

November 1989

**DEFICIT
REDUCTIONS FOR
FISCAL YEAR 1990**

**Compliance With the
Balanced Budget and
Emergency Deficit
Control Act of 1985**





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

**Comptroller General
of the United States**

B-221498

November 15, 1989

The President
The President of the Senate
The Speaker of the House
of Representatives

We hereby submit our report for fiscal year 1990 as required by section 253 of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended. Section 253 requires that the Comptroller General review the reports prepared by the Director of the Office of Management and Budget (OMB) under section 251 of the act and the orders issued by the President under section 252 of the act and render an opinion on whether the act's requirements regarding the reports and orders have been met. In our opinion, notwithstanding the matters discussed in appendix II, OMB's reports and the President's orders substantially complied with the act's requirements for projecting a deficit and calculating sequester percentages.

We report again, as we did last year,¹ that compliance with the act does not necessarily result in meaningful deficit reduction. Over the last 4 years of technical compliance with the act, budgetary gimmicks have proliferated, adding billions of dollars in budget costs over the long run. There is also an aura of unreality about the budget projections made under provisions of the act. Over the years, OMB's projections have sometimes been too optimistic. Additionally, the act limits OMB's flexibility to correct its inaccurate estimates and technical mistakes. Such restrictions mean that the deficit estimate in this year's OMB reports cannot be taken as a meaningful projection of the deficit that will actually occur in fiscal year 1990.

Furthermore, the act is not correcting the basic problem. The underlying imbalance between receipts and outlays in the nontrust fund part of the budget has worsened during fiscal years 1986 through 1989. The non-trust fund deficit actually increased from \$266 billion to \$276 billion over this period, a fact masked in the unified budget totals by the large Social Security surpluses.

¹ 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).

divided equally between the defense and nondefense accounts. OMB determined that sequestrable (nonexempt) defense resources would have to be reduced by 4.3 percent to effect outlay savings of \$8 billion, and sequestrable nondefense resources by 5.3 percent, to produce equal outlay savings. The President also submitted a PPA listing 15 days after his final sequester report for 1990.

The act gives OMB and the President some latitude in developing its projections and applying any sequester. OMB is free to use its own economic assumptions, and the President may exempt military personnel accounts from any sequester. In many other respects, however, the act limits the administration's discretionary authority. Examples include the following:

- To identify the budgetary resources available for making outlays in the coming fiscal year if no annual appropriations or continuing resolutions for the entire year have been enacted for parts or all of the budget, OMB must use the previous year's appropriations levels and make adjustments to reflect inflation and pay raises.
- OMB's deficit projections in its August and October reports must be based upon the same economic and technical assumptions used in OMB's regular mid-session (July) report on the budget. OMB can change its projections after its mid-session report only to reflect its estimate of the outlay or revenue effects of any new, signed legislation or changes in regulations.
- If OMB determines that a sequester of budgetary resources is needed to reach the deficit target, it must exclude specified exempt accounts or certain amounts therein from the computation and application of the uniform sequester percentages. The nondefense and defense sequester percentages must be uniformly applied across the nondefense and defense accounts with sequestrable resources.

Objectives, Scope, and Methodology

The objective of our review was to determine whether OMB and the President complied with the act's requirements in their August and October reports and orders. This involved a variety of tests to determine whether the procedures and rules imposed by the act had been followed. The emphasis was upon ascertaining whether OMB complied with the act's provisions for projecting a fiscal year 1990 deficit and computing the uniform sequester percentages for nondefense and defense programs. We also examined OMB's instructions to agencies on the preparation of the President's program, project, and activity listing and examined the list itself to see if it appeared to meet the requirements of

necessary to enforce apportionment at the PPA level. Without the necessary financial management systems, agency officials could find themselves at times in violation of the Anti-Deficiency Act's apportionment provisions. This significant extension of OMB's apportionment process could greatly complicate agency operations and produce unintended inefficiencies.

