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1991 Budget Estimates: What Went Wrong

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Comptroller General
of the United States

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

The General Accounting Office is very concerned that the $268.7 billion budget deficit for fiscal year 1991—the largest in the nation's history—was almost triple the original estimate of the Office of Management and Budget. Some of this large misestimate may be attributed to events that could not be anticipated, such as the full consequences of U.S. involvement in the Persian Gulf operation, but other components of the misestimate would have been smaller had better estimating procedures been followed.

This report analyzes some of the factors contributing to such a large misestimate for 1991 and makes recommendations to the Director of the Office of Management and Budget and the Secretary of the Treasury for improving future projections. We strongly believe that the accuracy of budgetary projections must be improved if the government is to make greater progress in getting its fiscal affairs in order.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate and House Committees on Appropriations and on the Budget; the Senate Committees on Governmental Affairs and on Finance; and the House Committees on Government Operations and on Ways and Means. Copies are also being provided to the Director of the Congressional Budget Office, the Secretary of the Treasury, and the Director of the Office of Management and Budget.

Charles A. Bowsher

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Comptroller General
of the United States

Executive Summary

Purpose

On October 29, 1991, the Department of the Treasury released its final Monthly Treasury Statement of Receipts and Outlays of the United States Government for fiscal year 1991, which showed a $268.7 billion total budget deficit for the year. This is the highest in the nation's history, far surpassing the previous record deficit of $221.2 billion, set in 1986. Equally disturbing is the fact that the $268.7 billion actual deficit in 1991 is more than two and a half times the Office of Management and Budget's (OMB) original baseline estimate of $100.5 billion for the year. This report assesses some of the factors that caused such a large misestimate. Based on an analysis of four areas in which there were particularly large misestimates, this report makes recommendations to the Director of OMB and the Secretary of the Treasury for providing a prompt analysis of the causes of misestimates at the close of each fiscal year and for improving future estimates.

Background

The President's budget for fiscal year 1991, released in late January 1990, forecast a baseline deficit of $100.5 billion for 1991. Baseline deficit estimates reflect estimates of outlays and revenues that would result if current policies are extended without change into the future. The budget also estimated that if the President's policy proposals were enacted, the deficit would be $63.1 billion, meeting the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings) target of $64 billion applicable at that time.

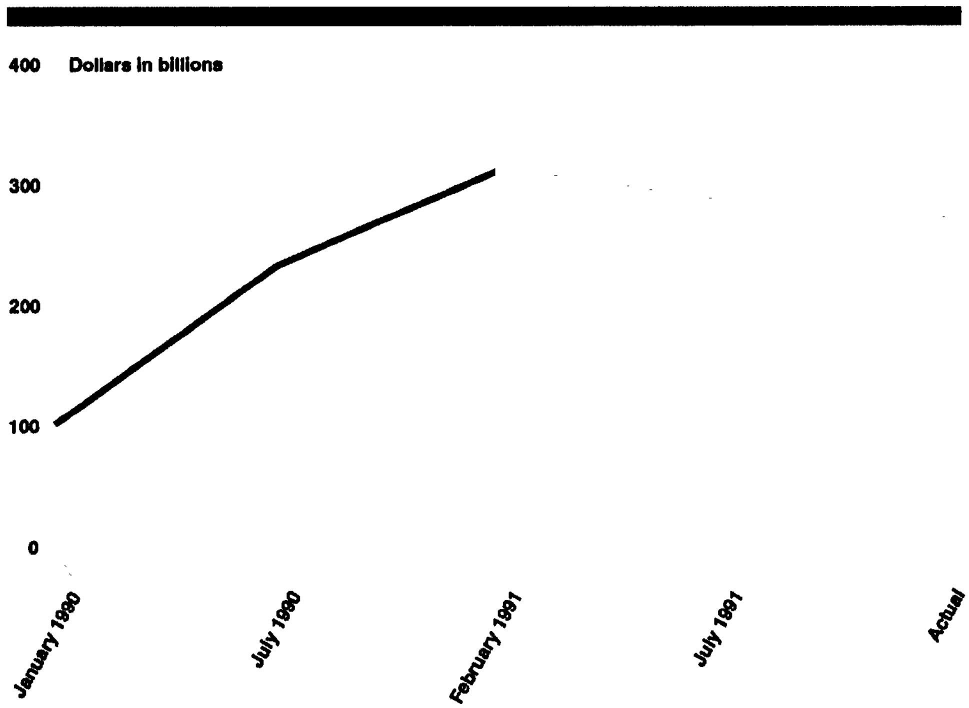
In May of 1990, concern about the economy, the difficulty of complying with the 1991 Gramm-Rudman-Hollings maximum deficit target, and the prospect of a large fiscal year 1991 sequester prompted budget summit negotiations between the Congress and the administration. The participants began with an informal agreement to achieve $500 billion in savings below the baseline deficit over 5 years. However, as the negotiators attempted to develop a budget compromise, they were confronted with significantly changing OMB baseline estimates. By September 1990, OMB's baseline deficit estimate had reached $293.7 billion.

When the budget negotiators finally reached an agreement in the fall of 1990, the Omnibus Budget Reconciliation Act of 1990 was enacted to implement the agreement. According to Congressional Budget Office estimates, the agreement provided for $482 billion in savings over 5 years and $33 billion in 1991. These estimated budget agreement savings for 1991 were far smaller than the estimate increases up to this point that were not the direct result of legislation. This demonstrated that enacting budget savings does not guarantee that the deficit will go down.

Results in Brief

The fiscal year 1991 OMB baseline deficit estimate varied from $100.5 billion in January 1990 to $310.3 billion in February 1991, with an actual deficit of $268.7 billion, more than two and a half times the original January 1990 estimate.

Figure 1: 1991 Baseline Deficit Estimates - January 1990 to Actual



The $168.2 billion increase in the deficit over the original estimate was the net result of some factors that reduced the deficit and others that added to the deficit. The following table shows the revenue sources and the programs that had the largest changes in estimates.

Table 1: Changes to the Fiscal Year 1991 Budget Estimates - January 1990 Estimates to Actual

Dollars in billions

Receipts	1991 budget baseline estimate	Actual	Change
Individual income tax	$523.6	$467.8	−55.8
Corporate income tax	128.6	98.1	−30.5
Social insurance contributions	416.9	396.0	−20.9
Excise taxes	34.9	42.4	7.5
Other	52.3	49.9	−2.4
Total receipts	**$1,156.3**	**$1,054.2**	**−102.1**
Outlays			
Deposit insurance Resolution Trust Corporation	$7.3	$50.8	43.5
Bank Insurance Fund	−2.8	7.4	10.2
Federal Savings & Loan Insurance			
Corporation Resolution Fund	2.8	8.6	5.8
Other deposit insurance	−0.1	−0.3	−0.2
Subtotal, deposit insurance	7.2	66.4	59.2
Department of Defense-military	296.0	261.9	−34.1
Medicaid	45.0	52.5	7.5
Unemployment insurance	18.6	28.4	9.9
Social security	264.7	269.0	4.3
Food stamps	16.4	19.6	3.2
All other programs	347.3	339.1	−8.2
Interest on the public debt	261.6	286.0	24.4
Total outlays	**$1,256.8**	**$1,323.0**	**66.2**
Total Deficit	**$100.5**	**$268.7**	**168.2**

Note: Totals may not add due to rounding.

These changes occurred for a variety of reasons, some of which are analyzed in detail in this report. The decrease in estimated Department of Defense (DOD)-military outlays was caused in part by a policy decision to reduce DOD-military funding below the baseline level. Most of the decrease, however, resulted from allies' contributions for Operation Desert Shield/Desert Storm that exceeded the additional 1991 outlays resulting from that operation. In the other areas GAO analyzed in detail—deposit insurance, individual income taxes, and Medicaid—there were also multiple reasons for the changes in estimates, but all were significantly affected by the deteriorating economy. Other major changes in estimates shown in the preceding table were also significantly affected by the economy, but data to determine these relationships precisely are not yet available. The $24.4 billion increase in the estimated interest on the public debt was a function of the higher deficits in 1990 and 1991, as well as higher interest rates.

Using incomplete information about OMB's categorization of the reasons for the deficit increase and assumptions based on the best available data, GAO has estimated the approximate amounts of these increase and decrease reestimates that can be attributed to various causes.

Table 2: GAO Estimates of Causes of Reestimates,[a] Fiscal Year 1991

Dollars in billions

	Deficit	Receipts	Outlays
January 1990 budget baseline	$100.5	$1,156.3	$1,256.8
Desert Shield/Desert Storm	−25.1	0	−25.1
Deposit insurance	59.2	0	59.2
Legislation/regulations	−30.7	17.7	−13.0
Economic reestimates	70.4	−50.7	19.7
Technical reestimates[b]	94.4	$−69.0	$25.4
Total reestimates	**$168.2**	**$−102.0**	**$66.2**
Actual	$268.7	$1,054.3	$1,323.0

[a]Estimated by GAO using OMB categorization and best available data. May not be exact.

[b]Because of ambiguity in categorization of changes, this probably includes substantial amounts of changes due to deteriorating economic conditions.

On the reduction side, policy changes in the form of new legislation and regulations produced about $30.7 billion in budgetary savings. In addition, burden-sharing contributions from the allied governments for Desert Shield/Desert Storm exceeded U.S. expenditures for that purpose in 1991, producing a positive cash flow which GAO estimates at $25.1 billion.

Most of the increases in the deficit estimates were due to factors other than legislation enacted or regulations promulgated after the submission of the 1991 budget. For instance, the spending actually required to meet existing deposit insurance commitments was $59.2 billion higher than the original estimate. In addition, GAO estimates that at least $70.4 billion of the increase in deficit estimates was due to the poor performance of the economy. While it is unrealistic to expect precision in forecasting a recession, the administration's January 1990 economic assumptions were more optimistic than most forecasts at that time.

So-called technical reestimates, which are those reestimates that are not directly attributable to legislation, regulations, or explicit changes in economic assumptions, accounted for $94.4 billion of the increase in the deficit estimates, including a $69.0 billion downward revision in estimated receipts. Since technical reestimates are defined as a residual, there are many possible reasons for them. These include changes in the weather that affect farm support payments, changes in behavior (such as more young people deciding to go to college and applying for guaranteed student loans) as well as the use of faulty estimating procedures and models. Because of the complexity in determining the causes of changes in budget levels, a significant part of what are classified as technical reestimates may also be related to the deteriorating economy.

GAO's Analysis

In order to understand better why the actual 1991 budget results differed from administration estimates made over the 20 months prior to the end of the fiscal year, GAO analyzed in some detail the estimates and actual results in four areas: deposit insurance, individual income tax receipts, Desert Shield/Desert Storm, and Medicaid.

Deposit Insurance

Deposit insurance outlay estimates were the most volatile component of the fiscal year 1991 budget. The administration's February 1991 estimate exceeded the January 1990 estimate by $104.3 billion, while actual outlays were $45.1 billion lower than the February 1991 estimate (but still $59.2 billion higher than the original estimate).

Estimates of Resolution Trust Corporation (RTC) outlays, which are currently the largest component of deposit insurance spending, changed from a January 1990 estimate of $7.3 billion to a February 1991 estimate of $84.6 billion. The actual 1991 outlays were $50.8 billion. A part of this swing in the estimate stemmed from the fact that the early estimates did not include the costs of working capital. The July 1990 Mid-session Review of the Budget estimate, and all subsequent estimates, included working capital needs. Exclusion of working capital outlays from the original estimate was disclosed in the budget documents. Nevertheless, that action contributed to a significantly understated estimate of the overall deficit.

Apart from its decision to exclude working capital outlays from the original estimate, OMB's ability to produce realistic budget estimates for RTC has been limited for two reasons: (1) OMB works closely with the RTC Oversight Board and analysts at the Department of the Treasury rather than obtaining information directly from RTC and (2) at the time 1991 estimates were evolving, RTC had no long-term plan for resolving failed institutions and OMB had to rely on RTC's short-term financial operating plans, which only projected RTC activity for 3 months. In view of the size of the RTC program, the lack of a well-developed plan as a basis for developing budget estimates is disturbing. RTC is now required to provide the Congress with a 1-year plan prior to each fiscal year, updated quarterly.

The Federal Deposit Insurance Corporation's (FDIC) Bank Insurance Fund (BIF) outlay estimates also fluctuated widely, from a January 1990 estimate of -$2.8 billion (meaning estimated premium income in excess of estimated outlays) to a February 1991 estimate of $15.9 billion. The actual outlays were $7.4 billion.

The wide variation in the BIF budget estimates was primarily the result of OMB's adopting, in February 1991, a new method for estimating BIF outlays and incorporating a cash flow model instead of relying on FDIC's survey method. By the time of the July 1991 Mid-session update, however, actual outlays were far below what the new OMB model had projected in February, and OMB revised its estimate downward. Analysts are uncertain about the reasons for the lower than expected outlays.

Estimates for other, smaller deposit insurance entities also fluctuated, but the total amounts involved are small relative to the RTC and BIF expenditures.

Estimates of deposit insurance outlays would fluctuate less, and deposit insurance costs would be recognized in the budget more promptly, if deposit insurance expenditures were subject to budgetary treatment similar to that provided for credit programs by the Credit Reform Act of 1990. Practical difficulties of implementing such treatment must be carefully considered, however, before such treatment should be adopted.

Individual Income Tax Receipts

Estimates of individual income tax receipts fell steadily from a January 1990 estimate of $523.6 billion to an actual total of $467.8 billion. Policy changes had relatively little effect on this $55.8 billion decrease. According to OMB, enactment of the Omnibus Budget Reconciliation Act of 1990 resulted in an increase in tax receipts for 1991 of less than $5 billion.

