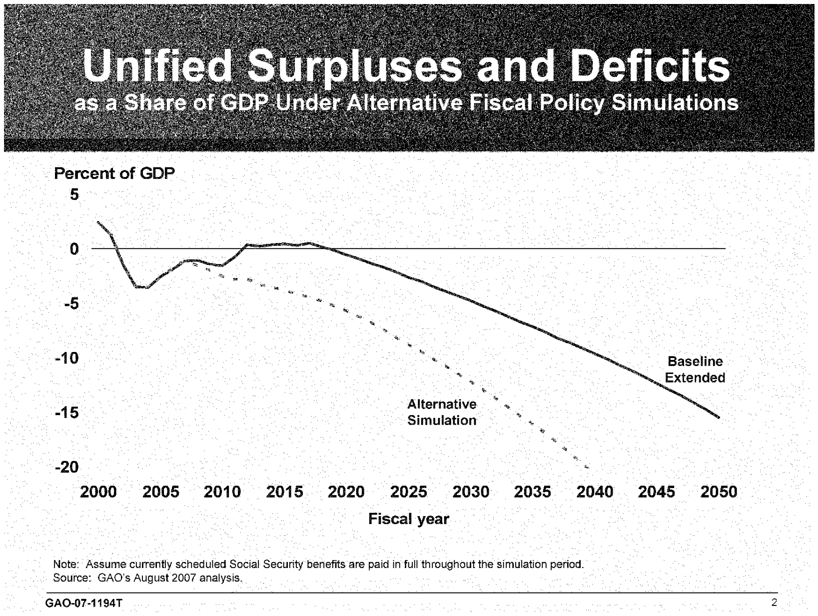
The term "performance budgeting" encompasses a range of approaches, activities and processes, but they all have one idea in common and that is more explicitly linking resources to results. And in all candor, the Federal Government does an extremely poor job of that. As it holds promise, this is a means for facilitating reexamination of the government.

Through the President's management agenda and its related initiatives with the Office of Management Budget's Program Assessment Rating Tool, the administration has taken steps in the right direction by calling attention to successes and needed improvements in Federal management and performance.

As we previously noted, PART itself has certain strengths and weaknesses. The weaknesses need to be addressed and the strengths need to be capitalized on. Whatever approach is taken in the future, however, in our view it will be important not only to look at programs on activities that run through the spending side of the budget, but also to look at those policies that run through the tax side of the budget. Any reexamination or performance budgeting effort that fails to include tax expenditures in the review of Federal activities and policies and whether or not they are achieving their intended goals will fall short of its full potential and will fall short of our Nation's needs.

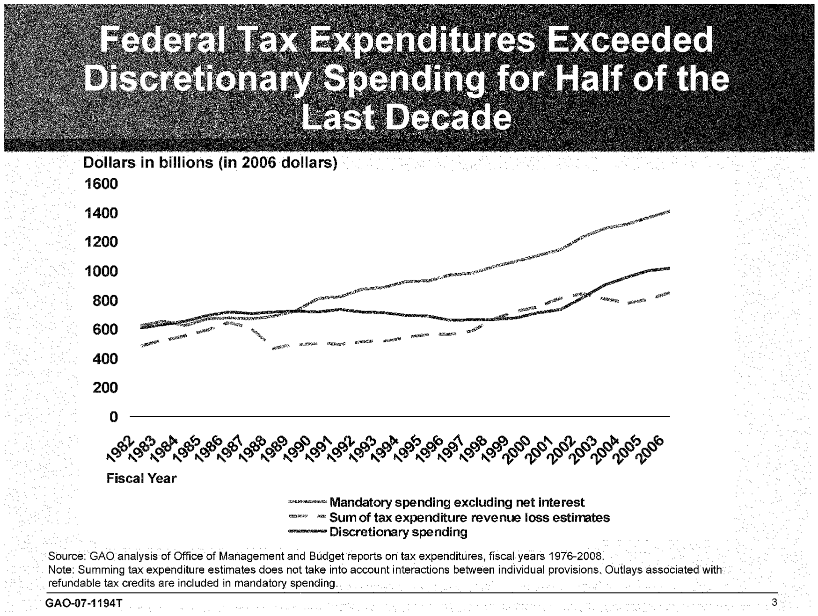
As I have previously testified before this committee, known demographic trends and rising health care costs are major drivers to our Nation's large and growing structural deficits. And I am going to take you through three quick graphics, two of which are in your material. The first one is not.

First graphic, please.



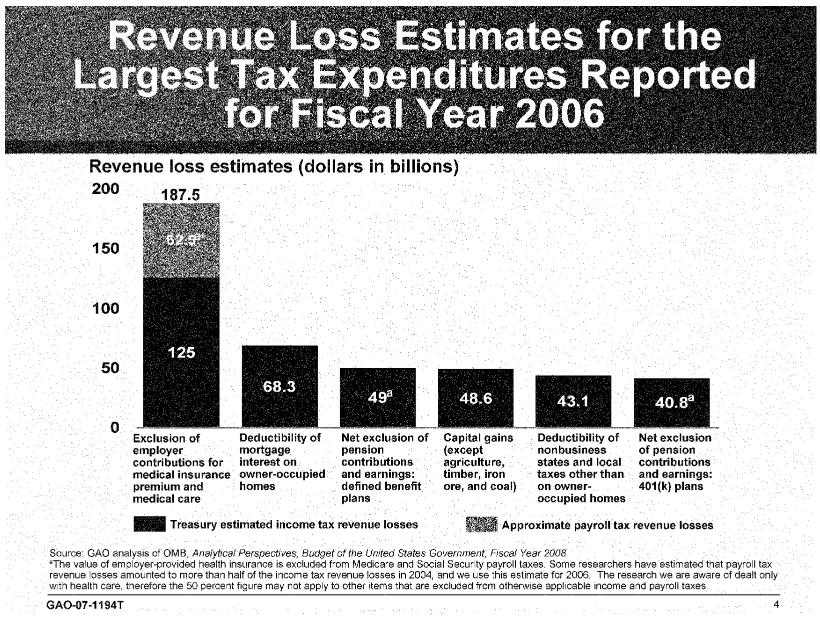
This represents the long-run fiscal situation for the Federal Government based upon CBO's baseline extended, or, in my view, a more realistic alternative simulation which assumes no reform of Social Security and Medicare; discretionary spending growing by the rate of the economy; and historical tax levels over the long term. Reality may be somewhat in between, but either one is unacceptable.

Next please.



The next one is on page 11 of my testimony. It shows you what has happened since 1982 in constant dollars with regard to mandatory spending, which is the green line, which is growing out of control, represents 62 percent of the Federal budget last year. That is on auto pilot. The blue line, which is discretionary spending, which Congress has responsibility for dealing with every year, and the red line which represents the sum of tax expenditures or the revenue losses associated with them. And as you will see, the tax expenditures in some years exceed discretionary spending and yet they are not in the financial statements, they are not part of the budget process, they are not part of the appropriations process. They are off the radar screen. And it is important that they be on the radar screen because they cost money and they may or may not be working.

Next, please.



It is important to keep in mind that these involve $800-plus billion in the aggregate. Health care alone is close to $200 billion for 2006. Now, these are based upon Treasury estimates after the end of 2006. And in this particular case, we unbundled the defined contribution plans from the defined benefit plans. So If you add those together, you will see that the pension tax preferences would be number two to health care on that basis. But the bottom line is these numbers are just too big to be off the radar screen.

Accordingly, to reexamine the base of all major Federal spending and tax programs, policies, and activities by reviewing the results and testing their continued relevance and relative priority for our changing society is important, and the sooner we start doing it, the better. Reexamination is not a one-time activity. It must be a continuing process and we should expect even the initial round to take several years.

We could accomplish more if the intent of the Government Performance and Result Act, which was to develop a comprehensive governmentwide performance plan, was fully implemented. We think more needs to be done in that regard. But in doing it, we need to move beyond programs by programs and agency by agency to looking more horizontally and to also considering tax preferences.

I think it is also important to keep in mind that the United States is one of few major industrialized nations without a set of key national outcome-based indicators. What do I mean by that? Economic, safety, security, social, and environmental outcome-based indicators in order to be able to assess which programs and policies are working and which aren't working. How do we stand as a Nation? How are we trending? And how do we compare to others?

And when you look at some statistics published by the OECD, of which the United States is one of 30 member countries, on a portfolio of indicators, the United States ranks 16 out of 28 on outcome-based indicators. As a certified public accountant, I can tell you that is below average.

We can and we must do better. And I think performance budgeting is a way that can help us see the way forward and make some very tough choices.

In summary, performance budgeting is one means that can help us be able to put our Nation on a more prudent, sustainable fiscal path, to separate the wheat from the chaff with regard to which programs and policies are working and which aren't, and make sure we are targeting our resources and preferences to accomplish the best greater good in a way that does not undercut the economy. But I cannot stress enough that performance budgeting cannot be merely an executive branch action. The legislative branch has to be a key partner in this effort. And for performance budgeting to work, the information must be not only useful, it must be used. And if it is not, it is a waste of time.

Thank you, Mr. Chairman.

Chairman SPRATT. Thank you, General Walker.

[The prepared statement of David M. Walker follows:]

United States Government Accountability Office

GAO

Testimony
Before the Committee on the Budget, House of Representatives

For Release on Delivery
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21ST CENTURY CHALLENGES

How Performance Budgeting Can Help

Statement of David M. Walker, Comptroller General of the United States

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Accountability * Integrity * Reliability

GAO-07-1194T

GAO Accountability•Integrity•Reliability

Highlights

Highlights of GAO-07-1194T, a testimony to Committee on the Budget, House of Representatives

Why GAO Did This Study

As part of its work to improve the management and performance of the federal government, GAO monitors progress and continuing challenges in using performance information to inform budgetary choices (performance budgeting). In light of the nation's long-term fiscal imbalance and other 21st century challenges, we have reported that the Government Performance and Results Act of 1993 (GPRA) and performance budgeting can support needed reexamination of what the federal government does, how it does it, and who does it. GAO remains committed to working with Congress and the Administration to help address these important and complex issues.

What GAO Recommends

GAO is not making new recommendations. We have previously reported that reexamination requires a comprehensive perspective that crosses agencies, includes all major tools of government, and considers both spending programs and tax provisions. How different programs or policies in the same area support each other or work at cross purposes is important. Government-wide strategic and performance plans—especially if created in consultation with Congress and supported by KNIs—could provide a framework for reexamination. GAO has also suggested that Congress consider the need to develop vehicles and structures for such review and for communicating its top performance concerns.

To view the full product, including the scope and methodology, click on GAO-07-1194T. For more information, contact Susan J. Irving at (202) 512-9142 or irvings@gao.gov.

September 20, 2007

21ST CENTURY CHALLENGES

How Performance Budgeting Can Help

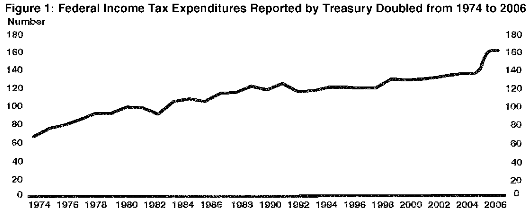
What GAO Found

Reexamining the base of all major existing federal spending and tax programs, policies, and activities by reviewing their results and testing their continued relevance and relative priority for our changing society is an important step in the process of assuring fiscal responsibility and facilitating national renewal. Reexamination can arm decision makers with better information on both individual program results and entire portfolios of programs and tools—encompassing a wide range of discretionary, entitlement, tax, and regulatory approaches—addressing common goals.

GPRA provided a foundation for strengthening government performance and accountability. The President's Management Agenda and the Program Assessment Rating Tool (PART)—OMB's framework for assessing federal program performance—continue to build on GPRA's foundation. Properly done, these and future efforts—along with a set of Key National Indicators (KNI)—could provide a strong basis to support the needed review, reassessment, and reprioritization process.

Moving forward, for performance budgeting and program reviews to hold appeal beyond the executive branch and actually have an impact on legislation, congressional buy-in on what to measure and how to present this information is critical. In addition, tax expenditures result in forgone revenue that in some years has approximated the size of total discretionary spending. Yet relatively little is known about the effectiveness of these provisions, which are often aimed at policy goals similar to those of federal spending programs. To date, PART has generally not been applied to tax expenditures. GAO continues to urge as a next step a more comprehensive and consistent approach to evaluating all programs relevant to common goals. This would require assessing the performance of all programs related to a particular goal—including tax expenditures—using a common framework.

Figure 1: Federal Income Tax Expenditures Reported by Treasury Doubled from 1974 to 2006



Source: GAO analysis of Office of Management and Budget (OMB) budget reports on tax expenditures, fiscal years 1976-2008

Note: The number of tax expenditures reflects all provisions reported by Treasury, including those enacted but effective for future fiscal years. Fluctuations in the trend lines from year to year may reflect changes in Treasury's methodology.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss performance budgeting as a way to help government meet the pressing challenges of the 21st Century by prompting review of federal activities and programs. The federal government is in a period of profound transition and faces an array of challenges and opportunities to enhance performance, ensure accountability, and better position the nation for the future. A number of overarching trends—including the nation's long-term fiscal imbalance—drive the need to reexamine what the federal government does, how it does it, and who does it. The term "performance budgeting" encompasses a range of approaches, activities, and processes but they all have in common the idea of more explicitly linking resources to results. As such it holds promise as a means for facilitating a reexamination effort. Reexamination can enhance the government's capacity to assess competing claims for federal dollars by arming decision makers with better information both on the results of individual programs as well as on entire portfolios of programs and tools—encompassing a wide range of discretionary, entitlement, tax, and regulatory approaches—addressing common goals.

Through the President's Management Agenda (PMA) and its related initiatives, including the Office of Management and Budget's (OMB) Program Assessment Rating Tool[1] (PART), the Administration has taken steps in the right direction by calling attention to successes and needed improvements in federal management and performance. As we have previously reported,[2] PART itself has certain weaknesses we believe should be addressed and several strengths on which future efforts should

[1] OMB describes PART as a diagnostic tool meant to provide a consistent approach to assessing federal programs as part of the executive budget formulation process. It applies 25 questions to all "programs" under four broad topics: (1) program purpose and design, (2) strategic planning, (3) program management, and (4) program results (i.e., whether a program is meeting its long-term and annual goals) as well as additional questions that are specific to one of seven mechanisms or approaches used to deliver the program. There is no standard definition for the term "program." OMB defined the unit of analysis (program) as (1) an activity or set of activities clearly recognized as a program by the public, OMB, and/or Congress; (2) having a discrete level of funding clearly associated with it; and (3) corresponding to the level at which budget decisions are made.

[2] GAO, *Performance Budgeting: Observations on the Use of OMB's Program Assessment Rating Tool for the Fiscal Year 2004 Budget,* GAO-04-174 (Washington, D.C.: Jan. 30, 2004) and *Performance Budgeting: PART Focuses Attention on Program Performance, but More Can Be Done to Engage Congress,* GAO-06-28 (Washington, D.C.: Oct. 28, 2005).

build. Whatever approach is taken in the future, however, it will be important to include not only those programs and activities run through the spending side of the budget but also those run through the tax side. Any reexamination or performance budgeting effort that fails to include tax expenditures in the review of federal activities and whether they are achieving their intended policy goals will fall short of its potential.

In my testimony today I will focus on three main points:

- The extent of our long-term fiscal and governance challenges necessitates a thorough reexamination of government programs and spending;
- Performance budgeting can help accomplish the goal of reexamination; and
- Congressional support and comprehensive crosscutting program assessments are critical to reexamination.

In addition, I offer some ideas for moving forward.

This testimony draws upon our wide-ranging work on the use of performance information in government—including the Government Performance and Results Act of 1993[3] (GPRA), PART, agency coordination and collaboration, tax expenditures, and key national indicator (KNI) systems. We conducted our work for this statement during August and September 2007 in accordance with generally accepted government auditing standards.

Long-Term Fiscal Challenge Provides Context and Impetus for Reexamining Federal Programs

As I have previously testified before this committee,[4] known demographic trends and rising health care costs are major drivers of the nation's large and growing structural deficits. The nation cannot ignore this fiscal pressure: it is not a matter of whether the nation deals with the fiscal gap, but how and when. Although it is the "big three"—Medicare and Medicaid and to a lesser extent, Social Security—that drive this phenomenon on the spending side, other federal spending cannot be ignored. Difficult as it may seem to deal with these long-term challenges, policymakers must not only address these entitlement programs but also reexamine other budgetary priorities in light of the changing needs of this nation in the 21st century. It

[3] Pub. L. No. 103-62 (1993).

[4] GAO, *Long-Term Budget Outlook: Deficits Matter—Saving Our Future Requires Tough Choices Today,* GAO-07-389T (Washington, D.C.: Jan. 23, 2007).

will be necessary to work on several fronts at once. In fact, our history suggests that *all* major spending and revenue programs and policies need to be subject to periodic reviews and that exempting major areas can undermine the credibility and support for the entire process.[5]

These challenges would be difficult enough if all we had to do is figure out how to fund existing commitments. But as the nation continues to change in fundamental ways, a wide range of emerging needs and demands—for example, evolving defense and homeland security policies, increasing global interdependence, and advances in science and technology—can be expected to compete for a share of the budget. Whether national security, transportation, education, or public health, a growing population will generate new claims for federal actions on both the spending and tax sides of the budget. Many of our programs were designed decades ago to address earlier challenges. Outmoded commitments and operations constitute an encumbrance on the future that can erode the capacity of the nation to better align its government with the needs and demands of a changing world and society.

Accordingly, reexamining the base of all major existing federal spending and tax programs, policies, and activities by reviewing their results and testing their continued relevance and relative priority for our changing society is an important step in the process of assuring fiscal responsibility and facilitating national renewal. A periodic reexamination offers the prospect of addressing emerging needs by weeding out programs and policies that are redundant, outdated, or ineffective. Those programs and policies that remain relevant often could be updated and modernized by improving their targeting and efficiency through such actions as redesigning allocation and cost-sharing provisions, consolidating facilities and programs, and streamlining and reengineering operations and processes.

We recognize that taking a hard look at existing programs and carefully reconsidering their goals and financing are challenging tasks, as making decisions about reforming programs and activities creates winners and losers. Furthermore, given the wide range of programs and issues covered, the process of rethinking government programs and activities may take a

[5] For more information on reexamination of federal programs, see GAO, *21st Century Challenges: Reexamining the Base of the Federal Government,* GAO-05-352T (Washington, D.C.: February 2005) and *Suggested Areas for Oversight for the 110th Congress,* GAO-07-235R (Washington, D.C.: Nov. 17, 2006).

generation to unfold. We are convinced, however, that reexamining the base offers compelling opportunities to both redress our current and projected fiscal imbalance while better positioning government to meet the new challenges and opportunities of this new century.

Performance Budgeting Can Help Facilitate Reexamination

Performance budgeting can help enhance the government's capacity to assess competing claims in the budget by arming budgetary decision makers with better information on the results of both individual programs as well as entire portfolios of policies, tools, and programs designed to address common outcomes. It is useful to start with a review of the current landscape. The management and performance reforms enacted by Congress in the past 15 years have provided some new ways to gain insight into the financial, program, and management performance of federal agencies and activities. With GPRA as its centerpiece, the statutory and management framework laid out in the 1990s provided a foundation for strengthening government performance and accountability. As our work as shown,[6] GPRA has succeeded in expanding the supply of performance information and promoting institutionalization of a culture of performance as well as providing a solid foundation for more recent budget and performance initiatives.