Other Matters

Although the Balanced Budget and Emergency Deficit Control Act of 1985 has probably helped constrain the level of the unified budget deficit, we have serious reservations about its continued usefulness.

First, the act's focus on annual deficit reduction targets encourages short-term "fixes" to meet the targets, with too little consideration given to real, long-term solutions. In the years just prior to the act, there was a trend toward making more budgeting decisions in a multiyear context. Not only has this been reversed under the pressures of the act, but there is also an increasing use of budgetary gimmicks to give the appearance of meeting the targets. Often, the result is higher long-term costs. A prime example is the recent establishment of an off-budget, government-sponsored entity to borrow \$30 billion to finance part of the government's rescue of the savings and loan insurance deposit system. This off-budget treatment holds down the reported fiscal year 1990 deficit; however, in the long-run, the interest cost to the government will be at least \$2 billion higher than the cost would have been had the rescue remained on-budget and used funds borrowed from Treasury. Another gimmick shifts paydays between fiscal years. The short-term focus of current budgeting also encourages such questionable practices as using lease-purchase agreements to acquire government office space. These agreements delay the recognition of costs and ultimately cost more than direct purchases or construction. Unfortunately, pending budget-related legislation contains many other provisions that would establish such arrangements.

Second, the act does not address the growing deficit in the nontrust fund side of the budget. The Congressional Budget Office's baseline projections (based on current law) show this deficit growing to just over \$300 billion by the end of fiscal year 1994. However, because of the concurrent increase in annual trust fund surpluses—particularly those of Social Security, whose annual surpluses are expected to surpass \$100 billion in 1994—it is possible that the reported unified budget deficit will decline somewhat over the same period, giving the illusion of progress in deficit reduction. By not addressing the nontrust fund deficit,

approaches are in the long run inadequate substitutes for political leadership, good-faith negotiations, and compromise on difficult policy matters.

We think that the aim of negotiations should be bipartisan agreement on a realistic multiyear plan of meaningful deficit reduction. The November 1987 budget summit agreement was a step in this direction, showing that effective actions can be started through such an approach. We further think that future realistic agreements should (like the 1987 agreement) consider all means of reducing the deficit, not simply reducing spending in the one-fourth of the budget involving discretionary spending, the focus of the current act. All programs and revenue options should be considered for discussion and possible inclusion in the multi-year strategy.

In addition, we have proposed a restructured budget to give the Congress and the President a sounder basis for making deficit reduction decisions.³ Our proposal would retain the unified budget but change its organization to distinguish between trust funds, business enterprise-type funds, and other government funds. Each section would be further divided into operating and capital components. Each of these components would have a subtotal which would be added together to produce the unified budget total.

Adopting our proposed restructured budget would not automatically reduce the deficit or eliminate the various budget gimmicks. In our opinion, however, it would facilitate real deficit reduction and reduce the incentives for off-budget fixes and other practices that undermine the discipline of the budget process. Deficit reduction targets could be established for each component, including the nontrust parts of the budget with their persistent and growing deficit problem. Such an approach would also permit decisions tailored to meet the special needs of enterprise-type activities such as the Postal Service. The operating and capital sections and subtotals would help decisionmakers balance spending for current consumption and investments, a matter of increasing importance as the nation seeks ways to increase the economy's long-term productivity and competitiveness.

Copies of this report will be provided to the Director of the Office of Management and Budget, the Director of the Congressional Budget

³See footnote 2.

Appendix I
Additional Material on Objectives, Scope,
and Methodology

projections in OMB's August and October reports to ensure that any changes resulted only from legislation enacted and signed into law or regulations promulgated after the date of the initial report.