This increase, however, was more than offset by decreases in tax receipts due to changes in the economic forecast. The administration's recognition of the 1991 recession, reflected in its economic assumptions, was the source of about $10 billion in the changing estimate of these tax receipts. Also, analysts at OMB and Treasury's Office of Tax Analysis indicated that the forecasting model used was limited by inaccurate estimates of national income from Commerce's Bureau of Economic Analysis, and the timing of data from employers' income tax withholding and Social Security tax payments. While changes due to these factors are classified by the Office of Tax Analysis as technical, some of the changes are related to the deteriorating economy.

Desert Shield/Desert Storm

Estimates of DOD-military outlays for fiscal year 1991 decreased by $34.1 billion from the administration's January 1990 baseline estimate of $296.0 billion to the actual outlays of $261.9 billion reported in October 1991. About $9 billion of that decrease reflects policy decisions to reduce defense spending, but GAO estimated that $25.2 billion of the reduction resulted from Desert Shield/Desert Storm. GAO estimated that DOD-military gross outlays for fiscal year 1991 increased by $18.4 billion as a result of Desert Shield/Desert Storm, but the $43.6 billion in allied contributions received during the year (which are counted as offsetting collections, or negative outlays) resulted in a decrease in net DOD-military outlays of $25.2 billion. Since agencies other than DOD had 1991 outlays for Desert Shield/Desert Storm of $0.1 billion, the net effect of Desert Shield/Desert Storm on the 1991 deficit was a decrease of $25.1 billion.

While the 1991 deficit was reduced by $25.1 billion as a result of Desert Shield/Desert Storm, GAO estimates that the total multiyear effect of the operation will be to increase the deficit by $0.6 billion. Assuming that all currently available funds will be obligated and no further appropriations will be enacted for Desert Shield/Desert Storm, GAO estimated that net outlays will be increased by $48.9 billion in the 1990s as a result of Desert Shield/Desert Storm. (This reflects just the incremental funding; the estimated full costs of the operation are significantly higher.) If the full $48.3 billion of contributions pledged is received, all but $0.6 billion of the increased expenditures will be offset.

GAO's ongoing analysis of Desert Shield/Desert Storm spending has indicated, however, that some cost and funding requirement estimates have been inflated. It seems likely that it will not be necessary to obligate all the available funds in order to meet legitimate Desert Shield/Desert

Storm funding requirements. Inadequacies in DOD's cost accounting systems will make it very difficult to determine the legitimacy of costs charged to Desert Shield/Desert Storm.

While the estimated net effect of Desert Shield/Desert Storm on the multiyear deficits is small, the timing of the transactions involved causes significant fluctuations in the effect on annual deficits. Most of the contributions were received in fiscal year 1991, while Desert Shield/Desert Storm outlays will continue to flow in 1992 and later years. As a result, the $1.5 billion increase in fiscal year 1990 and the $25.1 billion decrease in 1991, will be followed by 1992 and later year deficit increases that could total $24.2 billion by the end of the decade. If some of the currently available funds are not obligated, these deficit increases would be smaller. However, the enactment and obligation of additional appropriations for Desert Shield/Desert Storm would make these deficit increases even larger.

Medicaid

Medicaid outlay estimates for fiscal year 1991 increased from $45.0 billion in the January 1990 budget to actual outlays of $52.5 billion.

Medicaid cost estimates increased because of federal and state legislation, court decisions, and other program changes affecting eligibility and reimbursement rates. Federal matching rates were affected by increasing state use of provider donations and provider-specific taxes to fund increased reimbursements to providers.

Changes in economic conditions also affected Medicaid spending. For example, the 1991 recession caused an increase in the number of Medicaid recipients as unemployment increased and incomes grew more slowly or fell. Inflation is another economic variable affecting Medicaid spending. Many of the sources GAO interviewed cited a recent, unexpected upturn in acute health care inflation as a factor in the 1991 cost underestimation. This inflation apparently contributed to a change in cost trends that the fiscal year 1991 budget estimates did not capture.

The 1991 Department of Health and Human Services-OMB Task Force recommendations for improving Medicaid estimates focused mainly on resolving technical and organizational problems that relevant state and federal agencies can address. They included: centralizing federal responsibility for Medicaid within the Health Care Financing Administration's Medicaid Bureau, improving communication and information flows between the states and the Medicaid Bureau, creating a consistent federal forecasting methodology, improving the quantitative and analytic skills of personnel, attaching greater priority to estimating the impact of legislation, and eliminating most uses of provider taxes and voluntary contributions. Essentially, the Task Force advocated a larger federal role in overseeing and regulating a program that is mostly controlled by the states and increasingly financed by the federal government.

Conclusions

Information is not currently available that would allow a precise analysis of the causes of budget reestimates in fiscal year 1991. OMB traditionally includes information about the most recently completed fiscal year in the President's budget submission, by which time attention is focused on the current and coming fiscal years.

The tremendous increases in the fiscal year 1991 deficit estimates from the President's budget in January 1990 to the end of the fiscal year raise questions about the estimating process itself. That process is inherently difficult, but policymakers need to have the best possible information available to guide them in the decision-making process.

Recommendations

GAO recommends that the Secretary of the Treasury and the Director of the Office of Management and Budget agree on a procedure to ensure the prompt reporting of an analysis of the causes of changes in budget estimates for the most recently completed fiscal year.

GAO also recommends that the Director of the Office of Management and Budget review that agency's procedures for assessing the accuracy of its budget estimates and the underlying estimating practices in order to better identify means of improving the accuracy of the budget estimates.

Agency Comments

The report was provided to Department of the Treasury and Office of Management and Budget officials for their comment. They reviewed the report and the GAO recommendations and concurred.

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Abbreviations

AFDC	Aid to Families with Dependent Children
BEA	Bureau of Economic Analysis
BIF	Bank Insurance Fund
CBO	Congressional Budget Office
CFO	Chief Financial Officer
DOD	Department of Defense
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
FDIC	Federal Deposit Insurance Corporation
FRF	Federal Savings and Loan Insurance Corporation Resolution Fund
FSLIC	Federal Savings and Loan Insurance Corporation
GAO	General Accounting Office
GNP	gross national product
HCFA	Health Care Financing Administration
HHS	Health and Human Services
IRS	Internal Revenue Service
OBRA	Omnibus Budget Reconciliation Act of 1990
OMB	Office of Management and Budget
OTA	Office of Tax Analysis
OTS	Office of Thrift Supervision
RTC	Resolution Trust Corporation
SSI	Supplemental Security Income

Introduction

Generally, the Department of the Treasury and the Office of Management and Budget (OMB) present the year-end budget data of the federal government and issue a press release several weeks after the September 30 end of a fiscal year. The press release focuses on differences between the actual data reported by Treasury and the Mid-session Review of the Budget updates to budget estimates released by OMB 3 months earlier. However, we believe that important lessons can be learned from a more systematic examination of the year-end results, particularly when they are compared to the expectations embodied in the budget estimates as they evolved. In that spirit, this report examines budget estimates and actual budget results for fiscal year 1991.

Background

On October 29, 1991, the Department of the Treasury released its final Monthly Treasury Statement of Receipts and Outlays of the United States Government for fiscal year 1991, which showed a $268.7 billion deficit for the year. This is the highest in the nation's history, far surpassing the previous record deficit of $221.2 billion recorded in fiscal year 1986.

In contrast, the President's 1991 budget, released in late January of 1990, had forecast a baseline deficit of $100.5 billion for 1991. Baseline estimates reflect outlays and revenues that would result if current policies were extended without change into the future.

Table 1.1 shows that the OMB estimate of the fiscal year 1991 deficit more than tripled from the January 1990 baseline estimate of $100.5 billion to a February 1991 baseline estimate of $310.3 billion. The actual deficit of $268.7 billion reported in October 1991 represented a decrease from the February 1991 baseline, but was still more than two and a half times the original January 1990 baseline estimate.

Table 1.1: OMB Estimated Deficits Versus Actual Deficit

Dollars in billions

	Fiscal year 1991
January 1990 baseline estimate	$100.5
February 1991 baseline estimate	$310.3
Actual	$268.7
Change from January 1990 estimate to actual	$168.2

Fiscal Year 1991 Deficit Estimates

The President's budget for fiscal year 1991, submitted in January 1990, had an estimated $63.1 billion deficit. This met the applicable Balanced Budget and Emergency Deficit Control Act of 1985 (also known as Gramm-Rudman-Hollings) deficit target of $64 billion. However, as mentioned above, OMB's baseline deficit estimate (which excluded the policy changes proposed by the President) totaled $100.5 billion. Under the Gramm-Rudman-Hollings provisions in effect at that time, a deficit estimate of that amount on October 15, 1990, would have triggered a sequester of over $35 billion.

Underlying the President's 1991 budget were economic assumptions which included steady growth in the Gross National Product (GNP) after 1990 and declining interest, inflation, and unemployment rates. The economic assumptions (which are developed jointly by the Council of Economic Advisers, Treasury and OMB) followed the administration's "long-term, growth-oriented target path." These assumptions were more optimistic than those made at that time by the Congressional Budget Office (CBO) and many private forecasters. CBO estimated in March 1990 that the President's fiscal year 1991 budget deficit estimate would be $26 billion higher if the CBO economic assumptions, which were similar to the Blue Chip assumptions at that time,[1] were used instead of the administration assumptions. These administration assumptions, as well as the CBO and most private forecasts, proved to be overly optimistic. See appendix I for a comparison of these assumptions with a current estimate of economic performance in calendar year 1991.

Although the administration did not officially revise its deficit estimates until July 1990, the baseline deficit increased significantly through the winter and spring of 1990 due to a faltering economy and rising deposit insurance costs. Concern about the economy, the difficulty of reaching the Gramm-Rudman-Hollings target, and the growing prospect of a large fiscal year 1991 sequester prompted budget summit negotiations between the Congress and the administration on the 1991 budget. These negotiations began in mid-May.

The summiteers began with an informal agreement to achieve $500 billion in reductions below the baseline deficit levels over 5 years. However, as the negotiators attempted to develop a budget compromise, the baseline deficit projections increased dramatically.

[1] Blue Chip Economic Indicators, Eggert Economic Enterprises, Inc., February 10, 1990. The Blue Chip forecast is based on a survey of 50 private forecasters.

OMB's Mid-session Review reestimate, issued in July 1990 during the summit negotiations, more than doubled the original baseline deficit estimates—from $100.5 billion to $231.4 billion. In September 1990, in order to provide the budget negotiators with more up-to-date estimates, OMB again revised the baseline projections—increasing the deficit estimate to $293.7 billion.

The budget negotiations resulted in a deficit reduction agreement between the President and the Congress and the enactment in November 1990 of legislation—Public Law 101-508, the Omnibus Budget Reconciliation Act of 1990 (OBRA)—to implement the agreement. OBRA also included changes in Gramm-Rudman-Hollings that eliminated the requirement to achieve a $64 billion deficit, or any other fixed deficit target, in fiscal year 1991. Savings from the agreement, including promised future restraint in discretionary programs, were estimated by CBO to total $33 billion in fiscal year 1991 and $482 billion for the 5 years from 1991 to 1995. These estimated 1991 OBRA savings were far smaller than the amount of any of the upward reestimates of the deficit up to this point. This demonstrates the difficulty of achieving short-term reductions in the budget deficit through policy changes when economic conditions are deteriorating and expenditures for programs such as deposit insurance are escalating. Based on the CBO estimate of 1991 savings, we calculated a post-OBRA baseline deficit estimate of $260.7 billion.

The President's 1992 budget was transmitted to the Congress in February 1991, and under the heading "The Deficit Outlook—Worse Before Better," presented a 1991 baseline deficit estimate that reached $310.3 billion despite the savings from the budget agreement. According to the Budget, the two primary causes of the deterioration were an increase in outlays for deposit insurance and a decrease in estimated receipts, due in most part to a weaker economy. The increase in estimated deposit insurance outlays is discussed in detail in chapter 3 and the individual income tax receipt portion of the decrease in estimated receipts is discussed in chapter 4.

From data published in the July 1991 Mid-session Review, we estimated a baseline deficit of $283.5 billion as of July 1991.[2] This decrease from the February estimate was due primarily to slower-than-expected resolutions of failed savings and loans by the Resolution Trust Corporation (resulting in reduced 1991 outlays), and the one-time situation where cash contributions received from other countries in 1991 for Desert Shield/Desert Storm exceeded outlays attributable to the operation in 1991. (These contributions are shown in the budget as offsets to outlays rather than as governmental receipts.) These are discussed in detail later in the report.

The actual outlays, receipts, and resulting deficit for 1991, which were reported in the final Monthly Treasury Statement in October 1991, represented a relatively small change from the 1991 Mid-session Review policy estimates published just 3 months earlier in July 1991.

Figure 1.1 shows the history of budget deficit estimating for 1991 over 20 months, during which time the estimates increased to more than triple the original estimate before the actual deficit of more than two and one half times the original estimate was reported.

[2] The Mid-session Review revised the policy deficit estimate downward (from $318.1 billion in February 1991 to $282.2 billion), but did not show a revision of the baseline. For this study, we have constructed a baseline deficit estimate assuming that the economic and technical changes made to the President's Budget policy deficit estimate would apply identically to the President's Budget baseline deficit estimate. Adding in enacted policy changes allows us to arrive at an estimated baseline deficit of $283.5 billion as of July 1991.

