United States General Accounting Office

GAO

Report to the Congress

August 1989

BUDGET ISSUES

Restructuring the Federal Budget—The Capital Component

GAO/AFMD-89-52

GAO

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

Comptroller General
of the United States

B-223368

August 24, 1989

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

The federal deficit is widely viewed as the number one fiscal problem facing the nation today. Because of this deficit, the federal government cannot act as if it has unlimited financial resources. Thus, the nation is faced with a fundamental policy decision: how much to spend on governmental programs and services and how to finance them.

As a decisionmaking tool, the federal budget should be comprehensive and portray federal programs and amounts in a way that is useful to decisionmakers and the public. Unfortunately, the current cash-based, unified budget no longer meets the needs of decisionmakers and an informed public. When combined with the complex Gramm-Rudman-Hollings deficit reduction process, the result is a budget that is very complicated and of limited usefulness.

- It makes no distinction between operating expenses and capital investments, which leads to unsound deficit reduction strategies and creates a budget bias against capital investments.
- The budget does not highlight the use of Social Security and other trust fund surpluses, now running at about $100 billion a year, to finance deficits in other government activities, which hampers planning for the time when those surpluses may no longer be available.
- It does not identify the totals for activities, such as the Postal Service, established to be primarily self-financing enterprises. This sometimes leads to proposals to remove such activities from the budget.

We propose that the unified budget be retained but that its format be changed to distinguish between capital investments and operating expenses and to clearly identify trust funds, enterprise-type funds, and other government funds. Each part would have a separate total which would be added together to produce the unified budget total. It is important to note that our proposal is designed to reform the unified budget, make it more workable, and reduce pressures to remove federal activities from the budget.

Table 1 shows fiscal year 1988 budget results restructured according to our proposal, which shifts the focus away from a single deficit figure of $155 billion for that year. If our proposal is adopted, the Balanced Budget and Emergency Deficit Control Act of 1985's (Gramm-Rudman-

Hollings) targets could be revised to focus on an appropriate balance between spending for operations and investments and for general, trust, and enterprise activities.

Table 1: GAO's Fiscal Year 1988 Restructured Budget Results

Dollars in billions

	Total	General	Trust	Enterprise
Operating surplus/ deficit (-)	$-131	$-248	$124	$-7
Capital financing requirements	-24	-23	2	-3
Unified budget financing requirements	**$-155**	**$-271**	**$126**	**$-10**

We plan to issue a summary report on our proposed restructuring activities shortly. We have previously reported on the need for a restructured budget to distinguish between programs financed through trust funds and those which should be considered part of the general operations of government.[1] The summary report also will present our proposed reforms of budget cost reporting and the budget process itself.

This report sets forth the conceptual framework for the capital budget component of our restructured unified budget proposal. We believe this would improve the federal decisionmaking and control processes. The capital budget would identify the revenues, investments, and "capital financing" needs for capital investments, and it would clearly distinguish them from current operating amounts and "operating deficits." In the future, we will be reporting on the enterprise component of a restructured budget.

Problems With Current Unified Budget Structure

The current unified budget structure focuses attention exclusively on a single surplus or a deficit total, whether it is the Office of Management and Budget's (OMB) or the Congressional Budget Office's (CBO) unified deficit numbers or the Gramm-Rudman-Hollings deficit targets. The reported unified deficit number—$155 billion for fiscal year 1988—is widely viewed as the key indicator of the federal government's fiscal policy. While it is important to have a single number for fiscal policy purposes, an exclusive focus on such a number is misleading and hampers budget decisionmaking. This approach has two major problems concerning capital investments.

[1]We recently issued two reports on our trust fund work: Budget Issues: Trust Funds and Their Relationship to the Federal Budget (GAO/AFMD-88-55, September 30, 1988) and Social Security: The Trust Fund Reserve Accumulation, the Economy, and the Federal Budget (GAO/HRD-89-44, January 19, 1989), and we will soon be reporting on other trust fund work.

First, the exclusive focus on a single, cash-based total leads to unsound deficit reduction strategies. States distinguish between spending for capital investments and spending for operating expenses, and they focus upon the latter in their balanced budget requirements. Under the present federal budget structure, however, it is difficult for the President and the Congress to apply deficit reduction efforts in a way that balances needs for operating expenses with needs for capital investments. For example, Gramm-Rudman-Hollings calls for deficit targets that apply without differentiation to capital and operating programs. This is because the budget makes no systematic distinction between outlays for capital investments and those for current operations.

This single-number focus of federal deficit reduction efforts is based upon a highly questionable premise: all outlays are the same, whether for capital investments or operating expenses. This is not the case. Capital outlays, whether they are for buildings or loans, produce future streams of benefits to the government or the economy. The benefits may be cash flows, facilities to carry out government operations, or other such economic returns.

Failure to recognize the critical distinction between capital investments and operating expenses complicates economic policymaking. Officials cannot readily discuss and set in public policy the needed balance between spending for short-term consumption needs (operating expenses) and long-term infrastructure and productivity enhancing needs (capital investments). Striking the correct balance is important for short-term economic stabilization and long-term economic growth.

Second, under the current, cash-based budget, there is a budget bias against capital programs, which could lead to uneconomical decisions. Under present budget scorekeeping rules, a $10-million outlay to construct a building (a capital investment) in a given year contributes to the year's deficit the same as a $10-million outlay for vehicle or airplane fuel costs (an operating expense). This scorekeeping practice "front-end loads" the costs shown in the budget for the acquisition, since the project will have sizable start-up cash payments. Such a capital project is also at a disadvantage during budget deliberations when competing with an alternative means of acquiring the use of a building that would have lower front-end costs, such as leasing, but which has significantly higher long-term costs. This could lead decisionmakers to select the leasing option even though it would entail larger, long-term costs without the sizable benefit of eventual ownership. In a sense, it requires a capital asset to have a 1-year payback to be able to compete equally with current operating programs—a clear manifestation of the budget's focus on short-term thinking.

The costs of credit programs (direct loans and loan guarantees made by the government) are similarly distorted because of the current budget's cash-flow orientation. A portfolio of $100 million in new direct loan outlays counts toward the deficit the same as $100 million in grants, even though the $100 million in direct loans does not represent $100 million in costs. This cash-flow treatment does not recognize that the government, in making these loans, receives a financial asset (the note promising future repayments), and that at least a portion of the loan outlays will be repaid in the future. This omission makes direct loan programs seem more costly (in outlay terms) in their early years, but it gives the opposite impression in later years when loan repayments are netted against new disbursements for calculating reported (net) loan outlays.

The cash-based recognition of credit program costs also distorts loan guarantees. Under current practices, loan guarantee default costs are recorded in the budget at the time default payments are made. Since most defaults on loan guarantees occur in future years, rather than in the year of authorization, the loan guarantees are treated as if they were cost free at the time decisions about program activities are being made.

A capital budget within the unified budget would eliminate these and other deficiencies.

Restructure the Current Unified Budget to Include a Capital Budget

GAO proposes restructuring the current unified budget to include a capital and an operating budget within the unified budget. Tables 2 and 3 illustrate, respectively, at a summary level, the current unified budget and our capital budget. Both budgets reflect the $150 billion and $155 billion total deficits for fiscal years 1987 and 1988, respectively.

As table 3 shows, our capital budget would differ from the current unified budget (table 2) in that it would identify the revenues, investments, and "capital financing requirements" for federal capital investment activities, and it would clearly distinguish them from current operating amounts and the "operating surplus/deficit."[2] The operating budget's "operating surplus/deficit" and the capital budget's "capital financing requirements" would result in a single budget number referred to as the "unified budget financing requirements." This total would be consistent with the total now defined by the current unified budget as the "surplus/deficit."

Table 2: Current Unified Budget for the U.S. Government

Dollars in billions

	Actual 1987	Actual 1988
Receipts		
General taxes and receipts	$527	$549
Earmarked taxes and receipts	327	360
Total receipts	**$854**	**$909**
Outlays		
Civil functions	$584	$622
Defense function	282	290
Interest on debt	138	152
Total outlays	**1,004**	**1,064**
Surplus/deficit(-)	**$−150**	**$−155**

Table 3: GAO's Capital Budget for the U.S. Government

Dollars in billions

	Actual 1987	Actual 1988
Operating Budget		
Operating revenues	$958	$1,013
Operating expenses	1,073	1,144
Operating surplus/deficit(-)	**$−115**	**$−131**
Capital Budget		
Capital revenues	$57	$67
Capital investments	142	141
Asset consumption charge	−50	−50
Net capital investments	92	91
Capital financing requirements	**$−35**	**$−24**
Unified budget financing requirements	**$−150**	**$−155**

[2] Our proposal treats amounts received from the public differently than the current budget, which offsets them against gross outlays. Under our proposal, these amounts are reported as budget receipts, resulting in the expense and investment figures shown in table 2 which are larger than the outlays reported in table 1. Our approach, while not changing the unified budget financing requirements, more accurately represents the true level of federal outlays.

Operating and capital amounts would also be provided for each budget function, agency, and program. In cases where a single program involves both capital and noncapital items, it would include account-level schedules that report total program costs. Further, if this proposal is adopted, the Balanced Budget and Emergency Deficit Control Act of 1985 could be amended to establish separate targets for capital financing requirements, the operating deficit, and the unified budget financing requirements.

The capital budgeting proposal in this document is only a conceptual framework. It is not an implementation plan for establishing a capital budget in the current unified budget. Many questions must be answered before a capital budget is implemented, such as the treatment of human capital[3] and research and development investments, the treatment of accrued liabilities, the classification of consumable inventories and stockpiles, the specific alternatives for financing capital projects, and the legislation that would be required. These issues, as well as many others, must be addressed prior to implementing a capital budget in the federal government.

Although much needs to be done, we believe that implementing a capital budget, within the context of the unified budget, would substantially improve the federal budget decisionmaking and control processes. Although implementation may take time, a capital budget would represent an important step toward building a modern and effective financial management structure for the federal government.

The Pros and Cons of a Capital Budget

As mentioned above, the usefulness of the current unified budget would be greatly enhanced if its structure were modified to include a capital budget. This would provide the President and the Congress a sounder basis for targeting areas for deficit reduction. For example, Gramm-Rudman-Hollings deficit targets could be established for the (1) "capital financing requirements" of the capital component of the budget, (2) "operating deficit" of the operating component of the budget, and (3) "unified budget financing requirements" of the total budget. This would eliminate a weakness in the existing law that obscures the important distinction between operating expenses and capital investments.

