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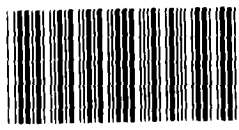
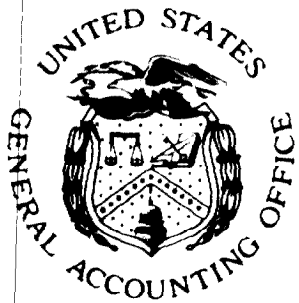
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BY THE COMPTROLLER GENERAL  
**Report To The Committee On  
Environment And Public Works  
United States Senate**  
OF THE UNITED STATES

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**Pros And Cons Of A Separate Capital Budget For  
The Federal Government**

Despite billions of dollars spent each year for investment in capital facilities, the Federal Government has neither an overall policymaking process nor a government-wide analysis of information to support capital investment policymaking. Adopting a separate capital budget might focus attention on national capital investment needs and stimulate the development of information needed for policy decisions. However, GAO believes that these objectives can and should be met within the current unified budget structure.



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COMPTROLLER GENERAL OF THE UNITED STATES  
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B-201050

The Honorable Robert T. Stafford  
Chairman, Committee on Environment  
and Public Works  
United States Senate

The Honorable Jennings Randolph  
Ranking Minority Member  
Committee on Environment and  
Public Works  
United States Senate

On February 26, 1981, we issued a report entitled "Federal Capital Budgeting: A Collection of Haphazard Practices," (PAD-81-19). In that report, we pointed out that a policy analysis of capital investment that cuts across all agencies and programs was needed and suggested that this analysis be carried out within the unified budget rather than in a separate capital budget. As a result of that report, the committee asked us to analyze the advantages and disadvantages of the Federal Government using a separate capital budget. The committee was also interested in the information needed to formulate national policy for investing in capital assets. On June 28, 1982, we briefed committee representatives on the results of our study. This report transmits to the committee our analysis of the advantages and disadvantages of a separate capital budget. It also presents three options that provide the Congress with information it could use for consideration in formulating policies and programs for capital investments without adopting a separate capital budget.

We analyzed the merits of the major existing arguments for and against a separate Federal capital budget. We have not attempted to explore every issue, but have sought instead to clarify the basic needs a separate capital budget would serve, how well it would serve them, and what other alternatives exist. We looked at dual budgeting systems used by State and local governments and private businesses since the Federal Government itself has no historical experience with a separate capital budget (in the sense that capital or investment-type programs are planned, budgeted, and financed separately from current expenditures). Therefore, we had to consider a dual Federal budget as a hypothetical replacement for the existing unified budget. We based our analysis, conclusions, and recommendations upon our own

knowledge and experience of the characteristics and qualities of budget systems. We looked at the separate capital budget only as one tool for making more informed decisions about capital investments. We did not study the overall economic implications or balanced budget implications of such a budget. (A complete statement on our objectives, scope, and methodology is included in appendix I.)

A separate capital budget could help focus attention on national capital investment needs. But unavoidable problems in creating such a budget and its implications for weakening aggregate spending controls suggest that a simpler solution be considered first. We believe that improved Federal capital investment information can be provided within the basic structure of the unified budget. We present three options for supplying such information: (1) display capital investments separately in a resectioned unified budget; (2) prepare a new infrastructure and capital investment analysis; (3) improve Special Analysis D, "Investment, Operating, and Other Federal Outlays," and restore the Special Analysis on Federal Public Works Activities.

#### CURRENT PRACTICES

Business accounting practices dictate that current operating and capital investment outlays be separated to determine the organization's profit or loss. Capital investment outlays are shown as a series of operating charges (depreciation of assets) in the operating budget. This is necessary so that the investment is allocated to the proper accounting period for determining the earnings for the period, the Federal tax liability, and the depreciated value of the asset.

State and local governments often use separate capital and operating budgets because they are legally required to balance their operating budgets. Separate capital budgets also serve as plans for acquiring and financing capital investments. Distinguishing between capital and operating expenses is necessary because State and local governments usually operate under legislative borrowing and taxing restraints. State and local governments are also subject to review by investment bankers in determining if a jurisdiction is a good credit risk. A good credit rating is needed by a governmental unit to borrow money to finance capital assets.

In contrast to businesses and State and local governments, the Federal Government currently uses the unified budget, in which the acquisition of capital assets is treated like any current operating expense. Use of the unified budget recognizes the Federal Government's involvement in national economic stability and growth. This responsibility is uniquely Federal and has been carried out in part through a flexible fiscal policy. This involvement in national economic stability requires the Government to focus on its total spending (including outlays for both capital and current operations) in relation to its total

revenues. The unified budget is designed with this objective in mind. (These matters are discussed in greater detail in appendix IV.)

#### CURRENT CONCERNS

In our prior report, "Federal Capital Budgeting: A Collection of Haphazard Practices," we reported that

1. our Nation's infrastructure (public facilities such as bridges, highways, airports, and water and sewage systems) is deteriorating;
2. a process for integrating Federal activities affecting the Nation's public facilities does not exist;
3. decisions on public facilities are made by a program-by-program or project-by-project approach;
4. a short-term approach is taken to long-term problems.

Presently, the Federal Government does not take a comprehensive look at capital investment programs across agency and program lines to see how they fit into a national strategy for maintaining and improving the Nation's public facilities. Both the executive branch and the Congress tend to set priorities for physical capital investment program-by-program. There is no consistent basis for setting priorities among projects and programs, and there is no framework in which to identify those having similar objectives and those that are at cross-purposes. This program and project orientation makes planning for public facilities vulnerable to short-term factors, thus impairing the stability and predictability needed for an efficient capital investment program.

At the time this report was being made final, hearings were being conducted on budget reform in both the House and the Senate. Issues being discussed covered a wide range of changes, such as capital budgeting, biennial budgeting, advanced budgeting, budget structure, and congressional procedures. We have said in our testimony at these hearings that these changes should give particular attention to grouping the Federal Government's programs and activities into policy areas of (1) investment in capital assets, (2) research and development, (3) aid to State and local governments, (4) credit assistance, (5) entitlements for individuals, (6) interest, and (7) operating expenses. Investments in capital or physical assets should involve longer term decisions on programs and funding whenever possible. Greater stability for investment programs is a necessary ingredient in program efficiency. A longer term focus on investment decisions would allow the Congress to consider budget levels in relation to the overall conditions and needs for the Nation's public facilities and its defense structure.