Figure 1.1: 1991 Baseline Deficit Estimates - January 1990 to Actual

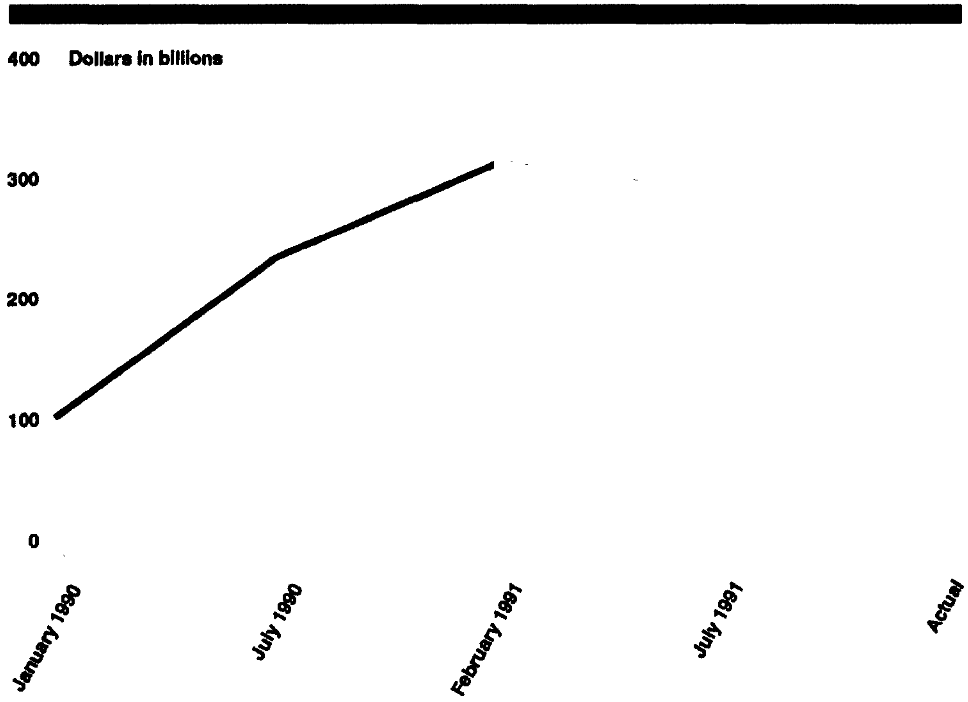
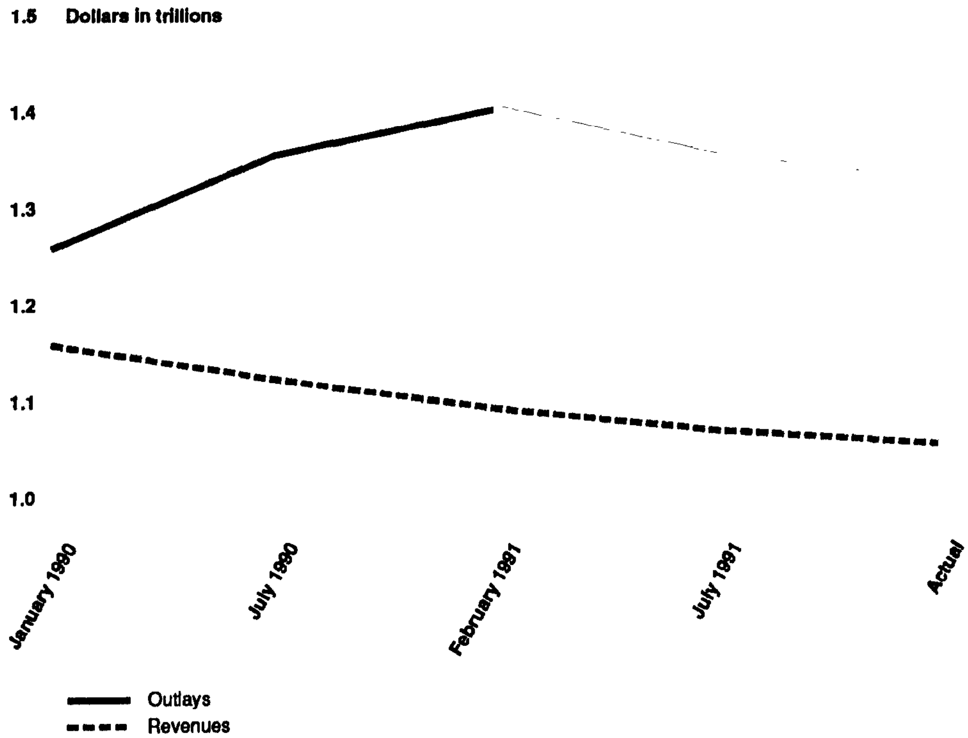


Figure 1.2 shows the outlay and revenue estimates that produced the deficit estimates.

Figure 1.2: 1991 Baseline Outlay and Revenue Estimates - January 1990 to Actual



Objectives, Scope, and Methodology

This report is the first of what is expected to be a series of annual reports assessing the government's financial results for the recently completed fiscal year. The objectives of this report are (1) to examine budget actuals compared to estimates for fiscal year 1991, with an emphasis on identifying program areas where the estimates were particularly high or low compared to the final actual numbers and (2) to identify the reasons for the misestimates and make recommendations for improving the accuracy of future budget estimates.

First, we reconstructed a chronology of escalating OMB deficit projections for 1991, and examined the stated reasons behind the deficit increases. For this, we relied mainly upon the OMB projections and accompanying explanations that were published from January 1990 (when the President's budget proposal was first released) through July 1991. Our emphasis was on baseline 1991 budget estimates, meaning the estimates of outlays and revenues made by OMB assuming that current policies are extended into the future without change. We did not concern ourselves with the outlay and revenue estimates associated with the President's policy proposals. The baseline estimates do, however, by definition, incorporate the results of policy changes when enacted.

Second, we examined the effects on fiscal year 1991 budget estimates of the savings associated with OBRA, which was enacted about a month after fiscal year 1991 began. In order to do this, we used CBO's January 1991 estimates of the legislation's outlay and revenue savings.

Third, in order to identify the programs worthy of more detailed examination, we looked at program-level 1991 budget estimates in the Mid-session Review (published by OMB in July of 1991) and compared them to program-level 1991 budget estimates in the President's fiscal year 1992 budget submitted in February 1991. Because we were primarily concerned with the effect on the deficit estimates of individual program outlay and revenue estimates, we examined only these programs that had a relatively large impact on the deficit rather than those that had increases or decreases that were very large as a percentage of program spending. For example, actual Rural Electrification Administration outlays of $100 million were less than one quarter of the $405 million estimated in February 1991.

We selected four areas for further study: Medicaid; deposit insurance (the Resolution Trust Corporation's, the Federal Deposit Insurance Corporation Bank Insurance Fund, and the Federal Savings and Loan Insurance Corporation Resolution Fund); individual income tax receipts; and Operation Desert Shield/Desert Storm.

To familiarize ourselves with how the budget estimates were made in each of these areas, we interviewed cognizant Congressional Budget Office and OMB analysts as well as program and budget personnel in the agencies administering the programs. This involved obtaining information concerning the budget estimating process, the estimating cycle, and the information used to make budget estimates in each of the four areas. It also involved collecting information about the circumstances surrounding the budget estimates, such as changes in economic conditions and changes in policy that affected the budget estimates.

Much of our study was conducted before the actual outlay and revenue data for fiscal year 1991 were known. To ensure that there were no additional, unexpected spurts or shortfalls in outlays or revenues deserving further study, we monitored the Monthly Treasury Statements during the audit phase of our work.

We must note that the actuals upon which we base this report are not backed up by audited financial statements. In fact, many agencies are reporting incomplete, inaccurate, and inconsistent information to Treasury. Audits of agencies continue to show instances of inadequate accounting systems, poor internal controls, and unreconciled data, which severely diminish the reliability of the information provided to Treasury.

We expect the Chief Financial Officers (CFO) Act of 1990 to lay the groundwork for extensive reform of federal financial management. A new financial management leadership structure has been established in OMB. A CFO in each major agency will report directly to the agency head and oversee all financial management activities of the agency. Agencies are required to prepare multiyear financial management plans and to conduct financial statement audits of all their trust and revolving funds and commercial activities. The discipline created through the process of implementing this new legislation should lead to greater accountability and integrity in the systems used to manage our government.

We conducted our work between July 1991 and November 1991 in accordance with generally accepted government auditing standards. We asked staff at the following agencies for their review of our data and other factual material: the Congressional Budget Office; the Department of Health and Human Services' Health Care Financing Administration (Medicaid); the Resolution Trust Corporation and Federal Deposit Insurance Corporation (deposit insurance); and the Department of Defense's Office of the Comptroller (Desert Shield/Desert Storm). Several minor changes were suggested, and we made the changes as appropriate.

Actual Fiscal Year 1991 Results

The size of the fiscal year 1991 deficit, as well as the very large reestimates of that deficit that occurred between January 1990 and the reporting of the actual deficit in October 1991, deserve attention.

Record High Deficit

The $268.7 billion deficit for fiscal year 1991 is in nominal terms the highest in the nation's history, far exceeding the previous record deficit of $221.2 billion recorded in fiscal year 1986. It is $48.3 billion higher than the fiscal year 1990 deficit of $220.4 billion.

The actual 1991 deficit is not the highest ever as a percent of gross national product (GNP), however. The 1991 deficit was 4.8 percent of GNP. The 1983 deficit of $207.8 billion represented 6.3 percent of GNP, the highest in recent years. In the midst of the Second World War, in 1943, the deficit reached 31.0 percent of GNP. From the end of that war until the 1980s, however, the deficit exceeded 4.0 percent of GNP only twice, in 1948 and 1976. In the 1980s the deficits averaged 4.1 percent of GNP.

The magnitude of the deficit problem is hidden in part by the Social Security and other trust fund surpluses. The $268.7 billion deficit includes the effects of a $53.5 billion fiscal year 1991 surplus in the social security trust fund and a total surplus of $58.7 billion in all other trust funds. Excluding the Social Security surplus, the fiscal year 1991 deficit was $322.2 billion. With all trust funds excluded, the 1991 deficit is $380.9 billion. This is a record-high deficit in nominal terms, but as a percent of GNP, the 6.81 percent registered in 1991 is surpassed even in recent years by the 6.95 percent recorded in 1983.

Causes of Budget Reestimates

The increases in the deficit estimates resulted from changes in estimated receipts from various sources and changes in estimated outlays in a number of programs. The $168.2 billion increase from the deficit estimate in the President's fiscal year 1991 budget in January 1990 to the actual deficit reported in October 1991 was the result of changes in estimated receipts from a number of sources and changes in estimated outlays in a number of programs. The following table shows the revenue sources and the programs that had the largest changes in estimates.

Table 2.1: Changes to the Fiscal Year 1991 Budget Estimates - January 1990 Estimates to Actual

Receipts	1991 budget baseline estimate	Actual	Change
Individual income tax	$523.6	$467.8	$−55.8
Corporate income tax	128.6	98.1	−30.5
Social insurance contributions	416.9	396.0	−20.9
Excise taxes	34.9	42.4	7.5
Other	52.3	49.9	−2.4
Total receipts	**$1,156.3**	**$1,054.2**	**$−102.1**
Outlays			
Deposit insurance Resolution Trust Corporation	$7.3	$50.8	$43.5
Bank Insurance Fund	−2.8	7.4	10.2
Federal Savings & Loan Insurance Corporation Resolution Fund	2.8	8.6	5.8
Other deposit insurance	−0.1	−0.3	−0.2
Subtotal, deposit insurance	7.2	66.4	59.2
Department of Defense-military	296.0	261.9	−34.1
Medicaid	45.0	52.5	7.5
Unemployment insurance	18.6	28.4	9.9
Social security	264.7	269.0	4.3
Food stamps	16.4	19.6	3.2
All other programs	347.3	339.1	−8.2
Interest on the public debt	261.6	286.0	24.4
Total outlays	**$1,256.8**	**$1,323.0**	**$66.2**
Total Deficit	**$100.5**	**$268.7**	**$168.2**

Note: Totals may not add due to rounding.

These changes occurred for a variety of reasons. In the following chapters, we analyze in detail the reasons for changes in estimates of (1) individual income taxes, (2) deposit insurance outlays, (3) DOD-military outlays, and (4) Medicaid outlays. The decrease in estimated DOD-military outlays was caused in part by a policy decision, reflected in the OBRA 1990 defense spending limit, to reduce DOD-military funding below the baseline level. Most of the decrease, however, was the result of allies' Desert Shield/Desert Storm contributions which exceeded the additional 1991 outlays resulting from Desert Shield/Desert Storm. In the other three areas we analyzed, there were also multiple reasons for the changes in estimates, but all were significantly affected by the deteriorating economy. It seems quite likely that the other major changes in estimates shown in the preceding table were also significantly affected by the economy, although, in the case of excise taxes, the likely effects of the economy may have been more than offset by policy or other changes. Interest on the public debt was $24.4 billion higher than estimated in January 1990. This increase in outlays is the result of all the factors that caused receipts to be lower and other outlays higher than anticipated, including the effect of the economy on those receipts and outlays, plus the effect of higher than anticipated interest rates on the debt required to finance the higher deficit.

The increases in the deficit estimates resulted from causes other than explicit policy decisions of the Congress or the administration. Although we did not analyze the reasons for changes in estimates in all areas of the budget, we were able to estimate the aggregate amount of changes in estimated outlays and receipts (and the resulting changes in the estimated deficit) attributable to several categories of causes. These estimates are based on the available information about OMB categorizations of the reasons for changes, although incomplete information about those categorizations required us to make certain reasonable assumptions based on supplemental data from other sources. These estimates should, therefore, be considered approximations.

Table 2.2: GAO Estimates of Causes of Reestimates,[a] Fiscal Year 1991

Dollars in billions

	Deficit	Receipts	Outlays
January 1990 budget baseline	$100.5	$1,156.3	$1,256.8
Desert Shield/Desert Storm	−25.1	0	−25.1
Deposit insurance	59.2	0	59.2
Legislation/regulations	−30.7	17.7	−13.0
Economic reestimates	70.4	−50.7	19.7
Technical reestimates[b]	94.4	−69.0	25.4
Total reestimates	**$168.2**	**$−102.0**	**$66.2**
Actual	$268.7	$1,054.3	$1,323.0

[a]Estimated by GAO using OMB categorization and best available data. May not be exact.