[3]We are currently studying whether human capital programs should be included in a capital budget.

In addition to providing a clearer picture of the composition of federal expenditures, a capital budget would correct a budget bias against physical capital investments. This would be done by distributing outlays in budget reporting over the useful life of the capital investment. Each year's amount would be reported as an asset consumption charge (depreciation) in the operating budget.

Similarly, a capital budget would more accurately report the costs of the federal government's credit programs. The estimated subsidy costs of direct loans and loan guarantees would be reported in the operating budget. Direct loan disbursements, less the estimated subsidy costs incurred in making those loans, would be reported in the capital budget. The principal repayments received on the loans would be reported as capital budget revenues. This treatment would put direct loan programs on a comparable basis with grant programs. In addition, loan guarantees, terminated for defaults, less the estimated subsidy costs in guaranteeing those loans, would also be reported in the capital budget. This budgetary treatment would provide important information not now reported.

A capital budget would also help focus public attention on the nation's physical infrastructure needs. Federal, state, and local governments have invested billions of dollars in physical capital investments—highways, bridges, water and sewer systems, airports, buildings, and the like. Many of these structures are deteriorating. A capital budgeting approach would help highlight the problem—new investments would be compared to asset consumption amounts—and encourage replacement planning.

Finally, a capital budget would provide a direct link with agency and governmentwide financial statements. These statements would include balance sheets as well as revenue and expenditure statements. This would enable officials to focus on the impact that budgetary decisions have on the government's assets, liabilities, and overall financial condition.

There is, however, some opposition to a capital budget at the federal level, and arguments have been made against it. While some of these arguments suggest areas where special care is needed in formulating a capital budget, we believe that overall they are not decisive arguments against the adoption of a capital budget. Some of the more popular arguments are summarized below.

Some opponents of capital budgeting at the federal level argue that a capital budget could obscure the aggregate deficit problem by redirecting attention to operating deficits. This is not the intention of our proposal, nor do we think this would occur. The main purpose of the capital budget concept, as presented in this proposal, is to provide useful information on the composition of expenditures on a unified budget basis and to allow decisionmakers to make more informed and potentially more discriminating spending decisions.

Opponents also argue that a capital budget could produce a budget bias in favor of "brick and mortar" programs, such as roads, bridges, airports, medical facilities, and military hardware. We do not think a capital budget would cause a substantial preference for brick and mortar programs, but rather that it would partly remove a currently strong bias against these programs. The current treatment recognizes all outlays for capital in a given year as budget costs for that year, even though the capital asset that is acquired is not used up in that year. This "tags" capital projects in the budget documents with overstated initial costs. A capital budgeting approach, which distributes capital costs over the years of use, would correct this current bias, not create a bias in favor of capital.

A related concern of opponents is that a capital budget would shift the focus of the budget away from broad program and policy questions of how resources will be allocated to narrower questions of public capital investment and how such investment is to be financed. Our capital budgeting proposal is designed specifically to avoid this problem by maintaining the current aggregate, functional, and programmatic presentations of the current unified budget.

Some opponents of a capital budget argue that a budget with capital assets financed by long-term debt could constrain fiscal policies intended to counter short-term fluctuations in the economy (countercyclical policy). The credibility of this argument centers on two assumptions: (1) that capital expenditures would be reported and funded within a totally separate capital budget with decisions on debt financing of capital made independent of the fiscal needs of the economy as a whole and (2) that capital projects must be financed through the issuance of separate debt. Under our proposal, both the operating and capital amounts would be reported within the context of the unified budget. Further, our proposal contains no specific requirement restricting the financing of capital assets to long-term debt.

Some observers argue that capital budgeting would lead to more "budget gimmicks." We agree that there are potential problems, but they can be prevented by developing adequate safeguards, such as establishing definitional standards for capital assets and monitoring through audit, review, and oversight how those standards are applied. We would also note that this current system has ample room for gimmicks.

Others contend that a capital budget would make sense only if the federal government were like a state or private corporation. When compared to the federal government, states and private corporations have relatively limited resources. We do not assume that the federal government has the same financial base as a state or private corporation. Clearly, the federal government has financial resources that are unavailable to other entities. Furthermore, we do not think that a capital budget is useful mainly for debt management purposes. Rather, it is important for the government to know the composition of its expenditures, as between operating expenses and capital investments. A capital budget would provide this critical distinction at the federal level. It would permit decisionmakers to consider the trade-offs between spending for current expenses versus long-term investment needs.

Opponents also say that a capital budget would significantly complicate an already complex and time-consuming budget process. This concern stems from the belief that a capital budget would be completely separate from the operating budget. However, if capital budgeting is implemented in the form we propose—and within the unified budget—then this would not be true to any great extent.

Public Comments on GAO's Capital Budget Proposal

We invited comments on an exposure draft of our proposal from various individuals, professional associations, academicians, public interest groups, and various levels of government. Thirty-two of the forty-one respondents generally support a capital budget proposal. Moreover, the support is fairly widespread among the various respondents. Eleven of the fifteen federal departments and agencies submitting comments support the proposal. All state officials who replied also agree with the concept. Furthermore, organizations like the National Governors' Association as well as some of the country's leading economists also endorse the approach. For example, the National Governors' Association's current policy calls for a federal capital budget which is similar in many ways to our proposal.

There was, however, some disagreement. The House Budget Committee, CBO, OMB, four federal agencies, and two former federal officials disagree with our concept of a capital budget for the federal government. In addition, some of the respondents commenting on the exposure draft also raised certain concerns about the implementation of our proposal. There is a footnote to these comments. In the weeks preceding the issuance of this report, the leadership of the House Budget Committee, CBO, and OMB changed. It is our understanding that the House Budget Committee and OMB are again studying the capital budgeting concept for the federal government. We do not know whether their reviews will result in any changes to their positions.

Appendix IV discusses the comments that we received on the exposure draft of our capital budget proposal. Appendix VII lists the respondents who submitted written comments on the exposure draft.

Appendix I discusses in detail our capital budget proposal. Appendix V presents sample formats of how some restructured budget tables would look. Appendix VI discusses the methodology we used in developing the capital budget numbers.

Appendix II provides a complete discussion on the benefits of capital budgeting. Appendix III discusses in more detail the arguments against capital budgeting, as well as our views on them.

We are sending copies of this report to the Director, Congressional Budget Office; the Director, Office of Management and Budget; the Chairman, Council of Economic Advisors; all federal departments and agencies; and interested Members of Congress and congressional committees. We are also making copies available to other interested parties.

This report was prepared under the direction of Frederick D. Wolf, Assistant Comptroller General, Accounting and Financial Management, and James L. Kirkman, Director, Budget Issues. The major contributors to this report are identified in appendix VIII.

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Contents

Abbreviations

CBO	Congressional Budget Office
GAO	General Accounting Office
OMB	Office of Management and Budget

GAO's Capital Budget Proposal

We propose restructuring the current unified budget to include an operating and a capital budget within the unified budget. As table I.1 shows, the operating component of the restructured unified budget would report all operating revenues and expenses for programs and activities that are not classified as capital investments as well as the "operating surplus/deficit." The capital component of the restructured unified budget, as illustrated in table I.2, would report the revenues, investments, and "capital financing requirements" for federal capital investment activities.

Under our proposal, amounts received from the public, or nonfederal sources, which are currently offset against gross outlays, would be treated differently. Such amounts, currently termed "proprietary receipts" and "offsetting collections," are not reported as "budget receipts." Rather, they are netted against gross outlays to produce the (net) outlay totals in the budget. In effect, these receipts and collections are "buried" in the outlay totals. In fiscal year 1988, these receipts and collections totaled $168.7 billion, and they included such amounts as loan repayments received by federal lending agencies; medicare premiums; sales of government assets, products, and services; and rent and royalties from outer continental shelf leases.

We have recommended against netting such amounts against gross outlays on the grounds that the resultant outlay totals understate the true level of federal outlays.[1] Under our proposal, these amounts would not be netted against gross disbursements for purposes of calculating operating expenses and capital investments. Rather, they would be reported as budget receipts. This results in expense and investment figures in the capital budget (see table 3) which are larger than the outlays reported in the current unified budget (see table 2). Throughout this report, our restructured budget amounts reflect this new approach. Such an approach does not, however, change the "bottom line," that is, the unified budget financing requirements.

[1] Federal Budget Outlay Estimates: A Growing Problem (GAO/PAD-79-20, February 9, 1979) and Federal Budget Totals Are Understated Because of Current Practices (GAO/PAD-81-22, December 31, 1980).

Table I.1: Operating Component of GAO's Restructured Budget

(Dollars in billions)

	Actual 1987	Actual 1988
Operating Budget		
Operating revenues		
General taxes	$498.4	$519.5
Payroll and other earmarked taxes	304.6	335.0
Fees, royalties, and other earnings	154.8	158.3
Total operating revenues	**$957.8**	**$1,012.8**
Operating expenses		
Civil functions	$667.6	$700.0
Defense function	199.8	227.2
Interest on debt	145.4	157.0
Asset consumption charge	50.0	50.0
Credit subsidy costs		
Direct loans	1.0	1.0
Loan guarantees	8.7	8.7
Total operating expenses	**$1,072.5**	**$1,143.9**
Operating surplus/deficit(-)	**$−114.7**	**$−131.1**

Table I.2: Capital Component of GAO's Restructured Budget

(Dollars in billions)

	Actual 1987	Actual 1988
Capital Budget		
Capital revenues		
Loan receipts	$37.6	$46.5
Other capital receipts	19.1	20.6
Total capital revenues	**$56.7**	**$67.1**
Capital investments		
Financial asset disbursements, less credit subsidy costs	$35.1	$35.2
Physical asset additions	107.3	105.9
Total capital investments	**$142.4**	**$141.1**
Asset consumption charge	−50.0	−50.0
Net capital investments	**92.4**	**91.1**
Capital financing requirements	**$−35.7**	**$−24.0**

We should note that because of our approach and the quality of existing data on capital expenditures and asset consumption charges (depreciation), we had to make several assumptions in developing the numbers.

Therefore, we would emphasize that the numbers in all the tables in this report are approximations for illustrative purposes only. Appendix VI discusses the methodology that we used in developing our budget numbers.

Operating Component of Restructured Budget

The operating component of the restructured budget, as illustrated in table I.1, would report all operating revenues and expenses for programs and activities that are not classified as capital investments. The revenues would include general taxes; payroll and other earmarked taxes; and fees, royalties, and other earnings. As for expenses, they would include the costs of civil functions, the defense function, and the interest on the national debt.