As I have previously said,[7] PMA and its related initiatives, including PART, demonstrate the Administration's commitment to improving federal management and performance. Properly done, performance assessment and performance budgeting information produced by GPRA and PART could provide a strong basis to support the needed review, reassessment, and reprioritization process. By calling attention to successes and needed improvements, the focus that these initiatives bring is certainly a step in the right direction toward providing the kind of information needed for effective reexamination, and our work shows that progress has been made in several important areas over the past several years. For example, we have reported that the PART process continues to aid OMB's oversight of agencies and encourage improvements in executive budget formulation and agency program management. The PART has helped to structure and discipline OMB's use of performance information for internal program

[6] GAO, *Results-Oriented Government: GPRA Has Established a Solid Foundation for Achieving Greater Results,* GAO-04-38 (Washington, D.C.: Mar. 10, 2004).

[7] GAO, *21st Century Challenges: Performance Budgeting Could Help Promote Necessary Reexamination,* GAO-05-709T (Washington, D.C.: June 2005).

analysis and budget review, and made its use of this information more transparent. Many agency officials told us that the PART helped to create or strengthen an evaluation culture within agencies by providing external motivation for program review and focused attention on performance measurement and its importance in daily program management. Some officials said that the PART and the PMA helped them move away from "analysis by anecdote" and refocused their attention on the impact their programs have, instead of largely on output measures. Others echoed a similar sentiment—one indicated that the PART scores helped to create "a new sense of urgency" about performance measures and completing the changes to performance systems that were already under way.

Congressional Support and Comprehensive, Crosscutting Program Assessments Are Critical to Reexamination

Even the best performance data are insufficient to achieve real improvements in management and program results unless they are used by decision makers and managers alike to inform policy and management decisions. Key stakeholder outreach and involvement in developing performance information is critical to encouraging the use of such information in both performance budgeting and reexamination efforts. Moreover, little is known about the performance of tax expenditures, which are often aimed at policy goals similar to those of federal spending programs, such as those intended to encourage economic development in disadvantaged areas, finance postsecondary education, and stimulate research and development. Yet tax expenditures and their relative contributions toward achieving federal missions and goals are often less visible than spending programs, which are subject to more systematic review.

Lack of Congressional "Buy-in" and Participation Limits the Potential of Performance Budgeting Efforts

In order for performance budgeting and program reviews to hold appeal beyond the executive branch, and to actually have an impact on legislation, garnering congressional buy-in on what to measure and how to present this information is critical. Without congressional involvement and buy-in, these efforts are unlikely to play a major role in the authorization, appropriations, and oversight processes. Although congressional support is critical to sustain any major management initiative, Congress's constitutional role in setting national priorities and allocating the resources to achieve those priorities makes it especially important for performance budgeting and reexamination efforts. Lack of consensus by a community of interested parties on goals and measures and the way that they are presented can detract from the credibility of performance information and, subsequently, its use. Fifty years of past executive branch efforts to link resources with results have shown that any successful effort must involve Congress as a full partner. We have previously reported that past performance budgeting initiatives faltered in large part because they intentionally attempted to develop performance plans and measures in isolation from the congressional authorization, appropriations, and oversight processes.[8]

Some tension about the amount of stakeholder involvement in the internal deliberations surrounding the development of measures used in budget formulation and the broader consultations more common to the GPRA strategic planning process is inevitable. Compared to the relatively open-ended GPRA process, any budget formulation process is likely to seem closed. However, if performance information—and budget recommendations based on such information—is to hold appeal beyond the executive branch, congressional understanding and acceptance will be critical. Moreover, any performance budgeting effort that does not involve Congress will be limited in its ability to function as a tool to comprehensively reexamine the entire scope of federal spending, as a major player will be left out of the effort.

Performance Budgeting and Reexamination Require a Crosscutting Perspective

Existing performance budgeting initiatives provide a foundation for a baseline review of federal policies, programs, functions, and activities. Building on this foundation, several changes are in order to support the type of reexamination needed. For example, PART focuses on individual programs, but key outcome-oriented performance goals—ranging from low-income housing to food safety to counterterrorism—are addressed by a wide range of discretionary, entitlement, tax, and regulatory approaches that cut across a number of agencies, levels of government, and sectors. PART's program-by-program approach fits with OMB's agency-by-agency budget reviews, but it is not well-suited to addressing crosscutting issues or to looking at broad program areas in which several programs or program types address a common goal. The evaluation of programs in isolation may be revealing, but a broader perspective is necessary for an effective overall reexamination effort. It is often critical to understand how each program fits with a broader portfolio of programs, tools, and strategies to accomplish federal missions and goals.

[8] GAO, *Performance Budgeting: Past Initiatives Offer Insights for GPRA Implementation,* GAO/AIMD-97-46 (Washington, D.C.: Mar. 27, 1997).

Such an analysis is necessary to capture whether and how a program complements and supports other related programs, policies, and tools, or whether it actually works at cross-purposes to such other initiatives. OMB has reported on a few crosscutting assessments[9] in recent budget requests. We would urge as a next step a more comprehensive and consistent approach to evaluating all programs relevant to common goals. Such an approach would require assessing the performance of all programs related to a particular goal—including tax expenditures and regulatory programs—using a common framework.

Our federal tax system includes hundreds of billions of dollars of forgone revenue annually. In some years, total tax expenditures have approximated the size of total discretionary spending. Yet relatively little is known about the effectiveness of tax incentives in achieving the objectives intended by Congress.[10] PART, OMB's current framework for assessing the performance of federal programs, has generally not been applied to tax expenditures.

Tax Expenditures Have Doubled in Number and Represent a Substantial Federal Commitment

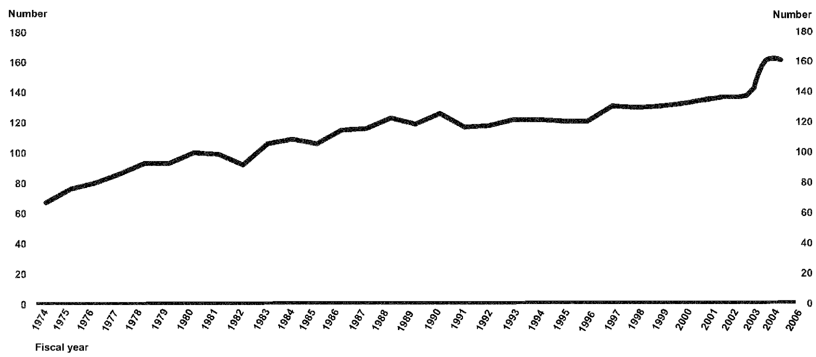
Tax preferences—which are legally known as tax expenditures—result in forgone revenue for the federal government due to preferential provisions in the tax code, such as exemptions and exclusions from taxation, deductions, credits, deferral of tax liability, and preferential tax rates. Excluding tax expenditures from program reviews is especially problematic because tax expenditures represent such a substantial investment in such a wide range of policy goals. Whether gauged in absolute numbers, by revenues forgone, or in comparison to federal spending, tax expenditures have been substantial over the last three

[9] In addition, OMB recently announced two new PMA initiatives aimed at improving the performance of federal credit programs and health information quality and transparency across the major relevant federal agencies.

[10] For more information on tax expenditures, see GAO, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined,* GAO-05-690 (Washington, D.C.: Sept. 23, 2005).

decades.[11] Between fiscal years 1974 and 2006, tax expenditures doubled in number from 67 to 161, as shown in figure 1. While some were dropped over the period, considerably more were added.

Figure 1: Federal Income Tax Expenditures Reported by Treasury Doubled from 1974 to 2006



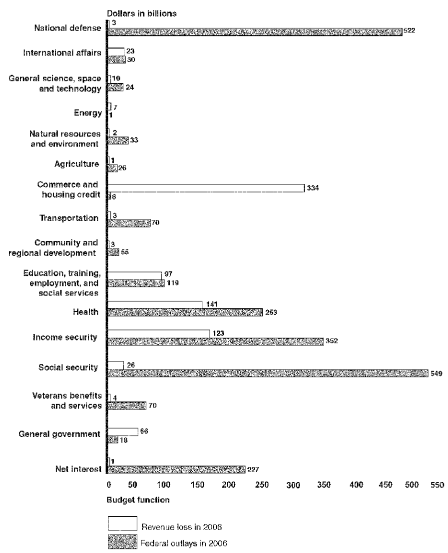
Source: GAO analysis of Office of Management and Budget (OMB) budget reports on tax expenditures, fiscal years 1976-2008.

Note: The number of tax expenditures reflects all provisions reported by Treasury, including those enacted but effective for future fiscal years. Fluctuations in the trend lines from year to year may reflect changes in Treasury's methodology.

[11] Summing the individual tax preference estimates is useful for gauging the general magnitude of the federal revenue involved, but it does not take into account possible interactions between individual provisions. Despite the limitations in summing separate revenue loss estimates, these are the best available data to measure the value of tax expenditures and make comparisons to other spending programs. Summing the estimates provides perspective on the use of tax expenditures as a policy tool and represents a useful gauge of the general magnitude of government subsidies carried out through the tax code. The estimates also can be used to compare tax expenditures to federal spending overall and by budget function. Other researchers also have summed tax expenditure estimates to help gain perspective on the use of this policy tool and examine trends in the aggregate growth of tax expenditure estimates over time.

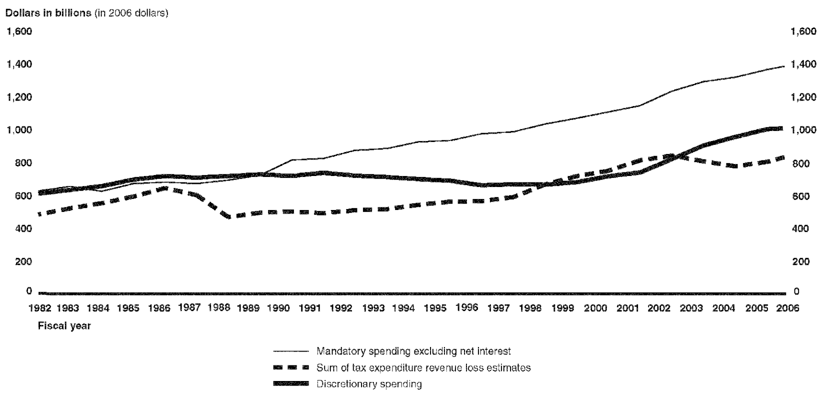
Tax expenditures span almost all federal mission areas, but their relative size differs across budget functions. As figure 2 shows, the sum of revenue loss estimates was greater than federal spending in these budget functions: energy, commerce and housing credit, and general government. For example, the $42.4 billion in outlays for the Department of Housing and Urban Development in fiscal year 2006 are far surpassed by the estimated revenue losses of $68.3 billion from the mortgage interest deduction (the second largest tax expenditure for that year). Moreover, as figure 3 indicates, revenue losses due to tax expenditures exceeded discretionary spending for half of the last decade.

Figure 2: Tax Preference Revenue Loss Sums Compared with Federal Outlays by Budget Function, Fiscal Year 2006



Source: GAO analysis of OMB budget reports on tax expenditures, fiscal year 2006.

Figure 3: Federal Tax Expenditures Exceeded Discretionary Spending for Half of the Last Decade

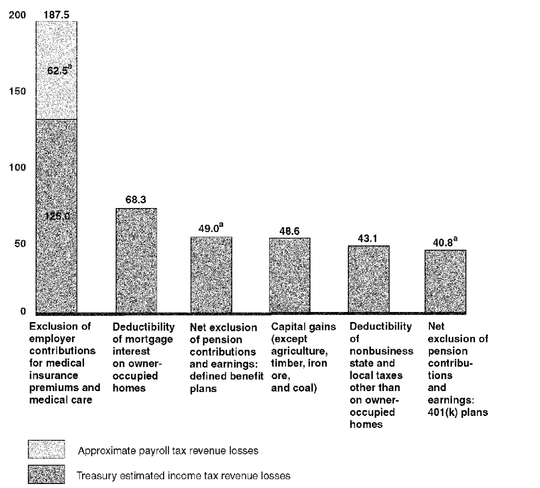


Source: GAO analysis of OMB budget reports on tax expenditures, fiscal years 1976–2008.

Note: Summing tax expenditure estimates does not take into account interactions between individual provisions. Outlays associated with refundable tax credits are included in mandatory spending.

Much of the revenue loss due to individual income tax expenditures is attributable to a small number of large tax expenditures. The six tax expenditures shown in figure 4—each with an annual revenue loss estimated at $40 billion or more—accounted for about 44 percent of the sum of revenue losses for all tax expenditures for fiscal year 2006.

Figure 4: Revenue Loss Estimates for the Largest Tax Expenditures Reported for Fiscal Year 2006



Source: GAO analysis of OMB, *Analytical Perspectives*, Budget of the United States Government, Fiscal Year 2008.

[a]The value of employer-provided health insurance is excluded from Medicare and Social Security payroll taxes. Some researchers have estimated that payroll tax revenue losses amounted to more than half of the income tax revenue losses in 2004, and we use this estimate for 2006. The research we are aware of dealt only with health care, therefore the 50 percent figure may not apply to other items that are excluded from otherwise applicable income and payroll taxes.

Tax expenditure estimates reflect federal income tax revenue forgone and do not account for provisions that exclude certain earnings from payroll taxes. As a result, this understates the total revenue forgone by the federal government for some of the largest tax exclusions. If payroll tax revenue losses were 50 percent of the $125 billion in income tax revenue loss estimated by the Department of the Treasury, the combined revenue loss associated with the exclusion of employer contributions for health insurance premiums would be $187.5 billion in 2006.[12]

Tax Expenditures Receive Little Scrutiny

So far, OMB has used PART to review tax expenditures in only a few cases, such as the Earned Income Tax Credit (EITC) compliance initiative, the New Markets Tax Credit, and the Health Care Tax administration. Generally, these reviews assessed how well Treasury and IRS administer the tax expenditures rather than the efficacy of the tax expenditures themselves. Since tax expenditures represent a significant investment of resources and in some program areas tax expenditures may be the main tool used to deliver services, this is a significant gap. For example, in the fiscal year 2006 budget request, OMB reported on a crosscutting PART assessment for Community and Economic Development (CED) programs. The CED crosscut examined the performance of 18 of the 35 federal community and economic development programs that were identified by OMB and that account for the majority of the $16.2 billion OMB estimates is spent annually in this area. Although OMB identified three tax expenditures in the CED portfolio, it did not assess all of them with the PART instrument even though Treasury's estimate of their combined "cost" was nearly $1.4 billion, or about 57 percent of Treasury's revenue loss estimates for community development.

Periodic review and reexamination of programs—including tax expenditures—is important to identify and mitigate against mission fragmentation, overlap, and conflict, as well as service gaps. In the same way that federal spending programs can work at cross purposes, tax expenditures meant to address certain policy challenges may exacerbate other key private sector and public policy challenges. For example, the income tax exclusion of employer-paid health insurance premiums reduces the after-tax cost of insurance for the beneficiary. However, the exclusion offers no benefit to workers whose employers do not offer health benefits or who purchase their own insurance. Further, this tax benefit also leads people to obtain more comprehensive coverage than they would otherwise and could increase the demand for health care to

[12] Some researchers have estimated that payroll tax revenue losses amount to more than half of the income tax revenue losses. See John Sheils and Randall Haught, "The Cost of Tax-Exempt Health Benefits in 2004," Health Affairs (Feb. 25, 2004); and Leonard E. Burman and Jonathan Gruber, "Tax Credits for Health Insurance," Tax Policy Center Discussion Paper No. 19 (Washington, D.C.: The Tax Policy Center, June 2005). This work dealt only with health care. Payroll tax revenue losses for certain other tax expenditures, such as pensions, could differ.

the extent that it shields those insured from the full costs of health care, complicating efforts to moderate health care spending. The exclusion also tends to favor higher-income workers more likely to have employer-sponsored coverage. Another example is higher education: students seeking federal grants and loans are penalized for having saved funds to pay for their education although the Internal Revenue Code encourages saving by exempting individuals from federal income taxation on interest income used to pay for postsecondary education.

If well designed and effectively implemented, tax expenditures can be an effective tool and appropriate to further some federal goals and objectives. Moreover, sometimes it may be cheaper and simpler to subsidize through the tax code than by setting up a separate program using a different tool. For example, the incremental administrative and compliance costs to deliver the tax credit for child and dependent care expenses may be relatively low compared to the costs of setting up a separate system for processing child care applications and sending vouchers to those eligible. However, tax expenditures may not always be efficient, effective, or equitable; consequently, information on these attributes can help policymakers make more informed decisions about resource allocation and the most effective or least costly methods to deliver federal support.

Regular review could also provide needed scrutiny of certain expenditures that have few controls. With some exceptions, tax expenditures generally are not subject to reauthorization and therefore lack the opportunity for regular review. Moreover, many tax expenditures—like mandatory spending programs—are governed by eligibility rules and benefit formulas, meaning funds are spent as required to provide benefits to those who are eligible and wish to participate. Thus, because they are not as visible in the budget as discretionary spending programs, tax expenditures run the risk of simply being a form of "back-door spending" embedded in the tax code and are effectively "fully funded" before any discretionary spending is considered.

Future Performance Budgeting Efforts Must Continue to Build on Lessons Learned in Order to Facilitate Effective Reexamination

The federal government is in a period of profound transition and faces an array of challenges and opportunities to enhance performance, ensure accountability, and better position the nation for the future. In our February 2005 report on 21st century challenges,[13] we outlined a number of approaches that could facilitate a reexamination effort. Agencies and OMB will need to continue to focus on ensuring that the growing supply of performance information is credible, useful, reliable, and used both in day-to-day program management and in formulating budget requests that focus on outcomes that can be achieved with resources requested. Further, the executive branch can help promote demand for and acceptance of performance information by developing goals and measures relevant to the large and diverse community of stakeholders in the federal budget and planning processes and presenting this information in a way that is tailored to the needs of congressional stakeholders. Engaging Congress early in the process may help target reviews with an eye toward those areas most likely to be on the agenda of Congress, thereby better ensuring the use of performance assessments in resource allocation processes throughout government. Lastly, taking a comprehensive and crosscutting approach to program assessment by more strategically selecting programs and policy areas for review—regardless of the agency in which programs are housed, and inclusive of all tools (e.g., grant, credit, regulatory programs, and especially tax expenditures) that bring resources to bear on a particular program or policy area—will provide robust, rich information about the performance of all tools aimed at federal and national challenges. Moving forward will require actions by both the executive branch and the Congress. Let me elaborate.

Executive Branch Actions

Although recent OMB efforts to assess programs in a crosscutting fashion represent progress, to provide the kind of information that can be of assistance in reexamining the base of government, we encourage a more extensive and consistent approach to evaluating all programs relevant to common goals. We recommended in 1994 and again in 2005 that OMB design and implement a structure for conducting reviews of tax expenditures' performance. Our recommendation is consistent with language in the Senate Committee on Government Affairs' Report on GPRA, which specified that the Director of OMB was to establish an appropriate framework for periodic analyses of the effects of tax expenditures in achieving performance goals. To significantly increase the

[13] GAO-05-325SP.

oversight and analysis of tax expenditures, the committee report also called for a schedule for periodic tax expenditure evaluations.

