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BUDGET ISSUES

Cap Structure and
Guaranteed Funding

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G A O

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Mr. Chairman, Members of the Committee:

It is a pleasure to appear before you as you consider the issues involved if guaranteed minimum funding levels are established for particular programs or areas within the budget. As requested, in my statement today I will cover four topics related to this issue: (1) the budget structure and current budgetary control regime, (2) the budget outlook, discretionary caps, and enforcement situation as the United States enters an era of projected unified budget surpluses, (3) potential implications of guaranteeing minimum spending levels on the discretionary side of the budget, and (4) the PAYGO side of the equation: permanent appropriations, mandatory trust funds, and mandatory special funds.

Budget Structure and Current Budgetary Control Regime

The unified budget was adopted in 1969 as a way of capturing all federal receipts and expenditures. This was seen as important to permit the federal budget to be used as an instrument of economic/fiscal policy. In addition, if the budget is to help the Congress and the President allocate federal resources, it should cover essentially all activities and transactions that are federal in nature. Equally important, the budget display needs to show distinctions between types of federal programs and the information necessary for evaluating the budget year and future years. Such a balance between a unified overview and sufficient compositional information ensures that programs included in the budget are subject to the kind of priority-setting and oversight deliberations the Congress must make during the budget and appropriations debate.

As all of you know, the Congress provides funds to agencies through budget accounts. These accounts vary in their orientation, specificity, and size.¹ A relatively few large accounts are associated with three-quarters of budgetary resources, and the rest are comparatively quite small. Accounts may be oriented to program, process, organization, or object—and more than one orientation is likely to be found in a given agency. For example, the Department of Health and Human Services has budget accounts ranging from children and families services programs, to processes like service and supply, to organizations like the National Institutes of Health, and to objects like retirement pay and medical benefits.

¹Budget Account Structure: A Descriptive Overview (GAO/AIMD-95-179, September 18, 1995).

The Congress has also recognized the variation among federal programs and activities in how it provides funding to these activities. For example, because the school year and the fiscal year do not match, the Congress generally forward-funds education programs so that the school year begins with funding for the first quarter in place. Some funds expire in 1 year if not obligated; others are available for several years, and some are permanently available for obligation.²

The Budget Enforcement Act of 1990 (BEA)³ established a budgetary control regime that divided the budget into two major parts: (1) discretionary spending, defined as spending that stems from annual appropriations acts, and (2) direct spending, or spending that flows directly from authorizing legislation; this latter is often known as mandatory. As all of you know, discretionary spending is subject to annual dollar limits (spending caps). Mandatory spending and receipts legislation are subject to a pay-as-you-go (PAYGO) requirement that legislation enacted during a session of the Congress be deficit-neutral. The question of guaranteed spending levels is relevant to both parts of the budget.

Budget Outlook and the Discretionary Caps

Assuming that budget caps hold, after nearly 30 years of unified budget deficits, current projections are for surpluses lasting far into the future. Although many recent budget agreements (Gramm-Rudman-Hollings, BEA, and the Balanced Budget Agreement) were designed to achieve this fiscal position, BEA's enforcement regime does not end with the advent of a surplus. Direct spending is still subject to the PAYGO rules, and discretionary spending is still subject to specified dollar caps.⁴

According to the Congressional Budget Office (CBO), discretionary spending in fiscal year 1999 is expected to make up about one-third of total outlays. Under the current statutory caps, these outlays will remain almost unchanged in dollar terms between fiscal years 1999 and 2002. Even if discretionary spending grows with inflation between fiscal years 2002 and 2009, it will fall to about 29 percent of total outlays.

²See Budget Process: Biennial Budgeting for the Federal Government (GAO/T-AIMD-94-112, April 28, 1994).

³Balanced Budget and Emergency Deficit Control Act of 1985 as amended by BEA as further amended by the Omnibus Budget Reconciliation Act of 1993 and the Budget Enforcement Act of 1997.

⁴CBO has opined that BEA enforcement applies regardless of whether or not there is a deficit. This point will likely be further discussed as an "on budget" surplus materializes.

Discretionary caps were first imposed by BEA in 1990. The structure of those caps—and so the constraints on trade-offs within the budget—has varied. When BEA was first enacted, there were three categories—defense, domestic, and international—established within overall discretionary spending caps for fiscal years 1991 through 1993. Although spending in any category could be below the caps, spending within a given category could not exceed the cap for that category—there could be no trading across categories. For fiscal years 1994 and 1995, the categories were collapsed into a single general discretionary cap for each year.