The act requires the President to transmit to the Congress a program, project, and activity (PPA) report within 15 days after issuing a sequester report. This report is to specify, for each PPA within each account, the base from which each sequestration is taken and the amounts to be sequestered. The PPAs for an account are to be determined by using the appropriation act, continuing resolutions, the OMB Budget of the United States Government, Appendix or related congressional committee and conference reports depending upon certain funding features of the account. We reviewed the related OMB instructions regarding the preparation of the PPA reports. We also interviewed agency and OMB officials to gain an understanding of the procedures involved in preparing these reports. We randomly selected 30 of the 300 accounts included in the PPA report. We compared the PPA report with the above mentioned documents to see if the agencies properly reported the PPAs.

Finally, we interviewed staff members of the House and Senate Budget Committees to elicit their views on compliance matters.

Our work was conducted in Washington, D.C., between August 21, 1989, and November 7, 1989.

unless they are specifically exempted in law. We found no exemption for this program's administrative expenses.

Estimation Problems

We identified two instances where OMB improperly estimated the amount of budgetary resources that will be available to an account for expenditure. Both pertain to the act's rules for projecting resources in the absence of a full year's appropriation at the time of OMB's reports.

Payment to the Postal Service Fund for Nonfunded Liabilities

OMB improperly projected a level of sequestrable resources for this account (18-1004-0-1-372). Section 251(a)(6)(C) of the act requires that, in projecting the budgetary resources of an account that has not yet received its appropriation for the entire fiscal year, OMB should use the prior year's appropriation and adjust it for inflation and pay increases. In this case, the prior year's appropriation was zero, and OMB therefore should not have included any amount for this account. Instead OMB included the President's fiscal year 1990 budget request of \$36.9 million as sequestrable resources because it believed the request amount to be a reasonable estimate. While this may be true, the act's provisions covering such cases are clear, and OMB should not have included an amount for the account.

Reimbursement to the Rural Electrification and Telephone Revolving Fund

OMB counted as sequestrable resources its estimated fiscal year 1990 appropriation for this account (12-3101-0-1-271). The account's appropriation reimburses the Rural Electrification and Telephone Revolving Fund for certain realized losses. OMB believes its estimate, reflecting prior activity levels and losses, is more realistic than any estimate based on the prior year's appropriation. However, since this account had not yet received its full year appropriation at the time of OMB's reports, OMB should have based its estimate on the 1989 appropriation level. Since it failed to do so, OMB underreported sequestrable resources by about \$117 million.

Other Account Problems

In its October report, OMB acknowledged five errors in its estimates of budgetary resources. The law, which requires that the October report use the same definition of the budget baseline as the August report, does not permit OMB to correct these errors in its October report. The errors are as follows:

- Transfer of Certain National Forest Fund Receipts (12-5220-0-1-302). OMB did not provide an estimate for this account in its report. Since this

Appendix II
Compliance Matters

military accounts because of OMB's instructions that a PPA report was not required because DOD's annual appropriations for fiscal year 1990 had not been enacted.

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is a permanent appropriation account, the law would require an estimate. OMB agrees with CBO's estimate of \$104 million.

- Assets Forfeiture Fund (15-5042-0-2-752). OMB has proposed restricting the availability of this permanent appropriation for fiscal year 1990. OMB erroneously used the restricted amount, although the Congress had not enacted this restriction. Under the law, OMB should not have considered this restriction in its fiscal year 1990 estimate. As a result, OMB understated sequestrable resources by \$24 million.
- Administration of Territories (14-0412-0-1-808). OMB overstated sequestrable resources by \$7 million when it erroneously included the amount of inflation attributable to an exempt program.
- Land Acquisition and Development Fund (42-4084-0-3-451). OMB understated sequestrable resources by \$7 million when it erroneously used its estimate of offsetting collections from the fiscal year 1989 budget, instead of the fiscal year 1990 budget.
- Guarantees of Mortgage-Backed Securities (86-4238-0-3-371). OMB understated sequestrable guaranteed loan limitations by about \$5.2 billion when it failed to adjust the fiscal year 1989 appropriation limitation for inflation.