Although incorporating tax expenditures into crosscutting reviews presents significant analytical challenges, we do not believe such challenges are insurmountable. Moreover, assessing the performance of tax expenditures is critically important given that many function as entitlement programs—although perhaps with even less transparency—and do not compete overtly in the annual budget process. Presenting tax expenditures alongside outlays is a first step in providing the public and policymakers with a more useful and accurate picture of the extent of federal support and activities. In fact, in the tax expenditure chapter in *Analytical Perspectives*, OMB has in the past included a section outlining possible performance measures developed by Treasury, which could be used to present information about the performance of tax expenditures. Although this overview was initially introduced in the 1997 budget and expanded in the 1999 budget, no performance information is actually displayed. OMB states that the measure examples provided are "illustrative" in nature, acknowledges that the performance measure discussion "although broad, is nonetheless incomplete," and notes that many tax expenditures are not explicitly cited.

One of the key impediments to moving forward in conducting reviews of tax expenditures' performance is the continuing lack of clarity about the roles of OMB, Treasury, IRS, and departments or agencies with responsibility for related spending programs. Designing a structure and approach for including tax expenditures in performance reviews will be challenging, but it is important. Ideally, reviews would look at federal involvement in a given policy area across related agencies and tools, which means a decision would have to be made as to which tax expenditures and which spending programs are relevant. The review would need to involve the departments or agencies with related spending programs, Treasury, and OMB. It might make sense for OMB and Treasury to conduct some case studies of the proposed review structure to identify (1) successful methods agencies devise for reviewing tax expenditures' performance, (2) how best to report the results of these reviews, and (3) how to ensure that adequate resources are available for such reviews. This type of effort can both strengthen the budget process itself and provide a valuable tool to facilitate a fundamental reexamination of the base of government.

Reexamination is not a one-time activity. It must be a continuing process and we should expect even the initial round to take several years. The process could be helped by the governmentwide performance plan required by GPRA, as well as a governmentwide strategic plan and a set of KNIs. GPRA requires the President to include in his annual budget submission a federal government performance plan. Congress intended that this plan provide a "single cohesive picture of the annual performance goals for the fiscal year." The governmentwide performance plan could help Congress and the executive branch address critical federal performance and management issues, including redundancy and other inefficiencies in how we do business. It could also provide a framework for any restructuring efforts. Unfortunately, this provision has not been fully implemented. Instead, OMB has used the President's budget to present high-level information about agencies and certain program performance issues. The agency-by-agency focus of the budget does not provide the integrated perspective of government performance envisioned by GPRA.

In addition, we have previously said that a governmentwide strategic plan could provide a framework to identify long-term goals and strategies to address issues that cut across federal agencies.[14] Such a plan for the federal government, supported by key national outcome-based indicators and a fully developed governmentwide performance plan to assess the government's performance, position, and progress, could be a valuable tool for governmentwide reexamination of existing programs, as well as proposals for new programs. Developing a strategic plan can help clarify priorities and unify stakeholders in the pursuit of shared goals and is therefore an important first step in articulating the role, goals, and objectives of the federal government. A governmentwide strategic plan can potentially provide a cohesive perspective on the long-term goals of the federal government and provide a much needed basis for fully integrating, rather than merely coordinating, a wide array of federal activities. The development of a set of KNIs could both be used as a basis to inform the development of governmentwide strategic and annual performance plans as well as link to and provide supporting information for outcome-oriented goals and objectives in agency-level strategic and annual performance plans. Successful strategic planning requires the involvement of key stakeholders and thus could serve as a mechanism for building consensus. Further, it could provide a vehicle for the President to articulate long-term goals and a road map for achieving them. In addition, a strategic plan can

[14] GAO-04-38.

provide a more comprehensive framework for considering organizational changes and making resource decisions.

Fully implemented, governmentwide strategic and performance plans—if developed in consultation with Congress—could also provide a framework for congressional authorization, appropriation, and oversight processes.

Congressional Actions

Congress of course has a number of regular opportunities to provide its perspective on specific performance issues and performance goals. When you create a new spending program or tax provision, you have the opportunity to say what you expect that program or incentive to achieve—and to direct that performance be tracked. I believe Congress should be clear about what performance information it wants and should expect that information to be provided. For discretionary spending programs, the annual appropriations process provides an opportunity to ask about the performance of an individual program and/or a group of programs within the same agency or within the jurisdiction of the appropriations subcommittee. When Congress considers the reauthorization of a program, it should have information on that program's performance—and on how that performance compares with other tools addressing the same or similar objectives. Reauthorization can—and should—be informed by performance information and evaluations.

Discretionary spending programs may be looked at in the annual appropriations process or when they are up for reauthorization. Although some entitlement programs require reauthorization and so offer up opportunities for evaluation and reexamination, others do not. With few exceptions, programs run through the tax code—tax expenditures—generally are not subject to reauthorization; as a result no review or evaluation of their effectiveness is triggered. For many mandatory spending programs and tax expenditures, congressionally initiated oversight may be the vehicle for evaluation. I would suggest that Congress specify the kind of performance information it would like for these programs and use that in crosscutting reviews.

The institutional challenge before you is to find a way to broaden your assessment beyond individual programs or agencies or even committee jurisdiction. It is not uncommon for multiple tools or programs—administered through more than one agency—to address a similar goal or national priority. Although this may make sense, it also complicates the task of evaluation, oversight, and reexamination.

We have previously suggested that Congress consider the need to develop a more systematic vehicle for communicating its top performance concerns and priorities; develop a more structured oversight agenda to prompt a more coordinated congressional perspective on crosscutting performance issues; and use this agenda to inform its authorization, appropriations, and oversight processes. Just as the executive branch needs a vehicle to coordinate and address programs and challenges that span multiple departments and agencies, Congress might need to develop structures and processes that better afford a coordinated approach to overseeing agencies and tools where jurisdiction crosses congressional committees.

In the past we have also suggested that one possible approach could involve developing a congressional performance resolution identifying the key oversight and performance goals that Congress wishes to set for its own committees and for the government as a whole. Such a resolution could be developed by modifying the current Congressional Budget Resolution, which is already organized by budget function. I note that this year your Committee took the first step by including in this year's Budget Resolution a directive that Committee "Views and Estimates" reports include recommendations for improved governmental performance based on "committee performance reviews of programs within their jurisdiction." I hope this Committee remains interested and continues to urge and support the other Committees in this effort.

You may also wish to consider what kind of structures will facilitate cross-cutting reviews. If a performance resolution or some other mechanism specifies areas for reexamination in any given year, what structure will enable you to look across agencies and at both programs run through the spending side of the budget and those run through the tax side? Challenging as this task may be, I believe it is critical to the successful assertion of Congress' role in setting the goals and objectives to be achieved with the programs it establishes and the resources it provides.

Concluding Observations

Much is at stake in the development of a collaborative performance budgeting and reexamination process. This is an opportune time for the executive branch and Congress to consider and discuss how agencies and committees can best take advantage of and leverage the new information and perspectives coming from the reform agenda under way in the executive branch. Through PMA and its related initiatives, including PART, the Administration has taken important steps in the right direction by calling attention to successes and needed improvements in federal management and performance. Some program improvements can come solely through executive branch action, but for any performance budgeting or reexamination effort to meet its full potential the assessments it generates must also be meaningful to and used by Congress and other stakeholders. I cannot stress this point enough—to make a difference, performance information must be useful and used. Hence I believe it is important for Congress to develop structures and processes that are flexible, adaptable, and inclusive of various perspectives to conduct successful performance reviews on those issues that cross jurisdictional boundaries. GAO stands ready to assist Congress in addressing the much needed baseline review of existing federal programs, policies, functions, and activities.

Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions you or the other Members of the committee may have at this time.

For future information on this testimony, please contact Michael Brostek, at (202) 512-9110 or brostekm@gao.gov or Susan J. Irving at (202) 512-9142 or irvings@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. Individuals making key contributions to this testimony were Jacqueline M. Nowicki, Assistant Director; Elizabeth Curda; Edward Nannenhorn; Amy Rosewarne; and MaryLynn Sergent.

Chairman SPRATT. And now the Director of the Congressional Budget Office, Peter Orszag.

STATEMENT OF PETER R. ORSZAG

Mr. ORSZAG. Thank you very much, Mr. Spratt, Mr. Ryan and other members of the committee. Both economic and common sense suggest that a program's budget should be linked to its effectiveness in achieving its objectives. The concept of performance-based budgeting, though, has been applied mostly to discretionary spending, which represents less than 40 percent of overall Federal expenditures. So, like Mr. Walker, my written testimony extends the concept of performance budgeting to two parts of the Federal budget that have not been examined as closely from that perspective: health insurance and tax expenditures.

In both cases, the amount of Federal funds at stake is substantial, and important questions exist about the cost effectiveness of those expenditures.

First with regard to health care, as I have said over and over again, rising health care costs represent the central fiscal challenge facing the Nation. My written testimony includes the chart that I have always used before this committee, but just for a change of pace I won't actually put it up.

If health care costs continue to grow at the same rate over the next four decades as they did over the past four decades, Medicare and Medicaid would rise from under 5 percent of the economy today, to 20 percent by 2050; yet very little analysis is undertaken of whether that spending is generating corresponding gains in the health of enrollees, which presumably is the ultimate objective of the programs.

Many treatments improve enrollees' health, and the benefits suggest that health spending, on average, improves health outcomes. But in many cases, such spending is not cost effective and in many cases it may not even improve health. One reason is that relatively little rigorous evidence is available about which treatments work best for which patients, or whether the benefits of more expensive therapies warrant their additional costs.

Although estimates vary, some experts believe that less than half of all medical care is based on or supported by firm evidence about its effectiveness. Much of the research that has been done about Medicare spending and its impact on health has focused on the traditional fee-for-service portion of the program that serves the vast majority of its enrollees. But the concepts behind performance budgeting could also be applied to the Medicare Advantage component of the program. The data currently collected, however, are not sufficient to do so.

Medicaid spending has also received relatively less attention. Like with Medicare, Medicaid spending at the State level varies substantially, even among enrollees who have qualified for the program, for the same reason. More research on the source of variation in the program's costs and its impact on enrollees' health is warranted.

In sum, we are spending a substantial amount of money on health care. It is the central long-term fiscal challenge facing the Nation, and yet we are doing too little to examine what we are getting in return.

The second area of the Federal budget that is often not examined from a performance budgeting perspective involves tax expenditures. Mr. Walker already laid out some of the amounts involved and they are obviously very significant. In each of the major cases, the reduction and receipts gives the appearance of a reduced impact on the Federal budget and on the economy. Indeed, most presentations of the budget omit any mention of tax expenditures. But tax preferences are effectively equivalent to collecting taxes at ordinary tax rates on the full potential tax base and then subsidizing the preferred behavior through outlays. Because selective tax reductions operate as expenditures for specific economic activities, their effectiveness can and should be evaluated in the same way as is done for spending programs.

Given the size of many tax expenditures, it is striking that they are subjected to little analysis of their effectiveness in achieving their objectives. In many cases, the specific outcome of the tax expenditure that is desired is unclear, and may even conflict with objectives of other policies. In a number of instances where the policy goal is clearer and not in conflict with other policies, the tax incentives do not appear to yield their desired effect in a cost-effective manner. For example, significant empirical questions exist about whether tax preferences for certain kinds of saving vehicles such as IRAs and 401(k)s have significantly boosted private savings or merely subsidized saving that would have occurred in the absence of those incentives.

In addition, many tax expenditures are structured in a relatively inefficient way. In particular, most tax expenditures are delivered in the form of a deduction or exclusion, which links the size of the tax expenditure or the value thereof to one's marginal tax bracket. However, unless one believes that there is a differential response by income category or broader social benefits that vary by income category when people do respond, from an economic efficiency perspective, it does not make sense to vary the subsidy rate per dollar of activity in any manner, either up the income distribution or down the income distribution. So from an economic efficiency perspective, unless you have evidence to the contrary that there is differential response rates, the most efficient approach to delivering a subsidy through the Tax Code is a uniform credit that does not vary with the household's income. My written testimony discusses that at more length.

I would also note that perhaps the most prominent example of a tax expenditure that appears to be inefficient is the exclusion for employer-provided health insurance, and my written testimony discusses that issue in more detail also.

To sum up, the growth of health care spending is the central long-term fiscal challenge facing the Nation, and existing tax expenditures entail a substantial reduction in the Nation's tax base. In both cases, Federal policy would be improved by applying principles of performance budgeting, evaluating whether the benefits derived warrant the resources provided. Thank you very much.

Chairman SPRATT. Thank you very much, Dr. Orszag.

[The prepared statement of Peter R. Orszag follows:]

CBO TESTIMONY

Statement of
Peter R. Orszag
Director

Performance Budgeting: Applications to Health Insurance Programs and Tax Policy

before the
Committee on the Budget
U.S. House of Representatives

September 20, 2007

This document is embargoed until it is delivered at 10:00 a.m. (EDT) on Thursday, September 20, 2007. The contents may not be published, transmitted, or otherwise communicated by any print, broadcast, or electronic media before that time.

CONGRESSIONAL BUDGET OFFICE
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Chairman Spratt, Ranking Member Ryan, and Members of the Committee, thank you for inviting me to testify today on performance budgeting. It is difficult to argue with the proposition that a program's budget should be linked to its effectiveness in achieving its objectives. But the concept of performance-based budgeting has been applied mostly to discretionary spending programs, which represent less than 40 percent of federal spending. That effort has taken many forms over the years, with the most recent version being the Program Assessment Rating Tool (PART).

Rather than assessing those past and ongoing efforts, my testimony extends the concept of performance budgeting to two other parts of the federal budget that have not been examined as deeply using that perspective: health insurance programs (and the health care costs that they cover) and tax expenditures. In both cases, the amount of federal funds at stake is substantial, and important questions exist about the cost-effectiveness of those expenditures.

- **Health Care Costs.** Rising health care costs represent the central fiscal challenge facing the country. Currently, net federal spending on Medicare and Medicaid totals about $560 billion; it accounts for about 20 percent of federal outlays and about 5 percent of gross domestic product (GDP). If spending per enrollee continued growing at the same average rate as it has grown over the past 40 years, federal costs for those two programs would amount to about 20 percent of GDP by 2050 (see Figure 1). Yet very little analysis is undertaken of whether that spending is generating corresponding gains in the health of enrollees, which presumably is the ultimate objective of those programs. To the extent that those programs are paying for services that make little or no contribution to health, opportunities exist to improve their efficiency.

- **Tax Expenditures.** Tax expenditures comprise various exceptions to the general tax rules—such as the income tax deduction that is allowed for interest paid on home mortgages—and total several hundred billion dollars per year. Those exceptions are often designed to encourage the tax-favored activities (such as home ownership). Tax expenditures may appear to reflect a reduced impact of federal policies on taxpayers, but they are effectively equivalent to collecting taxes at ordinary rates on the full potential tax base and then subsidizing the preferred behavior through outlays. Because selective tax reductions are like expenditures for specific economic activities, they can and should be evaluated in the same way as spending programs are. Applying performance budgeting to tax expenditures would therefore involve assessing whether they were achieving their purposes and whether they were doing so in a cost-effective manner.

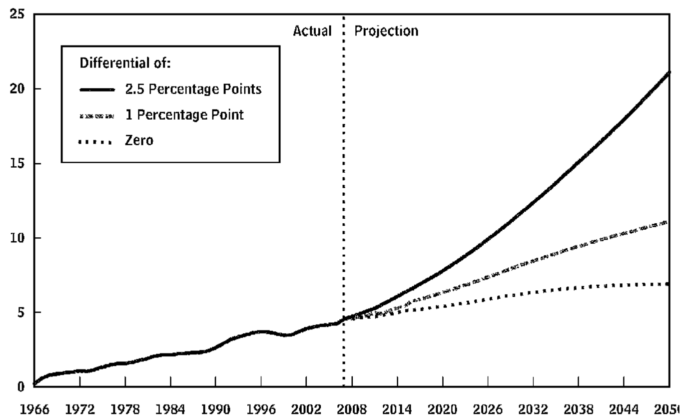
In examining those two components of federal spending from a performance-budgeting perspective, four themes emerge:

- A substantial share of Medicare spending—and of health spending for the country as a whole—does not seem to be improving the health of enrollees. Average costs in Medicare vary significantly from one region of the country to another,

Figure 1.

Total Federal Spending for Medicare and Medicaid Under Various Assumptions About the Health Cost Growth Differential

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Note: The health cost growth differential refers to the number of percentage points by which the growth of annual health care spending per beneficiary is assumed to exceed the growth of nominal gross domestic product per capita, after an adjustment for the growth and aging of the Medicare and Medicaid populations.

but the additional spending and use of services that occur in the higher-cost regions do not appear to yield improvements in life expectancy or other available measures of health. Some researchers have concluded that about 30 percent of the money spent on health care services is not contributing to better health—an estimate that could probably be applied to the Medicaid program and to the whole health sector. Capturing those potential savings, however, is a substantial challenge.

- Many of the special preferences in the tax code do not appear to be cost-effective in achieving their objectives. In some cases, tax expenditures appear to be in conflict with the purposes of other tax expenditures or explicit spending programs. In many more cases, preferences could be redesigned to reduce their costs substantially with minimal or no impact on the degree to which they were achieving their objectives.

- Both federal health insurance programs and tax expenditures could be subject to performance budgeting. The executive branch and the Congress generally engage in various forms of effectiveness reviews through their annual budgeting processes, but performance budgeting seeks to make that consideration more systematic and more consistent among programs. Assessing the effectiveness of any federal program in a more precise and systematic manner, however, is a complex undertaking, both because of disagreements about the goals of such programs and difficulties in measuring their impact accurately.

- Even with a systematic and well-designed assessment of performance, determining what specific policy steps to take as a result may be difficult. Unlike discretionary appropriations, the costs of federal health programs and tax expenditures are not set directly by policymakers but, instead, depend greatly on the actions of individuals and firms. The effects of any reforms aimed at improving performance thus depend on the responses to the policy changes. Despite those caveats, applying the concepts behind performance budgeting to health insurance programs and tax expenditures provides a useful framework for assessing those two major components of the federal budget.

Federal Health Insurance Programs

The Medicare and Medicaid programs currently provide health insurance coverage to nearly 100 million people.[1] Both of those programs are relatively effective in achieving the goal of providing insurance to their eligible populations: elderly people, disabled individuals, and poor mothers and their children. Prior to the advent of Medicare, most elderly Americans lacked meaningful health insurance, and before Medicaid came into existence, low-income, disabled, and institutionalized people generally faced significant difficulty finding affordable health insurance on the private market.[2] (Those programs also have the effect of transferring resources to enrollees who would otherwise have purchased their own insurance or paid for their own care.)

1. The Congressional Budget Office estimates that average enrollment in Medicare is about 43 million people in 2007 and that about 62 million individuals will be enrolled in Medicaid at some point during the year (some of whom will be enrolled for only part of the year); several million people (the "dually eligible") are enrolled in both programs simultaneously. The federal government also funds a number of other health insurance programs, including the State Children's Health Insurance Program, the Federal Employees Health Benefits program, the TRICARE program for members of the armed services, and the health care programs of the Department of Veterans Affairs—but spending on those programs is small relative to outlays for Medicare and Medicaid.

2. Some enrollees in Medicaid and the State Children's Health Insurance Program (SCHIP) would be able to obtain private coverage if those public programs did not exist, but the majority of current enrollees would probably be uninsured in the absence of the programs. For further discussion of that issue with regard to SCHIP, see Congressional Budget Office, *The State Children's Health Insurance Program* (May 2007).