Subsequent laws extended the caps and created new categories. The violent crime reduction trust fund was created with a separate spending limit carved out from the general purpose spending caps for fiscal years 1995 through 2000. Like previous caps, this spending limit serves as a cap, not a floor; thus less than the capped amount could be appropriated for violent crime—but any unused portion could not be reallocated to other areas of the budget.

The Budget Enforcement Act of 1997 changed the cap structure again for years 1998 through 2002. For fiscal years 1998 and 1999, it established three separate categories of discretionary spending: defense spending, violent crime reduction spending, and all other nondefense spending. For fiscal year 2000 it combined defense and nondefense leaving violent crime reduction as the only carve-out. For 2001 and 2002, these were combined into a single discretionary spending category.

However, the cap structure established in 1997 was further changed by the Transportation Equity Act for the 21st Century (TEA-21), which established two new outlay caps that apply separately to highway and mass transit programs for 1999 through 2003. It also specified annual guaranteed minimum spending levels, tied in the case of highways to Highway Trust Fund receipts. This law brought a change not only in structure but also in the nature of the caps—unlike previous caps, these are guaranteed spending levels.

The last comprehensive extension and revision of the caps in 1997 set the caps so that the budget would be balanced in 2002. It is not clear whether caps would have been extended beyond the year of budget balance. However, the budget reached balance earlier than planned and the Congress and the President now face the difficult situation of having to comply with tight budget caps at the same time that it is running a surplus.

Table 1 shows the current structure of the discretionary caps. For most categories, there are limits on both budget authority and outlays. However, because spending from the transportation trust funds is controlled by obligation limits, for the highway and mass transit categories, there are only outlay caps.⁵

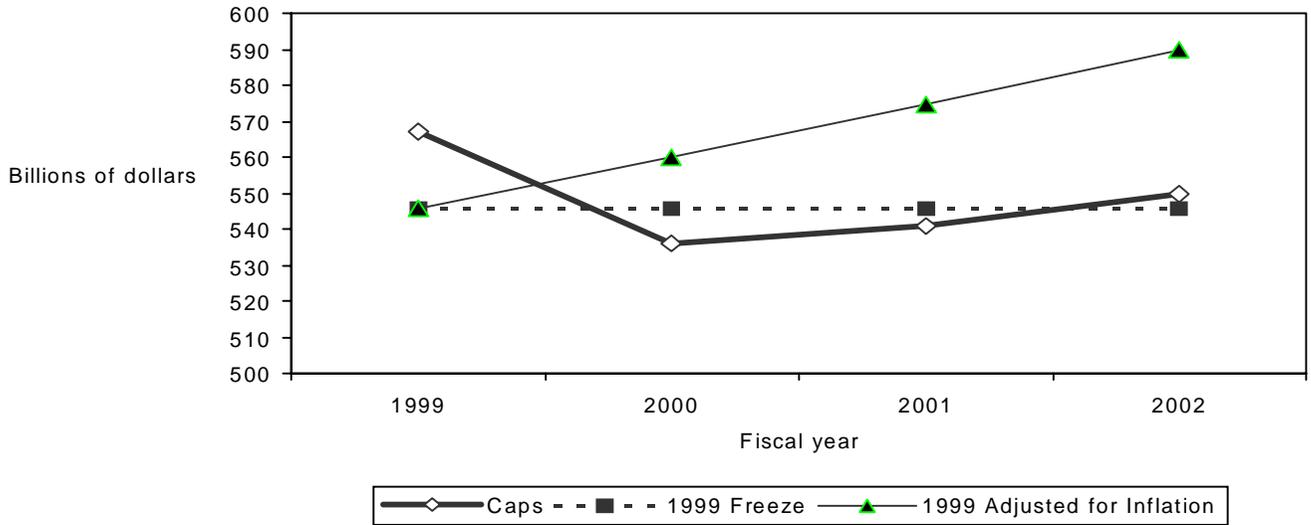
Table 1: Discretionary Spending Categories by Fiscal Year

1997	1998	1999	2000	2001	2002
Violent Crime Reduction	Violent Crime Reduction	Violent Crime Reduction	Violent Crime Reduction	Discretionary	Discretionary
Discretionary	Defense	Defense	Discretionary		
	Nondefense	Nondefense			
		Highway	Highway	Highway	Highway
		Mass Transit	Mass Transit	Mass Transit	Mass Transit

I don't need to remind any member of the Congress that over the next few years, as shown in figure 1, the limits on discretionary spending are very tight. The statutory caps are below the fiscal year 1999 freeze level, that is, if Congress chose to freeze appropriations at the fiscal year 1999 nominal dollar level (the 1999 freeze line), and substantially below the fiscal year 1999 level adjusted for inflation.