PPA Reporting Problems

On October 31, 1989, the President transmitted to the Congress the fiscal year 1990 PPA report. To identify PPAs, section 252 of the act requires the following:

- For funds provided in annual appropriations acts, OMB is to use PPAs "as set forth in the most recently enacted applicable appropriation acts and accompanying committee reports."
- If an annual appropriation act has not been enacted, OMB must refer to the continuing resolution and committee reports accompanying the acts referred to therein.
- For funds not provided in annual appropriation acts, OMB is to use the budget account activities identified in the program and financing schedules identified in the Budget Appendix for that fiscal year.

We believe that the general criteria OMB used to identify the PPAs listed in the report are consistent with the act.

In our review of the PPA report, we determined that about 63 percent of the accounts reported in OMB's final sequester report were not included in the PPA report. Based on our interviews with agency and OMB officials, we believe there was confusion regarding the information OMB needed for the PPA report. For example, DOD did not submit a PPA report for its

Compliance Matters

Account Problems Identified by GAO

We identified several accounts where we believe that OMB misapplied provisions of the act. We note that the errors, in the final analysis, did not materially affect OMB's compliance with the act. OMB's errors were of two types: the mis-classification of certain budgetary resources as either sequestrable or exempt and the improper estimation of the budgetary resources that some accounts will have for making outlays.

Classification Problems

We identified two instances where OMB improperly classified budgetary resources.

Supplemental Annuity Pension Fund

We continue to disagree with OMB's classification of this account (60-8012-0-7-602) as sequestrable. As we stated in prior compliance reports,⁴ the act's exemption of "Railroad retirement tier II (60-8011-0-7-601)" (see section 255(g)(1)(B) of the act) was intended to include railroad retirement supplemental annuities. In 1987, OMB administratively divided the tier II account, creating a separate account for railroad supplemental annuities called the Supplemental Annuity Pension Fund. OMB considers the new account to be sequestrable on the grounds that it was not explicitly identified as an exempt account in subsequent amendments to the act.

As we explained in greater detail in our earlier reports, we believe that the intent of the act and its amendments was to include railroad supplemental annuities in the exempt category. Further, we believe that OMB may not repudiate the exemption by administrative action to establish a new account. OMB should have treated the estimated \$114.9 million in supplemental annuities as exempt.

Vaccine Improvement Program Trust Fund

OMB improperly exempted approximately \$1.6 million in administrative expenses of the Vaccine Improvement Program. Payments from this trust fund (20-8175-0-7-551) to compensate certain patients for vaccine-related injuries or death are exempted from sequestration by the Public Health Service Act. OMB stated that they consider the entire account, including administrative expenses, to be exempt. Section 256(b) of the Balanced Budget and Emergency Deficit Control Act, however, provides that administrative expenses of exempt accounts are sequestrable

⁴Deficit Reductions for Fiscal Year 1988: Compliance With the Balanced Budget and Emergency Deficit Control Act of 1985 (GAO/OCG-88-1, December 15, 1987) and 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). This was also conveyed to the Railroad Retirement Board in a letter (B-229738, March 28, 1988).

Additional Material on Objectives, Scope, and Methodology

Our review was designed to determine whether OMB and the President had complied with the requirements of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, in OMB's reports of August 21 and October 16, 1989, and the President's orders of August 25 and October 16, 1989. To accomplish this, we conducted a variety of tests to determine whether specific provisions of the act had been implemented correctly.

The act required OMB to use the same economic and technical assumptions in making its deficit projections that it used in its mid-session report, issued on July 18, 1989. We therefore compared OMB's August and October reports with OMB's mid-session report to determine if the same assumptions were used. Our review did not include an assessment of the validity or reasonableness of these assumptions.