[b]Because of ambiguity in categorization of changes, this probably includes substantial amounts of changes due to deteriorating economic conditions.

The $168.2 billion increase in the estimated fiscal year 1991 deficit from January 1990 to the actual results for the year was not the result of explicit policy decisions by the Congress or the President to increase spending or cut revenues. In fact, the enactment of new legislation (excluding funding for Desert Shield/Desert Storm and for deposit insurance) and issuance of regulations reduced deficit estimates by $30.7 billion[1] between January 1990 and the end of fiscal year 1991.

Desert Shield/Desert Storm, which required enactment of new legislation to provide additional funding but can be viewed as a response to an unforeseen event rather than a change in policy, actually resulted in an estimated decrease in the 1991 deficit of $25.1 billion. (See chapter 5.) Reestimates of deposit insurance spending increased 1991 deficit estimates by $59.2 billion from the January 1990 estimates to the end of the fiscal year. (See chapter 3.) Although legislation was required to fund resolutions of insolvent thrifts, this deficit increase represented changes in the estimated outlays resulting from existing deposit insurance policies rather than a change in policy. Such changes are usually categorized as technical reestimates, but we thought the size of the deposit insurance reestimates and the unique nature of the deposit insurance situation warranted a separate category.

Changes in economic assumptions[2] resulted in a $70.4 billion increase in the estimated deficit, with $50.7 billion of that increase due to the depressing effect of the economy on receipts. Technical reestimates resulted in an increase of $94.4 billion in the deficit estimates, with $69.0 billion of that amount coming from technical reestimates of receipts.

Technical reestimates constitute a residual category of changes in estimates that are not due to legislation or regulation or to changes in economic assumptions. Thus, there are many possible causes of technical reestimates. Among the factors that can lead to technical reestimates are natural occurances such as severe weather. A drought can lead to poorer crop harvests than forecast, which can affect Commodity Credit Corporation farm price support spending. Changes in behavior, such as more young people deciding to go to college and applying for guaranteed student loans, can also cause a technical reestimate. Technical reestimates can also result from changes in economic circumstances that have not yet been recognized by revisions of economic assumptions or which only indirectly affect outlays or receipts. For instance, an increase in estimated Social Security benefit costs due to a higher than anticipated

[1] The estimate is approximate because it uses CBO's estimate of savings achieved in connection with OBRA as an approximation of OMB's assumed savings.

[2] The relevant economic assumptions are estimates of economic growth, inflation, interest rates, and other key economic indicators.

eligible population might be considered a technical reestimate, although a deteriorating economy that caused more people to retire might have caused the increase in the eligible population. Technical reestimates can also be caused by flaws in the original estimating procedures or models, even though underlying circumstances do not change. We discuss the causes of technical reestimates of individual income taxes, deposit insurance, and Medicaid in the following chapters.

Effect of Higher Deficit on Debt Service

Any federal government deficit, even if the factors causing it are of a temporary nature, permanently raises the federal government's borrowing and debt service costs. Arguably, much of the deficit increase for 1991 was due to factors that are relatively short-term rather than permanent: the cost of the savings and loan bailout and the ongoing recession. However, even temporary factors translate into permanent increases in federal government borrowing and debt service costs. The actual deficit is about $168.2 billion greater than had been estimated in January 1990. At average current interest rates, this increase alone will add about $12.3 billion in annual interest costs to future budgets.

These increases in borrowing and debt service costs in turn make it even more difficult to achieve meaningful deficit reduction. The fiscal year 1991 actuals include payments of $286.0 billion for interest on the federal debt (including intergovernmental interest payments), which equals 5.1 percent of fiscal year 1991 GNP. By way of comparison, spending for DOD-military in 1991 (including Desert Shield/Desert Storm expenditures but excluding allied contributions for that operation) totaled $305.5 billion, or 5.5 percent of 1991 GNP.

Conclusions

There is a need for more timely analysis and reporting of the causes of budget reestimates and a comprehensive review of the estimating process by OMB. As indicated above, information is not currently available that would allow a precise analysis of the causes of budget reestimates in fiscal year 1991. OMB has traditionally included such information about the most recently completed fiscal year in the President's next budget submission after the end of that year. CBO has also generally included an analysis of changes in budget estimates for the previous year in reports it submits to the Congress in January.

We think that information about and analyses of the causes of changes in estimates for the completed fiscal year should be made available closer to the end of the fiscal year, preferably at the same time that the final Monthly Treasury Statement is released. By the time that OMB and CBO publish their analyses in January or February following the end of the fiscal year in October, attention is firmly fixed on the current and coming fiscal years. At that point, policymakers are less likely to learn from what happened during the course of the previous fiscal year than they would be if the information were available promptly at the end of that year.

The tremendous increase in the fiscal year 1991 deficit estimates from the President's original budget submission in January 1990 to the end of the fiscal year raises questions about the estimating process itself. In three of the four areas where we looked in detail at the estimates (deposit insurance, Medicaid, and individual income taxes), there were questions about the adequacy of the estimating techniques or the information available to estimators. The fourth area, Desert Shield/Desert Storm, presented unique estimating difficulties.

We recognize the inherent difficulties of estimating the results of an incredibly complex budget in an everchanging environment, but policymakers need to be assured that they have the best possible estimates available to guide them in decision-making. It is evident that this was not the case in fiscal year 1991.

As discussed in chapter 3, OMB has already made changes in an attempt to improve deposit insurance estimating procedures. Also, a joint OMB-Health Care Financing Administration task force has recommended measures to improve Medicaid estimating that are discussed in chapter 6. We applaud these efforts, but much more needs to be done.

Recommendations

We recommend that the Secretary of the Treasury and the Director of the Office of Management and Budget agree on a procedure to ensure the prompt reporting of an analysis of the causes of changes in budget estimates for the most recently completed fiscal year. Ideally, this information and analysis would be made available when the final Monthly Treasury Statement for the year is released.

We also recommend that the Director of the Office of Management and Budget review that agency's procedures for assessing the accuracy of its budget estimates and the underlying estimating practices in order to better identify means of improving the accuracy of the budget estimates. In our view, this assessment should start with a systematic identification of areas in the budget in which the actual results departed materially from the original estimates. Each of these areas should then be examined in detail to determine the reasons for the variances and to identify improvements in the estimating procedures that would yield more reliable estimates in the future.

Deposit Insurance

Deposit insurance estimates were the most volatile component of the fiscal year 1991 budget. As shown in table 3.1, OMB's initial fiscal year 1991 net outlay estimates for deposit insurance totaled $7.2 billion in the President's fiscal year 1991 budget submitted to the Congress in January 1990. A year later, in the President's fiscal year 1992 budget, OMB estimated deposit insurance outlays at $111.4 billion. Actual deposit insurance outlays for fiscal year 1991 totaled $66.4 billion.

Table 3.1: Deposit Insurance - Estimates Versus Actual

Dollars in billions

	OMB net outlays fiscal year 1991
January 1990 estimates	$7.2
February 1991 estimates	$111.4
Actual	$66.4

Federal deposit insurance represents a commitment by the federal government to protect depositors against losses resulting from failures of insured deposit institutions. Expenditures to meet this commitment are considered direct spending under the Budget Enforcement Act of 1990 and cannot trigger a sequestration under Gramm-Rudman-Hollings unless the nature of the commitment is changed. However, the net outlays for deposit insurance are included in calculations of the deficit.

Virtually all of the variation in the estimates appeared in three deposit insurance accounts: the Resolution Trust Corporation (RTC), the Federal Deposit Insurance Corporation's (FDIC) Bank Insurance Fund (BIF), and the Federal Savings and Loan Insurance Corporation Resolution Fund (FRF). Two other deposit insurance accounts, the Savings Association Insurance Fund and the National Credit Union Share Insurance Fund, were not included in our study because outlays for these accounts were less than $100 million.

Resolution Trust Corporation

Background

The RTC becomes involved with a thrift institution when the Office of Thrift Supervision (OTS) or a state regulator determines that a federally insured thrift institution[1] will require an assisted resolution and appoints RTC as conservator or receiver to take control of the institution. If the institution is put into conservatorship, RTC appoints a managing agent and assumes responsibility for the institution's liabilities and assets. The institution's assets begin to be sold and the institution is prepared for resolution. At resolution, the insolvent savings institution is sold or dissolved and the institution is placed into receivership to settle any outstanding claims.

RTC resolves failed institutions by transferring deposits to healthy institutions or paying off depositors directly. In cases where the deposits are transferred, RTC provides cash or assets to cover the liabilities assumed by acquirers of the deposit franchises.

To finance resolutions, the government uses some combination of loss funds and working capital. Loss funds are the amounts that are not expected to be recovered because they are paid to cover a failed institution's negative net worth after its assets are written down to market value. Working capital is the amount of money spent for resolution that the federal insuring agency expects to recover from the future sale of the institution's assets. In the case of RTC, working capital is almost all borrowed money. The administration expects that less than half of all RTC's acquired assets will be sold within 2 years after resolution. Therefore, working capital borrowings are likely to be outstanding for a significant period.

Deposit insurance's impact on the federal budget is measured as net outlays. Net outlays are the difference between the cash disbursements spent to resolve failed institutions and the cash receipts obtained from offsetting collections such as the sale of acquired assets. The amount of net outlays for a single year, however, does not adequately reflect the costs of resolving failed thrifts. During the years when RTC resolves large numbers of failed institutions, RTC's net outlays include large amounts of working capital. RTC expects to recover the working capital from the future sale of assets acquired from failed thrifts. Thus, RTC's current high outlays will be partially offset by collections in future years. However, it is doubtful that RTC will, in fact, recover all the working capital borrowed due to major uncertainties related to the recovery values of acquired assets. OMB's July 1991 estimates indicate

[1] Excluding savings banks insured by FDIC.

that RTC's total net outlays will be $179.1 billion from 1991 through 1993 as RTC continues to resolve institutions, but from 1994 through 1996, net outlays are projected to be minus $104.6 billion as RTC continues to sell accumulated assets.

RTC Net Outlays Have Been the Most Volatile Element in Deposit Insurance

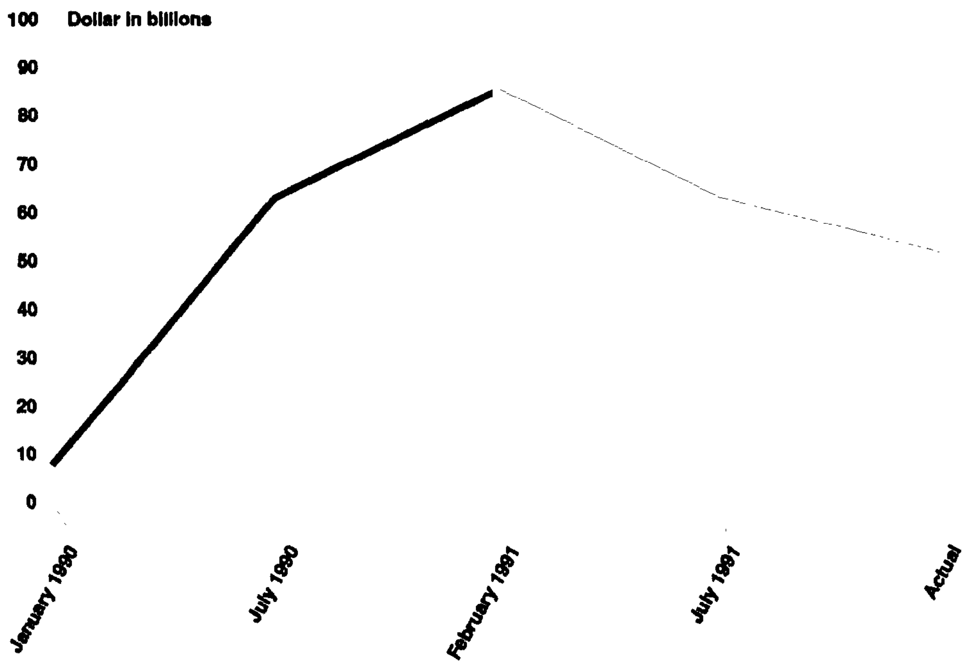
RTC budget estimates, as shown in table 3.2 and figure 3.1, were the most volatile part of deposit insurance in fiscal year 1991.

Table 3.2: Resolution Trust Corporation Outlays - Estimates Versus Actual

Dollars in billions

	OMB net outlays fiscal year 1991
January 1990 budget	$7.3
February 1991 budget	$84.6
Actual	$50.8

Figure 3.1: 1991 Resolution Trust Corporation Outlay Estimates - January 1990 to Actual



Early RTC Estimates Did Not Recognize or Include All Funding Requirements

OMB's January 1990 RTC net outlay estimate for fiscal year 1991 was far too low for two major reasons. First, initial estimates did not recognize the full magnitude of the problem of failed thrifts. The January 1990 estimate was based on the assumption that RTC would resolve a total caseload of about 500 institutions holding about $300 billion in assets and that thrifts holding $120 billion in assets would be resolved in fiscal year 1991. In May of 1990, however, the Treasury revised the projected case load from about 500 to between 700 and 1,000 institutions holding between $359 and $508 billion in assets. OMB's July 1990 estimate assumed that (1) RTC would resolve more than 1,000 institutions in its lifetime and (2) thrifts holding $160 billion in assets would be resolved in 1991.

The second reason that OMB's January 1990 estimate was low was that the administration excluded from the estimate working capital needed to finance the thrift bailout. Even before the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) in August 1989, we had informed the Congress that the administration's estimate of funding needs for RTC did not include working capital. In October 1989, we testified that the amount of cash needed by RTC in the process of resolving failed thrift institutions would exceed the $50 billion provided by FIRREA and suggested that borrowing from Treasury would be the least costly source of working capital. The administration, however, failed to include necessary working capital in the President's fiscal year 1991 budget proposal which was issued in January 1990.