A number of bills were introduced in the second session of the 97th and the first session of the 98th Congress dealing with public facilities and capital budgeting issues. The bills cover such ideas as a special analysis of capital investments, a capital budget within the unified budget, an inventory and condition assessment for public capital investments, dedicated revenues for capital investment programs, and national public improvement plans. One bill, H.R. 1244, has been reported out of the House Committee on Public Works and Transportation. This bill would require the President to provide more detailed information on each major capital investment program as part of the annual budget, starting in January 1984.

#### ADVANTAGES AND DISADVANTAGES OF A SEPARATE FEDERAL CAPITAL BUDGET

From 1979 through 1982, the Federal Government spent over \$268 billion in capital investments through grants-in-aid to support State and local government services to the public and in acquiring Federal assets directly. Despite this large investment, the Federal Government has neither an overall capital investment policy nor an analysis that cuts across agencies and programs to support such a policy. A separate capital budget is one of several ways to provide decisionmakers with such information. However, there is much debate as to whether a separate capital budget is the best way to handle capital investment decisions. Proponents and opponents of a separate capital budget cite a number of arguments for and against its use. Some of the purported advantages and disadvantages have merit, others do not. (A complete discussion of the advantages and disadvantages outlined below appears in appendix II.)

#### Advantages

Advocates argue that a separate capital budget would establish a useful planning process because it would focus on long-term projects, costs, and benefits. While some data are available now within the unified budget, it is not in sufficient detail or appropriate format for planning and making policy decisions on overall investment levels, financing methods, and level of government responsibility. To a large extent, it is not possible to determine the full scope and nature of the Federal Government's involvement in financing and influencing capital investment. A separate capital budget could provide more information on the Federal Government's involvement in acquiring assets directly and in providing grants-in-aid for capital investment. However, a separate capital budget would not necessarily disclose how the Government influences capital investment through tax expenditures and guaranteed loans, which do not result in measurable direct capital outlays. For example, it would not show the influence of tax expenditures (revenue losses attributable to provisions of the Federal income tax laws) such as investment credits and depreciation for public facilities constructed by the private sector and leased to the public sector. Neither would it show

the effect of federally guaranteed loans, except when a lender defaulted on loan repayment.

A separate capital budget would help focus attention on Government ownership and financing of assets that produce long-term benefits. Reliable information on the condition and maintenance of Federal, State, and local capital assets is not now available governmentwide. A separate capital budget could provide a stimulus for acquiring this needed data and help illuminate the amount of responsibility being assumed by the Government for maintaining assets financed by grants-in-aid.

A separate capital budget could help change public perception of debt financing by distinguishing between debt incurred to acquire assets from that incurred to finance current operations. It could show that borrowing to finance capital investments is accompanied by an increase in the Nation's assets. However, we believe that this should not infer that all capital assets should be acquired by debt financing, nor that debt financing should be used only for the acquisition of capital assets.

Advocates of a separate capital budget argue that a budget that uses debt financing of capital assets would increase equity between those who pay for the assets and those who use the assets. They argue that if the debt's repayment length approximates the acquired asset's life, each generation would pay for the portion of the asset it used. However, in our opinion, debt financing of capital assets could occur without the need for a separate capital budget.

### Disadvantages

Opponents argue that a separate capital budget with capital assets financed by long-term debt could constrain fiscal policies 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 a long-term investment strategy in mind, independent of short-term changes in the economy. Others believe, however, that the effect a separate capital budget would have on countercyclical fiscal policy would depend on the specific characteristics, such as linking capital investment to debt financing, that are built into such a system.

Opponents also argue that the adoption of a separate budget is quite likely to disrupt the existing budget process by requiring some changes in institutional structure, shifts in responsibility, and modifications of the budget cycle's timing. Thus, the need to relate aggregate debt, tax, and spending limits to two separate budgets--capital and operating--would introduce greater complexity into the already complicated budget process.

A separate capital budget, according to opponents, would increase the opportunity for manipulation because of the need to

distinguish and define "capital" and "operating." The difference between an operating deficit and surplus could depend on what is included in the definition of capital. We prepared five different models (see appendix V) to illustrate the effect of different definitions of capital. Using 1982 actual data (in which the unified budget incurred a deficit of \$110.6 billion), differing definitions of what represented capital investment could yield results for an operating budget ranging from a deficit of \$79.8 billion to a surplus of \$25.2 billion. In addition to defining capital, we believe that decisions on whether capital assets are to be depreciated and how depreciation is to be treated in the budget would have to be made.

Opponents argue that a separate 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 investment and how such investments are to be financed. They also argue that, under a dual budget system, capital assets would obtain a disproportionate share of total outlays. Unless programs are wholly capital or operating, a dual budget would dissect the individual programs by their operating and capital segments. Since these parts would appear in two separate budgets, capital assets' contribution to achieving either program goals or broader functional goals may be obscured. However, a separate capital budget is merely a process and would not, in itself, encourage a preference for capital items over the operating portion of the budget.

OPTIONS FOR PROVIDING CAPITAL  
INVESTMENT INFORMATION WITHIN THE  
UNIFIED BUDGET

A separate capital budget is one way of providing comprehensive information on public facilities and for making more informed decisions on Federal capital investments. In view of the disadvantages of that approach, we have developed three options that could be used within the unified budget to increase the comprehensiveness of Federal decisionmaking for capital expenditures: (1) display capital investments separately in a re-sectioned unified budget; (2) prepare a new "infrastructure and capital investment analysis"; and (3) improve Special Analysis D, and restore the special analysis on Federal Public Works Activities. In our opinion, the first option is preferable. (Options are discussed at length in appendix III.)

Display capital investments separately  
within the unified budget

The focus of this option is to establish sections in the budget that are dedicated to the display and discussion of capital investment, much like that currently displayed for credit programs in the "credit budget." In particular, Part 3 of the Budget--Budget Program and Trends--could contain a summary table and discussion of the overall effect of capital investment.



Detailed information on capital investments could be presented in Part 5--Meeting National Needs: The Federal Program by Function. Such a display in Part 5 could be divided among those easily measured financing methods included in the budget totals--direct Federal programs, grants-in-aid, and loans--and those financing methods that are neither as easily measured nor included in the budget totals--tax expenditures and loan guarantees. The advantages of such displays would be the identification of capital investments for making policy decisions, yet they would not be treated separately from operating costs when the purposes of the programs were reviewed. Most of the data needed to carry out this option are currently available, and costs should be minimal.