In addition to the above expenses, we would add two costs not currently recognized in the budget. The first cost would be an "asset consumption charge" which represents the consumption of the federal government's physical assets. Because the current budget does not include an asset consumption charge, it misstates the true cost of operating the government. Adding this cost to the operating budget would eliminate this omission and, therefore, improve cost comparisons between operating and capital programs. This asset consumption amount would be appropriated in the operating budget and credited to the capital budget.

The second cost would be the estimated subsidy costs associated with the budget year's new direct loans and loan guarantees. For direct loans, this would be the government's expected net loss on new loans, considering defaults and interest rate costs. On the latter cost, the government often earns lower interest on the loans it extends than the interest it must pay on the funds it borrows to finance those loans. Focusing on such costs rather than gross loan disbursements would put direct loan programs on a comparable basis with grant programs.

For loan guarantees, the subsidy costs would be the estimated payments, net of guarantee premiums and recoveries, the government makes to lenders when federally-insured borrowers default on the loans. Since currently these costs are not reflected in the budget when the loan guarantees are authorized, it appears that these guarantees are cost free. By including the estimated subsidy costs of loan guarantees in the operating budget (and requiring appropriations for these amounts when the guarantee authority is approved), the bias in favor of loan guarantees over other forms of federal assistance, such as direct loans or grants, would be eliminated.

As with the asset consumption charge, there would be an appropriation each year in the operating budget for the credit subsidy costs of direct loans and loan guarantees. The appropriated amounts would be transferred to the capital budget, where they would be dispersed when needed.

There are other operating costs not currently reported in the budget that should be, namely the annual accrued liabilities for pension programs. These amounts, however, would not involve transactions between the operating and capital budgets, and, as such, we did not shown them in table I.1. In our forthcoming summary report on budget restructuring, we discuss accrued costs for pension programs in greater detail.

In sum, the operating component of our restructured budget would reflect the annual costs of the government's use of its physical capital investments, the estimated subsidy costs associated with the budget year's credit activities, and the accrued costs for pension programs, as well as the costs for other current programs and activities. An operating surplus/deficit would be reported based on these revenues and expenses.

Capital Component of Restructured Budget

The capital component of the restructured budget, as illustrated in table I.2, would report both capital revenues and capital investments; these amounts would represent cash revenues and disbursements. Capital revenues would include user fees, excise taxes, and similar amounts which are earmarked by law to finance physical and financial capital investments. Capital revenues would also include most loan principal repayments and interest paid by the Treasury on securities held by the capital trust funds.

Capital investments would include disbursements for physical assets and financial assets. Physical assets would include tangible assets which cost $100,000 or more and provide economic benefits for more than 2 years. Financial assets would include legal instruments, such as federal direct loans, and guaranteed loans terminated for defaults, less the estimated subsidy costs the government incurs. The disbursement amount reported would represent a financial capital investment by the government, similar to a physical capital investment. Just as the government can acquire a fixed asset, such as a building, in exchange for cash, it also can acquire a financial asset, such as a note receivable, in exchange for a direct loan disbursement. Loan guarantee disbursements are similar.

The next section—"Definition of Capital Assets"—details our description of capital assets.

From the capital investments total, the "asset consumption charge" amount would be subtracted to produce "net capital investments." This adjustment is made to reflect the means of "financing" part of the year's costs of acquiring new physical assets. In effect, the asset consumption charge would finance part of the replacement costs of physical capital investments. The resulting net capital investments' amount represents the portion of capital investments which is capital expansion rather than simply capital replacement.

The amount by which net capital investments exceed capital revenues would be reported as "capital financing requirements." The term "capital financing requirements" is used instead of "capital deficit" in order to reflect the fact that the government is borrowing to finance a capital asset which has value and will produce a future stream of benefits.

Definition of Capital Assets

How to define the items that would be included in the capital component of the budget has been the focus of much debate. Over 20 years ago, for example, the last presidential commission on budget concepts expressed concerns about how to define capital assets. In its October 1967 Report of the President's Commission on Budget Concepts, the commission discussed the "difficult accounting problems" involved in defining capital. The commission stated that under a capital budgeting approach, "proponents of new spending programs would be tempted to stretch the capital budget rules on inclusion."

In order to ensure that only the appropriate items are included, we believe it is critical to have a disciplined view of what would be classified as capital. Under our proposal, we would define capital assets as being of two types—physical assets and financial assets.[2]

We would define physical assets as assets with the following characteristics: (1) they have form and substance, that is, they are tangible,

[2]OMB data show that, in fiscal year 1988, federal outlays for major physical investments ranged from $100.2 billion for acquiring federally-owned assets, to $124.8 billion if one also includes grants-in-aid to states and local entities in support of their capital projects. In addition, federal direct loan disbursements amounted to $33.7 billion. In total, these capital investments represented about 15 percent of total federal outlays in fiscal year 1988.

(2) their ownership resides or will reside in the public domain,[3] (3) they typically provide services or benefits, including for national defense and security, for more than 2 years, and (4) they cost $100,000 or more. Such assets would include, but would not be limited to, the following: roadways and bridges; airports and airway facilities; mass transportation systems; waste water treatment and related facilities; water resource projects; resource recovery facilities; public structures; space and communication facilities and equipment; defense facilities; major weapons systems and platforms, such as aircraft carriers and bombers; and strategic petroleum reserves and mineral stockpiles. Also, assets acquired by capital leases as well as leasehold improvements would be included. This definition excludes consumables such as inventories and spare parts. We are reviewing the issues surrounding inventories and stockpiles held by the federal government and will be reporting in the near future on how they should be treated under our capital budgeting proposal.

Financial assets, as we define them, would include principally notes and loans receivable as well as any legal instruments, such as bonds and other securities held by the federal government. Also, we would include guaranteed loans terminated for defaults.

In defining capital assets, we did not include investments in intangible assets. These would include investments in "human capital," such as education and training, or investments in research and development. Excluding these intangible investments from the capital portion of the budget does not reflect a belief that these investments are of lesser importance to the nation or to the individuals that they serve. Like investments in physical or financial assets, these investments also result in future benefits to society. As such, they could be viewed as capital investments. Nevertheless, we do not include them at this time in our definition of capital assets because of the difficulties involved in defining and measuring them, such as delineating the boundaries of human capital activities and measuring the future value and useful life of

[3]The federal government assists state and local governments by providing significant investments in infrastructure assets, most notably the interstate highway system and waterways, which are located on state and local property, but are generally available to the public at large. Our position is that the costs of such assets should be recognized in the federal budget if the costs are paid with federal funds (equity interest) and the infrastructure assets are part of the general public domain, rather than being clearly owned by another party. Also, such federal contributions should be depreciated, where applicable, over their useful lives. Conversely, infrastructure investments (capital grants) in projects or assets that are clearly owned by and benefit a single party or group and are not generally available to the public at large should not be capitalized by the federal government.

human capital and other intangible investments. We are, however, studying this matter further.

We acknowledge that our definition of capital assets is a general one. Good definitional standards need to be established in order to distinguish between capital investments and operating expenses. Further, it is not only crucial to establish good definitional standards, but also to monitor, through an independent evaluation, how those standards are applied. As such, our capital budgeting proposal would require that 31 U.S.C. 1112 (c) be amended to require that (1) the Comptroller General, in cooperation with the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Director of the Congressional Budget Office, establish criteria, principles, and standards for determining the content of the operating and capital budgets and (2) the Comptroller General review the implementation of these criteria, principles, and standards, as he deems necessary, and report to the Congress on whether actual and proposed appropriations, revenues, and expenditures presented in the capital budget represent activities, functions, and programs which support the acquisition, construction, or rehabilitation of capital assets.

Benefits of Capital Budgeting

The usefulness of the current unified budget would be greatly enhanced if its structure were modified to include a capital budget and an operating budget. This would provide the President and the Congress with a sounder basis for targeting areas for deficit reduction, correct a budget bias against physical capital investments, more accurately report the costs of the government's credit programs, help focus public attention on the nation's physical infrastructure needs, and provide a direct link with agency and governmentwide financial statements.

Provides a Sounder Basis for Deficit Reduction

The current budget structure focuses attention exclusively on a single surplus or deficit total—a $155 billion deficit in fiscal year 1988. It does not make a systematic distinction between receipts and outlays for capital investments and those for current operations. As a result, it is difficult for the President and the Congress to apply deficit reduction efforts in a way that balances needs for operating expenses with needs for capital investments. For example, Gramm-Rudman-Hollings deficit targets apply without differentiation to capital and operating programs, thus unnecessarily restricting the debt control options available to federal lawmakers. In this regard, the federal government is clearly out of sync with state governments.

At the state level, 37 states have reported that they have a distinct capital budget whereby the capital and current operations amounts are reported separately either within an overall budget or as separate budgets.[1] Thirty-four states require their governments to execute balanced budgets, and most of these states target their balancing requirements to their operating budgets only.[2] Expenditures for capital investments are not counted as operating expenses, but rather as a means of financing capital development. Debt financing is utilized for their capital projects, subject to separate state debt limitations. Further, some states control their debt by requiring that their annual debt service costs be included in budgets which are subject to balanced budget requirements.

In contrast, the single-number focus of federal deficit reduction efforts is based upon the highly questionable premise that all outlays are the same, whether for capital investments or operating expenses. This is not the case. Capital outlays, whether they are for buildings or loans, produce future streams of benefits to the government or the economy.

[1] Budget Issues: Capital Budgeting Practices in the States (GAO/AFMD-86-63FS, July 15, 1986).

[2] Budget Issues: State Balanced Budget Practices (GAO/AFMD-86-22BR, December 10, 1985).

These may be cash flows, facilities to carry out government operations, or other such economic returns.

Failure to recognize the critical distinction between capital investments and operating expenses creates an economic policymaking information gap. Without this information, officials cannot readily discuss and set in public policy the needed balance between spending for short-term consumption needs (operating expenses) and long-term infrastructure and productivity enhancing needs (capital investments). Such a distinction can be important in designing a mix of spending activities to address short-term economic stabilization needs and the requirements for long-term economic growth.