⁵Accounts in the highway category provide contract authority, which is liquidated from the Highway Trust Fund. Budget accounts for mass transit include both contract authority, liquidated from the Highway Trust Fund, and authorizations of appropriations from the General Fund of the Treasury. Contract authority is a form of budget authority that permits obligations to be incurred in advance of appropriations.

Figure 1: How Tight Are the Budget Authority Caps?



If the appropriations designated as emergency for fiscal year 1999 were to be continued as nonemergency spending this year, budget authority for fiscal year 2000 would have to be cut by \$26 billion below the fiscal year 1999 appropriated level. Even if those emergency appropriations from fiscal year 1999 are not continued for fiscal year 2000, to comply with the current caps budget authority must be cut \$10 billion below the fiscal year 1999 nominal level.

In its outlook volume, CBO noted the outlay caps “may be even harder to meet.” Outlays are projected to rise by \$21 billion between fiscal years 1998 and 1999. However, if the Congress froze appropriations at the fiscal year 1999 nominal dollar level, outlays in fiscal year 2000 would be \$13 billion over the outlay caps.

In summary then, the Congress and the President currently face a real challenge on the discretionary side of the budget. To comply with the fiscal year 2000 statutory caps, discretionary spending must be cut from its fiscal year 1999 appropriated level: budget authority by \$10 billion and outlays by \$13 billion, assuming that none of the emergency spending is continued.

Potential Implications of Creating Additional Guaranteed Funding Levels

Last year the Congress chose to make a change in the operations of the Highway Trust Fund—both its highway account and its mass transit account. The major changes were: (1) creation of separate outlay caps for highway and mass transit and (2) specification of annual guaranteed minimum funding levels—tied in the case of highways to Highway Trust Fund receipts. Some have suggested that a similar treatment might be warranted for the Airport and Airway Trust Fund. As you know, the House recently took a different approach in adopting legislation that ensures that future growth in aviation funding is financed by the trust fund and moves the Airport and Airway Trust Fund “off budget.”

You asked about the budgetary implications of creating new guaranteed funding levels within the discretionary limit as was done for highway and mass transit. In the past, separate caps within the overall discretionary spending limit were designed to place firewalls between different areas of spending and to limit trade-offs to programs within each category. For example, creation of separate defense and nondefense caps did not guarantee minimum funding levels for either category, but it did limit the extent to which one could be increased at the expense of the other.

Like the caps, a guaranteed minimum funding level limits the range of trade-offs. However, it also raises some additional issues. Its impact depends on the design of the guarantee. For example, if a guaranteed minimum funding level for area X is carved out of the general discretionary cap—and that cap is not increased—then the remaining activities within that cap must compete for what is left. If the guaranteed minimum funding level for area X is layered on top of the existing cap—i.e., if the remaining cap(s) are unchanged—then total discretionary spending increases and the surplus falls (or the deficit increases). In general, providing guaranteed funding levels to any one activity in the budget protects that activity from competition with other areas for finite resources. It, in effect, creates within the discretionary spending limits what might be considered a permanent appropriation (which is mandatory spending, not discretionary). Let me now turn to discussing this type of guaranteed funding.

Permanent Appropriations, Trust Funds, and Special Funds: How Do They Fit Into the Federal Budget?

The mandatory spending part of the budget is comprised of spending that is not controlled through the appropriations process but instead is provided and controlled indirectly through other forms of legislation.⁶ By design, this part of the budget generally can be thought of as having funding levels guaranteed at the amount necessary to satisfy program requirements. It includes permanent appropriations, contract authority, authority to borrow, and authority to make any payments for which budget authority is not provided in advance in appropriations acts.⁷ The largest of these in dollar terms is permanent appropriations,⁸ which I will focus upon today along with the fund types that often have permanent appropriations.

The federal budget consists of several types of funds: the general fund, special funds, public enterprise funds, intragovernmental funds, and trust funds.⁹ All of these except trust funds are considered to be “federal funds.” All unified budget transactions fall within either of two fund groups: (1) federal funds or (2) trust funds. Trust funds use permanent appropriations more than any of the other fund types.

Although some budget summary tables show only 12 major trust funds, in fiscal year 1997, there were about 110 trust funds.¹⁰ These covered a wide range of purposes: from social insurance (Social Security and Medicare), employee compensation (pensions and health benefits), insurance, natural resources and environmental cleanup to transportation. Social Security has by far the largest trust funds, followed by federal employee retirement funds (civilian and military) and the Medicare trust funds.