#### Prepare a new infrastructure and capital investment analysis

A new infrastructure and capital investment analysis could serve as an alternative to a separate capital budget. This option would include a descriptive analysis in the budget document discussing investment policy and policy changes, programs, trends, and problem areas. It would also include two special analysis tables--one covering existing assets and one covering new additions to public facilities. The special analysis tables would require the agencies to prepare and maintain inventories and condition assessment information against which current and proposed outlay levels could be judged.

Adequate condition and assessment data would be invaluable to Federal decisionmakers in addressing difficult choices, given the current budgetary constraints. However, the concepts, procedures, and data are not developed or readily available to currently undertake such an analysis. A number of problems, such as direct Federal investment versus grants and the compatibility of data bases, would have to be overcome. Considerable effort, time, and money may be required to fully execute this option.

#### Improve and restore special analyses of the budget

Special Analysis D, "Investment, Operating, and Other Federal Outlays," is currently prepared as part of the budget documents. As it is currently prepared, Special Analysis D distinguishes between payments made for current and capital items and subdivides the items between civil and national defense programs. Investment-type outlays are presented using such categories as loans, construction and rehabilitation of physical assets, acquisition of major equipment, commodity inventories, research and development, etc. Despite improvements to include summary tables of Federal outlays for major public physical capital investment, these categories do not consistently parallel congressional lines of responsibility for decisionmaking. The consistent use of budget functional categories to display capital

information in Special Analysis D would be one way of improving its usefulness.

A major component of Federal capital investment is public works--the public portion of the Nation's infrastructure. A special analysis, "Federal Public Works Activities," containing a very useful set of tables designed to describe the character and size of the Federal Government's role in public works, was discontinued as part of the budget after fiscal year 1974. According to OMB, sufficient information was available in Special Analysis D, and the increasing complexity of the budget process required elimination of marginal--but useful--analyses. OMB has provided more detailed information on public physical capital investment in a series of tables, but these are not included in the special analyses. These tables could be expanded to provide sufficient information on Federal public works activities and be presented clearly in the budget in a new special analysis equivalent to that which was discontinued. Since OMB has just encountered the experience of modifying and preparing additional information for the special analyses, implementation should not pose any significant problems.

#### CONCLUSIONS

The complexity of establishing a separate Federal capital budget and its implications for weakening aggregate spending controls suggest that a simpler solution be considered first. In addition, the unified budget and the congressional budget process were created so that the President and the Congress could address the Federal budget as a whole as well as in parts. Separating capital investment items into a dual budget would detract from the overall policy perspective that has been achieved.

We believe that a resectioned unified budget would provide information on capital investments during the formulation of the President's budget proposals and the Congress' debate and creation of the Federal Government's budget. This resectioned budget would identify Federal capital investment outlays and clearly distinguish them from current expenditures, without jeopardizing the functional and aggregate spending focus of the budget. We plan to initiate a project with one or two Federal agencies to develop the information that would be necessary to implement the overall objectives of providing capital investment data within a restructured unified budget.

#### AGENCY COMMENTS

We received written comments on a draft of this report from the Office of Management and Budget. A copy of the comments and our detailed analysis of them are included in appendix VI.

Basically, OMB totally disagreed with us on the need for an overall policy approach to capital investments and on the need for the separate identification of capital investments in the

budget. OMB cited two major concerns with this report: (1) Whatever the merits of an overall infrastructure policy, advocating such a policy does not justify the adoption of a capital budget. (2) The added reporting and policy review would gravely overstrain the budget process.

We have not recommended a separate capital budget. We stated that while a separate capital budget could provide benefits, information on capital investments for policy decisions can be provided within the unified budget. We outlined three possible options of doing this within the unified budget. OMB's comments made no distinction between any of these options and a separate capital budget and, therefore, did not directly address the issues raised in this report.

We agree with OMB that the budget process should not be overburdened. The budget already contains these capital investment programs and they are already reviewed by OMB. However, we are suggesting that the current budget structure be improved to focus on information and a review of capital investment. We recognize OMB's concern that changing the information in the budget and changing the focus of policy level review could require additional resources when making these changes. However, additional resource requirements should not be prohibitive, as evidenced by OMB's improvements in Special Analysis D for the 1984 budget. Modern data processing techniques should permit the budget to be reformatted in a variety of ways to serve a variety of purposes once the basic information systems are in place.

Based on OMB's comments, we have clarified a number of items in the report, particularly where information needed to make capital investment decisions at the agency level would not be added to the budget data base nor included in the budget itself.

\* \* \* \* \*

As arranged with your offices, we are sending copies of this report to the House and Senate Budget Committees, the House and Senate Appropriations Committees, the House Committee on Ways and Means, the Senate Finance Committee, the Congressional Budget Office, and the Office of Management and Budget. We will be glad to assist in developing a workable solution to the need for information to support decisionmaking on investment in the Nation's public facilities.



Comptroller General  
of the United States



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OBJECTIVES, SCOPE, AND METHODOLOGY

Because of recent interest in the idea of a separate capital budget, the Chairman and Ranking Minority Member of the Senate Committee on Environment and Public Works asked us to examine the advantages and disadvantages of the Federal Government using such a budget. The committee's request for this analysis and for an explanation of our previously stated position serves as the basis for this report.

We clarify the basic needs a separate capital budget would serve, present and analyze the potential advantages and disadvantages of using a separate Federal capital budget, and then consider three options for improving information on capital expenditures within the current unified budget.

When analyzing the advantages and disadvantages of a separate capital budget for the United States, one must examine its hypothetical attributes because the Federal Government has never used such a system. Thus, such an exercise could be highly speculative were it not for the controlled use of evidence and arguments that have bearing on this issue. Ideally, comparative data might be used in lieu of historical experience. Capital budgeting in the State and local governments and in the private sector might serve to exemplify the sorts of opportunities and drawbacks its adoption by the Federal Government would provide. Analogies cannot be pushed too far, however, especially when the differences between existing capital budgeting systems and that of a potential Federal equivalent are greater than the similarities. Comparative analysis, then, can help us to identify important budgeting practices but cannot determine their appropriateness in the Federal setting. Among the practices that emerge from the examination of existing dual budgeting systems are debt financing and the depreciation of capital assets and balanced operating budget requirements. Appendix IV contains a discussion of these.