A capital budget would give the President and the Congress a sounder basis for targeting areas for deficit reduction. For example, Gramm-Rudman-Hollings deficit targets could be established for the (1) "capital financing requirements" of the capital component of the budget, (2) "operating deficit" of the operating component of the budget, and (3) "unified budget financing requirements" of the total budget. This would eliminate a weakness in the existing law that obscures the important distinction between operating expenses and capital investments. To correct this weakness, the Balanced Budget and Emergency Deficit Control Act of 1985 could be amended to establish separate targets for capital financing requirements, the operating deficit, and unified budget financing requirements.

Eliminates Disincentives Toward Capital

Under the current budget scorekeeping rules, physical capital investments in a given year are treated as if they were costs incurred in that year. For example, a $10-million outlay to construct a building (a capital investment) contributes to the year's deficit the same as a $10-million outlay for vehicle or airplane fuel costs (an operating expense). This scorekeeping practice "front-end loads" the costs shown in the budget for the acquisition, since the project will have sizable start-up cash payments.

During budget deliberations, such a project is at a disadvantage. It must compete with an alternative means of acquiring the use of a building that would have lower front-end costs, such as leasing, but which has significantly higher long-term costs. This could result in decisionmakers selecting the leasing option even though it would entail larger, long-term costs.[3] More importantly, it could result in the project not being approved because of its initial effect on the budget even though the long-term benefits would outweigh the costs. In a sense, it artificially requires a capital asset to have a 1-year payback to be able to compete equally with current operating programs, a clear manifestation of the budget's focus on short-range thinking.

The disincentives toward capital expenditures also make it difficult to invest in productivity enhancing capital assets. In February 1988, the Postmaster General expressed his frustration when he stated the following: "Under the government's cash-basis accounting budget, a postal dollar invested in capital assets is given the same effect as a dollar in operating losses. No one can reasonably expect a self-supporting enterprise as pervasive as the Postal Service to do well if its service-improvement efforts and capital-modernization plans can be canceled in midstream whenever the latest reading on the government's overall bottom line looks bleaker than forecast."

Capital budgets used in the private sector deal with this budget bias by using a different scorekeeping approach. When companies make capital investments, they do not charge the investments against their current operating budget. Only an amount which reflects the annual consumption of the investments—known as an asset consumption charge, or depreciation—is reported as a cost in the operating budget.

Our proposal would use a similar approach. Capital expenditures would be distributed over the useful life of the capital investment. Thus, the amount reflecting each year's cost of using existing federal assets would be reported as an asset consumption charge in the current operating budget. Because of their long-term benefit stream, it is appropriate to annualize the costs of capital investments over the fiscal periods receiving the benefits. This would put capital investment amounts on a comparable basis with current operation amounts and eliminate the current budget bias against capital projects.

[3] An example of the higher long-term costs of leasing versus purchasing is illustrated in our review of the acquisition of a Corps of Engineers office building, Lease-Purchase: Corps of Engineers Acquisition of Building in New Orleans District (GAO/AFMD-88-56FS, June 7, 1988). In our report, we estimated that using the lease-purchase option instead of purchasing the building directly would result in a loss to the federal government of about $10.9 million, taking into account the time value of money over the 25-year lease term.

More Accurately Reports Costs of Federal Credit Programs

Similarly, a capital budget would more accurately report the costs of the federal government's credit programs (direct loans and loan guarantees), a subject much debated during the past few years. Under the current budget, for example, the budget does not identify the costs of direct loan programs—it records the cash flow of loan outlays and repayments only. A portfolio of $100 million in new direct loan outlays counts the same as $100 million in grants, even though the $100 million in direct loans does not necessarily represent $100 million in costs. This cash-flow treatment does not recognize that the government, in making these loans, receives a financial asset (the note promising future repayments) and that at least a portion of the loan outlays will be repaid in the future. This omission makes direct loan programs seem more costly (in outlay terms) in their early years. An opposite effect develops in later years when loan repayments flow back to the programs. The repayments are netted against new outlays and result in understating of the new outlays. Further, this omission also leads to using loan sales as a way to "reduce" the deficit.

The cash-based recognition of credit program costs also distorts loan guarantees. Under current practices, loan guarantee default costs are recorded in the budget at the same time default payments are made. Since most defaults on loan guarantees occur in future years, rather than in the year of authorization, they are treated as if they were cost free at the time decisions about program activities are being made.

Our capital budgeting approach would overcome these distortions by reporting in the current operations portion of the budget the estimated subsidy costs of direct loan and loan guarantee programs. Direct loan disbursements, less the estimated subsidy costs incurred in making those direct loans, would be reflected in the capital portion of the budget. The principal repayments received on the loans would be reported as capital budget revenues. This would put the financial costs of direct loan program costs on a more comparable basis with those of grant programs. In addition, loan guarantees terminated for defaults, less estimated subsidy costs for guaranteeing those loans, would also be reported in the capital budget. This budgetary treatment would provide important information not now reported.

Our budgetary treatment of credit programs is in line with recommendations in the 1967 Report of the President's Commission on Budget Concepts. The commission recommended that summary budget schedules identify direct loans on the basis of their unsubsidized values separately from other expenditures. In addition, the commission recommended that the subsidy elements be specifically disclosed in the expenditure account of the budget "since such subsidies are much more like grants than loans." The Commission did not study loan guarantees comprehensively and, therefore, it did not make any recommendations in this area. However, it expressed the opinion that all federal lending activity needed increased surveillance and direction.

Focuses Attention on Nation's Physical Infrastructure

With the increased pressure on the federal budget and the ongoing debate about the federal government's relationships with other levels of the public sector and the private sector, the way in which the federal government, states, and localities plan, budget, and protect the public capital investments needed for the future takes on added significance. Federal, state, and local governments have invested hundreds of billions of dollars in physical capital investments—highways, bridges, water and sewer systems, airports, buildings, and the like. Despite this huge investment, many important physical items are deteriorating. Billions more are needed to repair or replace these assets, causing widespread concern about ways to finance their repair and rehabilitation. A capital budget would help highlight the problem—new investments could be compared to capital consumption amounts—and encourage replacement planning.

Begins Providing a Link to Financial Statements

A capital budget would begin providing a link to agency-level and governmentwide financial statements, something we believe is essential to increasing both accountability and discipline in our financial management system. These statements would include balance sheets as well as revenue and expenditure statements. Such statements disclose the cumulative effect of decisions on the government's financial resources and provide early warning signals of financial problems to policy formulators and the public.

A capital budget would provide a useful complement to the financial statements. Together, the two would provide enhanced information on the government's assets, liabilities, and operations by linking past results with future plans. The financial statements would provide a snapshot of the cumulative results of past capital acquisitions adjusted for usage, while the capital budget would show the planned activities.

Arguments Against Capital Budgeting

Arguments have also been made against implementing a capital budget at the federal level. Opponents argue, for example, that a capital budget obscures the aggregate deficit problem, favors capital projects, and increases opportunities for budget gimmicks. While some of these arguments suggest areas where special care is needed in formulating a capital budget, we believe that overall they are not decisive arguments against the adoption of a capital budget. Some of the more popular arguments against capital budgeting, along with our views, are presented below.

Obscures the Aggregate Deficit Problem

Some argue that a capital budget could obscure the aggregate deficit problem by redirecting attention to operating deficits. This could happen if the federal government does what many states do—set balanced budget requirements on the operating amounts while minimizing such controls on capital amounts.

It is argued that no real difference exists between a deficit incurred for capital purposes and a deficit incurred for operating purposes. Both produce borrowing requirements which affect the credit markets in a like manner. The effects on "crowding out" credit available for private sector purposes as well as on interest rates are the same. Critics argue that, at a time when aggregate debt levels are a matter of great concern to the Congress and the public both, adopting a capital budgeting approach that could deflect attention from the overall deficit problem is not an appropriate measure.

Our view is that the capital budgeting concept, as presented in this proposal, is not designed to take attention away from the aggregate borrowing levels of the government. Its main purpose is to provide useful information on the composition of expenditures and allow decisionmakers to make more informed and potentially more discriminating spending decisions. When setting spending priorities, it is desirable for decisionmakers to know about the differing implications of operating versus capital programs.

By retaining the unified budget totals, our proposal not only provides additional information on debt financing for capital and operating components, but it also continues to report information on the federal government's total financing requirements (an amount equal to the current budget's deficit figure). In the same vein, our capital budgeting proposal addresses two major concerns raised in the October 1967 Report of the

President's Commission on Budget Concepts—the impact on credit markets of government borrowing for capital items and the government's ability to raise taxes in inflationary periods if the operating budget is balanced. Since our proposal is designed to maintain the budget's unified focus, officials could continue to assess the impact that the total level of government borrowing is having on the private sector's credit markets and interest rates. Further, our capital budgeting proposal does not suggest avoiding tax increases in inflationary periods when the operating budget is in balance. Our proposal is neutral on which fiscal policy should be followed. It merely makes clearer the options available to the President and the Congress.

Favors Brick and Mortar Programs

Some argue that a capital budget could produce a budget bias in favor of "brick and mortar" programs, such as roads, bridges, airports, medical facilities, and military hardware. In its October 1967 Report of the President's Commission on Budget Concepts, the commission stated that ". . . a further very persuasive argument against a capital budget is that it is likely to distort decisions about the allocation of resources. It would tend to promote the priority of expenditures for 'brick and mortar' type projects relative to other federal programs for which benefits could not be capitalized (including health, education, manpower training, and other investments in human resources)—even when there is no clear evidence that such a shift in relative priorities would in fact be appropriate."

We do not think that a capital budget would cause a substantial preference for "brick and mortar" programs, or tangible investments, but rather that it would partly remove a currently strong bias against these programs. As we discussed earlier in appendix I—the "Eliminate Disincentives Toward Capital" section—the current treatment recognizes all outlays for capital in a given year as budget costs for that year, even though the capital asset that is acquired is not used up in that year. This "tags" capital projects in budget documents with overstated initial costs. A capital budgeting approach, which distributes capital costs over the years of use, would correct this current bias, not create a bias in favor of capital.

It is true, however, that the bias against tangible investments is not generally removed for intangible investments, such as investments in human capital and research and development. As we discussed earlier in appendix I—the "Definition of Capital Assets" section—we have excluded, at this time, intangible investments from our definition of capital because of the difficulties involved in defining and measuring them. We believe, however, that the difficulties associated with including intangible investments, such as human capital and research and development, in a capital budget should not lead us to ignore the more readily measurable capital assets in the budget.[1]

Under our proposal, there would continue to be congressional budget process decisions on functional totals (with capital and operating breakdowns). Thus, decisions on overall budget priorities, for example, defense versus human resources, would likely continue to be the primary force driving the budget. Similarly, there is no reason to believe that the program priorities seen under Gramm-Rudman-Hollings would change under a capital budgeting approach. If Gramm-Rudman-Hollings' priorities were applied within a capital budgeting framework, many operating programs would continue to benefit from Gramm-Rudman-Hollings cutback exemptions, such as entitlements, while many capital programs would continue to be cut.

