

GAO

Report to the Chairman, Committee on
the Budget, House of Representatives

January 1991

BUDGET ISSUES

Effects of the Fiscal Year 1990 Sequester





United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

B-242051

January 18, 1991

The Honorable Leon Panetta
Chairman, Committee on the Budget
House of Representatives

Dear Mr. Chairman:

This report summarizes the effects of the fiscal year 1990 sequester on five federal civil agencies and discusses this information in the context of governmentwide sequester reductions and overall changes in the deficit estimate. The agency case studies were performed in response to your request for an examination of the sequester's effect on resources and programs in five agencies; separate reports have been issued to provide detailed results of this work for each agency. (These are found in the list of related GAO products at the end of this report.) In the course of performing that work, we also examined the sequester reductions taken in each sequesterable budget account governmentwide and collected information regarding the overall sequester and the year-end 1990 deficit figures.

Results in Brief

The 1990 sequester, ordered in accordance with the Balanced Budget and Emergency Deficit Control Act of 1985, as amended through December 31, 1987, had minimal negative impact on the five civil agencies we examined. Because the Office of Management and Budget's (OMB) \$116.1 billion projected deficit for fiscal year 1990 indicated the need for sequestering only \$16.1 billion governmentwide, a relatively small sequester of 1.4 percent for civil accounts and 1.5 percent for defense accounts was called for. The five agencies actually lost less than 1.4 percent of their final budget authority to sequester because (1) growth in agency appropriations offset sequester reductions and (2) appropriations enacted subsequent to sequestration were partially exempt from that process. Hence, agencies absorbed the sequester's reductions by postponing program expansions and improvements rather than reducing core services.

The pattern of increased budget authority and postsequester appropriation enactment reducing effective sequester percentages was found governmentwide. Once final budget authority is taken into account, less than one-fourth of all sequesterable budget accounts lost a full 1.4 or 1.5 percent to sequester.

was reduced from the original \$16.1 billion to \$5.7 billion, or 1.5 percent of resources in defense accounts and 1.4 percent in others. The President responded to this legislation with a new order sequestering the lowered amounts.

Most federal agencies were operating under a temporary continuing appropriations resolution on October 15, 1989, the deadline for the President's final sequester order. Under these circumstances, the law required that an assumed appropriation level, called the baseline,³ be used to calculate the sequester amount. Once full-year appropriations were enacted, the sequester was adjusted according to rules established in the law to govern postsequester appropriations. These rules are discussed in greater detail in appendix I.

In the past, we have raised several concerns about the effectiveness of the GRH law and the sequester process. (The reports that raised these concerns are found in the list of related GAO products at the end of this report.) Generally, compliance with the act has not resulted in meaningful deficit reduction. The large proportion of exemptions from sequester, budgetary gimmickry, optimistic deficit estimates, and inflexibility built into the process have resulted in an increasing fiscal imbalance in the nontrust fund portion of the budget. In addition, we have cited the ability to pass appropriation acts subsequent to sequestration as another factor increasing the deficit. We have called for a less mechanistic approach to deficit reduction.

Objectives, Scope, and Methodology

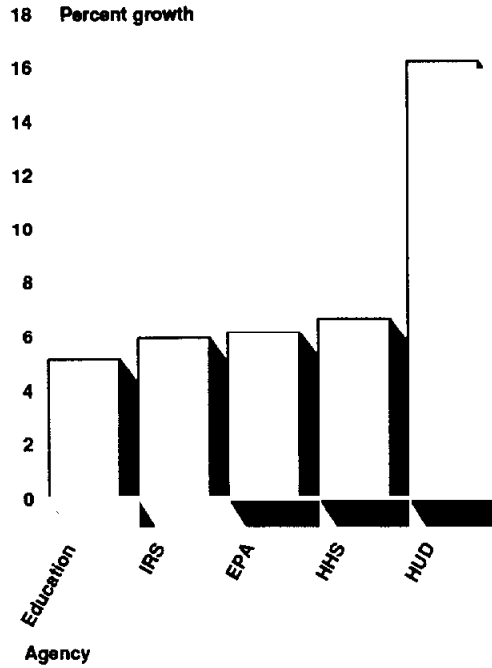
The objectives of our review were to summarize the key features of five agency case studies on the sequester's impact and to provide a governmentwide context in which to view those findings.