Whether the services that are financed by Medicare and Medicaid are always achieving the more fundamental goal of improving the health of enrollees is less clear, however. Indeed, concerns about the degree to which health care spending produces better health outcomes are not limited to public health care programs; they arise more generally in the health sector. Although many treatments improve enrollees' health, and the benefits from health spending probably exceed the costs, on average, evidence suggests that much spending is not cost-effective—and in many cases does not even improve health.[3]

One reason is that relatively little rigorous evidence is available about which treatments work best for which patients or whether the benefits of more-expensive therapies warrant their additional costs. As a result, decisions about what treatments to use often depend on the experience and judgment of the individual physicians involved, as well as on anecdotal evidence and conjecture. In many cases, that basis may be sufficient, but in other cases, that approach is not adequate to select the most effective choice of treatment. Although estimates vary, some experts believe that less than half of all medical care is based on or supported by firm evidence about its effectiveness.

Geographic Variation in Health Care Spending

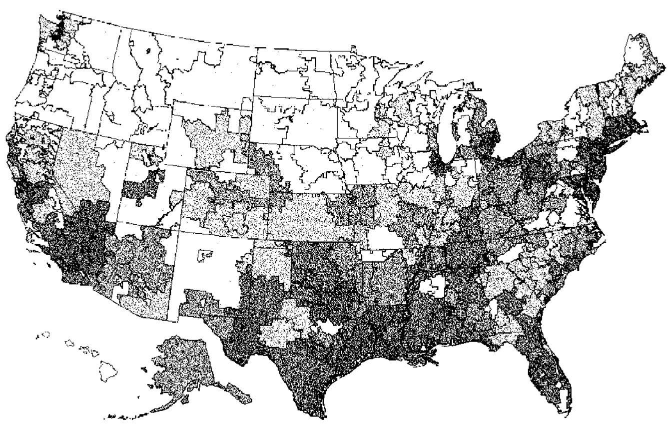
Partly as a result of limited evidence about their absolute or comparative effectiveness, the use of certain treatments and the types of care provided can vary widely from one area of the country to another. For example, even after adjusting for differences in age, sex, and race, researchers at Dartmouth College found about a fourfold variation in the share of Medicare beneficiaries receiving a coronary artery bypass graft; those differences were not correlated with rates of heart attacks in each region.[4] Geographic differences in the types of care provided can remain substantial even among patients who turn out to be in their last six months of life. (That analytic approach has been used in an effort to control for differences in the prevalence and severity of illness, on the grounds that large groups of patients who are nearing death are likely to have comparable health problems regardless of where they live.) For example, patients in the final six months of their life spend nearly 20 days in the hospital, on average, in the highest-use areas of the country, compared with an average of about six hospital days in the lowest-use areas; the

3. See David M. Cutler, *Your Money or Your Life: Strong Medicine for America's Health Care System* (New York: Oxford University Press, 2004).

4. See John E. Wennberg, Elliot S. Fisher, and Jonathan S. Skinner, "Geography and the Debate Over Medicare Reform," *Health Affairs*, Web Exclusive (February 13, 2002), pp. w96–w97. The analysis divided the country into about 300 "hospital referral regions," which reflect where Medicare enrollees typically receive hospital care. In 2003, bypass surgery rates ranged from about 2 to 3 per 1,000 Medicare enrollees in the lowest-use regions to about 9 to 10 per 1,000 in the highest-use regions. Although higher rates of bypass surgery could reflect higher rates of heart attacks, higher surgery rates could also prevent some heart attacks—a factor that could help explain the lack of correlation between those two measures.

Figure 2.

Medicare Spending per Capita in the United States, by Hospital Referral Region, 2003



$7,200 to $11,600 (74)
$6,800 to < $7,200 (45)
$6,300 to < $6,800 (55)
$5,800 to < $6,300 (60)
$4,500 to < $5,800 (72)
Not Populated

Source: Dartmouth Atlas Project, *The Dartmouth Atlas of Health Care.*

Note: Numbers in parentheses refer to the number of hospital referral regions with per capita spending in each range.

average number of visits to physicians in that period also varies by a factor of three.[5]

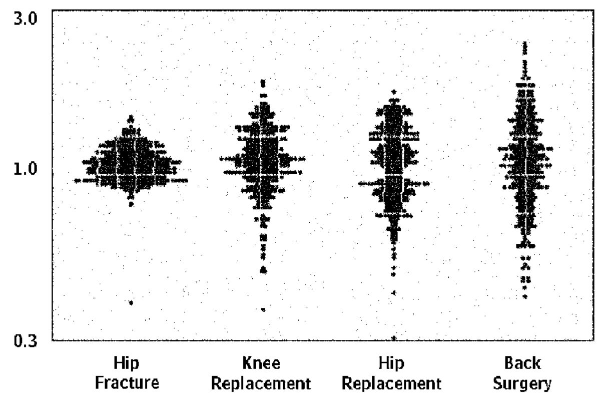
Those variations in the use of care correspond to substantial differences in Medicare spending per enrollee in different parts of the country, even after adjustments are made to account for differences in the age, sex, and race of enrollees in different areas (see Figure 2). In 2003, average costs ranged from about $4,500 per enrollee in the areas with the lowest spending to nearly $12,000 in areas with the highest spending. Some of those differences in spending reflect varying rates of illness as well as differences in the prices that Medicare pays for the same service, which are adjusted on the basis of local costs for labor and equipment in the health sector. But according to the Dartmouth researchers, differences in illness rates

5. Based on data from 2000 to 2003, available from www.dartmouthatlas.org.

Figure 3.

Rates of Four Orthopedic Procedures Among Medicare Enrollees, 2002 and 2003

(Standardized discharge ratio, log scale)



Source: Dartmouth Atlas Project, *The Dartmouth Atlas of Health Care.*

Notes: In the figure, each point represents a hospital referral region; the country was divided into about 300 such regions on the basis of where Medicare enrollees typically receive their hospital care.

The points indicate how the rate at which the procedure is performed (per 1,000 Medicare enrollees) in each referral region compares with the national average rate (which has been normalized to 1.0). Differences in procedure rates were adjusted to account for differences among regions in the age, sex, and race of enrollees and for measures of illness rates.

account for less than 30 percent of the variation in spending, and price differences can explain perhaps another 10 percent—meaning that more than 60 percent of the variation results from other factors.[6] Other studies have found that a larger share of the variation in spending (as much as 70 percent) can be accounted for by differences in health status and demographic factors, but even so, the remaining differences are large in dollar terms.[7]

Some evidence suggests that the degree of geographic variation in treatment patterns is greater when less of a consensus exists within the medical community about the best treatment to use—further buttressing concerns that services are

6. Wennberg, Fisher, and Skinner, "Geography and the Debate Over Medicare Reform"; and *The Dartmouth Atlas of Health Care, 1999* (Hanover, N.H.: Dartmouth Atlas Project), pp. 22–23.

7. See David Cutler and Louise Sheiner, "The Geography of Medicare," *American Economic Review*, vol. 89, no. 2 (May 1999), pp. 228–233.

being paid for that may contribute little to health. For patients who have fractured their hip, for example, the need for hospitalization is plain, and there is relatively little variation in admission rates for Medicare beneficiaries with that diagnosis (see Figure 3). For hip replacements and for knee replacements, more discretion is involved, and the surgery rates vary more widely. There appears to be even more variation in the rates of back surgery—a treatment whose benefits have been the subject of substantial questions. (Determining what share of any geographic variation in the use of procedures is attributable to differences in the treatments that doctors recommend and what share is attributable to differences in the prevalence of the underlying illness is challenging, however, so the comparison of procedures may be sensitive to the manner in which differences in illness rates are estimated.)

The Relationship Between Spending and Health Outcomes

The implications of the observed variations in treatments and spending depend primarily on their relationship to health outcomes. If life expectancy and other measures were better in the areas with higher spending, that outcome might suggest that increased spending in the low-cost areas would yield health benefits. However, a study using Medicare data showed that the higher-spending regions did not have lower mortality rates than the lower-spending regions, even with adjustments to control for different illness rates among patients and regions.[8] That study also found that higher spending did not slow the rate at which the elderly developed functional limitations. Furthermore, differences in spending are not correlated with simple measures of the quality of care that enrollees receive (see Figure 4). Although more research is needed about the impact of spending differences on morbidity and the quality of life (perhaps using more-extensive measures of health outcomes), the available evidence suggests that spending in the high-cost areas could be reduced without substantial adverse effects on the overall health of residents in those areas.

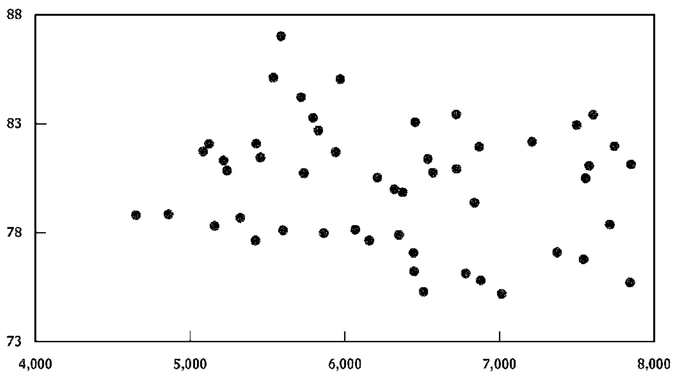
Much of the research that has been done about Medicare spending and its impact on health has focused on the traditional fee-for-service portion of the program, which serves the vast majority of its enrollees. But the concepts behind performance budgeting could also be applied to the Medicare Advantage program, under which enrollees can receive their benefits through a private health insurance plan. Currently, those plans are paid more than the costs for enrollees in the fee-for-service sector—about 12 percent more, on average—and most of the difference is returned to enrollees in the form of lower premiums, lower cost-sharing requirements, or additional benefits. Part of the rationale for the Medicare Advantage program is that enrollees will receive better care because it will be coordinated more effectively; by contrast, the fee-for-service program has no explicit mechanisms to coordinate care. Therefore, estimating the benefits of that coordination and

8. Elliot S. Fisher and others, "The Implications of Regional Variations in Medicare Spending, Part 2: Health Outcomes and Satisfaction with Care," *Annals of Internal Medicine*, vol. 138, no. 4 (February 18, 2003), pp. 288–298.

Figure 4.

The Relationship Between Medicare Spending and Quality of Care, by State, 2004

(Composite measure of quality of care)



Source: Congressional Budget Office based on data from Department of Health and Human Services, Agency for Healthcare Research and Quality, *National Healthcare Quality Report, 2005* (December 2005), Data Tables Appendix, available at www.ahrq.gov/qual/nhqr05/index.html, and data from the Centers for Medicare and Medicaid Services' Continuous Medicare History Sample.

Notes: The composite measure of the quality of care, based on Medicare beneficiaries in the fee-for-service program who were hospitalized in 2004, conveys the percentage who received recommended care for myocardial infarction, heart failure, or pneumonia. Spending figures convey average amounts by state.

comparing those benefits to their costs could be useful. Unfortunately, however, the data collected on Medicare Advantage plans are not sufficient to do so.[9]

An area that has received less attention is the variation in Medicaid spending and what that variation implies about the effectiveness of the services that enrollees receive. Medicaid spending at the state level varies substantially, even among enrollees who have qualified for the program for the same reason. For example, among elderly enrollees, spending averaged about $11,500 in 2004 but ranged from about $5,000 in the lowest-cost state to about $23,000 in the highest-cost

9. See the statement of Peter R. Orszag, Director, Congressional Budget Office, *The Medicare Advantage Program*, before the House Committee on the Budget, June 28, 2007.

state; for disabled enrollees, average costs varied to a similar degree.[10] Those variations, it should be noted, reflect not just differences in prices or the underlying sickness of enrollees but also differences in eligibility rules and in the scope of benefits provided by states. Although it is reasonable to assume that Medicaid spending is subject to the same forces that cause spending variations in the health care sector as a whole, more research on the sources of variation in the program's costs and its impact on enrollees' health is warranted.

Addressing the Performance of Medicare and Medicaid

To a certain extent, both Medicare and Medicaid are already subject to evaluations of their performance, but the question is whether or how they might benefit from a more systematic review. Research about geographic differences in spending and other assessments of the programs' contributions to health have been undertaken without formal requirements, and the executive branch and the Congress are aware of those analyses as they carry out their regulatory and legislative responsibilities. In addition, both Medicare and Medicaid have been assessed by the Administration's PART initiative.[11] But those examinations have not been as rigorous as the level and growth of spending on the programs would seem to warrant. The PART reviews, for example, focus much of their attention on how efficiently the administrative functions of each program are carried out, and both reviews state that the question of tying budget requests to performance goals—which is usually a standard component of such assessments—is not applicable because Medicare and Medicaid are mandatory programs and their "budgetary resources are not driven by performance goals."

One reason that tying spending in those programs to performance is difficult is that policymakers generally have only indirect control over how much is spent. Those programs entitle enrollees to receive coverage for specified medical services, but decisions about which services are medically necessary are largely left to doctors and their patients. Thus, although Medicare and Medicaid officials generally establish the prices that the programs will pay for each service, they have little control over the quantities that are used. Efforts to improve the programs' performance would therefore have to change the behavior of doctors, other providers, and patients—probably using some combination of information about what services were most effective or most cost-effective and incentives for doctors and patients to use those services.[12] An additional challenge within Medicaid is that

10. Data on average Medicaid costs at the state level were compiled by the Henry J. Kaiser Family Foundation and are available at www.statehealthfacts.org. Although elderly and disabled individuals represent about one-quarter of Medicaid enrollees, they account for about three-fourths of Medicaid spending.

11. Those assessments are available at www.expectmore.gov.

12. For additional discussion of those issues, see the statement of Peter R. Orszag, Director, Congressional Budget Office, *Research on the Comparative Effectiveness of Medical Treatments: Options for an Expanded Federal Role*, before the Subcommittee on Health of the House Ways and Means Committee, June 12, 2007.

decisions about what services to cover and how much to pay for them are made primarily by state program administrators, subject to limits and guidelines set in federal legislation and regulations.

Those challenges notwithstanding, some efforts have been made to encourage more effective use of resources in the federal health insurance programs—but those efforts to move from a fee-for-service system toward a "fee-for-value" system are at a very early stage. For example, Medicare recently initiated demonstration programs to test "pay-for-performance" approaches for hospitals and large groups of physicians. Initial assessments indicated that the additional payments to hospitals participating in the demonstration were not effective in bringing about improvements in the care they provided (perhaps because the payments were too small), while the demonstration program involving physicians' group practices may not have been designed in a way to effectively identify its effects. This year, Medicare will also make modest bonuses available to doctors who elect to report information on certain types of care that they provide (although the payments will not depend on their actual performance). Many states recognize the growing fiscal burden posed by Medicaid costs, and several of them have expressed interest in research on treatments' effectiveness. For example, more than a dozen state Medicaid programs are involved in a project (affiliated with the Oregon Health and Sciences University) assessing evidence about the relative safety and effectiveness of competing drugs in the same therapeutic class.

Federal Tax Expenditures

A second area of the federal budget that is often not examined from a performance-budgeting perspective is tax expenditures. The total size of tax expenditures is large, but because of the interactions among them, it is analytically problematic to sum estimates of the individual expenditures—each of which assumes that the tax code otherwise is unchanged. Nonetheless, some idea of their aggregate importance can be seen from estimates of the largest individual items. The largest single tax expenditure is for contributions to and earnings within employer-sponsored retirement plans, which are exempt from income taxation; according to the Joint Committee on Taxation's estimate, that exemption cost $110 billion in 2007 (see Table 1). The next largest tax expenditure, costing $100 billion, is for employer-provided health insurance—an amount that reflects only the impact on income tax receipts. The costs of providing that insurance are also exempt from payroll taxes, generating an additional tax expenditure estimated to exceed $60 billion.[13] Reduced tax rates on capital gains and dividends

13. See John Sheils and Randall Haught, "The Cost of Tax-Exempt Health Benefits in 2004," *Health Affairs*, Web Exclusive (February 25, 2004), pp. W4-106–W4-112.

Table 1.

The Largest Tax Expenditures and the Estimated Loss of Revenues, 2007

Tax Expenditure	Revenue Loss in 2007 (Billions of dollars)
Exclusion of Contributions to and Earnings Within Employer-Sponsored Pension Plans	110.2
Exclusion of Costs for Employer-Provided Health Insurance	99.7
Reduced Tax Rates on Capital Gains and Dividends	94.5
Deduction for Home Mortgage Interest	75.6
Exclusion of Capital Gains at Death	51.9
Child Tax Credit[a]	45.9
Earned Income Tax Credit[a]	42.8
Deduction for State and Local Income Taxes	41.1
Exclusion of Medicare Part A and B Benefits	34.9
Deduction for Charitable Contributions[b]	31.9
Exclusion of Benefits Provided by "Cafeteria" Plans[c]	30.6
Exclusion of Investment Income on Life Insurance and Annuity Contracts	26.1
Exclusion of Capital Gains on the Sale of Residences	25.2
Exclusion of Social Security and Railroad Retirement Benefits	24.1
Exclusion of Interest on State and Local Bonds	20.1

Source: Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2006-2010*, JCS-2-06 (April 25, 2006).

a. Includes refunded amounts counted as outlays.

b. Includes contributions to health and educational institutions.

c. Cafeteria plans are offered by employers and allow workers to choose what forms of compensation they receive. This estimate includes the tax expenditure for health insurance purchased through cafeteria plans, which is also included in the category for employer-provided health insurance.

diminished tax receipts by $95 billion, and the deduction for mortgage interest lowered federal revenues by $76 billion.[14]

In each of those cases, the reduction in receipts gives the appearance of a reduced impact on the federal budget—indeed, most presentations of the budget omit any mention of tax expenditures. But tax preferences are effectively equivalent to collecting taxes at ordinary rates on the full potential tax base and then subsidizing the preferred behavior through outlays. The reductions are achieved either by excluding some kinds of income from the tax base, allowing deductions for certain activities in arriving at taxable income, applying lower-than-normal tax rates to some kinds of income, or providing credits against tax liability for engaging in certain activities. Because selective tax reductions operate as expenditures for specific economic activities, their effectiveness can and should be evaluated in the same way as is done for spending programs.

Performance Limitations of Current Tax Expenditures

Given the size of many tax expenditures, it is striking that they are subjected to little analysis of their effectiveness in achieving their objectives. Indeed, in many instances, the underlying goal of the tax preference has never been made explicit. Superficially, it might be assumed that part of the purpose of the preference is to provide tax relief. But the burden of taxes could be reduced by having lower tax rates, rather than providing special treatment to certain activities. Tax reductions for specific activities, as opposed to a general reduction in tax rates, also affect the incentives to engage in those activities; therefore, the underlying goal of each preference is presumably to affect outcomes such as home ownership, health insurance coverage, charitable giving, and so on.[15]

In many cases, however, the specific outcome that is desired is unclear or appears to conflict with the objectives of other policies. And in instances in which the goal is both apparent and not in conflict with other policy measures, many existing tax preferences seem to fail to achieve that goal or to be relatively inefficient in

14. As the Joint Committee on Taxation has noted, its estimates for tax expenditures may differ from the impact on federal revenues that would arise if the relevant provisions of tax laws were repealed. Tax expenditure estimates seek to estimate how much revenue is lost given the current level of tax-favored activity—that is, assuming no changes in economic decisions by the affected parties. For example, the estimate of the tax expenditure for excluding from income the costs of employer-provided health insurance assumes that those costs become taxable as income at their current level. If that exclusion was repealed, however, people who had been obtaining such insurance could change the amount they worked or take other steps that affected their taxable income—factors that would be accounted for in a revenue estimate for such a proposal. For a discussion of that issue, see Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2006–2010*, JCS-2-06 (April 25, 2006).