Also, we should point out that under our proposal, the capital component of the budget would include capital investments in facilities and equipment which directly support health, education, manpower training, research and development, and other health and human resource activities. In addition, direct federal loans for such programs, which totaled $33.7 billion in fiscal year 1988, would be included in our capital budget.

Shifts Focus Away From Programs

A related concern that is sometimes expressed is that a capital budget would shift the focus of the budget away from broad program and policy questions of how resources will be allocated to narrower questions of public capital investment and how such investment is to be financed. Furthermore, for programs that are not wholly capital or operating, a capital budget would separate the capital amounts from operating amounts and obscure how the programs work as a whole. The question becomes: How could a programmatic focus be maintained if the capital part of the program was covered in the capital section of the budget, while the related operating part was covered in a different section of the budget?

[1]We are currently studying whether human capital programs should be included in a capital budget.

Our proposal is designed specifically to avoid this problem by maintaining the current aggregate, functional, and programmatic presentations of the current unified budget, modified by operating and capital breakdowns within each such category. Congressional budget reviews and decisions could address operating versus capital allocations, and, at the same time, programmatic and functional allocations within the operating and capital budgets. Budget resolution controls would not stop at the operating and capital totals but would also address functional breakdowns to maintain an overall programmatic orientation. Similarly, at the budget account level, sub-accounts for operating and capital would be employed for a single program with both types of expenditures. These sub-accounts would then be combined to provide aggregate information for each budget account. Table V.3 in appendix V illustrates our restructured program and financing table.

Constrains Countercyclical Fiscal Policy

Some opponents of a capital budget argue that a budget with capital assets financed by long-term debt could constrain fiscal policies intended to counter short-term fluctuations in the economy (countercyclical fiscal policy). Extensive debt financing could put constraints on fiscal policy because acquisition decisions would be made with long-term investment strategies in mind, independent of short-term changes in the economy.

The credibility of this argument centers on two assumptions: (1) that capital expenditures would be reported and funded within a totally separate capital budget with decisions on debt financing of capital made independent of the fiscal needs of the economy as a whole and (2) that capital projects must be financed through the issuance of separate debt. There is no reason, however, why either of these should occur under our capital budgeting proposal.

Under our proposal, both operating and capital amounts would be reported within the context of the unified budget. Therefore, the budget's current unified focus would be maintained and greater attention could be given to the operating and capital components. Under this approach, overall spending levels, as well as spending for operating and capital activities, would be considered and adjusted to meet countercyclical fiscal policy. Thus, fiscal policy options would be clarified, not lessened, under our proposal.

Further, our proposal contains no specific requirement restricting the financing of capital assets to long-term debt. Our proposal only requires that special and earmarked taxes designated by law for capital programs be treated as capital receipts in the capital budget. The extent to which capital expenditures are financed through debt is left up to the discretion of the Congress.

Increases Opportunities for Budget Gimmicks

Some observers argue that capital budgeting would lead to more "budget gimmicks." New opportunities would be created for adjusting the numbers to make them appear as though they are meeting certain targets or policy objectives. In the 1970s, for example, noncapital amounts were incorrectly classified as capital amounts in New York City. The same misclassification, opponents argue, could occur at the federal level.

We agree that these are potential problems, but they can be prevented by developing adequate safeguards. As we discussed earlier in appendix I—the "Definition of Capital Assets" section—definitional standards need to be established and agreed to by all parties in order to distinguish between capital investments and operating expenses. In addition, it is not only crucial to establish good definitional standards, but also to monitor, through audit, review, and oversight, how those standards are applied. This would minimize the chances of officials misclassifying operating amounts as capital amounts.

Assumes Financial Base Is Similar to That of a State or Private Corporation

Others contend that a capital budget would make sense only if the federal government were like a state or private corporation. When compared to the federal government, states and private corporations have relatively limited resources and responsibilities, thus leading them to limit their borrowings to areas that seem guaranteed to preserve or enhance their financial condition over several years. States with limited financial bases (narrow tax bases and no power to create money) are conscious of their bond ratings and the need to borrow mainly in areas that produce tangible, long-term benefits (capital). Likewise, private corporations prefer to borrow mainly for capital expansion and modernization. Such borrowings are collateralized and can be liquidated by asset sales or through increased profits over several years.

According to this line of argument, these factors do not apply to the federal government. Its ability to print money and raise taxes provide it a virtually unlimited financial base, unlike states and private corporations. Thus, there is no reason to distinguish between borrowing for capital and noncapital purposes. In any case, these observers argue, it is wrong to think of many of the government's capital investments as producing long-term benefits for the government or having asset sale value in the market place. This is particularly true of defense items, which absorb operation and maintenance costs over several years and do not generate additional revenues. Furthermore, who would buy a missile silo or ammunition storage facility?

We do not assume that the federal government has the same financial base as a state or private corporation. Clearly, the federal government has financial resources that are unavailable to other entities. Furthermore, we do not think that a capital budget is useful mainly for debt management purposes. Rather, it is important for the government to know the composition of its expenditures, as between operating expenses and capital investments.

A capital budget would provide this critical distinction at the federal level. It would permit decisionmakers to consider the trade-offs between spending for current expenses versus long-term investment needs. The changing requirements of short-term economic stabilization and of long-term economic growth may require a changing mix of spending for consumption versus spending for investments. Policymakers cannot easily make these adjustments without systematic budget reporting of the kind set forth in our proposal. Furthermore, the resulting extended time horizon of budget analysis would reduce somewhat the likelihood of decisions with adverse long-term financial consequences.

Adds Complexity to the Budget Process

Finally, it is said that a capital budget would significantly complicate an already complex and time-consuming budget process. This concern stems from the perception that a capital budget would be completely separate from the operating budget. However, if capital budgeting is implemented in the form we propose—and within the unified budget—then this would not be true.

This does not mean that some increase in complexity is not associated with our proposal. However, it is important to recognize that the budget, properly presented, consists of more than just one deficit number. We believe that the value and importance of the additional information provided under our proposal will more than outweigh any modest increases in complexity. Indeed, the new structure should help simplify budget debate and actions by providing a more meaningful breakdown of the budget's total.

Within the executive branch, our proposal would require changes in how information is presented in the President's budget. Information currently provided by agency, appropriation account, and budget function would continue to be reported. However, there would be a clear identification of the appropriation accounts, or parts of accounts, that are for capital purposes, and there would be new summary tables showing the capital and operating breakdowns within each agency and budget function.

On the congressional side, the main effect would be on the budget resolutions and related actions. Current functional categories—defense, housing, etc.—would be broken down into capital and noncapital sections, and the budget resolutions' aggregate totals would have capital and noncapital components. This treatment also could carry through to affect the way budget deficit targets are set in legislation such as the Gramm-Rudman-Hollings legislation. As we discussed in appendix II—the "Provide a Sounder Basis for Deficit Reduction" section—the Balanced Budget and Emergency Control Act of 1985 could be amended to establish targets for capital financing requirements, the operating deficit, and the unified budget financing requirements.

Public Comments on GAO's Capital Budget Proposal

We provided copies of an exposure draft of our proposal for comment to various individuals, professional associations, academicians, public interest groups, and various levels of government. (For a listing of those who commented, see appendix VII.) Thirty-two of the forty-one respondents generally support our capital budget proposal. Moreover, the support is fairly widespread among the various respondents.

Eleven of the fifteen federal departments and agencies that commented support the proposal, including the Departments of Agriculture, Commerce, Health and Human Services, Housing and Urban Development, Interior, and State as well as the General Services Administration, the Environmental Protection Agency, the Postal Service, the Tennessee Valley Authority, and the Veterans Administration (which became, in March 1989, the Department of Veterans Affairs). The agencies believe a capital budget would provide more realistic management information as well as improve decisionmaking and control. In addition, many believe a capital budget would more accurately report the costs of loan programs, correct the current bias against physical assets, and help focus public attention on our nation's deteriorating infrastructure.

The eight state officials who provided comments on the exposure draft also support the concept of a capital budget for the federal government. Their support stems from favorable state experience with capital budgeting. In their comments, some state officials noted that a capital budget would provide improved information, facilitate decisionmaking, highlight our nation's deteriorating infrastructure, and allow the financing of capital assets to be spread over the life of the asset.

All twelve public interest groups and academicians, including some of the country's leading economists, that commented on the exposure draft expressed general to strong support for our capital budget proposal. A major reason given for supporting a capital budget was the additional information such a format would provide decisionmakers. The National Governors' Association, for example, stated that its current policy calls for a federal capital budget and capital planning requirements which are similar in many aspects to our proposal. One leading economist stated that ". . . without capital budgeting we neither understand the deficit nor have an adequate guide for the best things to do about it."

The House Budget Committee, CBO, OMB, four federal agencies—Defense, Education, Energy, and Transportation—and two former federal officials, however, disagree with our concept of a capital budget for the federal government. Among them, they cited three major reasons:

- A capital budget would fragment the unified budget, destroy the comprehensive comparison of spending programs, focus attention only on the operating side, and weaken efforts to reduce the deficit.
- The federal budget should not be compared to state budgets since state budget practices are not consistently applied and do not have similar objectives to the GAO proposal.
- The definition of capital assets excludes human capital investments and investments in research and development even though these investments also yield future benefits. This would create a budget bias in favor of physical investments. We should add that some supporters of our proposal also raised concerns about excluding human capital from our definition of capital assets.

We present our positions on all these points in other sections of the report. Appendix III, "Arguments Against Capital Budgeting," presents our position on the first two points, and the section on "Definition of Capital Assets" in appendix I discusses our position on the last point.[1]

In addition to the above comments, some of the respondents commenting on the exposure draft also raised certain other concerns about our capital budget proposal. We would categorize them as implementation issues. The most frequently cited ones were (1) excluding a detailed discussion on using depreciation; (2) establishing separate Gramm-Rudman-Hollings targets for capital financing, the operating deficit, and total (unified budget) financing requirements of the government; and (3) giving the Comptroller General the power to establish definitional standards for the content of operating and capital budgets, if they are intended to be binding on the executive branch.