To summarize the case study results, we compiled the information collected in response to your request to examine the sequester's effect on the five agencies.⁴ We determined how the sequester was implemented in these agencies and also how it may have impaired programs and services. To ensure consistency in measuring funding changes among the five agencies, we used budget authority figures for 1989 and 1990; some

³In most cases, the baseline is the prior year appropriation adjusted upwards for employee pay raises, other personnel costs, and estimated price inflation.

⁴The agencies examined were the Department of Health and Human Services (HHS), the Internal Revenue Service (IRS), the Department of Education, the Environmental Protection Agency (EPA), and the Department of Housing and Urban Development (HUD).

Figure 1: Growth in Budget Authority From Fiscal Year 1989 to Fiscal Year 1990 in Selected Agencies



Note: Budget authority was measured after reductions from sequester and represents authority only in accounts subject to sequestration.

The timing of the agencies' appropriation enactments constituted the second factor diminishing the sequester's impact. As discussed in greater detail in appendix I, the portions of appropriations made after October 15 that exceeded baseline levels were not subject to sequester. Because the five agencies' appropriations were enacted after sequestration and were above the baseline levels, the sequester amount represented even less than 1.4 percent of the final budget authority. As shown in figure 2, none of the five agencies reported sequester amounts greater than 1.3 percent of sequesterable budget authority.

contributed to the problems reported in these accounts, it was not the primary factor.

Most Sequesterable Budget Accounts Lost Less Than Full Sequester Percentage

Our analysis showed that, as in the case study agencies, most budget accounts governmentwide did not experience the full sequester of their final budget authority. This occurred because the portions of post-sequester appropriations that exceeded baseline estimates were not required to be sequestered. In addition, the GRH rules credited accounts that received late appropriations below baseline estimates with a dollar-for-dollar reduction in the sequester amount. This rule substituted appropriation savings for sequester savings and, in 1990, reduced the \$5.7 billion sequester to \$3.7 billion. In many cases, both these rules reduced the actual percentage sequestered below the 1.4 and 1.5 percent rate.

In our analysis of the 672 sequesterable budget accounts, only 23 percent experienced the entire 1.4 or 1.5 percent sequester. About 31 percent lost nothing to sequestration, and the remaining 46 percent lost less than 1.4 or 1.5 percent of their appropriation. This evidence suggests that the limited impact reported in the case studies also characterized most of the rest of the government.

Meaningful Deficit Reduction Cannot Be Achieved Solely Through Sequester

The final figures for fiscal year 1990 show a deficit of about \$220.4 billion for the year, \$120.4 billion over the target specified in the law. OMB's earlier, lower estimates were based upon economic and technical assumptions that in hindsight proved too optimistic—most notably the costs of resolving the savings and loan crisis and declining revenues from a softening economy. The differences between the early OMB estimates, more recent revisions, and final figures are detailed in appendix II. Had the OMB sequester reports for 1990 projected a year-end deficit of this magnitude, they would have required a \$120.4 billion sequester. However, a sequester of that size most likely would have been unacceptable to the Congress and the President, as recent negotiations regarding fiscal year 1991's budget have demonstrated. For fiscal year 1991, legislative and executive negotiators labored at length to produce a multi-year budget agreement that combines revenue increases and spending cuts to avoid a \$100 billion-plus sequester. Such an approach might have been applied in fiscal year 1990, and meaningful deficit reduction achieved, if the larger deficit amount had been predicted.

The experiences of 1990 and 1991 suggest that meaningful deficit reduction requires more than simple reliance on a sequestration mechanism.

Contents

Abbreviations

CBO	Congressional Budget Office
EPA	Environmental Protection Agency
GRH	Gramm-Rudman-Hollings
HHS	Department of Health and Human Services
HUD	Department of Housing and Urban Development
IRS	Internal Revenue Service
OMB	Office of Management and Budget
RTC	Resolution Trust Corporation

Appendix I
Effects of Postsequester Legislation

target levels. While the credit for savings realized through the appropriations process reduced the sequester itself, it did not directly affect total deficit reduction because the savings were still realized: only the means by which they were realized changed.

These rules also appeared to create an incentive to enact full-year appropriations after sequestration, which was the pattern for most appropriation bills for fiscal year 1990. Table I.2 shows how the hypothetical accounts would have fared had the same full-year appropriations been enacted prior to October 15. In each case, a larger appropriation net of sequester was available when the appropriations were enacted late than if the same appropriations were enacted on time.