15. Although most preferences tend to complicate taxation, some serve to simplify tax collection, as when some kinds of hard-to-measure income are excluded from the tax base. For example, the exclusion of many forms of noncash income constitutes a type of tax expenditure and generates inefficiencies by favoring such income over cash compensation; at the same time, those exclusions significantly reduce the administrative complexity of the tax code.

achieving it. The following examples seek to illustrate those categories of tax expenditures, although the distinctions between them can be blurry:

- **Tax Expenditures with Objectives That May Conflict with the Objectives of Other Policies.** Various business tax expenditures appear to be in conflict with other spending programs or tax incentives. Some production incentives in the energy sector, for instance, run counter to the intent of other expenditures intended to reduce demand for energy, so the fundamental policy objective for both sets of programs is difficult to discern.

- **Tax Expenditures That May Fail to Achieve Their Objectives.** In a number of instances, the policy goal is clear and not in conflict with other policies—but tax incentives do not appear to yield the desired effect. For example, questions exist about whether tax preferences for certain kinds of savings vehicles, such as individual retirement accounts, have significantly boosted private saving or merely subsidized saving that would have occurred anyway.[16] People's decisions about saving may not be affected much by tax incentives, or ceilings on contributions to such accounts may largely limit the impact of those incentives on total saving. Another example is the deductions for property taxes and mortgage interest. Although those tax expenditures are intended to help lessen the cost of home ownership, evidence suggests that much of their value is reflected in higher prices for homes rather than accruing to home buyers.

- **Tax Expenditures That May Be Inefficient in Achieving Their Objectives.** Even in instances in which tax expenditures are likely to have achieved policy goals, many do so at substantially higher costs than may be necessary. For example, exemptions and deductions are commonly employed for purposes that could often be more efficiently achieved with flat-rate (and potentially refundable) credits, as in the case of employer-provided health insurance. In addition, some tax preferences would simply function better if provided in the form of outlays, such as tax credits for low-income housing.

That final category of tax expenditures warrants further comment. As a result of the progressive structure of the individual income tax, preferences in the form of exemptions or deductions increase in value as income rises—because higher taxable income places households into higher marginal tax brackets. An income tax deduction of $1, for example, is worth 35 cents to a taxpayer in the 35 percent marginal tax bracket and 15 cents to a taxpayer in the 15 percent bracket. The consequence is that the subsidy rate provided through the tax code for that type of preference also tends to rise with income. Yet unless taxpayers' reaction to the

16. See William G. Gale and John Karl Scholz, "IRAs and Household Saving," *American Economic Review*, vol. 84, no. 5 (December 1994), pp. 1233–1260. For a more favorable perspective on the effects of retirement tax incentives, see James M. Poterba, Steven F. Venti, and David A. Wise, "How Retirement Programs Increase Savings," *Journal of Economic Perspectives*, vol. 10, no. 4 (1996), pp. 91–112.

Table 2.

The Distribution of Selected Individual Tax Expenditures, by Income Class, 2005

Income Class (Dollars)	Deductions (Millions of dollars) Home Mortgage Interest	Charitable Contributions	State and Local Income, Sales, and Personal Property Taxes
Less Than 10,000	4	*	1
10,000 to 20,000	83	29	25
20,000 to 30,000	426	165	141
30,000 to 40,000	982	410	378
40,000 to 50,000	1,914	711	777
50,000 to 75,000	7,545	3,000	3,300
75,000 to 100,000	8,587	3,462	4,081
100,000 to 200,000	25,081	10,301	13,387
200,000 or More	17,475	17,851	17,881
Total	**62,097**	**35,930**	**39,969**

Source: Joint Committee on Taxation.

Notes: * = less than $500,000.

Numbers may not add up to totals because of rounding.

preference or the social benefit of that response varies systematically according to taxpayers' income, providing differential subsidy rates is inefficient.[17]

Those efficiency considerations are related to, but distinct from, concerns about the distribution of various tax expenditures. An analysis by the Joint Committee of Taxation shows that the benefits of several common high-value tax expenditures accrue primarily to higher-income taxpayers (see Table 2). Part of the reason is that those taxpayers have greater tax liability in the first place. They also tend to engage in more of the subsidized behavior. The distributional pattern, though, results in part from the progressive nature of the tax code and, therefore, the higher subsidy rates provided through deductions and exclusions to higher-income taxpayers than to lower-income taxpayers (which in turn may influence the pattern of subsidized behavior).

Tax Credits and Economic Efficiency

Empirical evidence demonstrating that high-income households are particularly responsive to tax incentives—or that their responses generate disproportionate social benefits—is lacking in most cases, raising questions about the efficiency of providing differential subsidy rates through the tax code. In the absence of such

17. See Lily L. Batchelder, Fred T. Goldberg Jr., and Peter R. Orszag, "Efficiency and Tax Incentives: The Case for Refundable Tax Credits," *Stanford Law Review*, vol. 59, no. 1 (October 2006), pp. 23–76.

evidence, the most economically efficient approach to subsidizing an activity through the tax code generally involves flat-rate credits available to all households.

As an example, consider the current exclusion for contributions to 401(k) plans (a vehicle for retirement savings offered through employers). The value of that exclusion rises with taxable income because of the link to marginal tax rates. By contrast, a 15 percent or 25 percent credit for 401(k) contributions would have the same marginal value for all taxpayers. If the credits were refundable, they would provide the same subsidy rate to all tax filers. Unless evidence exists that households in different marginal tax brackets are more likely to increase their saving in response to the tax incentive, or to generate larger benefits to society if they did increase their saving, such a flat tax incentive would generally be the most efficient approach to subsidizing retirement saving.

The exemption of income from state and local bonds provides another example. The exemption delivers different marginal benefits to different taxpayers depending on their income bracket. As a result, the subsidy that the exemption delivers to state and local governments is less than the value of revenues lost to the federal government. Less costly means of delivering the same subsidy could be to change the structure of the current tax expenditure from tax-exempt bonds to a variation on tax-credit bonds (discussed further, below) or to provide direct intergovernmental transfers.[18]

Perhaps the most prominent example of a tax expenditure that appears to be inefficient is the exclusion for employer-provided health insurance—which allows that form of compensation to avoid both income and payroll taxes. For a typical worker, those tax preferences amount to a subsidy from the government of more than 30 percent of the costs of health care services that are covered by employer-sponsored insurance. By reducing the price of that insurance, the tax subsidy encourages workers to purchase coverage through their employer and to secure more-extensive policies, increasing the share of costs that is covered and decreasing the share that is paid out of pocket. In turn, that more-extensive coverage puts upward pressure on total spending on health care. Moreover, the value of the exclusion is larger for households with higher income.

The potential effects of redesigning the current exclusion for employer-sponsored health insurance are illustrated by the President's recent proposal to replace that exclusion (as well as most current tax deductions for health insurance premiums and out-of-pocket costs) with a new standard deduction of $15,000 for couples who file joint tax returns and $7,500 for single filers. Under that proposal, all taxpayers not enrolled in Medicare who purchased qualifying insurance would be eligible for the deduction, and its value would not vary with the costs of the policy

18. See the statement of Donald B. Marron, Acting Director, Congressional Budget Office, *Economic Issues in the Use of Tax-Preferred Bond Financing*, before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means, March 16, 2006.

that was purchased. According to the Congressional Budget Office's (CBO's) estimates, by 2010 the number of people without health insurance would be about 6.8 million lower under the proposal than under current law. In addition, the fixed deduction would cause people to buy plans with less extensive benefits, on average; as a result, benefits for insured workers would decline by roughly 15 percent in 2010. At the same time, the Joint Committee on Taxation has estimated, the proposal would increase federal revenues by more than $300 billion over 10 years.[19]

Compared with people who would be uninsured in 2010 under current law, those gaining insurance coverage under the President's proposal would have higher income and be in relatively good health, on average. The reason is that the value of the new deduction would be greater at higher marginal tax rates, which are associated with higher income, whereas insurance premiums would be lower for people in better health; thus, the net cost of buying health insurance would be lowest for that group. Even so, the majority of newly insured people would come from lower-middle- and middle-income households, mostly because the uninsured population as a group has relatively low income. At the same time, the estimate of the net reduction in the number of uninsured individuals masks a number of offsetting shifts in coverage; overall, about 8.3 million people would newly gain coverage, CBO estimates, but about 1.5 million people would lose employment-based coverage and would end up uninsured. Those individuals are somewhat more likely to have lower income, as the tax deduction would be moderately less valuable to lower-income households and thus would offset a smaller share of their policy premiums.

As with other tax expenditures, a key issue in assessing the current tax expenditure for health insurance and the options for replacing or redesigning it is whether the responses of households to subsidies or the benefits of insurance coverage vary in proportion to income. Although households with higher income are more likely to have insurance coverage, it is not clear that those households are more responsive to subsidies than are lower-income households; rather, that pattern may simply reflect the larger subsidies provided to higher-income households. Nor do the social benefits of health insurance coverage appear to increase with income. Because most people who currently lack insurance have relatively low income—below 200 percent of the federal poverty level—some observers have argued that

19. For an analysis of the President's proposal to create a standard tax deduction for health insurance, see Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2008* (March 2007), pp. 57–62; for a more extensive and up-to-date description of the revenue estimate, see Joint Committee on Taxation, *Estimating the Revenue Effects of the Administration's Fiscal Year 2008 Proposal Providing a Standard Deduction for Health Insurance: Modeling and Assumptions*, JCX-17-07 (March 20, 2007). It is important to note that because the proposal represents a significant departure from the current tax treatment of health insurance, its estimated effects on coverage are highly uncertain. The Treasury Department estimated a smaller impact on the uninsured population—a net reduction of between 3 million and 5 million—but also estimated a much smaller effect on federal revenues. See Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2008 Revenue Proposals* (February 2007).

reforms of the current exclusion would reduce the number of uninsured by a larger degree if structured as refundable credits.

Other Options for Restructuring Tax Expenditures

Other tax expenditures have not exploited the possibilities afforded by the use of floors and ceilings to increase their "bang for the buck" and limit the degree to which they subsidize activity that would have occurred anyway. For example, a floor of 1 percent or 2 percent of adjusted gross income for deductible charitable contributions would reduce the incentive to make additional contributions by only a negligible amount while substantially reducing the loss of revenues associated with the tax expenditure. By virtue of the fact that income calculations are fundamental to the tax system, that structure lends itself readily to floors and ceilings—whereas such an approach applied to regular expenditures would significantly complicate administration.

Some tax expenditures are inefficient by virtue of being part of the tax system—and thus might be more efficient if converted to regular outlays. The low-income housing credit and tax-credit bonds may provide examples. Because they are subject to ceilings, they do not administer themselves automatically, and a separate institutional mechanism must be set up to allocate them. Incorporating them into the tax code thus appears to generate little benefit in terms of efficiency or administrative simplicity. Moreover, the apparent purpose of the housing credits is to make housing more affordable for low-income people—but the credits go to developers, who are more likely to have tax liability. Similarly, tax-credit bonds are intended to aid local governments, but the credits go to bondholders because local governments do not pay federal taxes. Because the tax benefits have only an indirect effect on the activity that policymakers are trying to encourage, those credits are probably a more costly way to provide support than simply spending the money as outlays.

To be sure, some expenditures undertaken through the tax system may be more efficient than ones delivered directly. In particular, the tax return can be a relatively efficient mechanism for administering programs whose eligibility depends on income because income must be computed for tax purposes. For example, the earned income tax credit is an income assistance program that could be structured as outlays, but building it into the tax code probably enhances its effectiveness significantly while reducing its administrative cost.[20] But as the foregoing examples suggest, many tax expenditures do not appear to have been evaluated sufficiently for cost-effectiveness. Consequently, the considerations of performance budgeting could be usefully applied to assessing them, both in terms of the connection between expenditures and outcomes and in terms of the efficiency of tax expenditures and outlays.

20. The earned income tax credit is a refundable credit that may exceed the amount that an individual owes in income and payroll taxes—in which case the refundable amounts involved are scored as outlays.

Conclusion

To sum up, the growth of health care spending is the central long-term fiscal challenge facing the nation, and existing tax expenditures entail a substantial reduction in the nation's tax base. In both cases, federal policy might be improved by applying principles of performance budgeting—gauging whether the benefits derived warrant the resources provided. Typically, performance budgeting has been applied to discretionary programs, where it has had a checkered history at best.[21] But lessons drawn from those efforts might be applied to a more systematic assessment of mandatory spending and tax expenditures.

21. For an analysis of the reports created by federal agencies under the Government Performance and Results Act of 1993—and of their utility in assessing agencies' performance and informing the budget process—see Congressional Budget Office, *Budget Options* (February 2001), Appendix A.

Chairman SPRATT. Let me put the question to all three on our panel. Is there some better systematic way that you can gain congressional review? Is part of the problem here overkill?

For example, Director Johnson, if your information largely comes from PART and from GPRA, and it comes with the budget—$2.8 trillion budget—it gets buried in a lot of budget detail. Do you think it would serve the interest of greater scrutiny if the information were prepared in some different form so it came to us in what was more discernible, easier to find, or otherwise it is scattered throughout your entire budget?

Mr. JOHNSON. Yes, sir, I do. Every subcommittee is different. For instance, the TUB committee's budget and appropriations that deal with the Education Department welcome a lot of performance information. It is really the model for all of the other agencies. And yet there are other subcommittees that state in writing that they don't want to be confused by my words, all this performance information. So it is not a universal acceptance or rejection. It varies by committee, which causes to us think we have an education challenge before us to explain to every subcommittee how this information can help them do a better job of budgeting or appropriating.

And every year when we talk about how to put our budget together, we talk about how to present this, how to focus on desired outcomes. The goal is not to spend $2.X billion. It is to accomplish, A, B, C, D. By the way, the cost to accomplish that is whatever it is. That ought to be the mindset, in our opinion. And our budgets, in our opinion, ought to be laid out to encourage that kind of thinking. But some committees—some subcommittees welcome that approach, are comfortable with that approach and others are not.

Chairman SPRATT. Are you familiar with the Selected Acquisition Report in the Department of Defense?

Mr. JOHNSON. No, sir, I am not.

Chairman SPRATT. Do you have any experience with—I am sure you have had—accounting variation reporting systems whereby you establish a baseline for costs, schedule, and performance and then measure against that over time?

Mr. JOHNSON. Well, that is the kind of rigor and approach that I—that is what I spend all of my time doing, is trying to create that sort of mindset and approach throughout the Federal Government.

Chairman SPRATT. Let me suggest that you take a look at the SAR, Selected Acquisition Report, created in about 1970. And somebody added the phrase—I think it was General Walker—if you want it to be useful, it has got to be used. It is a classic example of something that hasn't been intensively used, and therefore it has not become any more useful than it was, very much so, when it was first introduced.

Mr. JOHNSON. Let me make one comment on that. I have every spring for the first 4 years that I was in this job, gone out and did focus groups with career managers and talked about goals and having performance information and outcome goals and so forth. And what they told me every year, no matter who I talked to, we have always had some description of what our goal is. And sometimes it has been quantifiable, sometimes it has been general, sometimes it has been outcome, sometimes it has been output. But we have never, ever been held accountable for achieving them. So that is this—is it useful versus used, their comment to me is that this information has never been used to drive performance.

Chairman SPRATT. One of the recommendations made a long time ago—in fact, I wrote an article in General Walker's quarterly about it—is that somehow or another for weapon systems in the Pentagon,—there are about 40, I think, or about 50 that track with the SAR. The principals here and at DOD need to sit down early in the life of a program when it is about to take off and go into engineering development and establish the baselines that are pertinent to that particular system, things that you recognize the vulnerabilities that need to be watched, so that you don't have one template that applies to 40 different systems that are very different and diverse.

It would seem to me that on major programs you could have the same sort of attitude, that you would sit down with the committee and you would agree that we are going to watch these things, we are going to give you a periodic report on this. If there is going to be cost growth, it could happen here, watch it early. We don't have any of that kind of interactive activity at all.

Mr. JOHNSON. There is information, not of the sort you want, but what you just described is a great goal to shoot at. There is information now—every program—the evaluation of every program—overall evaluation and then the recent performance of that program relative to its goals for all 1,000-plus programs; $2.8 trillion is very public on expectmore.gov, the Web site.

What you are talking about is regular reports; here is where we are running behind schedule, ahead of schedule, whatever, and here is what we are doing to get back on track.

Chairman SPRATT. We would call this performance budgeting, but part of it is just reporting anomalies that will require further investigation should be called to our attention, like Dr. Orszag is pointing to the fact that a coronary bypass has a fourfold variation around the country. There needs to be an explanation of that, or the variation of Medicare expenditure per capita ranges from 4,500 to 11- or $12,000 per person. That is maybe not really performance, but it is the sort of thing where the executive agency says to the Congress, you should use your oversight and investigative powers to look into something like that.

Mr. JOHNSON. Right. We would welcome developing that and figuring out how to interact with Congress to provide exception reporting, or as you say, anomalies, to help you all better focus on how these programs are performing.

Chairman SPRATT. General Walker.

Mr. WALKER. Mr. Chairman, in addition to what you are talking about, I would like to raise it up a level that I think we need to focus on and I know you are interested in. The Federal Government spends $2.7 trillion a year. It issues thousands of pages of regulations a year. It forgoes revenues of $800 to $900 billion a year in tax preferences. And for the most part, it has no idea whether those programs, policies, and regulations are achieving the desired outcomes or not.

And one of the things that has to happen, I believe, is the Congress, which has the constitutional responsibility for appropriations and which has this budget process which this committee is responsible for, we need to get back to basics and we need to say what type of outcomes are we trying to achieve as a Nation when legislation is authorized, reauthorized, when the budget process is gone through, when the appropriators allocate funds and when the oversight committees end up conducting their oversight operations.

And that brings me back to the need for a set of key national outcome-based indicators: economics, safety, security, social, environmental. Thirty-eight percent of the budget last year, as you know, was discretionary. Sixty-two percent was on auto pilot. That has got to be on the radar screen. We have got to analyze that too. Furthermore, none of that counts tax expenditures. That has got to be on the radar screen too. We haven't done the basics. We haven't stepped back and said what are we trying to accomplish; are we doing that? And as a result, what the Federal budget is today in the government, it is an amalgamation of programs, policies, functions and activities from decades, many of which may be outdated, many of which may not be working. And given our challenges for the 21st century, we really need to focus at that level as well as making sure that we have, as you are saying, we are using the stuff that is being done now, we have a consistent approach and hopefully a streamlined and more results-oriented approach to the current processes that are here now.

Chairman SPRATT. Dr. Orszag?

Mr. ORSZAG. Again, I think an aggregate perspective is important. But if there were a single thing that policymakers could do to improve from a performance basis what we are getting today and in the future, it would be examining what we are getting in return for our health care expenditures, including the variation that you noted, both in Medicare and Medicaid. And since so much of the growth in the future is going to come from increased expenditures in that area, if there were just one thing to do it, it would be to make sure that we were getting value out of those dollars. And that would be a substantial improvement relative to where we are today.

Chairman SPRATT. Thank you all very much.

We have just had an ominous bell go off on a motion to adjourn. So that is not a good sign.