We believe that these implementation concerns are valid issues. However, the capital budgeting proposal in this document is a conceptual framework, not an implementation plan. The above implementation concerns, and other matters, such as the treatment of accrued liabilities, the classification of consumable inventories and stockpiles, the specific alternatives for financing capital projects, and the legislation that would be required, would have to be addressed prior to implementing a capital budget. However, we believe that these issues can be resolved and that capital budgeting can be effectively implemented for the federal government.

[1] In the weeks preceding the issuance of this report, the leadership of the House Budget Committee, CBO, and OMB changed. It is our understanding that the House Budget Committee and OMB are again studying the capital budgeting concept for the federal government. We do not know whether their view will result in any changes to their positions.

A New Structure for the Federal Budget—Sample Formats

Our capital budgeting proposal is designed to restructure the way information is currently presented in the President's budget and budget appendix so as to distinguish between operating and capital activities. In the budget, this restructuring would result in the reporting of operating and capital amounts in the budget's summary tables and listing of accounts. In the budget appendix, the account-level "program and financing" tables would be expanded to display, within each appropriation account, the program and financing amounts for operating and capital activities.

Tables V.1 through V.3 present sample formats of how some capital budget and budget appendix tables would look. These tables are presented for discussion purposes only to show how the current budget tables and budget appendix tables would be affected by the restructuring. For purposes of this report, we illustrate operating and capital totals not broken down into general, trust, and enterprise subtotals. Such subtotals would be part of our overall budget restructuring proposal. The numbers in the tables are approximations for illustrative purposes only. Appendix VI describes how we developed the numbers.

Budget Summary Tables

The President's budget currently contains summary tables showing governmentwide receipts, outlays, and the resulting surplus or deficit. Other summary tables provide data in total and by agency and function on budget authority and outlays. Under our proposal, several of these budget summary tables would be revised to include information on both operating and capital activities.

The restructured budget format would present the lead summary tables in terms of an operating budget, a capital budget, and a unified budget total, as illustrated in tables V.1 and V.2.

The operating budget would consist of operating revenues, operating expenses, and operating surplus/deficit(-) as described below.

- Operating revenues would include receipts not earmarked by law for capital programs, including amounts not now treated as receipts, but rather as offsets to outlays for calculating reported (net) outlays. The intent is to add clarity by reporting all revenues on the revenue side of the budget.

Table V.1: Capital Budget Summary Table—Format 1

(Dollars in billions)

	Actual 1987	Actual 1988
Operating Budget		
Operating revenues	$957.8	$1,012.8
Operating expenses	1,072.5	1,143.9
Operating surplus/deficit(-)	**$−114.7**	**$−131.1**
Capital Budget		
Capital revenues	$56.7	$67.1
Capital investments	142.4	141.1
Asset consumption charge	−50.0	−50.0
Net capital investments	92.4	91.1
Capital financing requirements	**$−35.7**	**$−24.0**
Unified budget financing requirements	**$−150.4**	**$−155.1**

Table V.2: Capital Budget Summary Table—Format 2

(Dollars in billions)

	Actual 1987	Actual 1988
Operating Budget		
Operating revenues		
General taxes	$498.4	$519.5
Payroll and other earmarked taxes	304.6	335.0
Fees, royalties, and earnings	154.8	158.3
Total operating revenues	**$957.8**	**$1,012.8**
Operating expenses		
Civil functions	$667.6	$700.0
Defense function	199.8	227.2
Interest on debt	145.4	157.0
Asset consumption charge	50.0	50.0
Credit subsidy costs		
Direct loans	1.0	1.0
Loan guarantees	8.7	8.7
Total operating expenses	**$1,072.5**	**$1,143.9**
Operating surplus/deficit(-)	**−114.7**	**−131.1**
Capital Budget		
Capital revenues		
Loan receipts	$37.6	$46.5
Other capital receipts	19.1	20.6
Total capital revenues	**$56.7**	**$67.1**
Capital investments		
Financial asset disbursements, less credit subsidy costs	$35.1	$35.2
Physical asset additions	107.3	105.9
Total capital investments	**$142.4**	**$141.1**
Asset consumption charge	$−50.0	$−50.0
Net capital investments	92.4	91.1
Capital financing requirements	**−35.7**	**−24.0**
Unified budget financing requirements	**$−150.4**	**$−155.1**

- Operating expenses would include the gross outlays to the public from noncapital activities. These expenses would also include (1) an asset consumption charge, which represents the year's depreciation of physical capital and (2) the estimated subsidy costs associated with the budget year's new direct loans and loan guarantees. Both costs are not currently recognized in the budget.

- Operating surplus/deficit(-) would be the difference between operating revenues and expenses.

The capital budget would consist of capital revenues, capital investments, and capital financing requirements, as described below.

- Capital revenues would be the receipts dedicated by law to capital assets, both physical and financial. These would include, for example, gasoline excise tax revenues earmarked for the Highway Trust Fund and repayments of principal on federal loans extended to farmers, businessmen, and others. Capital revenues would also include the interest revenues from the dedicated capital trust funds.
- Capital investments would include the outlays for physical and financial assets.
- Asset consumption charge would represent an adjustment made against the total capital investments amount to reflect the means of "financing" part of the year's costs of acquiring new physical assets. In effect, the asset consumption charge would finance part of the replacement costs of physical capital investments.
- Net capital investments would represent the amount by which capital investments exceed the asset consumption charge.
- Capital financing requirements would represent the amount by which net capital investments exceed capital revenues.
- Unified budget financing requirements would represent the total of the operating budget's operating surplus/deficit and the capital budget's capital financing requirements.

Under our proposal, there would be other budget summary tables showing operating and capital amounts. These tables would report, by agency and budget function, operating and capital breakdowns of information on budget authority and outlays. This would essentially involve reformatting existing budget summary tables. In addition, our proposal would add a new summary table to show the asset consumption charges by budget function and subfunction.

Budget by Agency and Account

The President's budget currently reports, within the "budget by agency and account" tables, information on budget authority and outlays in total, by agency, by fund type, and by appropriation account within an agency. Our proposal would require that this information continue to be reported for each agency and appropriation account as well as for the overall budget total, but subtotals would be reported within each of these levels for operating and capital amounts. The operating data would include amounts for credit subsidy costs.

Program and Financing Table

The appropriation accounts represent the building blocks for the entire federal budget. Detailed information for each individual appropriation account is reported in a "program and financing" table. These tables are found in the budget appendix and provide the most detailed level of program information in the budget. If the capital budgeting proposal presented here is going to lead to substantial improvements in financial management, then it must, as part of the annual appropriation process, focus congressional attention on the allocation of resources between operating and capital activities at the federal level, while retaining the programmatic format.

Under our capital budgeting proposal, there would be a separate account or sub-account for each operating program and similar treatment for each capital program. When it is desirable to keep the operating and capital parts of a single program intact, these amounts could be reported first in an overall program and financing table, and then in separate, back-to-back, program and financing tables. This format would provide the appropriation committees with information, in one section of the budget appendix, on total program amounts broken down by operating and capital activities. Table V.3 illustrates a restructured account having operating and capital components. It is important to note that this table's data would be reported in summary form and by operating and capital activities. Such reporting will facilitate the usefulness and accessibility of budget data.

Under our restructured program and financing table, both the summary and operating components would have a line for an asset consumption charge. While the asset consumption charge does not represent cash disbursements to the public, it does represent an operating cost and the amount made available to the capital budget to finance capital investments, and it is, therefore, reported in the program and financing tables. As table V.3 illustrates, it is reported as an activity which does not require an increase in obligations and cash outlays. The asset consumption charge could be treated as a form of budget authority.[1]

[1] New "credit subsidy" and "credit financing" accounts would be established for new credit activities under our credit reform proposal entitled, Budget Issues: Budgetary Treatment of Federal Credit Programs (GAO/AFMD-89-42, April 10, 1989). We have included this proposal in our capital budget proposal. The new accounts are not illustrated in this report.

Finally, table V.3 reports offsetting collections from nonfederal sources differently than in the current budget. Under current reporting practices, offsetting collections from nonfederal sources, as well as those from other federal funds, are netted against an account's total obligations and outlays for purposes of calculating reported outlays. The result is that the outlay amounts reported for an individual appropriation account are net of offsetting collections from both federal and nonfederal sources.

We have long taken the position that it is appropriate to report outlays net of offsetting collections from federal sources. This is one way of preventing the double-counting of the same disbursements. However, we have recommended against the netting of offsetting collections from nonfederal sources against total outlays for calculating reported outlays on the grounds that the resulting net outlays understate the true value of federal outlays to the public.

In table V.3, offsetting collections, for purposes of calculating budget authority, are treated just as they are now—as a source of funding. Thus, the requested amount of budget authority is reduced by offsetting collections from both federal and nonfederal sources. With the exception of credit programs, we believe this is how they should be treated because all offsetting collections represent a source of revenues to a particular program. (The budget authority requirements for credit programs are discussed in our report, Budget Issues: Budgetary Treatment of Federal Credit Programs [GAO/AFMD-89-42, April 10, 1989].)

For purposes of calculating reported outlays, however, offsetting collections from nonfederal sources, under our proposal, are not netted against outlays. This is reflected in table V.3 under the section "Relation of Obligations to Outlays." To compute the 1988 "obligations incurred, net federal funds" entry ($53.2), only the offsetting collections from the federal funds figure ($-18.4) has been netted against total obligations ($71.6). Our approach results in a 1988 reported outlay figure ($67.0) which is larger than what would be reported under current practices by the amount of offsetting collections from the nonfederal sources ($10.3). By treating offsetting collections in this manner, outlay numbers reported throughout the budget would be on a gross—not a net—basis. Our approach, however, would not change the reported surplus or deficit because the offsetting collections from nonfederal sources would be added to those amounts currently reported as budget receipts. The tables and numbers in this exposure draft were developed using our gross basis.

Table V.3: Restructured Program and Financing Table

(Dollars in millions)

ACCOUNT A - SUMMARY
36-0844-403

	Actual 1988	Estimate 1989	Estimate 1990
Program by activity:			
Activity A	$25.7	$27.1	$33.9
Activity B	45.9	49.2	47.3
Total obligations	**$71.6**	**$76.3**	**$81.2**
Financing:			
Offsetting collections			
Federal funds	$−18.4	$−16.3	$−17.9
Nonfederal sources	−10.3	−11.2	−10.7
Unobligated balances			
Start of year	−11.3	−17.6	−18.2
End of year	17.6	18.2	17.4
Budget authority	**$49.2**	**$49.4**	**$51.6**
Relation of obligations to outlays:			
Obligations incurred, net federal funds	$53.2	$60.0	$63.3
Obligated balance, start of year	102.8	89.0	91.2
Obligated balance, end of year	−89.0	−91.2	−86.3
Outlays	**$67.0**	**$57.8**	**$68.2**
Asset consumption charge	**$4.6**	**$4.8**	**$5.0**

Note: The numbers presented here are for illustrative purposes only; they are not actual or estimated numbers from the the federal budget.