The term “trust fund” as used in the federal budget is not the same as a private trust fund. The manager of a private trust has a fiduciary obligation

⁶By definition, the food stamp program, which receives annual appropriations, is also considered mandatory spending.

⁷We have reported on these types of spending authorities in Budget Issues: Inventory of Accounts With Spending Authority and Permanent Appropriations, 1996 (GAO/AIMD-96-79, May 31, 1996).

⁸In fiscal year 1998, about 66 percent of total spending was due to permanent appropriations.

⁹There are both revolving and nonrevolving trust funds. Revolving trust funds, which represent 12 of the 110 trust fund accounts and account groupings, are established to carry out a cycle of business-type operations.

¹⁰This is based on the Congressional Research Service report Federal Trust Funds: How Many, How Big, and What Are They For?, updated June 30, 1998. The 110 total actually groups some small trust funds together, counting them as one fund. The actual number of individual trust funds would be higher.

to the beneficiary and must manage the trust's assets on behalf of that beneficiary according to the stipulations of the trust. The manager cannot unilaterally alter the terms of that trust. In contrast, the federal government both owns the assets of most trust funds and can, through legislation, raise or lower the fund's collections or payments, or alter the purposes of the trust fund.¹¹

Within the federal budget, there is no substantive difference between most trust funds and special funds. Both are internal accounting mechanisms used to track the collection and use of funds earmarked for specific purposes. The only difference between a "special fund" and a "trust fund" is the word "trust" in the legislation establishing the account. Based on our analysis of OMB's receipt accounts, there are over 100 special funds. Examples are the Department of Veterans Affairs' medical care cost recovery fund and the Department of the Interior's reclamation fund.

How Do Trust and Special Funds Fit Into the Budget Enforcement Regime?

There is no single rule for budgetary control of trust or special funds. Although most trust funds operate with guaranteed funding levels in the form of permanent appropriations, knowing that a given account has been designated a trust or special fund does not tell you either whether spending is controlled through the appropriations process or whether it is subject to any limitations. Trust and special funds are classified as discretionary or mandatory depending on the nature of the substantive legislation creating the fund—i.e., depending on the nature of the activity funded. For example, Social Security, Medicare, and employee pensions are "direct spending," or mandatory, programs and have permanent appropriations. Outlays are solely a function of the design of the program, such as eligibility requirements and benefit formulas. As a result, under the BEA enforcement provisions, spending for these programs is subject to the PAYGO rules.¹² By far, the bulk of trust and special fund spending is due to permanent appropriations—in fiscal year 1998, permanent appropriations accounted for nearly 95 percent of total trust fund spending and over 80 percent of special fund spending.

¹¹The federal government manages some trust funds in a fiduciary capacity, such as trust funds owned by Indian tribes. These are not discussed in this testimony.

¹²Social Security has its own set of budget enforcement rules which protect its balances and remove its transactions from the deficit/surplus estimates and calculations made according to BEA.

In contrast, spending for discretionary—i.e., appropriated—programs is governed by the spending caps regardless of whether that spending flows from federal funds or trust funds. Spending from discretionary trust funds, such as the transportation trust funds, often is controlled by obligation limits, which limit outlays. As you know, some of these trust funds recently have been the object of debate regarding the creation of guaranteed funding levels for them as part of the discretionary spending limits. This would in effect grant them the equivalent of a permanent appropriation like most of the other trust funds. However, when the Congress created the various transportation trust funds, it decided to retain annual control over the timing of their spending, a decision that would be reversed by creating guaranteed funding levels. Any decision to create a guaranteed funding level within the current discretionary caps would further tighten the already tight caps for other discretionary spending programs, unless a decision was made to increase the caps. The legislation recently adopted by the House regarding the Airport and Airway Trust Fund removes the trust fund from all budget calculations and directs OMB to reduce the discretionary caps to reflect the discretionary baseline trust fund spending.

Conclusion

In general, providing guaranteed funding levels to any one activity in the budget protects that activity from competition with other areas for finite resources. The design of any guarantee can have implications for other federal activities and for federal resources. Whether to provide such a guarantee and to what activities is fundamentally a decision about priorities that only the Congress and the President can make.

This concludes my statement. I would be happy to answer any questions you or your colleagues may have.

Contact and Acknowledgments

For future contacts regarding this testimony, please contact Susan Irving at (202) 512-9142 or Christine Bonham at (202) 512-9576. Individuals making key contributions to this testimony included Christine Bonham, Robert Sexton, Carol Henn, and Carlos Diz.

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