But I am going to turn to Mr. Ryan, and let us make up as much as we can before we have to run over and vote and come back. Thank you, Mr. Ryan.

Mr. RYAN. Thanks, Mr. Chairman. I will try to be fairly quick because we have 13 minutes left.

Let me say for the record, I bristle at the notion or the term "tax expenditure." it kind of more or less assumes that this is the government's money unless we benevolently expend it back to people.

Be that as it may, let us focus on the health one. And if we are going to spend our time talking about this Nation's fiscal challenges, we probably should spend three-fourths of our time talking about health care.

And so what I want to ask from you—and I know Dr. Orszag and General Walker, you spent a lot of time on this—what do you think we can do to address the root cause of health inflation, number one?

Number two, does the health exclusion, that tax expenditure contribute to the problem of health inflation and is it really the primary reason which created the third-party payment system in the first place? Which I would argue is largely the biggest contributor towards health inflation.

And then I have a question about TRIA. And if there is time, I wanted to ask you, Director Johnson, about how does the PART program interact with the appropriations process? Do you come and talk to the appropriators and bring them through these things work or aren't working, and is there a connection between how we appropriate and the analysis you are doing? So let me stick with that. And then a quick TRIA question if I have time.

Mr. WALKER. That is a lot. First let me say with regard to the tax preference, I think it is part of the problem. The fact that we spend almost—the fact that we forego revenues—and by the way, tax expenditure is the Treasury's term. That is a generally accepted term, not mine. The fact that we forego almost $200 billion a year in tax preferences in the health care area, I think is part of the problem because it desensitizes people to the true cost of health care. They don't see it on their tax return, they don't see it on their W-2. It is the fastest growing part of compensation expense. It is a huge competitiveness problem for American businesses as well as a fiscal problem for the Federal Government.

So, yes, I think it is part of the problem. Secondly, I think part of the answer is better targeting of tax preferences and better targeting of government subsidies in the area of Medicare, et cetera. It is one thing to be eligible for a program or a preference. It is another to differentiate based upon your income and your ability.

Thirdly, we need national evidence-based practice standards in health care to reduce costs, to improve consistency, to enhance quality and to dramatically reduce litigation risk. And the Federal Government ought to pave the way through the programs that it has direct responsibility for. We have VA health care. We have health care that deals with civilian and military employees. We have an ability to pave the way and to lead by example there, and that is critically important.

Mr. RYAN. Dr. Orszag, at the end of your answer, if you could comment on the contributing factor to the tax expenditure and health care. We just passed a bill yesterday on TRIA, the Terrorism Risk Insurance, which I think you scored at $8.4 billion, but it left the floor with quote-unquote no score circumventing the PAYGO process. If you can comment on whether that is going to cost the Treasury money or not, I would appreciate that as well.

Mr. ORSZAG. Okay. Why don't I start with that? Insurance costs money because it provides some value to the insured households and businesses, even in the event that the thing you are insuring against doesn't occur. So when you insure your house against a fire, there is some value that is being provided and some expected cost of the insurance company, even if your house doesn't burn down.

And in the context of terrorism reinsurance, we all would hope and pray that—that probability of an attack is very low, but there is unfortunately, some probability, which is why firms want this insurance. And that was the basis of our score. It was consistent with what we had done in the past. I have seen some reports that people were surprised by our score, but it was fully in line with previous analysis that CBO has done. The amendment that was adopted reduced the score to zero by removing the certainty that is essential or integral to the provision of insurance, because the insurance will trigger on only if there is a future active Congress. And under our scoring, we don't evaluate future legislative action. So it was scored at zero, as amended.

With regard to the employer-provided tax expenditure, tax preference for health care, there is wide agreement among economists that that is a relatively inefficient approach to providing a subsidy through the Tax Code for health insurance. It creates a bias for employer-provided health care as opposed to individual. It creates a bias for gold-plated health care relative to less generous health care plans and creates a variety of other distortions. I think the challenge in thinking about options to reform or replace it is that employers are the central pooling mechanism that we have in the United States for health care. And so if you tinker or change the tax preference for employer-provided health insurance, what replaces it so that we are not all in an individual market, which doesn't work well in the health sector?

Mr. RYAN. Director Johnson, The PART in the appropriations process, how do we better connect the two?

Mr. JOHNSON. There is currently—I forget the exact correlation. I think you all ran a correlation of programs that are PARTed on a low score and what happens to their budget; does it go down? And there is a positive correlation. There is attention being paid whether programs work or not. More attention is paid in some committees than others, but there is a positive correlation. Every year we send up——

Mr. RYAN. In the administration's budget?

Mr. JOHNSON. Pardon me.

Mr. RYAN. In the administration's budget.

Mr. JOHNSON. It is not only in the budget, but money that is actually appropriated. It is not only what goes on in our budget, but it is not true that every ineffective or results-not-demonstrated program is recommended for a big reduction. Sometimes it is such a priority, we need to work to make it fix, and we need to fund it in the meantime. In some cases, we need more money to allow them to measure the quality in our parks and so forth and so on. So nothing automatic happens because of the current performance of a program. Nor should it.

So there is information that—we will send up like—several years ago it was 50, and last year it was 140 programs that we recommend for zeroing out or significant reductions. Usually a third, 40 percent, 25 percent of those are because of the way they PARTed. There are other reasons for the majority of those programs, why they were recommended for a big reduction. They are duplicative; they work, but they are duplicative, or it is not a priority or we can't afford it anymore or whatever. There is a variety of reasons. Performance is not the only reason, honestly, to drive your all's budgeting thinking or appropriations thinking.

But right now, performance is being looked at. And it can be looked at more and it can be looked at more consistently across all subcommittees. But most importantly, we can do a better job using this information to drive performance within the executive branch, which David talks about, within the discretionary programs; and then in the future, in the nondiscretionary programs.

Mr. RYAN. Thank you. I see we probably have time for somebody else to ask something.

Chairman SPRATT. We are down to 6 minutes. Okay, good. If you will bear with us, we will run and vote. We have got 6 minutes for this vote and then the two 5-minute votes following it. So we should be back in about 15 minutes, barring some antics on the floor. The committee stands in recess.

[Recess.]

Chairman SPRATT. Call the committee back to order and now recognize Mr. Edwards of Texas for 5 minutes.

Mr. EDWARDS. Thank you, Mr. Chairman. Mr. Chairman, thank you for holding this hearing. I think while there are sometimes partisan differences on this Budget Committee regarding what the priorities and responsibilities of the Federal Government ought to be, one issue in principle that ought to bring us all together is the idea that when we are spending taxpayers' dollars for programs, we should work together to see that those dollars are being spent effectively, efficiently, with clear goals in mind. And I think I can say as a Democrat to my Democratic colleagues, I think in years past sometimes we have tended to pass a bill based on—or funding based on a good intention, but good intentions aren't good enough when it comes to spending taxpayers' dollars. And we who believe in government ought to be the first in line to say we are going to be very tough on ensuring that programs are accomplishing their goals, because if they aren't, ultimately taxpayers will lose their credibility in the programs themselves.

So I salute you, Mr. Chairman, for holding this important hearing. I thank all of the witnesses for your input and your leadership in this area as well.

In that spirit, Mr. Johnson, let me say one reason I took a few more minutes to come back from our votes is I went downstairs from the House floor to talk to the subcommittee staff that I work with from my vantage point as Chairman this year of the Military Construction and Appropriations Subcommittee. And I asked if they had ever, in this year or in previous years, had ever met with OMB staff to review the analysis that your agency has carried out regarding the effectiveness of military construction and VA programs. And their answer was, no, not this year, and not in their memory.

So whether that is my subcommittee's fault or OMB's doesn't really matter. But let me just say, in the spirit of my opening comments, I would welcome your staff meeting with me or my staff as we start to go to conference on the MILCON-VA bill and look at what we can glean from that analysis.

And an example, the kind of question that is so basic to me that still can't get answered very well, is the VA health care system generally a good bang for the buck? My general belief is yes, it is. It is an outstanding system. And the conventional wisdom is that we provide quality care for fewer dollars than the private and nonprofit and for-profit health care system. But I am not sure I could quantify that judgment.

So by the same token, I was very involved in the new public-private partnership program we have had in military housing. And I think generally it has been accepted by the departments of the agencies within the Department of Defense as an outstanding program. But I haven't seen any kind of economic analysis to compare that to the old system. So I, for one, who at least chairs one appropriations subcommittee, would welcome more interaction between us on this.

Mr. JOHNSON. I will make sure that happens, sir.

Mr. EDWARDS. Thank you.

I would—Mr. Walker had brought up, Mr. Johnson, the issue of analyzing tax preferences. Whether we call them tax expenditures legally or tax preferences doesn't bother me one way or the other, but let us call them tax preferences out of respect for others. The fact is that GAO has put out a report saying that they do represent a huge loss of revenues based on preferences that some companies, some groups of individuals, some industries get compared to others. It also says that OMB has only rarely used the performance-based analysis on tax preferences. Could you tell me what the administration's official position is on that issue? And should we expand performance-based analysis to the effectiveness and efficiency and the clarity of goals of tax preferences?

Mr. JOHNSON. I know it was the administration's official position to develop the PART to analyze programs, both discretionary and nondiscretionary programs. And so the feeling about using something—using it or something like it to evaluate tax programs, it was not no, but not yet. That is still our position. And unofficially it sounds like it is something we ought to do, and we ought to review the mechanism, or decide that that mechanism—the PART mechanism or some version of the PART mechanism, and figure out what we want to do.

But our position has never been that we didn't want to do it; it was just not yet. We wanted to focus on how programs worked, because we wanted to use that then as the basis for driving performance management, people management within programs, and cause the Federal Government to become more purposeful about the way they spend the money.

Mr. EDWARDS. Right. Okay. Thank you. I see my time is up, so I will withhold my additional question. Thank you, Mr. Johnson.

Thank you, Mr. Chairman.

Chairman SPRATT. Thank you, Mr. Edwards.

Mr. Doggett is not here.

Mr. Scott of Virginia.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. Walker, you indicated that—I think implied that tax expenditures were hidden in the budget process. Doesn't PAYGO expose these expenditures, at least the prospectively, if we try to pass them in the past, in the future?

Mr. WALKER. My understanding is there is some prospective application, but not ones that already exist, if you will. They are in the base. And that is what I am talking about.

Mr. SCOTT. Okay. And when we were talking about performance measures, is that a Budget Committee function, or is it a suggestion that authorizing committees on reauthorization should consider, should be proactive in ascertaining whether or not the programs have been performing, and then kind of report to the Budget Committee or to the Appropriations Committee?

Mr. WALKER. I believe that the country would benefit and the Congress would benefit for having a set of key outcome-based indicators for budgeting, authorization, reauthorization, appropriations, and oversight purposes. When you are considering legislation to begin with, one of the basic questions ought to be what are you trying to accomplish, and how are you going to end up measuring whether or not it is making a difference? And so I think it crosses all those different constitutional responsibilities.

Mr. SCOTT. I serve as Chair of the Crime Subcommittee. What kind of performance budgeting policies would you suggest for budgeting in the area of crime policy?

Mr. WALKER. Crime rates, the nature of violent crime. I mean, there are issues that relate to actual outcomes. What are we doing, you know? Those would be a couple of examples in that area.

Let me give you a couple other examples that are outside that area: math proficiency, science proficiency, life expectancy at birth, infant mortality, household savings rates. There are a number of things that right now, quite frankly, we are measuring, and many other countries are measuring, but we are not using it for purposes of informing our decisions on spending programs, tax policies, and regulatory actions.

Mr. SCOTT. And if the expenditure on a crime policy issue did not lead to a reduction in crime, reduction in violence, then we ought to reconsider making that expenditure?

Mr. WALKER. Right. You need to have more evidence in order to be able to make informed decisions about which programs and policies are working and which aren't, how to redirect limited resources and authorities to achieve the maximum impact.

Mr. SCOTT. This is hard to understand, because most crime policy is slogan generated; that is, you come up with a good slogan and you codify it, and it helps politicians get elected. What you are suggesting is we ought to use our common sense and actually reduce crime. How does that help us get reelected?

Mr. WALKER. My objective, Mr. Scott, is to help the Congress help the country, help the American people.

Mr. SCOTT. Could you say a word about—a lot of the testimony is on health care, and it seems to me if you don't have employer-based health care, there would be no incentive—with the tax benefit—there would be no incentive for the employers to actually provide the health care.

Mr. WALKER. I will let Mr. Orszag——

Mr. SCOTT. We are trying to get more people insured. What would happen if we did not have this tax expenditure?

Mr. WALKER. Let me answer that and then go to Mr. Orszag.

First, I don't know that Mr. Orszag is talking about eliminating any tax preference. From my standpoint, I think you have to recognize that there are a variety of forces that cause employers to offer health care, not just the tax preferences.

Mr. SCOTT. If you don't have the tax preference, that is the rationale.

Mr. WALKER. No, no. Well, the number one benefit of preference by employees—and I used to practice as the worldwide head of a human capital consulting firm before I had this job—the number one employee benefit of preference for employees is health care. Number two is health care. Number three is health care. So the market says employees want health care as part of their basic compensation package. The tax incentives are icing on the cake, but they are by no means going to reduce the demand or desire of employees for health care.

And I will let Mr. Orszag——

Mr. ORSZAG. Yeah, Mr. Scott, if I could just add, clearly the current tax preference provides one incentive for employers to offer health care. But in analyzing proposals like the administration's proposal to transform the current tax preference into something else, we had to struggle with what other things, what other aspects of the employer-provided package would still persist? And our estimate suggests there would be a reduction in employer-provided coverage, but it would still be the bulk of coverage. And the reason is administrative cost savings from large employers being able to pool people together, and the pooling mechanism through employers. So unless you specifically——

Mr. SCOTT. That you get a group rate.

Mr. ORSZAG. You get a group rate, and you get administrative cost savings because it is not just a group rate by pooling people together, but you are doing it in an employment setting, where it is easier to sign people up, and the back office kind of steps are also easier.

Mr. SCOTT. Thank you, Mr. Chairman.

Chairman SPRATT. Thank you, Mr. Scott.

Mr. Boyd of Florida?

Mr. BOYD. Thank you, Mr. Chairman.

Mr. Chairman, I am very pleased that you have decided to take on this issue in this hearing. And also it is very obvious that these three panelists have a good grasp of the principles that would be required to take on this monumental task.

When I was in the Florida Legislature in 1994, I chaired a committee that wrote a piece of legislation called performance-based budgeting. That ultimately came into law, was signed by then Governor Lawton Chiles, and now we have 13 or so years of history of performance-based budgeting in Florida. And that has been hailed by some, including the National Conference of State Legislatures, as one of the premiere performance-based reporting and budgeting laws and States in the country.

I would ask those of you on the panel, are you familiar with this, and have you studied it, and is that or some other similar system one that we can use as a model? Because this is not going to be easy.

Mr. JOHNSON. There was a hearing 2 years ago, I think, and Mike Conaway and Congressman Cuellar were on the panel with me, and Congressman Cuellar was talking about the performance-based budgeting in Texas. I am sure it wasn't as good as it was in Florida, but maybe it was close. And a lot of the things that he pointed out were being done in Texas he was recommending be done here, that they have this kind of information and that kind of information. And the thing that came out of that hearing was actually the kind of information he is calling for exists, it is this performance information, but it is not used, which is—we haven't done a good job of communicating it, and maybe the interest level here, or piquing the interest, tweaking the interest level up here.

As you make this comment, I was writing down we need to look at, in our world, all the examples of performance-based budgeting in the States, and what are the lessons learned? How do different States use the information to make smarter budget decisions, appropriations decisions? And are there any suggestions about what we might be doing differently at OMB or in the executive branch, or what this committee or the appropriators might be doing differently? I bet that we haven't studied that to see if there are any lessons learned as much as we should have.

Mr. BOYD. Before we go to the other panelists to answer that question, I might add we went all over the country studying other governmental entities—Texas was one of them—but we found lots of our good work or good examples of good systems in cities, municipalities, and counties.

So, Mr. Walker?

Mr. WALKER. Mr. Boyd, I am somewhat familiar with that. As you know, I am a Florida CPA and lived in Florida a number of years. I know that Florida was an early adopter of performance-based budgeting. I know you had something to do with that. I know GAO did some work in the mid-1990s which included looking at a number of performance-based uses at State level, and Florida was a leader at that time. We haven't done work on it in recent years, and, quite frankly, we would entertain a request from this committee to take a look at what is the state of performance-based budgeting should you desire us to do that, because I think it clearly is meritorious.

Mr. ORSZAG. The only thing I would add is my understanding, for whatever it is worth, is that at the State level performance-based budgeting has not been widely applied to two of the areas that we were discussing here, in particular, for example, State Medicaid programs and exactly what they are accomplishing or not, and similarly SCHIP, and also tax expenditures. So they are very useful for the areas that they are applied to, but, at least from a Federal budget perspective, there are big pieces that are not as analyzed.

Mr. BOYD. It is obvious—well, I can tell you from having been through this exercise at a lower level of government that you have to—it is not about just having information, it is about creating a framework or a structure in which you use that information with definable and measurable principles or principles of measurement, performance, duplication, waste, fraud, and—all of those things come into play. But you have to have a structure which tells the bureaucracy of a government that this is the way we are going to do it, and that structure has to be in law. Obviously, that bureaucracy is a very, very difficult one to break through here in Washington, D.C. Are you folks optimistic that we could do that if Congress and the administration put our heads to it?

Mr. JOHNSON. I am confident, primarily because we are getting agencies to do this, to focus on results by holding them accountable for it. What we have found is—and it would be even stronger, it would be even more compelling if there were some congressional reasons for doing it, if some of this was in statute. We have found that when you sit around with agency leadership and say, here is what we want to do, here is how we want to run the railroad, don't you agree; you have goals and you have performance, you report on it quarterly or every 6 months or whatever, and you have corrective action plans and performance action plans, we want to make this very public, don't you agree this is a good idea? And they will say, well, yes, but let us do it this way. Then we say, here is the way we are going to run the railroad, and then every quarter let us assess who is doing what they said they were going to do, and when are we getting to the point where it is a desired level of performance management?

We do that. There is no law that says this will happen, but it is the President, starting with the President on down, that says, this is the way we are going to do it. And so you can say, well, then what if another President came in and it wasn't a priority, would you lose it? Maybe. But my sense is that the people in the agencies understand this is good for the agencies. This is something that by and large it will make HUD work better. It will make Interior work better. And so it will make it a better place to work, a better place to be a public servant. And so the employees get it. This is not something that is bad for them. But they want to be trained how to do it. They want to have the money to be able to do it. They want to have the time to be able to do it.

And so I think we have—what we need to do is figure out how to help agencies do it even more successfully going forward. It exists in the executive branch now. It is not locked in. It is not—doesn't permeate their entire being, but it is something they get, it is something they are doing because we are holding them accountable for doing it.

Mr. BOYD. Mr. Chairman, I know my time has run out. Are we going to have a second round so that we may continue with——

Chairman SPRATT. Go ahead, Mr. Boyd, if you would like.

Mr. BOYD. Okay. I would ask the other panelists to respond.

Mr. WALKER. First, Mr. Boyd, you already have one law that is called the Government Performance and Results Act. And as I noted in my testimony, we need full implementation of that law. We don't believe the executive branch has fully implemented the governmentwide performance plan. We think they need to do more on the horizontal dimension, and they also need to consider tax preferences, as I have noted.