In the absence of relevant historical data, other approaches must be used. All budgeting systems are designed to serve specific purposes. Among the most basic of these purposes is the allocation of resources, using a process and corresponding documentation that allows the allocation to be sufficiently visible to permit effective decisionmaking and oversight. So, when analyzing the advantages and disadvantages, we focused part of our analysis on the question, would it be easier to allocate Federal resources under a separate capital budget or the current unified budget?

In developing an alternative to a separate capital budget, we further divided the purposes of the budget into two parts to direct our analysis. First, a Government's budget and its supporting documentation should fully disclose both the costs and

the purposes of programs. Second, the display and analysis of capital expenditures within the context of the current unified budget should facilitate congressional decisionmaking and oversight. The options considered represent differing levels of commitment to augmenting the treatment of capital in the budget.

The visibility of decisions within any capital budgeting system is highly dependent on the definition of capital assets it employs. Also, how Federal capital assets are defined directly affects whether or not there will be a budget surplus or deficit. To illustrate this effect, we constructed a simplified model of a hypothetical Federal capital budget. The work of Maynard Comiez in his 1966 study, "A Capital Budget Statement for the U.S. Government," based on an earlier version prepared for the Bureau of the Budget (now the Office of Management and Budget), provided us with the basic analytical orientation we adopted in dealing with consequences of how capital is defined. Our hypothetical capital budgets are based on data from the President's budgets for fiscal years 1981, 1982, 1983, and 1984 and are discussed in greater detail and displayed in appendix V.

Notwithstanding the non-empirical character of our topic, we did consult relevant literature and data bases. To learn about existing capital budgeting systems, we reviewed diverse published materials on planning, budgeting, and accounting practices. Our experience, knowledge, and judgment about the Federal policy-making process have been used to assess the relevance of comparative information and analyses. Some of our data comes from a GAO capital budget report, <sup>1/</sup> for which over 100 in-depth interviews were conducted with officials in four States, four counties, four large city governments, and four corporations.

As a quality control measure, we provided our findings and conclusions to outside experts in the fields of budgeting, economics and public policy. Our analysis of the issues contained in this report has been refined on the basis of their comments.

#### LIMITATIONS

We did not study the detailed process, specific resource implications, nor the overall economic implications of producing and using a separate capital budget. Moreover, we looked at the effect on the computation of the deficit of only a limited number of definitions of capital investment and did not consider a separate Federal capital budget in light of specific balanced budget proposals. Were such a proposal to become enacted into law, its implications for capital investments would have to be evaluated with reference to its specific provisions. In the

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<sup>1/</sup>U.S. General Accounting Office, "Federal Capital Budgeting: A Collection of Haphazard Practices," (PAD-81-19, February 26, 1981).



final analysis, the net benefits of costs of separating the budget into a capital and current portion is subject to empirical analysis. But, as we have stated earlier, evidence and experience on the use of a dual budget for the Federal Government does not exist and therefore cannot be examined empirically. One alternative, which could be the subject of a future study, would be to use a simulation experiment examining the budgetary, policy, and economic implications of using a separate capital budget. In our judgment, however, similar insight may be available from students and practitioners of budgeting and the public policymaking process.

Also, we did not study the specific steps and problems of making a transition from the current unified budget to a dual budget system, if the latter were adopted by the Federal Government. Clearly, such a transition would be a complicated process that would require the cooperation of leaders and policy officials in both the Congress and the executive branch.

ADVANTAGES AND DISADVANTAGES OF A  
SEPARATE FEDERAL CAPITAL BUDGET

Measured in terms of the dollars it spends or lends for capital assets, the Federal Government can be said to play a major role in our Nation's public facilities. Measured in terms of those assets directly managed through federally run programs, that role is considerably smaller. The Federal Government directly or indirectly finances or encourages billions of dollars worth of capital acquisitions over which it has minimal or no control. Federal grants-in-aid, loans, loan guarantees, and tax expenditures (revenue losses attributable to provisions of the Federal income tax laws encouraging certain activities) constitute sources of funds and incentives for acquiring capital assets whose ownership and management is controlled by State and local governments, businesses, and private individuals. Regardless of how successfully these organizations and individuals have controlled federally financed assets, the accountability to the U.S. taxpayer requires that a Government budget fully disclose how economic resources are allocated to meet a legislatively defined range of needs. The display of capital asset resource allocations in a separate capital budget is one way of employing descriptive categories and analytical discussions to provide a maximum amount of meaningful information to both citizens and decisionmakers. However, whether or not a separate Federal capital budget is the best way to handle capital investment decisions is a question open to debate. The adoption of a separate Federal capital budget has a number of advantages and disadvantages. Some of them are discussed in the following sections.

ADVANTAGES

The advocates of a separate Federal capital budget believe that if a separate Federal capital budget were adopted, it would provide a way for allocating capital investment dollars in a manner consistent with Federal policy and program objectives, even though ownership of capital assets is vested in non-Federal sectors. They also believe that it is a highly desirable vehicle for tracking and controlling the allocation of capital investment resources.

They argue that such a budget would

- serve as a national strategy for coordinating the many Federal capital investment programs and assessing their effect on public facilities and on public and private sector capital formation,
- help focus public attention on the amount and condition of capital assets owned and/or financed by the Federal Government,

- help change public perceptions of the relationship between long-term borrowing for capital assets and its effect on the Federal debt,
- help provide a way to distribute the costs of long-term capital projects equitably among present and future users through depreciation or some other adjustment formula.

Serve as a national investment plan

In the same way that it serves State and local governments, Federal decisionmakers would find that a capital budget establishes a useful planning process because it would focus on proposed long-term projects, their estimated costs, and their anticipated national benefits. Capital outlay information is available now in Special Analysis D of the unified budget, but not in sufficient detail for planning and analyzing proposed policy.