OMB provided two major reasons for the administration's decision to exclude working capital. First, the administration was concerned about its effects on calculating a sequester from the Gramm-Rudman-Hollings deficit targets. The President's budget stated that including working capital would sharply increase the 1990 deficit, but decrease future year deficits. It suggested that a case could be made for excluding working capital from the target deficit calculations to avoid these large deficit swings.

Second, administration officials were uncertain how working capital would be provided. They listed three possible sources: direct federal funding, guaranteed federal funding, and private funding. Each option would result in different amounts of budgetary outlays or costs. This uncertainty was resolved in February 1990 when arrangements for borrowing from the Federal Financing Bank were finalized.

In March 1990, CBO estimated that the inclusion of working capital would increase fiscal year 1991 outlays by $26 billion. Since the President's budget as submitted was only about $1 billion under the Gramm-Rudman-Hollings target deficit of $64 billion for fiscal year 1991, including working capital would have forced the administration to propose about $25 billion in additional budget cuts.

Early OMB estimates of RTC outlays were also affected by the short time RTC had been in existence. OMB had very little historical data or experience upon which to base early estimates. Consequently, OMB made some assumptions that later experience showed were inaccurate. Some of the changes in later estimates reflect changes in these assumptions based on more data and experience.

In July 1990, OMB raised its estimate of the 1991 net outlays for RTC by $55 billion. This new estimate included working capital requirements. In all subsequent presentations of RTC budget estimates, OMB included working capital needs.

The Ability to Produce Realistic Estimates Was Limited

In formulating RTC estimates, OMB works closely with the RTC Oversight Board and analysts at Treasury instead of obtaining information for determining the RTC budget estimates directly from RTC.

OMB determines RTC budget estimates from information obtained from a cash flow model developed by the Treasury Department and the RTC Oversight Board. This model projects the sources and uses of both loss and working capital funds. The model makes several key assumptions, such as the number of thrift failures, the amount of losses associated with resolutions, the pace of resolutions, and the amount of assets passed to acquirers of failed thrifts. Each of these assumptions, however, is subject to a great deal of uncertainty and is difficult to estimate. The net outlay projections produced by the model are extremely sensitive to small variations in these assumptions. This sensitivity to different assumptions is largely unavoidable and makes RTC estimates extremely volatile.

The ability to produce realistic estimates of RTC net outlays was also limited by the absence of a long-term plan. For the January 1990 and the July 1990 estimates, the RTC financial operating plans only extended 3 months into the immediate future. In view of the size of the RTC program, the lack of a well-developed plan as a basis for developing budget estimates is disturbing. By October 1990, RTC began producing 6-month plans, and later plans extended 9 months into the future. Under the RTC Funding Act of 1991, the RTC Oversight Board is now required to provide the Congress with a 1-year financial operating plan prior to each fiscal year, updated quarterly. Treasury and the Oversight Board's model relies primarily on the plan and data measuring RTC's limited experience to determine the pace of RTC resolutions and the amount of assets passed to acquirers.

Although the RTC financial operating plans were used by OMB to develop budget estimates, RTC viewed them primarily as funding requests to the RTC Oversight Board. The Oversight Board reviewed and occasionally amended a plan and then distributed appropriated funds to RTC to carry out the approved plan. According to an RTC official, in order to avoid running short of funds, RTC, in its operating plans, tended to overstate what it was likely to accomplish.

Funding Constraints Slowed RTC Operations

In all of its estimates, OMB assumed unconstrained future funding would be available to RTC. However, funding for RTC was constrained for two periods during fiscal year 1991. At the beginning of fiscal year 1991, RTC was approaching the limitation, imposed by the FIRREA obligation limit, on amounts it could borrow as working capital to finance resolutions. RTC resolved this funding constraint in November 1990 by obtaining permission from the RTC Oversight Board (with the approval of the chairmen of the House and Senate banking committees) to change the way it calculated its compliance with the obligation limitation. The new method allowed RTC to borrow up to about $125 billion. This was $84 billion more than RTC had borrowed by September 30, 1990. However, until this issue was resolved, this funding uncertainty caused the RTC to reduce the pace of resolutions.

By January 1991, RTC reached a second funding limit. This time the limit applied to the amount of loss funds RTC could spend. From January to March of 1991, RTC had insufficient funds to cover the losses it would have incurred in resolving insolvent thrifts at its previous pace. RTC virtually suspended new resolutions until the enactment of the RTC Funding Act of 1991 on March 23, 1991. Analysts at CBO estimated that RTC lost 4 months of activity to these funding constraints. The slow pace of resolutions resulting from these funding constraints caused OMB, in July 1991, to revise its RTC net outlay estimates down by $22 billion.

By the end of fiscal year 1991, RTC again reached a funding constraint when it approached exhaustion of its loss funds. RTC was unable to initiate any new resolutions from October 1991 until legislation[2] that provided an additional $25 billion in loss funds was enacted in December 1991.

Asset Sale and Resolution Activity Was Slower Than Estimated

In July 1990, as the magnitude of the number and asset size of failed thrifts was realized, the administration's estimates of the inflow of cash from the sale of these acquired assets peaked at about $30 billion. However, because of the weakening economy and the slow market for real estate in many parts of the country, the February 1991 estimate assumed that assets would be sold at a slower pace. Actual receipts for the sale of these assets were $27 billion.

Actual RTC net outlays for fiscal year 1991 were $50.8 billion. This was $11.4 billion lower than the July 1991 Mid-session Review estimate. According to the joint Treasury/OMB press release accompanying the final Monthly Treasury Statement, the lower outlays from the Mid-session Review estimate were primarily attributable to a reduction in the number of thrifts resolved during the year.

Bank Insurance Fund

Background

The Bank Insurance Fund finances activities of FDIC intended to protect depositors at insured banks. BIF is financed by insurance assessments collected directly from insured banks, asset recoveries from the resolution of failed banks, and investment income. It has not been financed by general revenues. Until 1986, collections generally exceeded expenditures to resolve failed banks. For each year that there is a surplus and the fund exceeds its reserve target, after any rebates of premiums have been made to banks, the value of the surplus is added to the fund net worth. The fund net worth can be used to provide both working capital and loss funds when needed to resolve failed banks. By fiscal year 1985, BIF had accumulated a fund net worth of $19.5 billion.

[2] The Resolution Trust Corporation Refinancing, Restructuring and Improvement Act of 1991 (P.L. 102-233), December 12, 1991.

In every year since 1986, however, BIF has spent more to resolve banks than it collected. By fiscal year 1989, BIF's fund net worth had fallen to $14.3 billion. We estimated in August 1991 that, by the end of calendar year 1991, BIF would be insolvent, with a negative net worth of approximately $5 billion.[3]

In order to sustain BIF operations into the new year, legislation[4] was enacted in December 1991 to increase BIF's borrowing authority to approximately $70 billion, with the exact amount determined by a formula limiting the fund's outstanding obligations.

Estimates of BIF Expenditures Have Fluctuated

The President's 1991 budget estimated that collections would exceed expenditures by $2.8 billion, as shown in table 3.3. As the weakness of many major banks became apparent, net outlay estimates increased to as much as $15.9 billion in February 1991. However slower than expected resolutions of failing banks resulted in actual net outlays of $7.4 billion.

Table 3.3: Bank Insurance Fund - Estimates Versus Actual

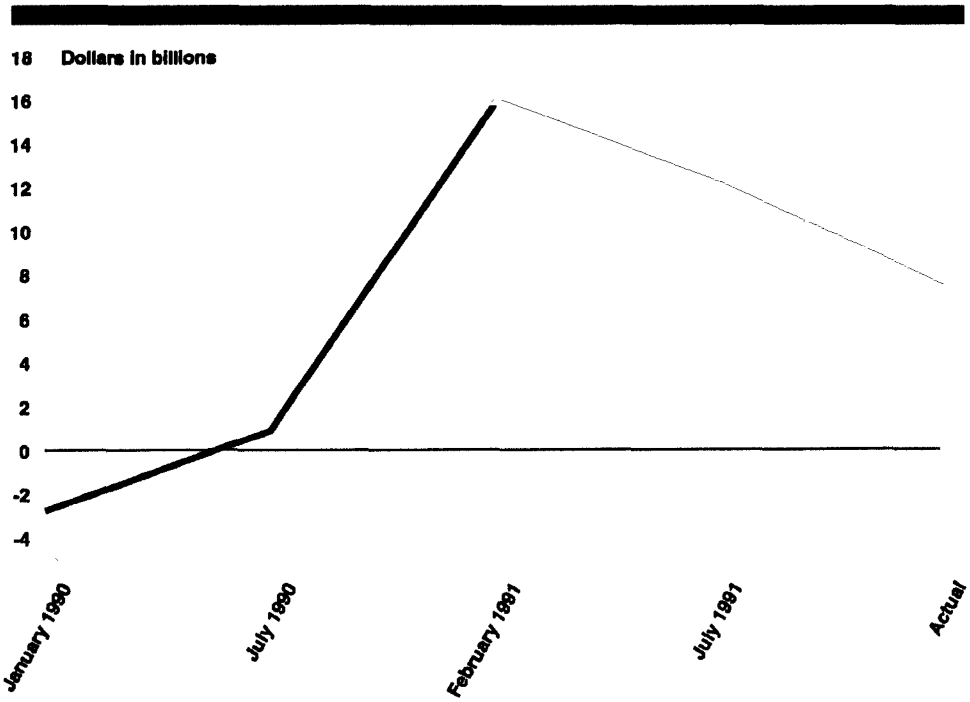
Dollars in billions

	OMB net outlays, fiscal year 1991
January 1990 estimate	$−2.8
February 1991 estimate	$15.9
Actual	$7.4

[3] See Financial Analysis: Short-Term Funding Needs of the Bank Insurance Fund and the Resolution Trust Corporation (GAO/AFMD-91-90, August 22, 1991). This estimate was reaffirmed in Financial Audit: Bank Insurance Fund's 1990 and 1989 Financial Statements (GAO/AFMD-92-24, November 12, 1991).

[4] The Federal Deposit Insurance Corporation Improvement Act of 1991 (P.L. 102-242), December 19, 1991.

Figure 3.2: 1991 Bank Insurance Fund Outlay Estimates - January 1990 to Actual



Adoption of a New Forecasting Method Altered Fiscal Year 1991 Estimates

The wide variation in BIF budget estimates for fiscal year 1991 is primarily the result of OMB's adoption of a new method for estimating BIF outlays, beginning with the President's budget in February 1991.

The January and July 1990, OMB estimates of BIF outlays were primarily based on FDIC estimates. Then, FDIC estimates projected BIF outlays for only 2 years. FDIC developed its estimates by surveying examiners in its Division of Supervision, which estimated by quarter the number of large and small banks expected to fail. From these estimates of the number, size, and timing of bank failures, historical averages were used to determine the type of resolution and the estimated cost of each failure. Variations between the January and July 1990 estimates are mostly the result of changes in the FDIC survey estimate. OMB recognized by the middle of 1990 that FDIC's estimates for BIF were too low. OMB believed that, due to large losses in real estate markets and from international lending, many banks were more vulnerable to failure than FDIC estimated.

In order to produce more accurate estimates and to project for 6 years, OMB developed an econometric and cash flow model to project BIF outlays. The new OMB model uses call report data, which includes data on earnings, equity, lending and deposits of most banks. OMB adjusts each bank's capital level by predicting loan loss provisioning and earnings for 3 years. The model then divides the banks into categories by size and adjusted equity capital levels. Next, the model assumes a probability of failure for each category, based on recent experience, and applies recent RTC and FDIC assumptions about the expected method of resolution. Loss rates on resolved institutions were assumed to average about 20 percent.

OMB's new model produced an estimate for the President's 1992 budget in February 1991 that was more than $10 billion higher than the survey-based estimate that FDIC submitted for the 1992 budget. The OMB model was intended to capture the magnitude of projected outlays and losses during the 1991 to 1996 period. According to OMB staff, due to the discretion of bank regulators, and the uncertainties about the timing of large bank failures, the net outlay estimates may not be very precise for any one year but are more accurate over several years. FDIC now incorporates OMB's model based projections into its cash flow projections.

BIF Outlays Slow Down

By the time of the July 1991 estimate, actual net outlays were far below what the OMB model had projected. Actual outlays through May 1991 were even lower than FDIC's survey-based projection. OMB revised its July 1991 estimate downward to reflect the lower than expected outlays in 1991 and to include the administration's recapitalization plan, since it had not been released until after the February 1991 estimates.

Actual net outlays for BIF were $4.7 billion lower than the July 1991 Mid-session Review estimate, a difference attributable to the "timing of the resolution of banks in financial difficulty," according to the joint Treasury/OMB press release accompanying the final Monthly Treasury Statement. Beyond this statement, we were unable to determine precise reasons why actual BIF net outlays were lower than expected. FDIC analysts, however, explained that FDIC resolution activity had not slowed due to funding uncertainty.

Analysts at CBO and OMB could not determine from the available information the precise reason for the low net outlays, but they provided three possible reasons. First, the marketing of failed bank assets is slower than in the past because RTC has already flooded the market for failed savings institution assets. As the market becomes saturated, it becomes more difficult for FDIC to find acquirers for failed banks. If an acquirer cannot be located, FDIC can resolve the bank by paying off the depositors directly. This method of resolution, however, is the most costly. Rather than resorting to the large cash outlays required to resolve a bank by paying off depositors directly, FDIC generally prefers to delay resolutions in order to find an acquirer.

Second, prior to receiving new borrowing authority in December 1991, BIF had almost exhausted its resources and some closings may have been delayed because of uncertainty about future funding. Such a delay in resolutions reduces outlays in the short term, but if the bank continues to lose money while it remains open, the eventual costs will be higher.

Third, it may be taking FDIC longer to resolve some banks, particularly large banks, than was assumed by the survey and the OMB model. A delay of a few months in resolving one large bank could shift billions of dollars of outlays from one fiscal year to another. BIF is more vulnerable to misestimates due to delays in resolving particular institutions than RTC is because it is difficult to predict when a multibillion dollar bank will be resolved; the flow of RTC resolutions is more predictable.