Secondly, we have also recommended in my testimony that the Congress ought to consider a congressional performance resolution. And this committee obviously could take the lead.

I think this committee could also take the lead on looking at the concept of key national indicators. And I think that is something that, quite frankly, is meritorious of moving forward with a public-private partnership to take that concept and make it a reality, as other countries have. We have done some work on that. We are happy to do more work on that.

I also think that this committee could also think about doing something similar to what the Senate Budget Committee did back early in my tenure, and that is to form some task forces on health care, key national indicators, selected issues that you may have an interest in to see what might be a proper way forward not just for this committee, but for the Congress. And we would be happy to work with you on that.

So first we have got to fully implement the existing laws, then we need to figure out what else can be done administratively. And

I come back to what I said earlier: Even if the information exists, it has got to be used. There is information that exists right now that is not being used. And that is a cultural issue; it is not a legislative issue. It is the fact that people aren't used to it, they are not being held accountable for it, and therefore why bother?

Mr. ORSZAG. If I could just tunnel in on one area, in addition to the comments that have already been made. With regard, for example, to Medicare, there would be statutory changes that would be required in order to significantly expand the information base that we have, which is currently lacking. We simply do not have enough information on what works and what doesn't, what is causing the variation in Medicare spending, what type of spending is worth it and what is not, what works better, what works not so well. And for Medicare to then incorporate that information into its payment system so that we would move from a fee-for-service to a fee-for-value, one would require statutory changes also. So in that particular area, as just one example, there are statutory changes that would be necessary to build the information base and then to apply the information.

Mr. JOHNSON. If I may have one more comment, a good bit of GPRA has been implemented. Agencies do a lot of reporting about performance. In my opinion, our opinion, the PART information gives us more consistent, higher quality, outcome-oriented performance information with which to comply with GPRA requirements.

I think most people would agree that little change in performance has come about as a result of GPRA. It is not because—for the programs that we are managing. It is not so much for the mandatory, and we have got nothing going on in the tax whatever you want to call it program. But for the discretionary programs that we pay a lot of attention to and are trying to hold, increasingly so, managers responsible for performing well, little attention is paid to what is reported to Congress about performance. It is not as specific in the GPA format as it can be, and, I think, as it should be, and when it is reported, very little attention is given to it. Very little—there is very little, so what? This program doesn't work. What are you going to do to cause this program to work at an exceptional level versus a marginal level? And this isn't a budget issue so much as at a congressional level, and I think we can even do a better job at the executive branch.

One of the things that has really helped sort of set the groundwork for change in the executive branch is 3 years ago or so, they changed the law that allowed the Senior Executive Service, 8,000 of them, 90 percent of which are career, to be held accountable for the performance—the performance measures—program performance measures in their performance goals. So they are not held accountable for having proper competencies; they are held accountable for the performance of their programs. And their pay increase can be tied to their performance rating.

We could have had this law 3 years ago and not been able to abide by it because we didn't have the performance measures used to evaluate a manager's performance. Now we have performance measures. They are not perfect, never will be, but they are very, very good. We have the data now to increasingly every year hold managers accountable for the performance of their programs. That is where real rubber meets the road is when individual executives in programs and all of their staff are held accountable for how their programs work. That can take place in the executive branch with the help of some legislation, and if we work together to prevent some legislation that would keep that from happening. There are some interests in this town that would like that not to happen, as you can imagine.

Mr. BOYD. Thank you, Mr. Chairman, for your indulgence.

Chairman SPRATT. We will go next to Mr. Cooper and then Mr. Porter of Nevada.

Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman. I can't think of a more important topic than helping taxpayers get more value for their money.

We have excellent witnesses here today. I am disappointed at Member response. This testimony should be required reading for all of our colleagues so that we can get more on top of these issues.

First let me focus on the Medicare discussion that Mr. Orszag was having with Mr. Boyd. I want to commend Peter for beefing up the CBO staff in the health care area, and I think there are some very explosive parts of the testimony for Members who really understand. First the map on page 5, the geographical differences in Medicare reimbursement are stunning. Completely different pay levels for doing exactly the same medical procedure, completely unjustifiable, but yet it has been law for 40-plus years. And we seem to live with those discrepancies.

But my real point is the chart on page 8, which shows the relationship between quality of care and expenditure of money on care. There are a lot of dots on the map. I wish that CBO in the future would put each State's identity on those dots, and also do what I think the Commonwealth Foundation has done, which is to draw a trend line over those dots so that you can see the inverse relationship between money and quality. So, in other words, the more you spend, you don't get more quality; the more you spend, the less quality you get, which is the opposite of what it should be. So I hope CBO wasn't pulling any punches in this case, but an overlay trend line would be helpful for Members so they could see clearly the relationship.

Mr. ORSZAG. I would hope that I am getting known for not pulling punches. So, no, that was not on purpose. We can look into the suggestions that you made for future publications.

Mr. COOPER. Thank you.

I thought the other most explosive element of the testimony was regarding tax expenditures, and here Comptroller Walker excels. Most Members of this body do not realize that the Ways and Means Committee's pocket jurisdiction is larger than the total discretionary spending of every other committee in Congress combined. Now, I am not against the Ways and Means Committee, but that is an amazing side feature of their jurisdiction, to be able to effectively spend $800, $900 billion a year, and that is not even their primary portfolio.

So I would like to ask Mr. Walker what we can do to try to rein in these expenditures in drag, basically, because they are masquerading as something else, and I think to a curious effect. What should we do about this expenditure problem?

Mr. WALKER. First, we need more transparency with regard to these tax preferences and the cost of these tax preferences. We need to have more transparency in the financial statements. We should have more transparency as part of the annual process the budget goes through, you know, maybe the congressional budget resolution that we recommended.

Secondly, we need to also subject them to an outcome-based analysis, and hopefully that the Congress can move forward with this concept of key national indicators through a public-private partnership. Then we should subject not just discretionary spending, but mandatory spending as well as tax preferences to an analysis of whether or not they are making an outcome-based difference.

I think whenever you are passing new legislation and reauthorizing existing policies and programs, you need to determine what you are trying to accomplish on an outcome-based measure. Put it right in the legislation and make sure, therefore, that there is a periodic analysis of that both on the tax side and the spending side that Congress automatically will consider as part of its normal constitutional responsibilities. Tax preferences are largely off the radar screen. You can't manage what you don't measure. You can't hold accountable what there is not adequate transparency for.

Mr. COOPER. I thank the gentleman for his response. This effectively—it seems to me you are saying that as uncontrollable as some entitlement spending is, tax expenditure spending could be even more uncontrollable, because oftentimes we don't even know what it is.

There is a Bush Treasury official, I think her name was Pam Olson, who testified before this committee a couple years ago saying that tax expenditure spending is basically unmeasured and unmeasurable, unverified and unverifiable. That should alarm anyone who is interested in good government. And yet year in, year out we seem to do very little about it.

I see that my time has expired, Mr. Chairman. Thank you for this important hearing.

Chairman SPRATT. Thank you, Mr. Cooper.

Mr. Porter?

Mr. PORTER. Thank you, Mr. Chairman. I appreciate this opportunity today. And we have three of the most talented individuals in Washington. And I say that I do respect, I appreciate your opinion, and have worked closely with you for a number of years, and I appreciate you being here. And we could choose who has talent or not, if you would like. I know, Mr. Walker, you were just in Las Vegas. Did you see O.J. While you were there? Anything we need to know about——

Mr. WALKER. It is amazing, you know. I was in there doing the Fiscal Wakeup Tour the day that O.J. got arrested, and I didn't come across him.

Mr. PORTER. You weren't at the Palace Station, obviously.

Mr. WALKER. Don't know him, haven't seen him, and don't really worry that I haven't.

Mr. PORTER. In all seriousness, we appreciate you being in Nevada. And I understand it was very well received. And thank you for your insights.

And again, thank you, Mr. Chairman.

And I guess I sometimes try to oversimplify things in trying to compile information and put it in words that maybe our constituents can understand, but it seems to me—and this may be more of a comment than a question, but it seems to me we need a day of reckoning in Congress, that there is 1 day of the year when we look at expenditures, we look at revenues, how much we have spent, or how much we have promised to spend, and on that particular day everything comes to a point where we see how much we don't have. And I know we go with continuing resolutions sometimes, and there is omnibus bills, but it doesn't seem to me, unless I am missing something, that there is 1 day of reckoning, other than tax day, of course, which I think should be election day, April 15th, where this Congress, this body—and I believe that we could do it together in a bipartisan way—look at this is where we are today, this is what we have promised, and this is what we don't have. Is there such a mechanism in place? Can we do that?

Mr. WALKER. I can tell you that I lead strategic planning for auditor generals around the world, and also I am on the board of the international organization, and some countries have such a thing. And I think one of the things that this Congress ought to consider is one time a year have the Director of OMB, the Comptroller General of the United States, and the Director of CBO report to the Congress as a whole—and I am talking about not just sending a paper, but I am talking about physically be there with the Congress—to present an assessment of where we are, and where we are headed, and the different perspectives. I think that would be invaluable. And I know that happens in some countries. Unfortunately it doesn't happen in ours.

Mr. PORTER. I think for families we look at our budget, and at the end of the year you look, and you look at your credit cards, and you look at your bills and how much income you have. There is a day with our families when we know we are short or we are doing okay. And the same with business. We have that. At the end of the year we reconcile our books. And I would like to work with you, if we could make that presentation to this body at some point so that we can see where—the American people can see where we are. I would appreciate that.

Mr. ORSZAG. I was just going to add that one of the purposes of CBO's budget outlook that is released in January and then in August is to give a snapshot of both where we have been and where we are going. And one of the purposes of the budget resolution, to the extent it is adopted on an annual basis, is to try to take that information into account. So I agree there is much more that can be done.

Mr. PORTER. Be more transparent. I think you are providing the information, but maybe we can consolidate it more concise.

Mr. ORSZAG. Yes.

Mr. PORTER. I would appreciate that.

Mr. WALKER. It is not just that, Mr. Porter. There is no question that CBO provides a lot of valuable information, and so does GAO, and so does OMB. But there is a difference between sending up electronic or print documents up here and appearing before the body of the whole and making an oral presentation, using charts and graphs that convey a lot of information very concisely. That is what is missing, and that is what is needed.

Mr. PORTER. Thank you.

Thank you, Mr. Chairman.

Chairman SPRATT. Mr. Etheridge is next.

Mr. Etheridge, would you yield just for a second and let me say a word?

Mr. ETHERIDGE. Yes.

Chairman SPRATT. This is the point I was going to make about the SAR. I recall when it was created in the Pentagon, I was working for the Comptroller when it was created. Twelve years later, when I came back here, came into Congress, I went over and started pulling out SARs just to see how they looked. They looked the same way they had 12 years ago. They weren't more useful because they hadn't been used.

One of the things that happens when you engage and use a document is it becomes better and better adapted to its intended purposes. When it sits on the shelf, nobody uses the end product, it just gives you the same old output every year.

Mr. Etheridge.

Mr. ETHERIDGE. Thank you, Mr. Chairman, and thank you for the hearing.

Let me thank each of you for being here. And I won't elaborate on the accolades, because we are honored to have you here. Let me just make a couple of points and ask a question.

I served as a State legislator before I came here, and chaired the Appropriations Committee, and then served 8 years as State superintendent and ran one of the largest budgets in our State. And what you say is true. But the real challenge gets below really that, as you well know. And let me just give an example, and then I am going to ask my question, because I do think that performance-based budgeting really holds some potential, really maximum potential, for public agencies if it is used and used properly.

For example, let me just give you one example, that we are underfunding education right now, in my view, if we are really going to continue to be a strong country. And if we are pairing it off against other things, I think that is dangerous. The administration sent a budget up cutting education by 1.5 billion, eliminating 44 various agencies. Sounds like a great idea if you don't know the difference, but when you start looking at it, it was a tool that was called Program Assessment Rating Tool. Sounds good. Makes sense. However, when you find out that, number one, none of the public participants were in it, none of the stakeholders were consulted, they just reached in and parceled them out, threw them up on the table, and the problem you have with that is the folks in the field are dealing with training the next generation of workers, and they don't have input.

That is not a very good performance-based process, in my view, having worked with it. People need to be engaged and believe it is fair. And we are getting close to a reckoning day. So I think you are absolutely right.

So let me ask you a question. And I do want to applaud the work that each of you are doing and thank you for it. It is very important to our work. To develop options, though, for policymakers to address the looming train wreck that you have been talking about, and I think it is one we have got to deal with on the budgets, on the horizons, in a variety of ways, and I want to thank Chairman Spratt for calling this meeting, let me just ask each one of you for one suggestion, just one, and you have given us a whole bunch, but just one that we could use to accomplish that purpose. Just one. Whoever wants to start first. Mr. Johnson?

Mr. JOHNSON. I think that this committee or Congress or the administration should publicly declare that they want to be held accountable for the government working well and better every year in a demonstrable, quantifiable degree.

Mr. ETHERIDGE. That is more like a policy statement. Okay.

Mr. JOHNSON. Just that commitment will drive behavior, will drive a level of transparency that doesn't exist now. It will drive an attention to performance or nonperformance that doesn't exist now. And it will drive real-life things happening unlike that are happening now.

Mr. ETHERIDGE. Very good. Thank you.

Mr. Walker?

Mr. WALKER. I testified before that with regard to our fiscal challenge, the best thing you can do is to reimpose tough statutory budget controls on both sides of the ledger, dealing not just with discretionary spending, but also mandatory reconsideration triggers for mandatory spending, and also to put tax preferences as part of that radar screen. You have to do that.

Now, as far as performance budgeting, I would say moving towards an annual congressional performance-based budget resolution—now, it is going to take you—you are going to have to do some work to get there, because you are right, there is a lot of debate about, well, which indicators do you want to use in order to assess performance? But agreeing that there is a desire to move to some type of annual congressional performance-based budget resolution and then putting in place mechanisms to make that a reality over time.

Mr. ETHERIDGE. Starts that dialogue.

Mr. ORSZAG. I would say if there is one step that, looking out over the future, you wanted—and you wanted to adopt a perspective to get more for your money from the Federal budget, it is in health care. And perhaps the most single auspicious thing that could be done if you wanted to move in that direction is to vastly expand the amount of comparative effectiveness research that is done; that is, examining what works and what doesn't through registries, through trials, et cetera, and then tying financial incentives and other incentives to the results of that research.

Mr. ETHERIDGE. Thank you. Thank all three of you.

Thank you, Mr. Chairman. I yield back.

Chairman SPRATT. Thank you, Mr. Etheridge.

Mr. Becerra?

Mr. BECERRA. Thank you, Mr. Chairman, and thank you to the witnesses for your testimony.

I am not sure if you explored this earlier or not, but I am interested in hearing your thoughts about the expenditure side. And, Comptroller General Walker, let me start with you and ask have you all done any analysis of the charitable deduction expenditure and whether or not we as a Nation are getting the value of that lost revenue in returned programming and services for Americans through that charitable deduction?

Mr. WALKER. We have done some work with regard to tax preferences in general. I do not recall any particular work that has focused specifically with regard to the charitable deduction and the value for money implication, but I will check and provide for the record a specific answer.

[The information follows:]

******** COMMITTEE INSERT ********

Mr. BECERRA. Let me offer any of the witnesses if they have any comment with regard to any work that may have been done to analyze that particular expenditure, the charitable deduction, and its value to America.

Mr. ORSZAG. There has been some academic work done. I will have to check on whether CBO has published work. The academic work has raised some interesting possibilities. So, for example, there is a recent study that shows a match for a charitable contribution may be more effective in eliciting charitable contributions than money back in your pocket, which is basically what a tax—the current tax preference does. So you give a dollar to a charity and there is a matching contribution, that, according to one study, generated more activity than you give a dollar to the charity and you get something back in your pocket in exchange.

Mr. BECERRA. Dr. Orszag, I am actually interested in the output side of that transaction, where we then determine how that charity uses the money. I would like to find out if anyone has analyzed how those organizations that receive that charitable deduction employ those dollars that they get as a result of taxpayers having less money to have to pay into the Treasury. Money forgone, my understanding, it is about $32 billion that the Treasury forgoes because people make these charitable deductions to these nonprofit organizations. And I am interested in finding out, for example, if we are getting our dollars' worth. I know there are a lot of poor people in this country. I am wondering how many of those charitable contributions end up helping people who are poor, end up helping people who have no health care.

Mr. WALKER. You are raising a very interesting point. First, there is audit authority and evaluation authority that we have, for example, when you are dealing with Federal grants. All right. So they are on the radar screen, because they go through the appropriations process and the budget process. But tax preferences don't. That is not Federal money. It is forgone Federal revenues. And therefore, you would even have an issue of whether or not we would have the audit authority, you know, with regard to a tax preference. That is not Federal money. It is forgone revenues.

Mr. BECERRA. Let me ask and see if any of you wish to volunteer an opinion on whether or not we are making the best investment of tax dollars or forgone tax dollars by providing this particular tax expenditure, the charitable deduction.

Mr. ORSZAG. Let me just say there are a variety of tax preferences associated with the nonprofit and charitable sector, not just the contribution one that you noted, but also the fact that they do not pay tax on their net revenue.

Mr. BECERRA. Correct.

Mr. ORSZAG. And there have been questions that have been raised about the degree to which some of those entities are performing services and doing things that are quasi-commercial in nature. And the dividing line between a purely charitable activity and a quasi-commercial activity has become blurred. CBO has done some work on that in the past and will be doing more in the future. And I guess I would leave it at that, that there have been questions raised about that line.

And then you are raising another issue, which is even within the charitable—you know, even within that more clearly charitable set of activities, how effective are they in actually achieving their objectives?

Mr. BECERRA. Right.

Mr. ORSZAG. Again, I think that is something that we don't have good answers on.

Mr. BECERRA. General?

Mr. WALKER. A few comments real quick. First, there is something called UBTI, unrelated business taxable income. And, for example, AARP pays a lot of money on—a lot of tax on that, because they make a lot of money with regard to their insurance programs. Furthermore, we have done work at GAO for the Senate on the issue of not-for-profit entities, for example, hospitals, and whether or not there is a meaningful difference at the type of services that they are providing versus for-profit hospitals, because obviously they are gaining a benefit through tax-exempt status, and presumably there should be a public welfare gain from that.

Mr. BECERRA. And, Mr. Chairman, I see my time has expired. If I could just explore one final question.

Is there something, General Walker, that we could do to perhaps expand that examination? Because I think it is a legitimate concern to find out if there is a difference between what a not-for-profit hospital is providing to the public versus a for-profit hospital, and whether or not there is a reason to give a not-for-profit hospital a tax advantage over a for-profit hospital in the work that they do in a community.

I also think there is a reason to explore whether or not many foundations are doing the work that we expect of them, especially family foundations are doing the work we expect of them to provide the general welfare of the public for the forgone taxes that they would otherwise pay. Is there something there that you think would be worth exploring by the GAO?

Mr. WALKER. First, let me do two things. One, I will provide back to your office information on what we have done and what we are doing with regard to not-for-profit hospitals. Secondly, I also want to think about whether or not there may be additional authorities that we might need in order to be able to do evaluations in situations where the Federal Government is forgoing billions of dollars of revenue and has a legitimate interest in trying to understand what public good is being obtained from that. There may be some need to look at our access authority and our audit authority here.

Mr. BECERRA. I look forward to hearing back from you on that.

Mr. Chairman, I thank you very much. Yield back.

Chairman SPRATT. Thank you, Mr. Becerra.