To a large extent, we are simply not aware of the full scope and nature of the Federal Government's contribution to public facilities and other capital investments. Diverse methods of financing, while useful in tailoring programs to meet policy objectives, tend to obscure the dimensions of the Federal role, especially when they do not result in measurable direct outlays from the Treasury, as is the case with tax expenditures and loan guarantees. <sup>1/</sup> While a separate capital budget would not necessarily resolve this problem, it could improve both the disclosure and planning of the various types of more direct Federal outlays used for capital investment purposes. At present, these are not fully reported in the various documents of the unified budget. Direct Federal programs, grants-in-aid, and direct loans are all employed to finance capital investments but are not always clearly identified as doing so. A separate Federal capital budget could require a more disciplined presentation of the scope and magnitude of Federal capital investments than currently exists within the unified budget. Such information is an important prerequisite for planning the acquisition of capital assets and for timing complex capital projects.

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<sup>1/</sup>Tax expenditures and loan guarantees, for example, are not direct outlays from the Treasury. It is difficult to assess how much capital investment can be attributed to these two vehicles of financing on the basis of information provided in the current unified budget. Nevertheless, tax expenditures provide powerful and, in large measure, uncontrollable (entitlements) incentives for private investment in a diversity of capital assets. At the same time, they represent sizeable amounts of revenue foregone by the Federal Government. Loan guarantees also make the purchase of capital assets possible without the need for direct Federal expenditures. In addition, they influence private credit markets in ways not fully described in the unified budget.

Until a more satisfactory solution is proposed, the more indirect spending could be handled in a special analysis of the budget that distinguishes whether these methods facilitate capital or current expenditures.

Focus attention on Federal assets and their condition

A capital budget would help focus public attention on the Government ownership and/or financing of assets that produce long-term benefits. As in the private sector, Government managers commonly make capital expenditures because they expect a future return in the form of increased services, benefits, or income for citizens. These capital expenditures represent collective investment and increase the Nation's assets. The value and stream of benefits derived from these assets decrease, however, if they are not adequately maintained. Also, the costs of owning and using capital assets increase over time. Thus, maintenance is a critical component of long-term capital investment strategy.

Presently, reliable information on the condition and maintenance costs of Federal capital assets is not available governmentwide. A separate capital budget would provide a stimulus for acquiring this needed data. It would also help to illuminate the degree of Federal responsibility being assumed for maintaining assets financed by grants-in-aid and loans but owned and managed by State and local governments. Bridges, highways, and waste-water treatment facilities are among the capital assets built with substantial Federal funding but whose maintenance costs fall on the budgets of State and local governments.

Change the public's perception of debt financing

Given the long-term benefits provided by capital assets, a case is sometimes made for treating a Federal deficit incurred to acquire these assets differently from one incurred for current expenditures. Borrowing to finance current expenditures requires extended payments for present benefits. Although there may be sound economic reasons for doing so, this practice makes it appear that the Government is spending beyond its means. In contrast, using long-term debt to finance capital projects requires extended payments for extended benefits. Such borrowing exchanges the extended repayment of loaned monetary assets for the future services of tangible capital assets. Thus, deficits resulting from borrowing to acquire capital assets is accompanied by an increase in the Nation's assets. A separate capital budget could be used to highlight the distinction between the two forms of debt and shape public awareness of the Federal deficit's composition as well as its absolute magnitude. Nonetheless, we believe that an inflexible rule requiring the debt financing of capital assets is not a necessary or useful requirement of a separate capital budget.

Increase intergenerational equity

It is often claimed that a separate capital budget that employs debt financing of capital assets contributes to increased equity between those who pay for and those who use these assets. If the life of the loan used for a capital acquisition approximates the service life of the asset acquired, then each generation pays for the amount of capital it actually uses. However, debt financing of capital assets could occur without the need for a separate capital budget.

DISADVANTAGES

Whatever benefits a separate capital budget might provide, serious practical problems are associated with its adoption by the Federal Government. Opponents of this budget system argue that it has the potential to

- impose constraints on countercyclical fiscal policy measures if capital investment were financed by long-term debt;
- require what may be extensive and costly changes in the current Federal budget process with little direct evidence of the potential benefits from doing so;
- introduce greater complexity and increased opportunity for manipulation into the framework of budget categories because of the need to define and decide what should be classified as a capital asset and, if required, how that asset should be depreciated;
- shift the focus of the budget away from broad questions of resource allocation to meet functionally defined national needs to narrower questions of public investment and how it is to be financed.

Constrain countercyclical fiscal policy

The effect a separate capital budget would have on Federal fiscal policies used to counter short-term swings in the economy depends on the specific characteristics that are built into a dual budget system, such as how capital and operating expenditures are separated, whether or not assets are depreciated, and how capital assets are financed.

Although there is no technical requirement that restricts the acquisition of assets by debt financing alone, the assumption that the adoption of a separate Federal capital budget would require this method to be used is what gives credibility to claims about its effects on fiscal policy. Three reasons might be advanced to justify this assumption: (1) debt financing would be desirable for increasing equity between those who pay for and those who use capital assets; (2) debt financing capital expen-

ditures would smooth the fluctuations in large Federal outlays; (3) a separate capital budget might be adopted along with a balanced budget requirement, which would require balancing current expenditures with current tax receipts and financing capital outlays through long-term debt.

The actual validity of the three reasons is less important than their persuasiveness in linking debt financing with the adoption of a separate Federal capital budget. If such a link were successfully made, then the consequences of debt financing for fiscal policy should be closely examined.

Were the Federal Government to use long-term borrowing for the bulk of its capital expenditures, the flow of one type of Federal outlay would be made independent of short-term changes in economic conditions. To a greater extent, capital acquisitions would be planned and financed to meet long-term capital needs, not to play a role in the short-term stabilization of the economy. Insulating capital outlays from serving the requirements of fiscal policy would necessarily increase the burdens on expenditures from the operating budget, tax policy, and monetary policy to act as instruments of overall economic policy. If a balanced operating budget were also a requirement of an adopted dual budgeting system, the corresponding constraints imposed on current outlays and tax receipts would make the task of stabilization even more reliant on monetary policy. <sup>1/</sup> How these potential consequences are viewed depends on the amount of Federal economic stabilization deemed both necessary and desirable.

#### Disrupt the budget process

The adoption of a separate capital budget is quite likely to unpredictably disrupt the existing budget process. A dual budget would more than likely require some changes in institutional structure, shifts in responsibility, and modifications of the budget cycle's timing. The need to relate aggregate debt, tax, and spending limits to two separate budgets--capital and operating--would introduce greater complexity into the already complicated budget process.