Federal Savings and Loan Insurance Corporation (FSLIC) Resolution Fund

FSLIC Resolution Fund Estimates Continue to Fluctuate

The FRF finances agreements between FSLIC and acquirers of failed thrifts, made prior to the creation of RTC in 1989, that made the federal government liable for future payments to the acquirers.

The magnitude of many of these payments is linked to interest rate levels and specified rates of return on assets. Thus, FRF estimates are subject to real estate and interest rate variables, and tend to fluctuate widely. Net outlays, which were estimated at $2.8 billion in January 1990, were estimated at $4.2 billion in July 1990 due to higher interest payments, decreased collections from asset sales, and higher assistance agreement payments.

Legislation enacted in 1990 directed RTC to renegotiate FSLIC agreements to reduce the overall costs to the Federal Government. The February

1991 estimate of $11.1 billion for fiscal year 1991 reflected the expectation that many of the agreements would be paid off in 1991 rather than in later fiscal years. The reduction in the FRF estimate in the July 1991 estimate resulted from the lower than expected expenditures for the purchase of assets. This may be because of a slower than expected pace at which the FSLIC agreements have actually been renegotiated and paid off, or because the FSLIC agreements as renegotiated require lower outlays than expected. FRF actual outlays of $8.6 billion were $0.6 billion below the Mid-session Review estimate.

Budgetary Treatment of Deposit Insurance

Deposit Insurance Outlays in Fiscal Year 1991 Are Not a Good Measure of Known Deposit Insurance Costs in That Year

Short term net outlay estimates for all three of the deposit insurance accounts described above have been extremely volatile. However, as described earlier, the single year net outlays, do not directly reflect costs. The long-term cost estimates for these deposit insurance accounts have been relatively stable compared to their outlay estimates. For example, the administration estimated in May 1990 that RTC's long-term cost for resolving failed thrifts would be between $89 and $132 billion. The administration has not revised this estimate even though it has significantly revised the annual outlay estimates three times since May 1990.

Short-term net outlays do not directly reflect costs for two major reasons. First, outlays vary from costs because they include working capital which is expected to be regained through future offsetting collections, the timing of which is uncertain. Second, outlays vary from costs because they result from variations in the pace of resolving failed savings institutions. Variations in the pace of resolutions affect when outlays occur, but do not affect the number of institutions that will ultimately be resolved. Delaying resolutions can, however, add to the costs of resolving these institutions. For instance, the administration estimated that total RTC costs could be increased by about $4 million each day that funding shortfalls prevent RTC from proceeding with resolutions.

The volatility and distorting effects of deposit insurance budget estimates that result from the timing of various transactions could be reduced if an alternate form of budgetary treatment for deposit insurance expenditures were adopted. We think that an approach similar to the budgetary treatment of federal credit programs instituted by the Credit Reform Act of 1990 is conceptually promising, although the practical difficulties in implementing such an approach must be carefully considered.[5] Such an approach would separate the deposit insurance costs to the government from the cash flows associated with the program. The costs would be included in the budget when they are incurred, while the cash flows would be reported in the means-of-financing section of the budget and would not affect the deficit. If this approach were effectively implemented (including reliable safeguards to ensure that cost estimates are unbiased and realistic), it would keep the timing of deposit insurance transactions from distorting the budget, and, in addition, would prevent delays in recognizing the costs of deposit insurance.

[5] For a discussion of alternative budgetary treatments of deposit insurance, including treatments similar to that applied to credit programs, see Budgetary Treatment of Depository Insurance: A Framework for Reform, Congressional Budget Office, May 1991.

Individual Income Tax Receipts

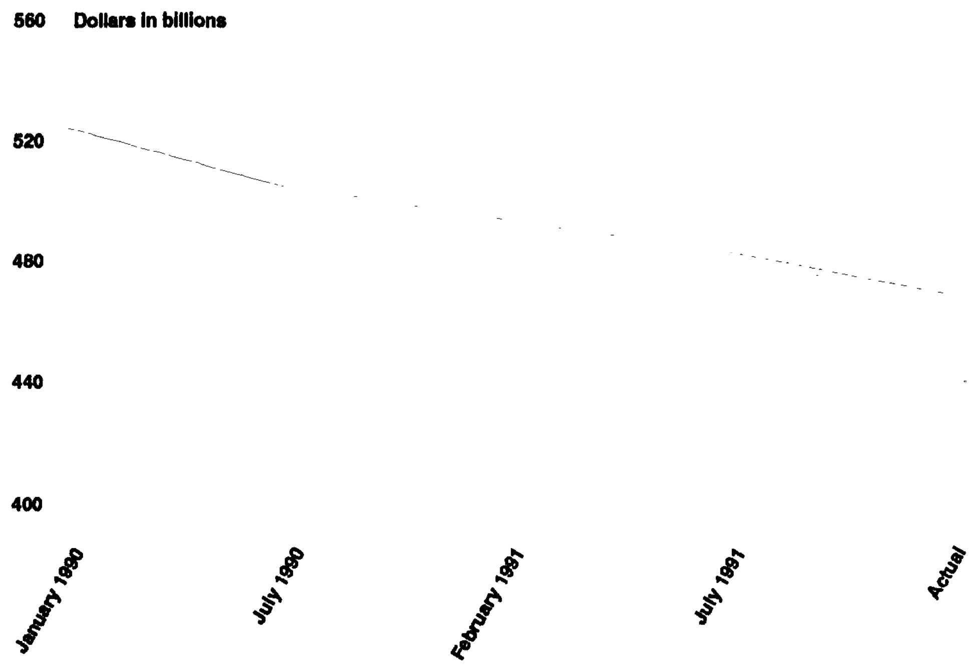
Tax receipt estimates for fiscal year 1991 were consistently reduced from the initial forecast of $1,156.3 billion in January 1990 to $1,068.7 billion in July 1991. Actual receipts were $1,054.3 billion. The largest single component of these reductions was individual income tax receipts, the estimates for which are shown in table 4.1.

Table 4.1: Individual Income Tax Receipts - Estimates Versus Actual

Dollars in billions

	Office of Tax Analysis baseline estimate, fiscal year 1991
January 1990 budget	$523.6
February 1991 budget	$492.3
Actual	$467.8

Figure 4.1: Individual Income Tax Receipt Estimates - January 1990 to Actual



Background

The administration's individual income tax receipt forecasts are produced by the Office of Tax Analysis (OTA) of the Department of the Treasury. To estimate individual income tax receipts, OTA employs a complex model, which uses four major data sources: (1) historical tax return information from the Internal Revenue Service, (2) economic forecast information determined jointly by OMB, Treasury, and the Council of Economic Advisers, (3) tax collection information primarily from the Internal Revenue Service (IRS), and (4) historical economic data from the Bureau of Economic Analysis (BEA) in the Department of Commerce.

The model forecasts individual income tax receipts by extrapolating tax return information from the past to the future, using the four data sources. To increase accuracy, the model adjusts the receipt forecast by determining the relationship between tax return data, which is generally about 2 years old, and collection information, which is current. If current collections differ from the amount predicted by extrapolating the tax return data, OTA adjusts the model to reflect the added information that actual collections indicate. These revisions are often carried forward to future years as well as used for the current year.

OTA classifies changes in the baseline receipt forecasts in four categories: changes in economic assumptions, technical adjustments, enacted legislation changes, and administrative action changes. The distinction between economic and technical changes, however, is somewhat arbitrary because it often depends on whether national income data reported by BEA are revised before or after receipt forecasts are made. If the national income data are revised before the receipts forecast is made, the change in estimated receipts is labeled an economic change. If the receipts forecast is made before the income data are revised, the change in receipts is labeled a technical change. Economic changes accounted for large reductions in the February 1991 estimate of fiscal year 1991 individual income tax receipts. Technical changes accounted for substantial reductions in both the July 1990 and the July 1991 estimates. Policy changes (defined here as changes from enacted legislation and administrative action), however, have caused relatively small changes in the receipt forecast.

Timing and Inaccuracies in Data Make Accurate Forecasts Difficult

Some of the variables that are of critical importance to the individual income tax receipt forecast model require data that may not be available in accurate form before the estimate is made. OMB and Treasury analysts have indicated that one of the largest sources of change in the 1991 revenue forecast came from inaccurate reporting of the nation's income by BEA.

Until July 1990, BEA overestimated 1989 wages and salaries by $58 billion. BEA acknowledged this discrepancy and, after the July 1990 Mid-session Review had been issued, made a downward adjustment in the estimated level of personal income. OTA's correction for this overestimate of personal incomes reduced the fiscal year 1991 receipt forecast substantially. Almost all of the $20 billion technical reduction from the January 1990 estimate to the subsequent July 1990 Mid-session Review estimate can be attributed to this overestimate of personal income. This change also lowered estimates for future years and would have been classified as an economic change if BEA had adjusted its personal income estimate before the July 1990 Mid-session Review receipt estimate was made.

Due to the time lag between collections data, tax return data, and actual economic data, many months may pass before the reasons for misestimates become evident. For example, most of the $10.4 billion reduction in the July 1991 forecast was a consequence of collections that were below what the model had forecast. At this time, however, analysts are still unable to determine the precise reason for the lower than expected collections. However, as actual tax return and economic data become available for the year, analysts will be able to determine the reason. This information may then be used to improve the model.

Another major source of inaccuracies cited by OTA in the forecast of receipts for fiscal year 1991 is the timing of data from employers' income tax withholding and Social Security contributions. Employers' payments for withholding and Social Security come to IRS in the same check. OTA estimates the amount that is the total for Social Security contributions and instructs the IRS on how much to deposit in the Social Security Trust Funds. During the course of each year, the accounts are reconciled and money is transferred to reflect the actual amount of income tax and Social Security contributions. In the fall of 1990, tax return data at the IRS indicated that more money should be transferred to the Social Security Trust Funds than OTA had previously estimated. This resulted in a downward technical change of about $4 billion in the February 1991 reestimate. This adjustment, however, did not affect the deficit or outyear receipt forecasts.

A Changed Economic Forecast Caused a Large Reduction in Estimated Receipts

In the February 1991 forecast, the administration altered economic assumptions in recognition of the recession. The change in economic assumptions was the source of most of the change from the July 1990 forecast to the February 1991 forecast. OTA attributed $10.3 billion of the reduction to altered economic assumptions.

Policy Changes Had a Very Small Effect on the Reestimates

Policy changes had relatively little effect on individual income tax receipt forecasts. The enactment of the Omnibus Budget Reconciliation Act of 1990 increased the baseline estimate of fiscal year 1991 receipts by $4.6 billion in the February 1991 estimates. This increase, however, was more than offset by economic changes.

Economic Forecasts, Economic Statistics, and the Tax Forecasting Model May Need to Be Improved

In summary, the estimating errors regarding individual income tax receipts came from (1) the onset of a recession that had not been forecast and (2) problems in estimating the components of national income and in translating those estimates into estimates of tax receipts.

The currently available data do not permit a precise attribution of the errors to each of the sources, but much of the error is certainly the result of the deteriorating economy. It has always been difficult to predict the timing and magnitude of turning points in the economy, especially the onset of a recession. It would be unrealistic to expect precision in such forecasts. Nevertheless, the errors in the 1991 estimate of individual income tax receipts were large enough to be worthy of detailed examination. For example, relatively few economists were forecasting a recession in 1991 as far ahead as January 1990. But most forecasts at that time were materially less optimistic than those of the administration. In view of this experience, it would be appropriate for the administration to reexamine its approach to developing the economic forecasts used in the budget process.

The relatively large "technical" adjustments to the revenue estimates suggest the need for reassessment in this area as well. From the available data, it is not clear whether these adjustments reflected the continuing deterioration of the economy or are indicative of problems in the national income statistics or in the model that translates these statistics into revenue forecasts. Under these circumstances, it would be appropriate for the administration to examine the results in greater detail to determine if corrective action is warranted.

Operation Desert Shield and Operation Desert Storm

The President's fiscal year 1991 budget submitted in January 1990 estimated baseline outlays of $296.0 billion in fiscal year 1991 for DOD-military activities. The final Monthly Treasury Statement for fiscal year 1991 shows actual outlays of $261.9 billion for the fiscal year, $34.1 billion lower than the original baseline level estimated in January 1990.

Table 5.1: Fiscal Year 1991 Baseline DOD-Military Outlays

Dollars in billions

	Amount
January 1990 Budget	$296.0
February 1991 Budget	$288.2
Actual	$261.9
Change from January 1990 Budget to Actual	$−34.1

This $34.1 billion reduction below the January 1990 baseline consists of two parts: (1) about $9 billion in reductions for activities other than Desert Shield/Desert Storm (we refer to these as basic activities in this report), which were assumed in the budget agreement and in the defense discretionary spending limit for 1991 established by OBRA 1990, and (2) an estimated $25.2 billion reduction in net outlays that is the result of allied contributions for Desert Shield/Desert Storm that exceeded the upward effect of the operation on fiscal year 1991 DOD-military spending.

This $25.2 billion reduction represents only the effect of Desert Shield/Desert Storm on DOD-military outlays in fiscal year 1991. We estimate that, due to approximately $0.1 billion in Desert Shield/Desert Storm outlays for agencies other than DOD, the total effect of Desert Shield/Desert Storm on the 1991 deficit was a decrease of $25.1 billion. More importantly, because Desert Shield/Desert Storm outlays will continue in fiscal year 1992 and later while most of the allied contributions were received in 1991, deficits will be increased in 1992 and later years as a result of Desert Shield/Desert Storm. We estimate that Desert Shield/Desert Storm could increase total deficits in the 1990s by nearly $0.6 billion.