Table I.2: The Effect of Late Appropriations on Hypothetical Sequester Amounts

Account	Appropriation amount	If enacted before October 15		If enacted after October 15		Difference
		Sequester	Net	Sequester	Net	
A	\$110,000	\$1,540	\$108,460	\$1,400	\$108,600	\$140
B	99,000	1,386	97,614	400	98,600	986
C	98,000	1,372	96,628	0	98,000	1,372
D	100,000	1,400	98,600	0	100,000	1,400

Legend

- A = Full-year appropriations exceed baseline
- B = Full-year appropriations are less than baseline, but greater than baseline minus sequester
- C = Full-year appropriations are less than baseline and less than baseline minus sequester
- D = Funding for new legislation

Note: Examples are those used in table I.1. The baseline in accounts A-C above is \$100,000, since account D is newly authorized, its baseline is 0.

The extent to which late appropriations benefited accounts varied depending upon the final appropriation's relationship to the baseline. As illustrated in tables I.1 and I.2, the lower the appropriation compared to the baseline, the more that the budget account gained from appropriating late. Hence, account C benefited the most of the three preexisting accounts. However, the new account—account D—benefited the most of all, since new accounts were not included in the baseline. The examples demonstrate not only the incentive for late appropriations, but also the GRII sequester's lack of uniformity in its ultimate application in conformance with the law.

**Appendix II
Growth in the Estimated Fiscal Year
1990 Deficit**

The passage of the Omnibus Budget Reconciliation Act of 1989 generated savings reducing the sequester from the indicated \$16.1 billion to \$5.7 billion. OMB subsequently credited this legislation with reducing the \$116.1 billion deficit by \$10.5 billion, to \$105.7 billion.

Other legislative and administrative changes made subsequent to October 15, 1989, however, increased the deficit. Most agency appropriation acts were passed after that date. For accounts in these agencies, the sequester was calculated against baseline estimates and, when appropriations were enacted, was subject to crediting rules established by the GRH law. These rules, which are explained in appendix I, reduced the \$5.7 billion sequester to \$3.5 billion, as the remaining \$2.2 billion in savings was realized instead through the appropriations process. However, they also permitted appropriation increases, new programs, the repeal of the catastrophic care legislation, and supplemental appropriations to raise deficit levels to \$113.1 billion, \$13.1 billion more than the target level.

Although savings resulting from sequestration were reduced by late appropriation enactment and legislative and administrative changes, these were ultimately minor components of the growing deficit amount. By July 1990, OMB reported a dramatic increase in its deficit estimate, raising it to \$220.1 billion, more than twice the \$100 billion target level.

As seen in table II.1, the largest single increase in OMB's deficit estimate is attributable to the potential 1990 cost of the savings and loan failures. OMB's October 1989 estimates included outlays of -\$0.1 billion for the Resolution Trust Corporation (RTC); the July 1990 estimate included a total of \$57.1 billion, an increase of \$57.2 billion over the estimate on which the sequester was based. Although the 1991 budget legislation changed the GRH law to exclude deposit insurance commitments from sequester calculations for 1991 and subsequent years, the law required that these costs be included in the 1990 deficit estimate.

Corrections to OMB's technical and economic assumptions played the largest roles in the remainder of the increase. According to OMB, \$30.2 billion of the additional deficit amount is attributed to changes in (1) estimates of the tax reform law's effect on the corporate tax base, (2) estimates of 1989 liabilities, and (3) assumptions regarding agency outlays. Another \$17.7 billion came from changes to OMB's economic assumptions, reflecting primarily the effect of the weakening economy on corporate profits and, consequently, on federal receipts. These and

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Related GAO Products

Case Study Fact Sheets

Budget Issues: Effects of the Fiscal Year 1990 Sequester at EPA (GAO/RCED-90-196FS, July 26, 1990).

Budget Issues: Effects of the Fiscal Year 1990 Sequestration on the Internal Revenue Service (GAO/GGD-90-101FS, July 30, 1990).

Budget Issues: Effects of the Fiscal Year 1990 Sequester on the Department of Education (GAO/HRD-90-150FS, August 3, 1990).

Budget Issues: Effects of the Fiscal Year 1990 Sequester on the Department of Health and Human Services (GAO/HRD-90-156FS, August 9, 1990).

Budget Issues: Effects of the Fiscal Year 1990 Sequester at HUD (GAO/RCED-90-217FS, August 10, 1990).