Changes in the current budget process resulting from the adoption of a separate Federal capital budget could only be justified if these changes produced substantial benefits. To assess the benefits and costs of moving away from the current unified

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<sup>1/</sup>These comments refer to the fiscal policy choices available to Federal decisionmakers under differing sets of requirements for the functioning of a dual budgeting system. In the absence of legislative changes to the contrary, the automatic stabilizers of the economy, such as unemployment insurance and the taxation of large marginal increases in profits, would still continue to operate.

budget, the capital budgeting experiences of non-Federal organizations would have to be examined so that a baseline for comparison could be established. Private businesses and State and local governments can provide us with information on the successes, failures, and operational characteristics of their capital budgeting systems. (See appendix IV.) However, all of these non-Federal organizations function within the market system and in an economic environment regulated in a variety of ways by the Federal Government, and many are recipients of substantial Federal resources. This makes it questionable whether any of them would serve as a relevant example. To accurately predict the benefits of capital budgeting for the Federal Government on the basis of private, State, and local experiences would require assumptions of comparability that ignore these important differences.

#### Complicate budget categories

Establishing a dual budgeting system requires the ability to distinguish between capital and operating expenditures and assumes that it is possible to clearly and unambiguously define capital assets. But, even among those public and private sector organizations that use capital budgets, no definitions of capital assets are universally accepted. In appendix V we illustrate how alternative definitions affect the size of the operating budget surplus or deficit. Whether or not the Federal operating budget were in balance would depend upon what is included in the definition of capital. Although any budgeting system can potentially be subject to manipulation and while strong oversight and accounting controls can minimize the occurrence of abuse, the complexity associated with defining Federal capital assets remains.

The problems of definition also interact with the question of how capital assets, once defined, should be treated within a dual budgeting system. More specifically, should Federal capital assets be subject to depreciation, how should it be handled in the budget, and what are the consequences of doing so? 1/

#### Shift the purpose of the budget

The primary purpose of the unified budget is to allocate resources based on policy decisions made by the President and the Congress. To reflect the major areas of the Government's responsibility, budget authority and outlays are organized in accordance with 17 functional categories designed to present the costs of policy choices without regard to the jurisdictions of specific

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1/Depreciation (the method of allocating the net cost of a tangible capital asset over the estimated useful life of the asset in a systematic and rational manner) of Federal capital assets is being addressed in a separate GAO study and will not be discussed in detail in this report. (See p. 28 for a discussion of business depreciation practices.)

Federal agencies. Although the yearly flow of Federal resources is a necessary concern of the budget process and is expressed in the budget documents, of even greater significance is the way those resources meet the basic needs of society and the economy as categorized in functional terms. The overriding objective of policy is to ensure that these diverse needs of society are considered in making budget decisions.

A dual budgeting system could result in treating policy and functional needs as secondary to the type of expenditure--capital investment or operating expense. Capital and current expenses present different technical problems to a resource manager and, consequently, could be separated to ensure optimal financial treatment of each. With a separate capital budget, the acquisition of assets could be more carefully managed, but the policy implications of financial decisions could be blurred. The allocation of resources for capital is not separable, in a policy sense, from the host of related operating expenditures with which it is joined to execute Federal Government programs.

A functional breakdown of expenditures in the unified budget presupposes that the primary policy goal of the budget--the satisfaction of different types of needs in society through the allocation of resources--will take precedence over the specific technical means used to achieve it. The possible financing of social and other non-capital programs with current revenues or of financing capital acquisitions through long-term debt has little bearing on how each type of expenditure is judged in policy terms. Programs are viewed as a unified whole regardless of the mix of capital and non-capital resources required for their implementation. In contrast, unless programs are wholly capital or operating, a dual budget dissects the individual programs by their operating and capital segments. Since these parts would appear in two separate budgets, capital assets' contribution to achieving either program goals or broader functional goals may be obscured.

Although it might be feared that capital assets would obtain a disproportionate share of total outlays under a dual budgeting system because of the special attention they would receive, specific conditions must exist for this to be a likely consequence. A separate capital budget does not in itself encourage a preference for capital items over the operating portion of the budget. Its execution, however, is often regulated by procedures that may have this result. Were a dual budget governed by the stipulation that the receipts and outlays of its operating portion be balanced, then capital outlays might appear relatively more attractive in the absence of any other constraints. The financing of capital acquisitions through long-term debt would in large measure exempt capital outlays from the direct budget balancing



requirements imposed on current outlays. However, large increases in debt-financed capital investments would eventually impose indirect burdens on the operating portion of a dual budget system. A requirement to charge debt service (interest) and depreciation of capital investments to the operating budget would increase current outlays in step with increases in capital investment. Additional revenues or reduction of operating costs would then be required to keep the operating budget in balance.

OPTIONS FOR PROVIDING CAPITAL INVESTMENT INFORMATION  
WITHIN THE UNIFIED BUDGET

Any budgeting system used by the Federal Government should disclose the full range of government programs and their associated costs, indicate the purposes and needs these programs are intended to serve, and suggest the nature and size of budgetary commitments that extend beyond a single budget year. These criteria and the desire to increase the information on Federal capital investments that is available for making budget decisions do not automatically entail adopting a separate capital budget. Many of the disadvantages of a dual budgeting system presented in our analysis might be avoided by considering alternative displays of budget information more closely tailored to the nature and range of Federal responsibilities. The following three options describe proposals for increasing the comprehensiveness with which Federal capital expenditures can be examined.

OPTION 1: DISPLAY CAPITAL INVESTMENTS  
SEPARATELY IN A RESECTIONED UNIFIED BUDGET

The need for more comprehensive information on the size and composition of Federal capital investments can be partially satisfied by collecting and prominently displaying capital investment data in the unified budget. Although the format in the budget documents would be altered, the fundamental purposes of the unified budget would still be served. Specifically, the budget functional categories used to aggregate outlays and budget authority across agency lines could continue to show how Federal policies serve national needs.

A primary focus of this option is to establish separate sections in the budget that are devoted to the display and discussion of capital investments. This kind of treatment of capital investments parallels that afforded to Federal credit programs for each function in the newly instituted credit budget. (See table 1.) Only those tangible physical assets traditionally identified as capital items--because of the long-term benefits they provide--would be included in these proposed sections of the unified budget. To the maximum degree possible, budgetary data on capital investments would distinguish the amounts associated with different financing mechanisms. Thus, displays would identify direct Federal programs, grants-in-aid, direct loans, loan guarantees, and tax expenditures. Best available estimates would be employed in those cases where actual budget authority and outlay figures could not be provided.