(Dollars in millions)

ACCOUNT A - SUMMARY 36-0844-403	Actual 1988	Estimate 1989	Estimate 1990
Program by activity:			
Activity A	$5.2	$5.7	$11.5
Activity B	20.4	22.6	19.7
Total obligations	**$25.6**	**$28.3**	**$31.2**
Financing:			
Offsetting collections			
Federal funds	$−13.8	$−11.5	$−12.9
Nonfederal sources	−5.1	−7.0	−5.9
Unobligated balance			
Start of year	−3.1	−8.2	−11.0
End of year	8.2	11.0	9.3
Budget authority	**$11.8**	**$12.6**	**$10.7**
Relation of obligations to outlays:			
Obligations incurred, net federal funds	$11.8	$16.8	$18.3
Obligation balance, start of year	34.0	8.4	8.1
Obligation balance, end of year	−8.4	−8.1	−18.1
Outlays	**$37.4**	**$17.1**	**$8.3**
Asset consumption charge	**$4.6**	**$4.8**	**$5.0**

(Dollars in millions)

ACCOUNT A - SUMMARY
36-0844-403

	Actual 1988	Estimate 1989	Estimate 1990
Program by activity:			
Activity A	$20.5	$21.4	$22.4
Activity B	25.5	26.6	27.6
Total obligations	**$46.0**	**$48.0**	**$50.0**
Financing:			
Offsetting collections			
Federal funds	$−4.6	$−4.8	$−5.0
Nonfederal sources	−5.2	−4.2	−4.8
Unobligated balance			
Start of year	−8.2	−9.4	−7.2
End of year	9.4	7.2	8.1
Budget authority	**$37.4**	**$36.8**	**$41.1**
Relation of obligations to outlays:			
Obligations incurred, net federal funds	$41.4	$43.2	$45.0
Obligation balance, start of year	68.8	80.6	83.1
Obligation balance, end of year	−80.6	−83.1	−68.2
Outlays	**$29.6**	**$40.7**	**$59.9**

Methodology Used for Developing Budget Numbers

In developing the budget numbers reported throughout this report, we started with the actual amounts for fiscal years 1987 and 1988 as reported in the Budget of the United States Government, Fiscal Year 1989 and the Budget of the United States Government, Fiscal Year 1990, respectively. We reclassified the amounts as operating expenses and capital investments to reflect our restructured unified budget. Tables 2, I.1, I.2, V.1, and V.2 illustrate our reclassified numbers. For table V.3, we developed the numbers for illustrative purposes only; they are not actual or estimated numbers from the federal budget.

The methodology that we used in reclassifying the numbers is discussed below under two sections—operating budget and capital budget. The explanation applies to the numbers for fiscal year 1988, but we used the same methodology in developing the fiscal year 1987 numbers. All numbers are in billions of dollars.

Operating Budget

Total operating revenues ($1,012.8) were derived by taking revenues as reported in the budget ($909.0), and then performing the following calculations:

- Adding proprietary receipts from the public ($34.7) and offsetting collections from nonfederal sources ($134.0).
- Subtracting offsetting collections from nonfederal sources for direct loan principal repayments ($46.5). These collections are reported as revenues (loan receipts) in the capital budget.
- Subtracting excise taxes collected ($18.4) for the Highway Trust Fund, Airport and Airway Trust Fund, Hazardous Substance Superfund, and Aquatic Resource Trust Fund (capital trust funds). These taxes are reported as revenues (other capital revenues) in the capital budget.

The total operating revenues were then split into the following categories:

- general taxes ($519.5) include the actual tax revenues credited to Treasury's general fund receipt accounts;
- payroll and other earmarked taxes ($335.0) include the actual tax revenues credited to Treasury's special and trust fund receipt accounts; and
- fees, royalties, and other earnings ($158.3) were derived by adding offsetting collections from nonfederal sources ($134.0), proprietary receipts from the public ($34.7), and non-tax revenues credited to Treasury's general, special, and trust fund receipt accounts ($36.1), then

subtracting those portions of the offsetting collections from nonfederal sources credited to the capital budget ($46.5).

Total operating expenses ($1,143.9) were derived by taking outlays as reported in the budget ($1,064.1), and then performing the following calculations:

- Adding offsetting collections from nonfederal sources ($134.0) and proprietary receipts from the public ($34.7). The current outlay number reported in the budget is net of these two amounts.
- Adding interest paid to the capital trust funds by the federal government ($2.2). Under the current budget, federal payments to trust funds are treated as intragovernmental transfers, and they are netted against outlays. In our restructured budget, they are treated as amounts flowing from the operating budget to the capital budget. They are treated as outlays in the operating budget and revenues in the capital budget.
- Adding the estimated annual consumption charge ($50.0) on federal assets. The Department of the Treasury's Consolidated Financial Statements of the United States Government, Fiscal Year 1986—Prototype reported $35 billion for depreciation in 1986 and $40 billion in 1985. OMB reported $22.6 billion for fiscal year 1987. However, the figure was in constant 1982 dollars, and it excluded capital expenditures for defense. We did our own calculation using Special Analysis D data. Assuming a 20-year life and using the straight line method of depreciation, we calculated $60.5 billion for depreciation in fiscal year 1987. Given the quality of the data and the assumptions made regarding asset life and depreciation method, we decided that $50.0 billion was a reasonable estimate.
- Adding the estimated subsidy costs for direct loans ($1.0) and loan guarantees ($8.7) reported for the first year by OMB in its credit reform proposal, which was included in its fiscal year 1989 budget.
- Subtracting guaranteed loans terminated for defaults. They are treated as financial asset disbursements in the capital budget.
- Subtracting capital investment outlays ($139.6). These capital investment outlays are reported in the capital budget.

Total operating expenses were then split into the following categories:

- Civil functions ($700.0) are total operating expenses ($1,143.9) minus defense function ($227.2), interest on debt ($157.0), asset consumption charge ($50.0), and credit subsidy costs ($9.7).
- Defense function ($227.2) were derived by taking the national defense budget function (050) amount ($290.4) and (1) adding offsetting collections from nonfederal sources ($7.1) and proprietary receipts from the

public ($0.8) (the national defense outlay currently reported in the budget is net of these two amounts) and (2) subtracting investment outlays made for national defense ($71.1) (these outlays are included in the capital budget).

- Interest on debt ($157.0) is gross interest on the debt ($215.9) minus intrafund transfers ($19.2) and interfund transfers ($41.9) plus interest to capital trust funds ($2.2).
- Asset consumption charge ($50.0) represents our estimate of the annual depreciation on federal assets. We used the same amount for fiscal years 1987 and 1988.
- Credit subsidy costs ($1.0 for direct loans and $8.7 for loan guarantees) are the estimated subsidy costs reported for the first year by OMB in its credit reform proposal, which was included in its fiscal year 1989 budget. We used the same amounts for fiscal years 1987 and 1988.

Capital Budget

Capital revenues ($67.1) were derived from the following:

- Loan receipts ($46.5) are offsetting collections from nonfederal sources, which, under current budget practices, are offset against direct loan disbursements to arrive at direct loan outlays. They consist mainly of repayments and prepayments of principal, repayments on defaulted loans, and proceeds from loan asset sales. In reporting only those offsetting collections from nonfederal sources, which are offset against direct loans as capital revenues, we assumed that all remaining offsetting collections from nonfederal sources ($87.6) were related to operating-type activities. However, there could have been cases where these collections came from an activity which we would classify as capital and treat as capital revenues. The current budget, however, does not allow us to make this fine a distinction. Therefore, we chose to report these collections as operating revenues. To the extent our assumption is wrong, we would be underreporting capital revenues.
- Other capital revenues ($20.6) are the excise taxes collected ($18.4) for the Highway Trust Fund, Airport and Airway Trust Fund, Hazardous Substance Superfund, and the Aquatic Resource Trust Fund and the interest paid to the above trust funds by the federal government ($2.2).

Capital investments ($141.1) were derived from the following:

- Financial asset disbursements ($35.2) are direct loan disbursements ($33.7) plus guaranteed loans terminated for defaults ($11.2) minus the estimated subsidy costs for direct loans and loan guarantees ($9.7).

- Physical asset additions ($105.9) are those amounts reported as physical assets in Special Analysis D ($124.8) minus community development block grants and certain defense outlays that we did not include ($18.9). In using these numbers, we assumed that they accurately reflected the federal government's annual physical capital investments. However, we had to make two qualifications. First, an ongoing GAO review on the quality of Special Analysis D data has revealed some inconsistencies both within and across agencies as to what is being reported as capital investments versus operating expenditures. Second, OMB's definition of physical investments differs from our capital budgeting definition. OMB uses a 1-year life and no dollar threshold, we use a 2-year life and a $100,000 threshold. Despite these differences, the Special Analysis D data is the only information available on the federal government's physical investments. Thus, we had no choice but to accept the data as the best estimate of the federal government's annual physical capital investments.

Respondents to GAO's Capital Budget Proposal

We formally requested comments on our capital budget exposure draft from the chairmen and ranking minority members of the Senate and House committees and other select Members of Congress; key congressional staff; federal officials in major departments and agencies; the members of the National Economic Commission; the former members of the 1967 President's Commission on Budget Concepts; selected state officials; various state, local, and other public interest groups; leading economists and other academicians; various certified public accounting firms and their related professional associations; and other selected individuals, groups, and organizations. We requested comments from 282 individuals, groups, and organizations, and we provided copies of our exposure draft to interested individuals, groups, and organizations who requested it. The comment period was from July 29 through November 10, 1988.

We received 41 sets of comments on our exposure draft. We would like to acknowledge and thank those individuals, groups, and organizations who submitted written comments.