Reports Discussing GRH and Sequester

Deficit Reductions for Fiscal Year 1989: Compliance with the Balanced Budget and Emergency Deficit Control Act of 1985 (GAO/AFMD-89-32, November 15, 1988).

Deficit Reductions for Fiscal Year 1990: Compliance with the Balanced Budget and Emergency Deficit Control Act of 1985 (GAO/AFMD-90-40, November 15, 1989).

Deficit Reductions for Fiscal Year 1990: Compliance with the Omnibus Budget Reconciliation Act of 1989 (GAO/AFMD-90-49, January 26, 1990).

The Budget Deficit: Outlook, Implications, and Choices (GAO/OCG-90-5, September 12, 1990).

**Appendix II
Growth in the Estimated Fiscal Year
1990 Deficit**

other adjustments brought the final OMB 1990 deficit estimate to \$220.1 billion.

The actual 1990 deficit level, as reported by the U.S. Treasury, was \$220.4 billion. Although this amount was foreseen in total by OMB in the July estimate, it represents declines in both receipts and RTC outlays from the levels OMB had forecast. The actual RTC outlays, which totalled \$46.5 billion rather than OMB's \$57.2 billion estimate, were lower in part because, according to the Final Monthly Treasury Report, certain RTC transactions made at the end of September were not actually expended until October 1, the beginning of fiscal year 1991. This final deficit amount is \$104.3 billion greater than the \$116.1 billion deficit estimated a year ago, at the time of sequester, an increase that is primarily attributable to optimistic assumptions.

Growth in the Estimated Fiscal Year 1990 Deficit

OMB's deficit estimates for fiscal year 1990 increased dramatically during the course of the year and were nonetheless slightly exceeded by actual year-end figures. The estimated deficit rose from \$116.1 billion in October 1989 to \$220.1 billion by July 1990, and the actual amount (\$220.4 billion) was somewhat higher. The changes since October 1989, as documented in table II.1, reflect increases in the estimated costs of the savings and loan failures, a declining economy, optimistic technical assumptions, and the costs associated with new legislation. This appendix outlines the nature of the estimate changes that occurred over the course of the year.

Table II.1: Changes in the Estimated Budget Deficit, Fiscal Year 1990

Dollars in billions		
Chronology of changing estimates	Deficit estimate	Changes to estimate
October 1989 estimate	\$116.1	
Omnibus Budget Reconciliation Act		\$-10.5
December 1989 estimate	105.7	
Other post-October 15 legislative and administrative actions		
Sequester savings		-3.5
Postsequester appropriations		3.6
Repeal of catastrophic care legislation		5.2
Other		2.2
Deficit level after sequester and postsequester actions	113.1	
Changes in technical assumptions		
Resolution Trust Corporation outlays		57.2
Others		30.2
Changes in economic assumptions		17.7
All other changes, net		1.8
July 1990 estimate	220.1	
Decreases in receipts		12.8
Decreases in outlays		
RTC outlays		-10.6
Others		-1.9
Final deficit amount	\$220.4	

Note: Totals may not add due to rounding.

Source: U.S. Office of Management and Budget, Mid-Session Review of the Budget, July 16, 1990; Budget of the United States Government, Fiscal Year 1991; OMB sequester reports to the Congress, October 1989 and December 1989; and Final Monthly Treasury Statement, October 1990.

OMB's \$116.1 billion estimate was adjusted subsequently to reflect the positive and negative effects of legislative and administrative actions.

Effects of Postsequester Legislation

Under the GRH law applicable to fiscal year 1990, certain rules applied when full-year appropriations had not been enacted by October 15, the sequestration deadline. In such cases, the law required that the baseline, an assumed appropriation level, be used for computing the sequester. In most cases, the baseline was the prior year's appropriation adjusted upward to reflect the federal employee pay adjustment and other personnel costs, plus price inflation estimated as specified in the GRH law. If the full-year appropriation enacted was less than the baseline amount, the decrease reduced the sequester amount dollar for dollar to credit the account with the savings achieved through the appropriations process. This also reduced the sequester percentage. On the other hand, if the final appropriation was larger than the assumed level, the sequester was limited to the amount calculated against the baseline. In this case, the sequestered amount did not change, but the effective sequester percentage went down. Similarly, appropriations made after October 15 to support new laws and regulations through new budget accounts were not sequestered because they were not in the baseline estimate.