Background

The United States commenced the military operation known as Desert Shield/Desert Storm in August 1990, 5 days after Iraq's invasion of Kuwait. While the Budget Enforcement Act of 1990 stipulated that incremental costs associated with Desert Shield/Desert Storm would be emergency costs not subject to the defense discretionary spending limits established by the act, the net outlays resulting from Desert Shield/Desert Storm are included in calculations of the budget deficit. These net outlays were the sum of U.S. expenditures for Desert Shield/Desert Storm and offsetting collections received as contributions from U.S. allies in the conflict.

Effect of Desert Shield/Desert Storm on DOD-Military Outlays

There are three possible components of the effect of Desert Shield/Desert Storm on DOD-military net outlays:

- increased outlays for Desert Shield/Desert Storm activities, which would increase the deficit;
- decreased outlays for basic activities because Desert Shield/Desert Storm delayed obligations for the basic activities, which would decrease the deficit, and;
- offsetting collections (which are counted as negative outlays) from allied contributions for Desert Shield/Desert Storm, which would also decrease the deficit.

The final Monthly Treasury Statement reported that allied contributions collected in fiscal year 1991 totaled $43.6 billion, but neither the exact amount of the outlay increase for Desert Shield/Desert Storm or the decrease in outlays for basic activities due to Desert Shield/Desert Storm is known at this time. OMB has so far been unable to identify how much of total DOD-military outlays are attributable to Desert Shield/Desert Storm and how much to all other DOD military activities.

DOD does track obligations for Desert Shield/Desert Storm, but is unable to measure Desert Shield/Desert Storm outlays precisely. Desert Shield/Desert Storm appropriations are transferred to regular program accounts for obligation. The obligations made for Desert Shield/Desert Storm purposes are recorded, but DOD has not determined which outlays from the program accounts flow from these obligations and which flow from obligations for basic activities.

In the course of preparing the President's fiscal year 1993 budget, OMB and the DOD Comptroller plan to analyze the year-end outlay data from the fiscal year 1991 final Monthly Treasury Statement in order to update spendout rates for each of the DOD accounts. As part of this exercise, they are expected to attribute outlays to Desert Shield/Desert Storm based on their knowledge of spending from the various accounts. This information is expected to be published in the 1993 budget.

Estimate of Desert Shield/Desert Storm Effects in Fiscal Year 1991

In the meantime, however, we have estimated the total effect of Desert Shield/Desert Storm on fiscal year 1991 DOD-military outlays, excluding allied contributions. (We refer to the outlays excluding the contributions in this report as gross outlays.[1]) We did not have information that would allow us to divide this effect between increases for Desert Shield/Desert Storm activities and decreases in outlays for basic activities due to Desert Shield/Desert Storm.

We made our estimate by comparing what OMB believed DOD-military outlays would be in fiscal year 1991 without Desert Shield/Desert Storm with the actual DOD-military outlays, which include the effects of Desert Shield/Desert Storm. Subtracting OMB's February 1991 baseline estimate of $287.1 billion in outlays for basic activities[2] (adjusted for fiscal year 1991 supplemental appropriations for non-Desert Shield/Desert Storm activities) from the $305.5 billion in actual DOD-military gross outlays produces an estimate of $18.4 billion in increased outlays due to Desert Shield/Desert Storm.[3] When the $43.6 billion in allied contributions received in fiscal year 1991 is taken into account, we estimate that the net effect of Desert Shield/Desert Storm on DOD-military outlays in fiscal year 1991 was a reduction of $25.2 billion.

Table 5.2: Effect of Desert Shield/Desert Storm on Fiscal Year 1991 DOD-Military Outlays

Dollars in billions

	Amount
Estimated DOD-military baseline outlays for basic activities in February 1991 budget	$287.1
Actual total DOD-military gross outlays (including Desert Shield/Desert Storm expenditures)	$305.5
Estimated increase in gross outlays due to Desert Shield/Desert Storm	$18.4
Offsetting collections from allied contributions	$−43.6
Estimated net effect of Desert Shield/Desert Storm on DOD-military outlays	$−25.2

[1] These are not the actual gross DOD-military outlays since they still include offsetting collections other than the allied contributions.

[2] This excludes $1.2 billion in estimated outlays for Desert Shield/Desert Storm that were included in OMB's baseline estimate of $288.2 billion for DOD-military outlays but includes an estimated $0.1 billion in non-Desert Shield/Desert Storm outlays from fiscal year 1991 supplemental appropriations (P.L. 102-27). The President's February 1991 budget also included a "placeholder" of $8.2 billion for anticipated Desert Shield/Desert Storm net outlays, but this amount was not included in the DOD budget or in the baseline estimate of total budget outlays.

[3] We assume that this amount represents Desert Shield/Desert Storm gross outlays greater than $18.4 billion offset by decreased outlays for basic activities. OMB estimated in July 1991 that gross outlays for DOD-military Desert Shield/Desert Storm activities would total more than $29 billion in fiscal year 1991, but since only $31.6 billion was obligated in 1991 it seems unlikely that outlays would be as high as $29 billion.

This estimate is an approximation since some non-Desert Shield/Desert Storm DOD-military outlays could have gone up or down since the February estimate independently of any effect from Desert Shield/Desert Storm. However, any such changes are unlikely to be large enough to cause this estimate to significantly understate or overstate the effect of Desert Shield/Desert Storm.

In addition, it should be noted that Desert Shield/Desert Storm also likely had a small effect on nondefense spending. More than $200 million was appropriated for fiscal year 1991 for Desert Shield/Desert Storm-related activities of the Departments of State, Education, and Veterans Affairs. (More than $500 million was appropriated, but a substantial part of this was made available for obligation in fiscal years after 1991.) The final Monthly Treasury Statement does not specify the amount of outlays that resulted from these appropriations in fiscal year 1991, but OMB estimated in August 1991 that nondefense Desert Shield/Desert Storm outlays in 1991 would total $137 million. Based on that estimate, we think that the total effect of Desert Shield/Desert Storm on the fiscal year 1991 deficit was a $25.1 billion reduction.

Costs of and Funding Required for Desert Shield/Desert Storm

The effect that Desert Shield/Desert Storm had on gross DOD-military outlays in fiscal year 1991 does not represent either the actual costs of or the total funding required for Desert Shield/Desert Storm. DOD estimates incremental costs of $61.1 billion for Desert Shield/Desert Storm.[4] Incremental costs are costs incurred over and above what would have been incurred in the absence of Desert Shield/Desert Storm. For example, activating reserves; paying troops danger and overseas premiums; outfitting troops with nuclear, chemical, and biological gear; replacing parts over and above normal use; and paying for airlift and sealift services all represent incremental costs. The value of lost equipment, spent munitions, and in-kind assistance from the allies also represents an incremental cost. The incremental costs do not represent the full costs of Desert Shield/Desert Storm since they do not include the basic pay and maintenance costs of U.S. troops involved in the operation or the costs of purchasing weapons and other materials used but not lost or expended in the conflict.

According to DOD, additional funding is not needed to cover all of the incremental costs. There is no need for additional funding to cover the

[4] Operation Desert Shield/Storm: Costs and Funding Requirements (GAO/NSIAD-91-304, September 24, 1991).

costs of (1) equipment lost and munitions spent that do not need to be replaced as DOD scales back military forces over the next few years or (2) goods and services, such as fuel, provided as in-kind assistance by the allies. In addition, some of the incremental costs have been funded through internal DOD restructuring. We define these incremental costs for which funding is needed as the Desert Shield/Desert Storm funding requirement.

DOD so far has identified total DOD-military Desert Shield/Desert Storm funding requirements of $47.1 billion, not including $2.1 billion of funding that was provided for Desert Shield/Desert Storm as a fiscal year 1990 supplemental.[5]

Total Effect of Desert Shield/Desert Storm on the Deficit

Just as the $18.4 billion increase in DOD-military gross outlays in fiscal year 1991 does not fully reflect either the DOD costs or funding requirements of Desert Shield/Desert Storm, neither does the $25.2 reduction in DOD-military net outlays reflect the longer-term effect of Desert Shield/Desert Storm on DOD-military net outlays or on budget deficits. The $25.2 billion is an estimate of the effect of Desert Shield/Desert Storm on 1 year's DOD-military budget only, while Desert Shield/Desert Storm will affect the budget for several years. In addition, there are Desert Shield/Desert Storm outlays for agencies other than DOD.

Based on appropriations already enacted (and appropriations that lapsed at the end of 1991, as reported by OMB) we estimate that gross DOD and other agency outlays for Desert Shield/Desert Storm will total nearly $49 billion[6] from fiscal year 1990 through the end of the decade. This does not include long-term retirement and disability costs associated with Desert Shield/Desert Storm, which DOD estimates have a net present value of $3.3 billion. This estimate assumes that all of the currently available funds will be obligated. As we have indicated in an earlier report, however, we think that some of the DOD Desert Shield/Desert Storm cost and funding requirement estimates have been inflated.[7] It is likely that it will not be necessary to obligate all of the available funds in order to meet legitimate Desert Shield/Desert Storm funding requirements. The inadequacies of DOD's cost accounting systems make it very

[5] GAO/NSIAD-91-304, September 24, 1991.

[6] This includes $304 million in DOD funds made available for Operation Provide Comfort (humanitarian assistance to Kurds in the Persian Gulf) that DOD does not report as part of its Desert Shield/Desert Storm obligations, but which clearly resulted from Desert Shield/Desert Storm.

[7] GAO/NSIAD-91-304, September 24, 1991.

difficult to determine the legitimacy of costs charged to Desert Shield/Desert Storm. It will be particularly difficult to assess the legitimacy of obligations incurred in fiscal year 1992 and later, long after the conflict has ended.

If all of the available funds are obligated, no additional funds are appropriated, and the full $48.3 billion in contributions pledged by the allies is collected, the net effect of Desert Shield/Desert Storm would be to increase deficits in the 1990s by about $0.6 billion.

Table 5.3: Multiyear Deficit Effect of Desert Shield/Desert Storm

Dollars in billions

	Amount
Outlays from DOD fiscal year 1990 supplemental	$2.1
Possible outlays from appropriations in fiscal year 1991	$36.4[a]
Possible outlays from appropriations in fiscal year 1992	$10.4
Total possible gross outlays	$48.9
Allied contributions pledged	$−48.3
Multiyear deficit effect	$0.6

[a]This is based on $31.636 billion in fiscal year 1991 Desert Shield/Desert Storm obligations reported by DOD, $304 million obligated for Operation Provide Comfort, $3.923 billion appropriated for DOD in fiscal year 1991 that remains available for obligation (based on OMB's estimate that $8.137 billion in Desert Shield/Desert Storm appropriations lapsed at the end of 1991), and $532 million appropriated in 1991 for agencies other than DOD.

These data suggest that, over a period of several years, the outlays for Desert Shield/Desert Storm will be nearly offset by allied contributions. The timing of these transactions is quite different, however. Most of the allied contributions were received in 1991 while the Desert Shield/Desert Storm gross outlays will extend into 1992 and beyond. Because of the difference in timing, the overall effect of Desert Shield/Desert Storm was a $1.5 billion increase in the 1990 deficit, an estimated reduction in the deficit for 1991 of $25.1 billion, and a resulting increase in the deficit in 1992 and the next few years of $24.2 billion.[8] In addition, deficits will be increased in later years by the long-term retirement and disability costs associated with Desert Shield/Desert Storm.

[8] This assumes that any reduction in outlays for basic activities due to Desert Shield/Desert Storm in fiscal year 1991 represented just a delay in those expenditures so that outlays for these activities will be increased in 1992 and later years by an amount equal to the reduction in 1991. If, instead, some part of that reduction represented the permanent elimination of the need for an expenditure due to Desert Shield/Desert Storm, that part of the reduction should be counted as an offset in determining the incremental costs of Desert Shield/Desert Storm, and Desert Shield/Desert Storm funding requirements should be adjusted downward by that amount.

Table 5.4: Timing of Desert Shield/Desert Storm Effects on the Deficit

Dollars in billions

	Amount
1990 deficit effect	$1.5
1991 deficit effect	$−25.1
1992 and later deficit effect	$24.2
Total deficit effect	$0.6

If not all of the available funds for Desert Shield/Desert Storm are obligated, the deficit increases in fiscal 1992 and later years would be smaller. Additional appropriations and obligations for Desert Shield/Desert Storm would, of course, increase the deficit effect. We will continue to monitor DOD's reported Desert Shield/Desert Storm costs, funding requirements, and obligations in order to assess whether additional obligations and the consequent increase in the deficits are justified.

Medicaid

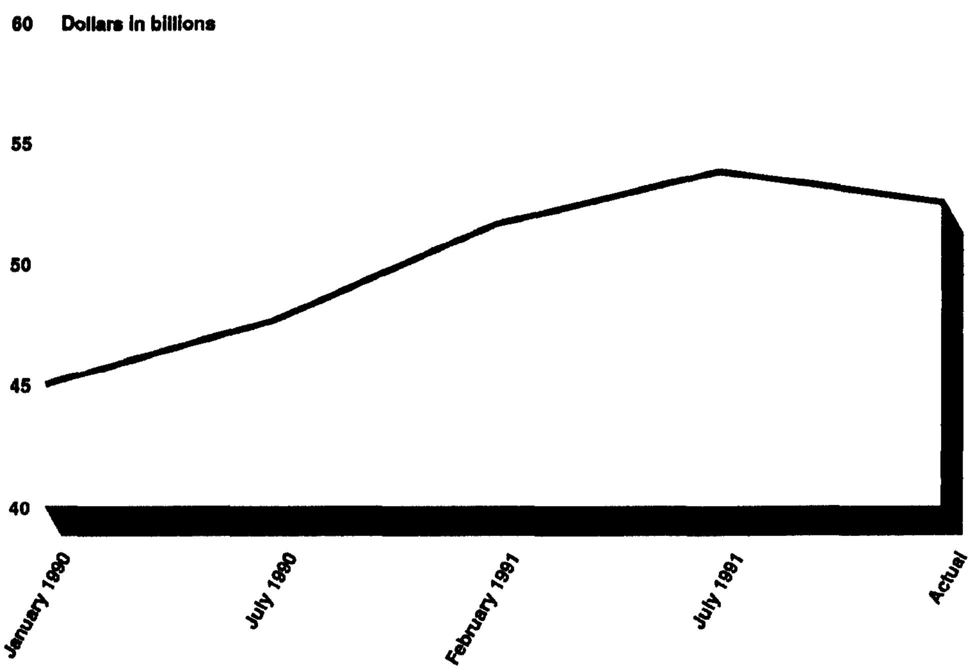
Estimates of Medicaid outlays in fiscal year 1991 increased from $45 billion in the President's budget submitted in January 1990 to actual outlays of $52.5 billion reported in October 1991, an increase of $7.5 billion.