- Dr. John F. Adhearne, Vice President and Senior Fellow, Resources for the Future;
- John Alderson, Acting Administrator, General Services Administration;
- Barry B. Anderson, Acting Assistant Director for Budget Review, Office of Management and Budget;
- Professor Robert N. Anthony, Ross Graham Walker Professor of Management Control, Graduate School of Business Administration, Harvard University;
- James L. Blum, Acting Director, Congressional Budget Office;
- Kay Bulow, Assistant Secretary for Administration, Department of Commerce;
- Roland W. Burris, Comptroller, State of Illinois and past president of the National Association of State Auditors, Comptrollers, and Treasurers;
- Bruce M. Carnes, Deputy Under Secretary, Department of Education;
- Susan C. Crampton, Secretary, Agency for Transportation, State of Vermont;
- Governor Mario M. Cuomo (New York), Chairman, National Governors Association Task Force on the Federal Budget Deficit;
- James R. Durrall, Vice President and Chief Financial Officer, Tennessee Valley Authority;
- Dr. Robert Eisner, William R. Kenan Professor of Economics, College of Arts and Science, Northwestern University;
- Clyde O. Glaister, Comptroller, Department of Defense;
- Louis L. Goldstein, Comptroller of the Treasury, State of Maryland;

- The Honorable William H. Gray, Chairman, House Committee on the Budget;
- Charles L. Grizzle, Assistant Administrator for Administration and Resources Management, Environmental Protection Agency;
- Edward Y. Hirata, Director, Department of Transportation, State of Hawaii;
- Judith L. Hoffmann, Assistant Secretary for Administration, Department of Housing and Urban Development;
- Bernard B. Hurst, Director, Department of Transportation, State of Ohio;
- Anthony L. Itteilag, Director of Budget, Department of the Interior;
- Kermit H. Justice, Secretary, Department of Transportation, State of Delaware;
- Kermit V. Kierbert, Director, Transportation Department, State of Idaho;
- John Kincaid, Executive Director, Advisory Commission on Intergovernmental Relations;
- Duane R. Kullberg, Managing Partner-Chief Executive Officer, Arthur Andersen & Co.;
- The Honorable Richard P. Kusserow, Inspector General, Department of Health and Human Services;
- Joseph H. Linnemann, Acting Comptroller, Department of State;
- S. Anthony McCann, Assistant Secretary for Management and Budget, Department of Health and Human Services;
- Howard M. Messner, Executive Vice President, American Consulting Engineers Council;
- M. Richard Porras, Assistant Postmaster General, United States Postal Service;
- Dr. Alice M. Rivlin, Senior Fellow, Economics Studies Program, The Brookings Institution and Director, Congressional Budget Office (1975-1983);
- Dr. Allen Schick, School of Public Affairs, University of Maryland;
- Harold Seidman, Department of Political Science, The Johns Hopkins Center for the Study of American Government;
- Jon H. Seymour, Assistant Secretary for Administration, Department of Transportation;
- Elizabeth E. Smedley, Controller, Department of Energy;
- Albert Sommer, Acting Executive Director, The Conference Board;
- Dr. Elmer B. Staats, Comptroller General of the United States (1966-1981) and member of the President's Commission on Budget Concepts (1967);
- Dr. Herbert Stein, American Enterprise Institute for Public Policy Research;

- R. E. Stotzer, Jr., Engineer-Director, Department of Highways and Public Transportation, State of Texas;
- The Honorable Thomas K. Turnage, Administrator, Veterans Administration;
- Dr. George von Furstenberg, Rudy Professor of Economics, Department of Economics, Indiana University; and
- Larry Wilson, Director, Office of Financial Management, Department of Agriculture.

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Glossary

The following terms are used in this report.

Appropriation Account	A summary account established in the Department of the Treasury for each appropriation and/or fund showing transactions to such accounts.
Asset Consumption Charge	GAO's capital budgeting proposal uses this term to denote depreciation. See depreciation.
Balanced Budget	A budget in which receipts are equal to or greater than outlays.
Brick and Mortar	An expression used to describe physical or tangible assets.
Budget Deficit	The amount by which the government's budget outlays exceed its budget receipts for a given fiscal year.
Budget Function Classification	A system of classifying budget resources by function so that budget authority and outlays of budget and off-budget federal entities, loan guarantees, and tax expenditures can be related in terms of national needs being addressed.
Budget Gimmick	A expression used to describe various techniques used to circumvent the normal budget process.
Budget Receipts	Collections from the public and from payments by participants in certain social insurance programs. These collections consist primarily of tax receipts and social insurance premiums, but also include gifts, receipts from court fines, certain licenses, and deposits of earnings by the Federal Reserve System. Budget receipts are compared with budget outlays in calculating the budget surplus or deficit.
Budget Surplus	The amount by which the government's budget receipts exceed its budget outlays for a given fiscal year.

Capital Assets

GAO's capital budgeting proposal defines capital assets, or capital investments, as physical assets and financial assets. See capital investments, financial assets, and physical assets.

Capital Budget

In GAO's capital budgeting proposal, the capital budget of the unified budget segregates capital revenues and capital investments from the operating budget's revenues and expenses. Capital revenues and capital investments are excluded from calculations of the operating budget's surplus or deficit, but the operating budget is charged for depreciation.

Capital Financing Requirements

In GAO's capital budgeting proposal, capital financing requirements represent the amount by which net capital investments exceed capital revenues. See net capital investments and capital revenues.

Capital Investments

In GAO's capital budgeting proposal, capital investments include physical assets and financial assets. See physical assets and financial assets.

Capital Revenues

In GAO's capital budgeting proposal, this term includes taxes, user fees, and similar amounts which are earmarked by law to finance physical and financial assets. It also includes most loan principal repayments.

Civil Function

In GAO's capital budgeting proposal, the civil function amounts shown in the tables include the total of all budget functions except national defense (050) and interest on debt (900).

Countercyclical

Actions aimed at smoothing out swings in economic policy. Countercyclical actions may take the form of monetary and fiscal policy.

Credit Subsidy Costs

GAO's capital budgeting proposal defines credit subsidy costs—such as interest and default costs—as the losses incurred by the government as a result of its direct and guaranteed loan programs.

Defense Function

In GAO's capital budgeting proposal, the defense function amount shown in the tables includes the total of the national defense budget function (050).

Depreciation

The systematic and rational allocation of the costs (historical, replacement, or current value) of equipment and buildings (having a life of more than 2 years) over their useful lives. To match costs with related revenues in measuring income or determining the costs of carrying out program activities, it reflects the use of the asset(s) during specific operating periods. See asset consumption charge.

Entitlements

Legislation that requires the payment of benefits to any person or unit of government that meets the eligibility requirements established by such law.

Expenditures

With respect to the provisions of the Antideficiency Act (31 U.S.C. 665) and the Congressional Budget and Impoundment Control Act of 1974 (Public Law 93-344, 31 U.S.C. 1301, note), the term expenditures has the same definition as outlays. See outlays.

Expenses

In GAO's capital budgeting proposal, expenses represent the cost of the federal government's operations. They include outlays for civil functions, defense function, interest on debt, credit subsidy costs, and asset consumption charges.

Fees, Royalties, and Other Earnings

In GAO's capital budgeting proposal, these are amounts received from nonfederal sources that are of a business-type or market-oriented nature. They include both proprietary receipts from the public and offsetting collections from nonfederal sources, such receipts as rents and royalties on the outer continental shelf, sales or rentals of government products and services, military sales, and medicare premiums. Also included are non-tax budget receipts such as court fines, custom duties, gifts, etc. See budget receipts.

Financial Assets

In GAO's capital budgeting proposal, financial assets include any legal instrument such as bonds, notes, and other securities held by the federal government. Also, these include guaranteed loans terminated for defaults.

General Taxes

Taxes whose revenues are not dedicated to specific programs. They include individual and corporate income taxes.

Interest on Debt

In GAO's capital budgeting proposal, the interest on debt shown in the tables represents the gross interest on the debt, less intrafund and interfund transfers.

Net Capital Investments

In GAO's capital budgeting proposal, net capital investments represent the amount by which capital investments exceed the asset consumption charge.

Off-Budget Entities

The budget authority, outlays, and receipts of certain federal entities that have been excluded from budget totals under provisions of law. Although the fiscal activities of these entities are not reflected in budget totals, they are included in the deficit calculations made under Gramm-Rudman-Hollings.

Offsetting Collections From Nonfederal Sources

Collections from transactions with the public that are of a business-type or market-oriented nature. Under current budget procedures, they are offset against both budget authority and outlays at the appropriation account level. In GAO's capital budgeting proposal, these collections are counted as either capital revenues in the capital budget or fees, royalties, and other earnings in the operating budget.

Operating Budget

In GAO's capital budgeting proposal, the operating budget consists of all revenues and operating expenses for programs and activities that are not classified as capital investments.

Outlays

Payments made through issuance of checks, disbursement of cash, or electronic funds transfer to liquidate obligations. Outlays can also occur by the maturing of interest coupons in the case of some bonds, or by the issuance of bonds or notes (or increases in the redemption value of bonds outstanding).

Payroll and Other Earmarked Taxes

Taxes whose revenues are dedicated by law to specific programs. They include such taxes as social insurance taxes, customs duties, unemployment insurance taxes, and gasoline taxes.

Physical Assets

In GAO's capital budgeting proposal, physical assets are assets with form and substance (tangible), whose ownership resides or will reside in the public domain, which typically provide services or benefits, including for national defense and security, for more than 2 years, and which cost $100,000 or more. As currently defined, physical assets do not include consumable inventories or investments in human capital and research and development. These issues are currently being reviewed.

Proprietary Receipts From the Public

Collections from the public as the result of business-type or market-oriented activities. Under current budget procedures, they are offset against budget authority and outlays at the agency and functional total level. In GAO's capital budgeting proposal, these collections are counted as other revenues in the operating budget.

Revenues

In GAO's capital budgeting proposal, revenues are collections received (by cash, check, or electronic funds transfer) for public use. They include general taxes, earmarked taxes, and other revenues.

Scorekeeping

Procedures for tracking and reporting on the status of budgetary actions, including tabulations and reports on actions affecting budget authority, receipts, outlays, the surplus or deficit, and the public debt limit.

Sequestration

The cancellation (or withholding) of budgetary resources pursuant to Gramm-Rudman-Hollings. Once cancelled, sequestered funds are no longer available for obligation or expenditure.

Unified Budget

The present form of the federal government's budget in which receipts and outlays from both federal funds and trust funds are consolidated.

Unified Budget Financing Requirements

In GAO's capital budgeting proposal, the unified budget financing requirements represent the total of the operating budget's operating surplus/deficit and the capital budget's capital financing requirements.

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