Table I.1 presents hypothetical examples that illustrate how above-baseline appropriations were protected from sequestration and below-baseline appropriations were credited against sequester reductions.

Table I.1: The Effect of Sequester Rules on Hypothetical Accounts Receiving Late Appropriations

Account	Sequester amount on the October 15 deadline				Sequester amount after enactment of full-year appropriations			
	Baseline	Sequester	Percent	Net	Appropriation	Sequester	Percent	Net
A	\$100,000	\$1,400	1.4	\$98,600	\$110,000	\$1,400	1.3	\$108,600
B	100,000	1,400	1.4	98,600	99,000	400	0.4	98,600
C	100,000	1,400	1.4	98,600	98,000	0	0.0	98,000
D	0	0	0.0	0	100,000	0	0.0	100,000

Legend

- A = Full-year appropriations exceed baseline
- B = Full-year appropriations are less than baseline, but greater than baseline minus sequester
- C = Full-year appropriations are less than baseline and less than baseline minus sequester
- D = Funding for new legislation

These rules could prevent sequestration from reducing the deficit to target levels. Appropriations exceeding baseline levels not only raised the deficit beyond the estimated level, the excess amount also escaped sequester. Unless these increases were offset by a greater or equal dollar amount of decreases, excess appropriations could raise the deficit above

Contents

Letter		1
Appendix I Effects of Postsequester Legislation		12
Appendix II Growth in the Estimated Fiscal Year 1990 Deficit		14
Appendix III Major Contributors to This Report		17
Tables		
	Table I.1: The Effect of Sequester Rules on Hypothetical Accounts Receiving Late Appropriations	12
	Table I.2: The Effect of Late Appropriations on Hypothetical Sequester Amounts	13
	Table II.1: Changes in the Estimated Budget Deficit, Fiscal Year 1990	14
Figures		
	Figure 1: Growth in Budget Authority From Fiscal Year 1989 to Fiscal Year 1990 in Selected Agencies	5
	Figure 2: Fiscal Year 1990 Sequester Amounts as Percentage of Actual Budget Authority in Selected Agencies	6
Related GAO Products		20

Eliminating the deficit can be achieved only as a result of political leadership, good faith negotiations, and compromise on difficult policy choices. We have long advocated such an approach to the deficit as preferable and more effective in the long run than exclusive reliance upon the GRH sequester mechanism.

We are sending copies of this report to the Director, Office of Management and Budget; the Director, Congressional Budget Office; and other interested parties. Copies will also be made available to others on request.

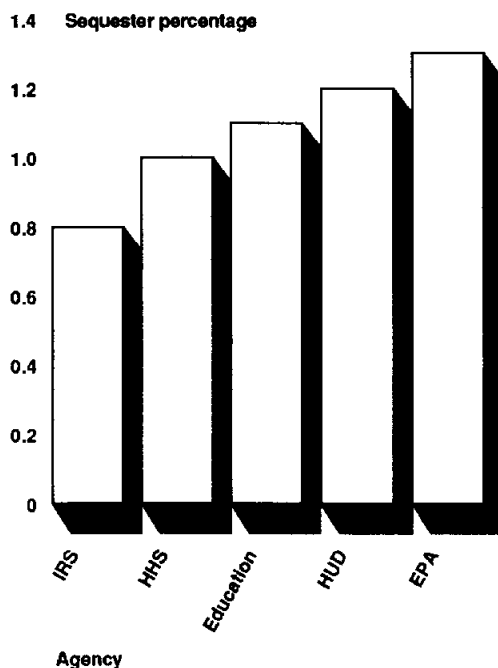
This report was prepared under the direction of James L. Kirkman, Director, Budget Issues, who may be reached on (202) 275-9573 if you or your staff have any questions. Major contributors to this report are listed in appendix III.

Sincerely yours,



Donald H. Chapin
Assistant Comptroller General

Figure 2: Fiscal Year 1990 Sequester Amounts as Percentage of Actual Budget Authority in Selected Agencies



As a result of these factors, although agency officials reported reductions in levels of service they planned to provide in 1990, these represent cutbacks in existing service levels in only a few instances. In most of those instances, the agency told us that the sequester compounded the effect of other stresses on those programs but did not in itself cause services to fall below those previously provided.