All of the proposed sections of the budget are designed to convey a better sense of the distribution and future implications of Federal capital investments than is currently possible. Projections 5 years beyond the current budget year, or even longer, would help to identify the direction and levels of Federal capital investments and could aid in planning the commitment of resources. Such planning might also include assessing the maintenance and

Table 1  
Credit Programs--General Government  
 (in millions of dollars)

	Actual 1982	Estimate			
		1983	1984	1985	1986
Direct loans:					
Loans to U.S. territories (loans made by FFB):					
Net outlays	-18	a/	a/	a/	-1
Outstandings	66	65	65	64	64
Federal buildings fund (loans made by FFB):					
New obligations <u>b/</u>	12				
Net outlays	8	-9	-10	-10	-11
Outstandings	522	513	504	493	48
Total, direct loans					
New obligations	12				
Net outlays	-11	-9	-10	-11	-12
Outstandings	588	579	569	588	546
Guaranteed loans					
Federal building fund:					
Net change	-35	-19	-20	-22	-21
Outstandings	674	655	635	613	592
Total credit budget (new obligations and new commitments)	12				

a/\$500 thousand or less

b/These are commitments made by the agency to guarantee loans that the FFB will disburse. In effect, they are commitments for off-budget direct loans, and are counted as such in the credit budget. Policy responsibility for these loans rests with the guaranteeing agency.

Source: Budget for fiscal year 1984.

Option 1 proposes a capital investment display similar to the credit budget. Modifications to the credit program example would be necessary to accommodate the various capital investment financing mechanisms or incentives: direct Federal outlays, grants-in-aid, loans, guaranteed loans, and tax expenditures.

operational costs associated with the acquisition of capital assets. The expectation that capital investments will provide a long-term stream of benefits presupposes the long-term commitment of resources for proper maintenance.

Resectioning the budget to enhance its treatment of capital investment would directly affect the presentation of the President's budget proposals found in the primary budget document. More specifically, the following would be altered: Part 3, Budget Programs and Trends; Part 5, Meeting National Needs: The Federal Program by Function; and Part 9, Summary Tables. In Part 3, the addition of a new section discussing Federal capital investment policy in an overall sense and the inclusion of summary tables projecting long-term investment and other trends would facilitate the planned use of scarce resources.

The new section in Part 3 could be aggregated and analyzed in many different ways, depending upon the perspective one wishes to take and which elements of the budget one wishes to emphasize. We suggest a table (see table 2) and discussion of four broad areas: defense and international, domestic programs, retirement and insurance, and interest. Such a presentation would display these broad "programs" by investment type and current activities and would provide a broad perspective for policy analysis. Actual and proposed budget authority and outlays for capital investments and current activities by function (see table 3) could appear in a new comprehensive table in Part 9.

More detailed new information on Federal capital investments could appropriately be placed in Part 5 of the budget. This part examines the range of Federal programs categorized by budget function. It is also the location of the tables that already display Federal credit activities, which, as we noted previously, serve as a precedent for handling capital investments suggested here.

In Part 5, the discussion of each functional area of Federal responsibility begins with a National Needs Statement. We propose adding a specific reference to capital investment needs to the statements concerning each of the functional areas, for which this is a relevant consideration. (See figure 1.) No such reference would be necessary, for example, in the case of Interest, functional code 900.

To present data on capital investments for each applicable budget function, separate displays could be used for two broad categories based on financing methods that have different characteristics. The first category would include direct Federal programs, grants-in-aid, and direct loans, all of which are included in the budget totals and result in expenditures whose magnitude, at least in principle, is subject to computation. (We recognize, of course, that there will be problems in estimating the proportions of grants-in-aid that are actually capital-related.) The second category would include loan guarantees and tax expenditures.

Loan guarantees for capital investment purposes represent a contingent liability for the Federal Government. Direct outlays from the Treasury result only in those instances when recipients of federally guaranteed loans default on repayment. Tax expenditures constitute the conscious relinquishment of tax revenues to encourage certain types of expenditures by private businesses and individuals. They are not included in the budget totals and are not subject to the controls of the appropriation process. Because the ultimate cost to the Federal Government of both loan guarantees and tax expenditures is sufficiently difficult to calculate with accuracy, capital investment data in the second category could only be based on best available estimates.

Table 2

Analysis of Defense and International, Domestic Programs, Retirement and Insurance Programs, and Interest by Investment-Type and Current Activities  
(billions of dollars)

	Budget Authority			Outlays		
	1981	1982	1983	1981	1982	1983
Defense and international						
Physical assets	\$ 53.9	\$ 73.9	\$ 98.7	\$ 39.7	\$ 46.9	\$ 62.2
R&D	18.6	22.3	26.6	17.0	20.6	24.7
Loans	14.6	6.4	6.1	5.1	4.8	5.5
Current activities	131.1	147.5	164.1	120.1	139.0	155.1
Offsetting receipts	-11.1	-12.8	-14.4	-11.0	-12.8	-14.4
	<u>207.1</u>	<u>237.3</u>	<u>281.1</u>	<u>170.8</u>	<u>198.5</u>	<u>233.1</u>
Domestic Programs						
Physical assets	31.9	29.5	26.9	37.0	34.2	28.9
R&D	17.3	16.2	16.4	17.0	17.3	16.7
Loans	3.7	4.6	3.1	1.4	2.0	1.6
Current activities	153.7	131.1	111.3	138.2	138.4	123.0
Offsetting receipts	-24.2	-31.7	-33.1	-24.2	-31.7	-33.1
	<u>186.0</u>	<u>149.7</u>	<u>124.6</u>	<u>169.4</u>	<u>160.2</u>	<u>137.1</u>
Retirement & Insurance						
Current activities	291.4	333.0	349.3	282.8	321.1	340.1
Offsetting receipts	-18.7	-21.6	-21.3	-18.7	-21.6	-21.3
	<u>272.7</u>	<u>311.4</u>	<u>328.0</u>	<u>264.1</u>	<u>299.5</u>	<u>319.4</u>
Interest (current)	96.6	117.4	134.8	96.6	117.4	134.8
Offsetting receipts	-13.0	-16.6	-20.4	-13.0	-16.6	-20.4
	<u>83.6</u>	<u>100.8</u>	<u>114.4</u>	<u>83.6</u>	<u>100.8</u>	<u>114.4</u>
Total	749.4	799.2	848.1	687.9	759.0	804.0
Undistributed off-setting receipts	-31.0	-33.7	-46.2	-30.7	-33.7	-46.4
Total	<u>\$718.4</u>	<u>\$765.5</u>	<u>\$801.9</u>	<u>\$657.2</u>	<u>\$725.3</u>	<u>\$757.6</u>