Mr. Ryan, do you have any further questions?

Mr. RYAN. No.

Chairman SPRATT. Let me say to our witnesses today, Director Johnson, General Walker, Director Orszag, thank you very much for your time, and more than that for your insightful advice on a topic that we clearly need to pay more attention to.

I also—earlier on I recognized the contribution of Dr. Posner, and Barry Anderson as well. Dr. Posner is here.

[The prepared statement of Mr. Posner follows:]

Prepared Statement of Paul L. Posner, Director, Public Administration Program, George Mason University

Mr. Chairman and Members of the Committee, I appreciate this opportunity to share my perspectives on the prospects for performance budgeting in general and the Program Assessment Rating Tool (PART) process in particular. In brief, performance informed budgeting has become institutionalized at the federal level through two successive Administrations. The use of performance data to inform budget decisions can potentially improve the decision making process and the outcomes of government by ensuring that performance goals and results are taken seriously at all levels. The benefits of strengthening the link between resources and results suggest that some form of performance budgeting is here to stay—it would not be surprising if the next Administration continued this agenda with initiatives of its own. While we should never expect to "depoliticize" the inherently political process of budgeting, performance information provides valuable new perspectives that can help transform the kind of debate—budget options can be compared not just based on their potential costs but on their relative contribution to policy outcomes we care about as a nation.

In rethinking how to design the next round of performance budgeting, the PART process of this Administration will form an important foundation. Now that nearly all programs in the budget have been covered by at least one PART review, policymakers have an opportunity to create a process to better inform the difficult budgetary tradeoffs the nation will be facing in the years to come. Rather than engaging in yet another round of reviews revisiting the same programs, it is time to build on the base of measures and assessments developed under both GPRA and PART to do broader- based and more selective assessments of broad program areas. Such assessments should review the relative contribution of multiple programs to overarching program goals, e.g. improving food safety, or providing for low income housing, and should include all major tools of government used by the federal government to reach those broad outcomes, including tax expenditures. The assessments should also be performed in an open and inclusive manner that ensures the engagement of significant stakeholders and the Congress itself. While PART served the President's interests, a revised assessment process could achieve greater credibility and support if it were more open and inclusive. Enhancing the prospects for Congressional attention to performance issues is vital if we are to promote this agenda for the future.

THE SURPRISING STAYING POWER OF PERFORMANCE BUDGETING

Performance based reforms have had a long history in the United States at all levels of government. Often led by state and local initiatives, public administrators at all levels have become gripped by waves of performance reforms intended to improve performance and enhance public confidence in government. Ushered in with great expectations, reforms such as Planning-Programing-Budgeting, Zero Based Budgeting, and Total Quality Management, achieved significant improvements but are widely acknowledged to have fallen well short of their mark in institutionalizing a sustainable focus on performance within government over the longer term. This checkered history of reforms encouraged a certain amount of cynicism about the efficacy of performance management to achieve lasting success in government.

One lesson learned from these past initiatives is that the ultimate success of performance reforms will be predicated on their integration with the most important process engaged in by public managers every year—the budget process.1 The introduction of performance goals and metrics into the budget process gained the moniker of "performance budgeting" and this has become a fundamental feature of current performance reforms at federal, state and local levels of government, as well as in most OECD nations.2

Notwithstanding the failures of prior incarnations of performance management, since 1993, performance management reforms in general, and performance budgeting in particular, has achieved a level of continuity and sustainability that is at once both surprising and tenuous. The Government Performance and Results Act (GPRA), passed in 1993, has ushered in a period where performance information and justifications have become widely accepted in federal agencies, in OMB reviews and even, sporadically, in certain committees of the Congress itself. Notably, the reform has not only survived through two Administrations of different parties, and has become a vital part of the management reform strategies of both the Clinton and Bush Administrations.

Under the GPRA, agencies were required to prepare strategic and annual performance plans and reports that covered the program activities in their budgets. While agencies had primary responsibility for preparing these plans, OMB reviewed the plans as part of the budget process and eventually worked with agencies to integrate performance plans into agency budget justifications. GAO found in its ten-year retrospective that federal managers reported having significantly more types of performance measures and that GPRA had begun to facilitate better linkage between performance information and planning and budget decisionmaking, although more remained to be done to promote the use of this information for resource allocation. 3 The surprising staying power of GPRA is partly due to its statutory origins, as reformers realized that past initiatives undertaken without the support of the Congress failed to transcend the terms of their executive political champions

ADMINISTRATION PERFORMANCE BUDGETING INITIATIVES

The Bush Administration built on the GPRA infrastructure to carry performance budgeting initiatives further along the continuum. While the agencies had made progress in developing the "supply side" of performance plans and measures under GPRA, the demand for this information by budget decisionmakers proved to be episodic at best, particularly in the Congress. Although performance reformers hoped that building credible performance plans would in themselves prove compelling enough to foster their own demand, these high hopes proved to be unfounded. Some fear that agencies may eventually lose interest in generating the supply of information if the supply is unrequited by the demand and actual use of the information.

The Administration sought to strengthen the linkage of performance with budgeting. First, they included budget and performance integration (BPI) as a key initiative within the President's Management Agenda and evaluated agencies' progress periodically by using a scorecard published in the budget. As part of this initiative, OMB encouraged agencies to restructure their budget presentations and underlying account structures to better align budget resources with performance goals. Beginning with the fiscal year 2005 budget, OMB required agencies to submit a "performance budget" that would integrate the annual performance plan and the congressional budget justification into one document. While framed as a strategy to promote the GPRA agenda of linking plans with budgets, this initiative was viewed by appropriators and some agency managers as laying down the proverbial gauntlet by eliminating traditional information presentations that long served as the foundation for congressional appropriations and oversight. 4

The Administration's Program Assessment Rating Tool (PART) added a program review and assessment component to performance budgeting. The PART initiative was justified as a way to promote greater attention to the performance perspective that was originally fostered by GPRA. Moreover, the initiative also was premised on the need to transcend the traditional focus of budget process from one that focused disproportionate attention on incremental changes to existing programs to a process where the base itself is periodically reexamined. Given the fiscal challenges facing the nation both now and over the longer term, such a periodic reexamination can be healthy for any political system.5

The PART process consists of a series of questions rating the purpose and design, planning, management and results of each program in the budget. Programs receive ratings based on the answers to these questions, with ratings ranging from effective to ineffective and a separate category, results not demonstrated, when programs fail to have sufficient information or documentation. To date, OMB has assessed the performance of nearly 1000 programs, covering 96 percent of all programs in the budget.

While PART can be viewed as building on GPRA, there are differences to be sure. One observer contrasted PART and GPRA by noting that GPRA was a "passive" strategy relying on the power of well developed plans and metrics to create their own demand. In contrast, PART constituted a more active strategy, where performance information would form the basis for explicit judgments of a program's effectiveness that would become part of the executive budget formulation process. Moreover, while GPRA plans and metrics were largely developed by federal agencies themselves, PART marked a new departure by placing control of performance assessments in the hands of OMB. It was the President's budget agency that designed the process and made the final judgments on program assessments, with the active participation of the agencies. At least in the initial years of implementation, agencies were encouraged to replace GPRA goals and measures with those developed under PART, substituting OMB's judgment for that of the agencies.

The PART process has itself been assessed by GAO and others in the federal community. The process has institutionalized more formal and systematic program reviews in the executive budget process and has jump started a more regular conversation between OMB and the agencies on the performance of their programs. This has arguably led to a greater focus on performance as part of the budget review process. Agencies have a more powerful incentive to improve their performance data and measures to protect themselves in this review process in the future. Some agency officials suggest that PART has stimulated initiatives to focus on management issues that the agency may not have addressed on its own. While funding levels have been changed in some cases, changes to program design and management were a more prevalent outcome of the PART process, according to the GAO.6

However, the PART process raises some vexing questions about the ability of any process to develop the appearance of a "bottom line" rating for complex government programs. Unlike the private sector, there is no single bottom-line for most federal programs. Given the multiple purposes and goals reflected in most programs, OMB staff invariably had to make judgments on how to answer yes/no questions on such issues as whether the program was effective in reaching its goals and whether the costs of the program were reasonable. Notwithstanding claims that PART rests on "objective" ratings, this is often not possible in the high stakes world of federal budgeting where multiple stakeholders have their own interpretations of seemingly straightforward numbers. A single performance indicator, whether it is trends in drug abuse, serious crimes or welfare caseloads, is subject to multiple interpretations about what the performance data mean and how it should be used in making decisions. The GAO assessment of PART concluded that the experiences with the rating tool illustrate "the inherent limitations of any tool to provide a single performance answer or judgment on complex federal programs with multiple goals."7

Moreover, the PART process used discrete budget program activities as its unit of analysis for assessments. The assessment of detailed budgetary activities have the advantage of more closely tying performance assessments to the budget, but at the price of accepting the current budget structure as a given. However, there is a tradeoff—while performance data may gain greater influence in budgeting, this may come at the expense of the breadth and openness that characterize strategic planning processes. The PART focus on relatively narrow budget accounts and activities contrasts with the broader planning and goal orientation of the GRPA planning process. The key question agencies are charged with answering in their GPRA plans and metrics is what difference does the agency and its programs make for outcomes that matter to the various publics in a democratic society? In many cases, whether it be low income housing, job training, food safety or child nutrition, such outcomes are achieved from the results of a number of programs and governmental tools, often crossing agency lines.

Finally, any assessment will invariably reflect the interests of the entity that controls the process. As part of the President's budget preparation, PART clearly must serve the President's interests. However, it is unlikely that the broad range of actors whose input is critical to decisions will use performance information unless they believe it is credible and reliable and reflects a consensus about performance goals among a community of interested parties. This consensus building process is critical—if the goals in the plans gain broad support, their use in the budget will become more accepted and credible. The measures used to demonstrate progress toward a goal, no matter how worthwhile, cannot appear to serve a single set of interests without potentially discouraging use of this information by others. In the case of PART, the control of the process by OMB has arguably served to erode the support for the assessment process by such key players as Congressional appropriators and authorizers. The absence of broad based support will limit the impact that such a process can have longer term on the sustained development and improvement of linkages between performance and budgeting. I might add that most efforts to integrate performance information into budgeting suffer to some degree from the absence of open collaboration with stakeholders and the Congress, reflecting the closed nature of the budget process where deliberations are considered to be "predecisional" and not subject to public disclosure our debate. This is true not only for the budgetary figures and decisions themselves, but also for performance plans and PART scores that comprise the President's budget under both Clinton and Bush Administrations.

WERE DO WE GO FROM HERE?

PART and GPRA established the valuable expectation that performance will inform budget decisions. Continuity is important—the attention devoted to performance information by both Clinton and Bush Administrations have prompted agencies to take the generation of goals and measures and data more seriously. The momentum will hopefully continue. The long term budget models of GAO, CBO and OMB have reached the consensus that the federal deficits of today are but a prelude to the serious and unsustainable deficits of tomorrow. As the baby boom retires, the budget challenges will become even more daunting—and the first baby boomers retire next year. A performance based assessment process will help the nation update its priorities as all programs increasingly compete for increasingly limited resources. The question is—how do we build on the recent reforms to establish a performance assessment process that will be sustainable and relevant over the longer term?

PART has served to continue and heighten the focus of agencies on performance and has prompted some to redouble their efforts to more systematically evaluate their own programs and improve the base of information upon which such evaluations rest. However, now that nearly all programs have been reviewed, it is an ideal time to rethink the assessment process. Simply continuing the current process through yet another round of assessments would not constitute the best use of scarce analytic resources in the agencies and the budget community. The completion of the cycle of PART reviews, instead, should provide the occasion to refocus the attention of the budget community on a broader, yet more targeted assessment process that would be more inclusive and open than PART has proved to be. The process I have in mind would refocus assessments on the broader outcomes that individual federal programs are attempting to influence together, building on the results of both GPRA planning and individual PART reviews.

The experiences of other nations can be examined to help us rethink our own process. Other nations, too, have undertaken comprehensive reexamination efforts. New Zealand, Australia, Canada, and the Netherlands, for example, have undergone performance-based budgeting and performance management reforms aimed at reprioritizing the base of their respective budgets that spanned a number of years. In Canada, an OECD study concluded that a program review exercise delivered $18.8 billion in savings over three years, contributing to the achievement of the nation's deficit reduction targets in the mid 1990's.

In the Netherlands, reconsideration reviews are conducted on both particular programs as well as broader crosscutting areas selected for each budget cycle, with participation by working groups of central budget and departmental staff as well as external experts, resulting in a public report with recommendations to be considered. According to OECD, the process has been in place since 1981 and has lead to significant savings as well as many reforms of major policy areas. 8 In their broader crosscutting reviews, which they call Interdepartmental Reviews, their system is different than PART in several respects. First it is selective, with about 10 reviews each year. Second, it has a broader focus as reviews address an entire policy area or governmentwide management concern. Third the reviews are more collaborative involving a partnership the budget office, agencies and outside researchers and academics.

Our own recent experience as well as that of other nations suggests it is time to consider a revised assessment process within the context of continuing and enhancing the connection between performance planning and budgeting.. Such a process should include the following elements:

- Continuing and enhancing the GPRA planning process as the foundation for the assessment process. This process has succeeded in generating the "supply side" of performance budgeting, producing plans and reports with progressively greater coverage and credibility. Such a process can be enhanced by the implementation of a goverrnmentwide performance plan to capture those important outcomes that are the produce of the programs of several different agencies.

• Continuing efforts to tie performance plans and metrics into the budget formulation process in both executive and legislative stages. This should encompass changes to budget presentations and structures to highlight the performance implications of budget decisions—an initiative begun under the Clinton Administration and carried forward during the Bush Administration under the Budget and Performance Integration. The goal of these initiatives is to change the debate to focus more on how given levels of resources will achieve particular performance goals and targets. Accountability should increasingly come to focus on the setting and accomplishment of discrete performance targets. These targets can be articulated both in budget presentations within the executive process as well as in appropriations debates and reports.

• Targeting future assessments based on such factors as the relative priorities, costs, and risks associated with related clusters of programs and activities addressing common strategic and performance goals. More selective reviews would help ration scarce analytic resources as well as focus decision makers' attention on the most pressing policy and program issues. The Netherlands Interdepartmental Reviews provide an illustration of a long standing assessment process that selects several broad program areas for review each fiscal year, in a process that has been established for over 25 years.

• Adopting a broader unit of analysis keyed to program outcomes, not budget accounts. PART's focus is overly narrow and fails to focus attention on the most important areas for governmental policymaking—the relative contribution of different programs and tools to policy outcomes. Thus, rather than producing separate reviews of the many different job training programs in differing budget years, a more comprehensive review process would cover all significant programs together in one assessment. Such a review should cover all significant governmental tools address broader outcomes, including the more indirect tools such as tax expenditures and regulatory programs.

• Establishing a more open process that is more independent of OMB and the agencies. The Netherlands process entails reviews by committees often chaired by independent experts, with participation by budget and agency officials. There are many options to open up the assessment process here. One option that could be considered would be to anchor the process in a nonprofit organization while guided by OMB and the Congress. While including a broader base of stakeholders, such assessments must be truly independent and neutral to attain the credibility necessary to influence budgetary decisions.

Mr. Chairman, it is vital that such a revised assessment process engage the Congress. Given the strong role Congress plays in both budgeting and management oversight, Congressional involvement will prove to be vital in reinforcing the importance of performance assessment and ensuring that such a process reflects a broader base of values and interests. PART has served the President, but as a result was not perceived to serve the interests of other actors in the system, most notably the Congress. While Congress has largely ignored PART assessments and performance budgets, such a posture risks giving the President unimpeded access to the performance high ground. As we have learned from PART and even GPRA, performance reviews are anything but objective, and turn on highly contestable formulations of program goals, selection of particular measures and highlighting of particular results. Performance information would be more credible if Congress were engaged in selecting reviews, highlighting key differences with executive interpretations and using their own information resources to challenge executive data.

Several alternatives might be considered to enhance Congressional involvement in program assessment:

• A more collaborative approach could be adopted where the new President and the Congress could reach agreement about those areas to be assessed in each budget year. Congress could help ensure that areas that are ripe for reexamination, such as those up for reauthorization, would get attention in the executive review process. The resulting assessment process could have greater credibility in the process. Such a process would require the Congress to articulate its oversight and reexamination priorities centrally and OMB to invite Congress to help determine executive assessment priorities.

• Congress could request the GAO to undertake a series of assessments of broad program areas deemed in need of reexamination by the leadership. The agency would engage in an evaluation synthesis, systematically examining the evidence from other studies, including its own, of the effectiveness of federal program design for the area in question. Such studies could, in effect, constitute Congress' own assessment process oriented to the oversight and performance priorities expressed by its own leadership in contrast to those articulated by the President.

• Congress could adopt its own performance assessment and review process linked to the budget process. The Budget Committees could be the vehicle to accomplish this by reporting out a "congressional performance resolution" as part of the budget resolution. Such a resolution could be the vehicle to engage the full Congress in debate over those areas most ripe for review and assessment each year. The resolution could be viewed as a requirement that committees undertake the assessments through hearings, GAO studies and other vehicles that they deem appropriate to reexamine the program areas identified in the resolution. This would more forcefully place Congress in the forefront of the performance budget process. Just as the budget resolution helps identify priorities for scarce resources, the performance resolution could jump start a healthy process for prioritizing those areas that most warrant a reexamination of goals, program design or management processes.

• Budget committees could not only spearhead such a resolution but also become a focal point for undertaking more systematic oversight of important crosscutting issues, perhaps in concert with other committees. Similar to a process undertaken by the Senate Budget committee in the l990's, a budget committee driven oversight process could add value to the traditional oversight conducted by other committees by conducting assessments that both cut across current committee jurisdictions and have significance for current and future budgets.

Mr. Chairman, this concludes my statement. I would be glad to respond to any further inquiries by the Committee.

ENDNOTES

[1] U.S. General Accounting Office, Performance Budgeting: Past Initiatives Offer Insights for GPRA Implementation (Washington, D.C.: GAO, 1997)

[2] Organization of Economic Cooperation and Development, Performance Information in the Budget Process: Results of the OECD 2005 Questionnaire (Paris: OECD, 2005)

[3] U.S. Government Accountability Office, Results-Oriented Government: GPRA Has Established a Solid Foundation for Achieving Greater Results (Washington, D.C.: GAO, 2004, GAO -04-38)

[4] U.S. Government Accountability Office, Performance Budgeting: Efforts to Restructure Budgets to Better Align Resources With Performance (Washington, D.C.: GAO, 2005) GAO-05-117SP

[5] U.S. Government Accountability Office, 21st Century Challenges: Reexamining the Base of the Federal Government (Washington, D.C.: GAO, 2005) GAO-05-325SP

[6] U.S. Government Accountability Office, Performance Budgeting: PART Focuses Attention on Program Performance, but More Can Be Done to Engage Congress (Washington, D.C.: GAO, 2006, GAO-06-26)

[7] U.S. Government Accountability Office, Performance Budgeting: Observations on the Use of OMB's Program Assessment Rating Tool for the FY 2004 Budget (Washington, D.C.: GAO, 2004, GAO-04-174)

[8] OECD, Reallocation: The Role of Budget Institutions (Paris, OECD: 2005)

Chairman SPRATT. We appreciate you coming, and we appreciate your very methodical and clear set of proposals that you sent in your testimony. Thank you very much indeed.

The hearing is adjourned.

[Whereupon, at 12:21 p.m., the committee was adjourned.]

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