Table 6.1: Medicaid - Estimates Versus Actual

Dollars in billions

	OMB outlays, fiscal year 1991
January 1990 budget	$45.0
February 1991 budget	$51.6
Actual	$52.5

Figure 6.1: 1991 Medicaid Outlay Estimates - January 1990 to Actual



Background

Medicaid, established under Title XIX of the Social Security Act, is a joint federal-state entitlement program that provides medical assistance to some groups of the nation's poor and medically needy populations. Within broad federal guidelines, states design and run their own programs, determining both eligibility and benefits. States are generally required to cover some groups, including those who receive cash assistance from welfare programs like Aid to Families with Dependent Children (AFDC) and Supplemental Security Income (SSI). States have the option to cover other groups who are poor or need medical assistance but do not qualify for welfare assistance.

The federal government awards grants to states to help finance Medicaid. These matching funds, which can range from 50 percent of program costs to 83 percent, are determined by a formula based on states' relative per capita incomes.

Many Problems Make Estimating Medicaid Costs Difficult

Medicaid has many characteristics that make cost estimation difficult. The program is large and complex, and each state establishes its own plan. The program also changes considerably over time, as economic conditions, political priorities, and other initiatives influence the eligibility of individuals and the scope of benefits they receive. In addition, volatile health care inflation compounds other problems associated with forecasting trends in numerous variables.

Estimates of federal Medicaid spending fell short of actual expenditures in fiscal year 1991 by billions of dollars due to a variety of technical, organizational, economic, and policy reasons. Economic and policy reasons, which are largely outside the control of the relevant federal and state agencies that administer Medicaid, had a significant impact on program spending. They caused unforeseen shifts in program trends relating to eligibility, participation, inflation, reimbursement rates, and financing. Also, technical and organizational problems with how the federal and state governments administer the Medicaid program contributed to cost underestimation.

Fiscal year 1991 was not the first year in which Medicaid outlays have been underestimated. The President's fiscal year 1990 budget estimated Medicaid outlays of $37.6 billion in that year, but actual outlays were $41.1. OMB stated that this $3.5 billion increase was due primarily to technical factors.

A 1991 Department of Health and Human Services (HHS)-OMB Task Force report identified problems with estimating Medicaid costs and recommended actions to resolve some of them. The Task Force found that aggregate state estimates of federal Medicaid expenditures were remarkably accurate during the 1980s, despite complicating factors. However, the fiscal year 1991 estimates reflected much greater error due to trend changes in program eligibility and benefits. The Task Force attributes about one-fourth of the fiscal year 1991 estimating error to technical problems, and the remainder to various economic and federal and state policy changes.

Policy Reasons Play a Significant Role in Cost Underestimation

Policy reasons for Medicaid cost underestimation include the impact of legislation, court decisions, and other program changes on eligibility and reimbursement rates. Policy impacts are closely related to economic conditions, and also are difficult to forecast and measure because of the leading role played by each state in setting the policies for the Medicaid program in that state.

Recent federal legislation has expanded Medicaid eligibility beyond groups traditionally covered, like AFDC and SSI recipients, particularly to include other low-income pregnant women and children. Also, states are increasing both program coverage and payment rates to improve health care for large segments of the poor and disabled. For example, some states now cover costs for as many as one-third of births by complying with the required minimum income threshold for pregnant women and children. Concern for better health care also has led to greater Medicaid payments to nursing homes and institutions serving the disabled and mentally retarded. The fiscal year 1991 budget estimates may not have accurately reflected the cost impact of recent eligibility expansions, some of which may produce lagged effects on states' Medicaid programs.

Increases in Medicaid payments to hospitals contributed to cost underestimation for fiscal year 1991. Apparently, budget estimates failed to account for an upward trend in hospital reimbursement rates for Medicaid services. Although states set reimbursement rates, hospitals can challenge rates considered unreasonably low in court. Recent court decisions in favor of such challenges have forced states to increase reimbursement rates. States must provide additional compensation to hospitals that serve a disproportionate share of low-income patients. These "disproportionate-share" payments have contributed to Medicaid cost increases.

Many states have political incentives to underestimate Medicaid costs. In an era of tight budgets and competing demands on limited resources, low estimates of Medicaid costs would allow the funding of other programs in the state budget. Since the federal government must reimburse states for Medicaid costs actually incurred, there is little penalty for making artificially low estimates. Since the federal government generally accepts states' Medicaid estimates for incorporation into the budget, such practices could have affected the fiscal year 1991 budget figures, but data that could confirm this are not yet available.

Economic Conditions Also Affect Medicaid Costs

The state of the economy impacts Medicaid spending because program eligibility depends on income and medical need. For example, the recent recession caused an increase in the number of Medicaid recipients as unemployment increased and incomes fell or grew more slowly. Economic fluctuations are difficult to forecast and represent an unavoidable source of estimation error that varies from year to year. Since economic problems often underlie or interact with other problems affecting Medicaid spending, their direct impact is difficult to determine. The HHS-OMB Task Force identifies economic fluctuations as a relatively minor reason for cost underestimation in fiscal year 1991.

Inflation is another economic problem affecting Medicaid spending. Many of the sources we contacted cited a recent, unexpected upturn in health care inflation as a factor in 1991 cost underestimation. This inflation apparently contributed to a change in cost trends that the fiscal year 1991 budget estimates did not capture.

Participation rates, which measure the percentage of the eligible population that actually receives Medicaid benefits, also have increased unexpectedly. It is not clear whether state outreach efforts or economic conditions are primarily responsible for this change. However, it is another uncontrollable source of estimation error.

Changes in federal Medicaid outlay estimates described as technical adjustments actually may reflect direct and indirect economic effects. They are technical adjustments in the sense that states adjust their cost estimates, which the federal government then incorporates into its official estimates, but the states often have made their adjustments because of economic effects.

Data and Methodologies Are Inadequate

The HHS-OMB Task Force report criticizes the quality, timeliness, and accessibility of Medicaid data. Much of the criticism surrounds the adequacy of the Health Care Financing Administration's (HCFA) Form 25, the primary source for federal budget estimates. States collect programmatic and funding data on Medicaid and transmit the information to

HCFA by submitting specific forms. HCFA Form 25 contains budget estimates and is the basis for quarterly grant awards to the states. The Task Force considers some of the form's information outdated and not particularly useful. In addition, there are doubts about how diligently state officials complete the form. Some officials reportedly did not understand the purpose of the form, and officials in one state failed to update initial budget estimates in subsequent HCFA Form 25 submissions. Overall, the report finds the form inadequate for capturing the reasons for Medicaid trend changes.

The sophistication of data collection and analysis varies considerably by state. Some states have automated data base systems and perform relatively complex analyses, while others use only ad hoc methods. The lack of a national, automated data base and independent or consistent forecasting system hinders the aggregation and manipulation of state-level data to project federal outlays. This variance in data collection and analysis compounds the variance in reporting effort and accuracy on HCFA Form 25.

The use of different methodologies at both the state and federal level may exacerbate estimation errors. States do not always incorporate the same assumptions and concepts into their Medicaid estimates. For example, state fiscal years differ from each other and from the federal fiscal year; states incorporate the impact of some legislation and regulations into cost estimates, but not necessarily the same ones; HCFA uses different methods to project costs for the budget year and for future years; and HCFA makes an aggregate "add-on" adjustment to the sum of state estimates based only on past errors and not specific effects.

Organizations and Processes Are Uncoordinated

In the Medicaid program, communication and information flow through a network of state and federal agencies that administer the program. There really are over 50 Medicaid programs since states—along with the District of Columbia, Puerto Rico, and the territories—largely determine eligibility and benefits. Also, multiple state entities sometimes have responsibility for administering the program, collecting and reporting the data, and setting reimbursement rates. Medicaid responsibilities are also divided at the federal level. Although the Medicaid Bureau has a primary role in evaluating state Medicaid plans and data, other HCFA offices—including regional offices—also contribute.

Lack of adequate oversight and shared program responsibilities complicate cost estimation. HCFA offers the states limited feedback on the relative accuracy of their estimates, and has no independent system for producing estimates to evaluate states' performance. States and HCFA regional offices have a great deal of programmatic and funding information, but not necessarily the ability to analyze the information. HCFA's Office of the Actuary has expertise in making projections, but does not participate in estimating budget year costs—only outyear costs.

One of the most significant organizational problems with estimating Medicaid costs is that the budget process in many states is separate from the federal reporting process. State personnel who formulate the budget do not necessarily gather and report Medicaid information to HCFA. Formulating the state budget may have priority over other tasks, and incentives to spend time and effort transmitting information to HCFA may be lacking. In addition, a separate budget process can result in political priorities, accounting measures, and other differences between estimates used by the states and estimates used by HCFA.

States and the Administration Dispute Medicaid Financing

A number of states have developed new Medicaid funding mechanisms that have increased federal expenditures. These states have received contributions from or assessed taxes on Medicaid providers, and have either redistributed these receipts to hospitals through the disproportionate-share payment system or have simply returned them to the same providers through increased reimbursements. Because federal payments to a state are based on the state's gross costs, including costs financed by provider donations or provider-specific taxes, this practice has increased federal payments by more than the net increase in costs to the states. According to the HHS-OMB Task Force, the use of provider taxes and voluntary contributions by many states unexpectedly increased federal Medicaid expenditures in fiscal year 1991 by $3 billion or more.

The administration has opposed the use of taxes and contributions that reduce the state share of real expenditures at the expense of the federal budget. HHS considers this a loophole in federal controls, and has released interim-final regulations that would restrict such practices beginning January 1, 1992. The HHS-OMB Task Force estimates that the overall effective federal matching rate could increase from 57 percent to 62 percent by 1996 if such practices are not restricted.

Legislation was enacted in December 1991[1] that nullifies the regulations proposed by HHS and instead imposes restrictions agreed to by the Congress and the Administration. These would prohibit the use of voluntary provider donations to increase federal matching payments and would limit the kind and amount of taxes that could be used to increase the federal payments.

The dispute over provider taxes and voluntary contributions represents a disagreement over the fundamental relationship between the federal and state governments. Over time, demands on both state and federal resources will continue to increase. Restricting the use of provider taxes and voluntary contributions will shift some of the Medicaid financial burden back to the states, but it will not ease the overall burden on national resources.

Task Force Recommends a Greater Federal Role

The HHS-OMB Task Force recommendations for improving Medicaid estimates focus mainly on resolving technical and organizational problems that relevant state and federal agencies can address. They include: centralizing federal responsibility for Medicaid within HCFA's Medicaid Bureau; improving communication and information flows between the states and the Medicaid Bureau; creating a consistent federal forecasting methodology; improving the quantitative and analytic skills of personnel; attaching greater priority to tracking and estimating the impact of federal and state legislation; and eliminating most uses of provider taxes and voluntary contributions. Essentially, the Task Force advocates a larger federal role in overseeing and regulating a program that is mostly controlled by the states and increasingly financed by the federal government.

[1] The Medicaid Voluntary Contributions and Provider-Specific Tax Amendments of 1991 (Public Law 102-234), December 12, 1991.

Economic Assumptions

The administration's economic assumptions are developed jointly by the Council of Economic Advisors, the Department of Treasury, and the Office of Management and Budget. Table I.1 shows the administration's economic assumptions for calendar year 1991, as presented in the President's fiscal year 1991 budget submitted in January 1990. It also shows the corresponding Congressional Budget Office (CBO) assumptions from January, 1990 and the Blue Chip economic indicator assumptions from February 1990. The table also shows the Blue Chip estimates for calendar year 1991 made in November 1991.

Table I.1: Calendar Year 1991 Economic Assumptions

	Winter 1990 assumptions			Current estimates
Indicator	FY 91 budget, January 1990	CBO report, January 1990	Blue Chip,[a] February 1990	Blue Chip,[a] November 1991
GNP[b]				
nominal dollars	7.5	6.5	6.5	3.3
constant dollars	3.2	2.4	2.4	−0.4
GNP deflator[b]	4.2	4.0	4.0	3.8
Consumer Price Index[b,c]	4.0	4.3	4.2	4.2
Unemployment[d]	5.3	5.5	5.6	6.7
Interest Rate				
3 month T-Bill[e]	5.4	7.2	7.3	5.5
10 year T Notes[f]	6.8	7.7	7.9	8.0

[a]Eggert Economic Enterprises, Inc., Blue Chip Economic Indicators.

[b]Percent change, year over year.

[c]The administration lists CPI for urban wage earners and clerical workers, while CBO and Blue Chip lists it for all urban consumers.

[d]The administration measures unemployment as the annual average, percent of total labor force including armed forces residing in the United States, while the CBO projection is for total labor force excluding the armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.

[e]The 3-month T-Bill rate is the average rate on new issues within a period, on a bank discount basis.

[f]The Blue Chip indicators don't project a 10-year Treasury Note rate. The rate shown for 1990 is a CBO caluculation based on an estimated relationship between rates on 10-year bonds and the Blue Chip projected Aaa bond rate. Rate shown for 1991 is based on a similar calculation prepared by GAO.

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