Where officials reported significant negative impact, they cited other factors affecting their programs, with sequestration playing a role in a larger overall problem. All five agencies, for example, reported difficulties in financing employee compensation costs. Absorption of the 3.6 percent employee pay raise and reductions to support the government's war on drugs combined with the sequester to create budget problems in the agencies' administrative accounts. Officials reported that they were forced, in varying degrees, to tightly control spending on supplies and equipment to ensure funding sufficient to support current personnel. Although none reported reductions in force, most stated that the inability to fill vacant positions and to procure needed equipment has indirectly weakened overall agency operations. While the sequester

case studies, however, used obligational authority for that purpose. Further details on the methodology used to examine the selected agencies may be found in the five case study reports.

To provide a broader, governmentwide context in which to view the case study findings, we examined the governmentwide implementation of the sequester to determine the extent to which budgetary accounts experienced the full 1.4 and 1.5 percent reductions for nondefense and defense accounts, respectively. We obtained the amount of the sequester, the base against which it was calculated, and the final appropriation for all 672 sequesterable appropriation accounts in the federal government and calculated the sequester as a percentage of final budget authority. Data were obtained from the Budget of the United States Government, Fiscal Year 1991, and from the Revised Final OMB Sequester Report to the President and the Congress. We did not examine the sequester's application to other types of spending authority (for example, collections, lending authority, and obligational authority) as the data were not available.

We also tracked 1990 deficit estimates as reported over the course of the year. We obtained OMB estimates of the fiscal year 1990 deficit as they were reported from October 1989 through July 1990 and compared the sequester reductions and the target deficit level for 1990 with final financial results.

The contents of this report have been discussed with agency officials and OMB, and their views have been incorporated where appropriate. We performed our work from January 1990 through August 1990.

The Sequester Had Minimal Impact on the Five Agencies Examined

Several factors diminished the impact of the 1990 sequester on the five agencies we examined. As a result of these factors, the agencies, in most instances, absorbed the sequester's reductions by postponing program expansions and improvements rather than reducing core services.

First, growth in agency appropriations offset sequester reductions. Each agency received significantly more sequesterable budget authority in 1990 than in 1989. Consequently, as shown in figure 1, each agency had a net increase in budget authority for 1990 even after sequester reductions.

Final 1990 results show the deficit at \$220.4 billion, \$120.4 billion over the target level. Had OMB projected such a deficit in its earlier sequester reports, a very large \$120.4 billion sequester would have been indicated and might have induced meaningful nonsequester deficit reduction to avoid such large and potentially damaging budget reductions. We continue to believe that the deficit cannot be eliminated by exclusive reliance on sequestration and must instead employ good faith negotiations, political leadership, and compromise on difficult policy matters.

Background

The Balanced Budget and Emergency Deficit Control Act of 1985, as amended through 1987, commonly referred to as Gramm-Rudman-Hollings (GRH), established deficit targets to lead to a balanced unified budget by fiscal year 1993.¹ The law required OMB to annually submit an initial report on August 25 and a final report on October 15 to project the deficit for the fiscal year. If OMB projected a deficit in excess of the target amount plus \$10 billion, the President was required to issue a sequester order to reduce budgetary resources² sufficiently to reach the target deficit level. The amount to be sequestered was to be divided evenly between defense and nondefense accounts not exempted in the law; because the defense and nondefense budgetary resources are not equal, this rule could result in defense accounts having a different sequester rate than nondefense accounts.

The law set the 1990 fiscal year deficit target at \$100 billion. In its August 1989 report, OMB estimated a \$116.2 billion deficit—exceeding the target by \$16.2 billion—which OMB reduced to \$116.1 billion in its October 1989 report. Estimates in both reports required a sequester of 4.3 percent in defense accounts and 5.3 percent in nondefense accounts subject to sequestration.

The Omnibus Budget Reconciliation Act of 1989, enacted on December 19, 1989, approved measures to reduce the budget deficit. As a result of savings in a number of programs, the total sequester amount

¹As this report was being prepared for publication, the Omnibus Budget Reconciliation Act of 1990 (Public Law 101-508) was enacted and amended GRH in several significant ways. Changes included revising the deficit targets to result in a deficit of \$83 billion by 1995, excluding the Social Security fund for deficit calculation, and requiring the President to revise the targets for updated economic and technical factors in 1992 and 1993. The GRH procedures discussed in this report pertain to those in effect prior to the 1990 act.

²Budgetary resources are the authority given to an agency to incur obligations of any type. Such resources include budget authority, direct loan authority, loan guarantee authority, unobligated balances (in defense accounts only), and the authority to obligate offsetting collections.