We reviewed OMB's outlay rates to determine if the aggregate outlay rates for sequestrable discretionary resources were, as required by the act, within one-half of 1 percent of the rates in OMB's final report last year. We also examined the outlays projected for entitlement programs to determine if they were fully funded.

Because OMB's August report was issued this year before any regular appropriation bills for 1990 had been enacted, we examined a judgmental sample of accounts to ensure that OMB used the required inflation rate for developing, from fiscal year 1989 levels of budgetary resources, a projection of 1990 resources and outlays. Since only one appropriation law for 1990, Energy and Water Development Appropriations Act, had been enacted prior to OMB's October report, we compared the projections in the two reports and checked to see if the appropriated amounts were properly included in the October report.

The act requires CBO to issue advisory reports in August and October prior to OMB's initial and final reports. We therefore compared the OMB and CBO reports and examined those accounts where there was a difference of \$5 million or more between OMB's estimate of sequestrable resources and CBO's estimate. As required by the act, OMB's reports listed these accounts and provided an explanation for the differences. We also examined certain other accounts identified in CBO's sequester report.

Because OMB's reports indicated that a sequester would be required, we replicated OMB's calculations of sequestrable resources, sequester percentages, and sequester dollar amounts to ensure that these steps had been performed correctly. We also examined differences between the

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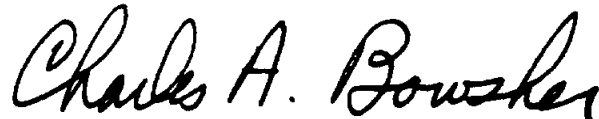
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Abbreviations

CBO	Congressional Budget Office
GAO	General Accounting Office
OMB	Office of Management and Budget
PPA	program, project, and activity

Office, Members of the Congress, and interested congressional committees. Copies will be made available to other interested parties on request.

This report was prepared under the direction of James L. Kirkman, Director, Budget Issues, who may be reached on 275-9573 if you or your staffs have any question. The major contributors to this report are identified in appendix III.



Charles A. Bowsher
Comptroller General
of the United States

where the long-term problem lies, the act helps decisionmakers postpone the difficult choices needed to correct this underlying imbalance.

Third, OMB's final deficit projections under the act cannot reflect appropriations or other spending authority enacted after the date of OMB's final report in October. We reported a year ago that, during the first week after OMB's final report for fiscal year 1989, the Congress and the President enacted into law an additional \$500 million in spending legislation. Following that, additional spending legislation was enacted during the year, including the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). FIRREA alone appropriated another \$20 billion for on-budget spending. Similarly, the cost to the government of the California earthquake disaster could not be included this year in OMB's final fiscal year 1990 deficit estimates. The legislation providing about \$3 billion in disaster assistance was not enacted until after OMB's final report.

Fourth, certain budget accounting requirements under the act make OMB's deficit projections unrealistic. The law prohibits OMB from making changes in its economic and technical assumptions after its mid-session report unless a law is enacted and signed or a regulation promulgated. In addition, OMB is prohibited from correcting any errors made in its August sequestration report in its October report. These restrictions were placed in the act to minimize OMB's opportunities to manipulate budget projections by arbitrarily adopting new economic and technical assumptions. As a result, however, OMB cannot revise or correct earlier inaccurate estimates and mistakes in its reports under the act. For this reason, OMB was unable to record in its final report for 1990 about \$8 billion in outlays under FIRREA, even though OMB knew at the time that the \$8 billion would be spent in fiscal year 1990. In its August report, OMB had projected that this money would be spent in fiscal year 1989 rather than 1990. Having made that technical assumption for its first report, OMB could not change it in its October report, even when it became apparent that the outlays would not be made until 1990. Such unrealistic estimating procedures diminish the accuracy of OMB's deficit projection. As a result, OMB's projections cannot be taken as a meaningful estimate of the deficit that will actually occur.

In view of these problems, we believe that a fundamentally different approach is needed. In our opinion, the starting point should be a recognition by all parties that, in our system of government, formula

the law. Appendix I provides more information on the kinds of tests we conducted.

Our review did not encompass an assessment of the validity or reasonableness of the economic and technical assumptions used.

Overall Compliance

Our tests and interviews gave us reasonable assurance that OMB and the President substantially complied with the legally prescribed procedures and rules. We identified, however, a few accounts where we believe OMB inappropriately applied the act's requirements. These OMB decisions pertained to relatively small dollar amounts. Different OMB decisions on these matters would not have altered OMB's basic determination that there was an excess deficit, and its computation of the uniform sequester percentages would not have changed. Appendix II contains additional information on these compliance matters.

Concerning programs, projects, and activities, OMB guidance to agencies on developing their portion of the PPA list appears to have been designed to ensure implementation of the sequestration in the manner required by law. However, there apparently were ambiguities in OMB's guidance on what accounts agencies should include. Thus, while the President's listing included accounts of most agencies—the notable exception being the military accounts of the Department of Defense—many accounts or portions of accounts of those agencies were not included in the list. These matters are also discussed further in appendix II.

Implementation of the Sequester

We are concerned about OMB's steps to implement the sequester. In OMB's supplemental bulletin to the executive Departments and agencies pertaining to the sequester for fiscal year 1990 (90-01, October 16, 1989), the OMB Director stated that OMB's apportionment procedures and controls apply to amounts at the PPA level and that agencies' financial management systems must control all obligations and expenditures at that level. This new OMB policy extends OMB controls over agencies' spending to levels of detail not usually seen in previous OMB controls. This could cause at least two problems. First, it could seriously impede the agencies' ability to adapt to the sequester in the manner least disruptive to their operations. For example, it could preclude reprogramming between the PPAs without reapportionment approval by OMB. Second, it is not clear that the agencies have the accounting and fund control systems

We believe that such problems strongly point to the need for a different approach to deficit reduction. We have proposed combining a restructured unified budget with a bipartisan agreement between the Congress and the administration on a multiyear plan for deficit reduction. The budget summit agreement of 1987 was such a multiyear plan. The basic purpose of the restructured budget we have proposed would be to focus increased attention on the large and persistent nontrust fund deficit and permit more informed decisions on spending for long-term investments and enterprises established to be largely self-financing. We discuss our alternative approach in a recently released report.²

Background

The act establishes deficit targets to lead to a balanced unified budget by fiscal year 1993. The deficit target for fiscal year 1990 is \$100 billion. Each year, OMB is required to submit an initial report on August 25th and a final report on October 15th projecting the fiscal year deficit. If OMB projects a deficit in excess of the target amount plus \$10 billion, the President must issue a sequester order to reduce budgetary resources sufficiently to bring the estimated deficit down to the target level. The act also requires the President to report to the Congress, within 15 days after any presidential sequester order, the base and sequester amounts for each sequestrable program, project, and activity (PPA) within the accounts. The basic objective of this reporting requirement is to assure that any reduction applied to subaccount levels is not used to eliminate a program, project, or activity or change the PPA priorities indicated in law.

The Congressional Budget Office (CBO) is required to submit similar reports to the Congress and OMB on August 20th and October 10th. These advisory reports provide CBO's projections of the deficit and, if CBO projects an excess deficit, CBO's sequester computations. Although CBO's conclusions are only advisory, OMB's reports must explain key differences between its and CBO's conclusions.

OMB's August 1989 and October 1989 reports for fiscal year 1990 projected a deficit of about \$116 billion. Since this estimate is above the amount that would trigger a sequester (\$110 billion), the President issued sequester orders requiring reductions of budgetary resources to reduce outlays by \$16 billion and bring the deficit down to the \$100 billion target level. The \$16 billion reduction was, as required by law,

²Managing the Cost of Government: Proposals for Reforming Federal Budgeting Practices (GAO/AFMD-90-1, October 1989).