Table 3

Analysis of Investment and Current Activities  
by Function  
(billions of dollars)

	Budget Authority			Outlays		
	1981	1982	1983	1981	1982	1983
050 National Defense						
Investment	\$ 72.2	\$ 95.9	\$124.9	\$ 56.6	\$ 67.4	\$ 86.7
Current	110.8	123.8	139.2	103.8	120.9	135.5
Offsetting						
Receipts	- .7	- .9	-1.1	- .7	- .9	-1.1
Total	<u>182.3</u>	<u>218.9</u>	<u>263.0</u>	<u>159.7</u>	<u>187.4</u>	<u>221.1</u>
150 International Affairs						
Investment	14.9	6.7	6.5	5.2	4.9	5.7
Current	20.3	23.7	24.9	16.3	18.1	19.6
Offsetting						
Receipts	-10.4	-11.9	-13.3	-10.4	-11.9	-13.3
Total	<u>24.8</u>	<u>18.5</u>	<u>18.1</u>	<u>11.1</u>	<u>11.1</u>	<u>12.0</u>
250 General Science, Space, and Technology						
Investment	6.5	7.0	7.8	6.3	6.9	7.6
Current	.1	---	---	.1	.1	---
Offsetting						
Receipts	---	---	---	---	---	---
Total	<u>6.6</u>	<u>7.0</u>	<u>7.8</u>	<u>6.4</u>	<u>7.0</u>	<u>7.6</u>
270 Energy						
Investment	7.1	6.6	4.4	10.4	8.2	4.7
Current	1.5	1.6	1.6	1.6	1.5	.9
Offsetting						
Receipts	-1.9	-3.3	-1.6	-1.9	-3.3	-1.6
Total	<u>6.7</u>	<u>4.9</u>	<u>4.4</u>	<u>10.1</u>	<u>6.4</u>	<u>4.0</u>
300 Natural Resources and Environment						
Investment	8.4	8.4	8.2	10.7	10.8	9.7
Current	5.1	5.1	4.7	5.1	5.2	4.8
Offsetting						
Receipts	-2.4	-3.5	-4.6	-2.4	-3.5	-4.6
Total	<u>11.1</u>	<u>10.0</u>	<u>8.3</u>	<u>13.4</u>	<u>12.5</u>	<u>9.9</u>

Figure 1National Needs Statements  
Contained in Part 5 of the Budget

## TRANSPORTATION

National Needs Statement:

- Maintain a safe, reliable, and efficient transportation system to meet the needs of commerce and the public, with maximum reliance on the private sector and, secondarily, on State and local governments.

The Federal Role in Meeting the Need:

- Assist the States in developing and maintaining a highway system capable of providing for interstate commerce and the national defense.
- Provide capital assistance to repair and modernize existing mass transit systems, especially in large cities, while operating subsidies are phased out.
- Encourage the development of self-sufficient, cost-effective rail systems for freight and passengers.
- Provide safe and reliable management of the air space and of facilities within which the aviation system operates.
- Facilitate a safe, reliable, and efficient marine transportation system.

Source: The Budget for fiscal year 1983.

{ Option 1 would add a statement on capital investment similar to this for each functional category having significant capital investment activity. In the 1983 budget, such a statement appeared only in the Transportation function. In the 1984 budget, the format for national needs statements has been modified and shortened.

Although capital investments could be displayed separately in the budget, such information must be aggregated from data derived from individual appropriation accounts. These accounts are included in the Budget Appendix, but data displayed within them do not currently lend themselves to aggregate presentations a resectioned budget would require. OMB instructions (OMB Circular A-11, July 1982) for preparing budget estimates recommend how to deal with capital investment in the program and financing (P&F) schedules. Section 32.2 provides that direct Federal capital investment will be shown separately from current operating expenses in the "program by activities" section of the P&F schedules if the amounts are material. Otherwise, they will be included in operating expenses without identification. Amounts reported in P&F schedules will be consistent with the amounts reported for the corresponding classification categories for Special Analysis D. Where capital investments are shown separately, the side headings "Operating expenses" and "Capital investment" will be used.

Identification of Federal capital investments at the appropriation account level would be facilitated if detailed displays of information were more frequently and consistently presented. This is currently not the case. Some accounts clearly distinguish between operating and capital, and others make no distinction at all. Sections on "capital investment" either display an aggregated dollar amount for all capital activities or use highly specific descriptive categories. Many of those accounts that make no distinctions do, in fact, finance capital investment, as indicated in the object classification displays.

Another difficulty with the existing presentations of capital investment in the program and financing schedules is that there is no distinction between capital and operating costs funded through Federal grants-in-aid. (See table 4.) We have previously discussed displaying by budget function the aggregate capital investment that is funded through direct Federal programs, direct loans, and grants-in-aid. Consistent treatment of capital investment would also require displaying information on the percentages of grants used for capital investment purposes. Such information could be provided in displays for individual appropriation accounts as well as in summary tables. In the absence of hard data, estimates of the relative proportions of capital and operating costs funded by grants-in-aid would be useful. Also, it would be desirable to obtain more reliable information that distinguishes between the capital and operating components of grants for previous budget years in the column that presents actual as opposed to estimated outlays.

The separate display of capital investment in the unified budget should be carried out uniformly and consistently in all those sections of the budget documents to which the distinction between capital investments and operating expenditures applies, including the individual appropriation account information as well as the summary tables.



Table 4

Urban Mass Transportation Fund  
Program and Financing (in thousands of dollars)

<u>Identification Code 69-1119-0-1-401</u>	<u>1982 Actual</u>	<u>1983 Est.</u>	<u>1984 Est.</u>
<u>Program by Activities:</u>			
Direct Program:			
Urban Discretionary Grants	1,707,705	1,608,000	---
Urban Formula Grants	1,348,884	1,236,000	300,000
Nonurban Formula Grants	74,320	70,000	51,500
Formula (block) Grants	---	---	1,973,500
Interstate Transfer Grants	567,483	365,000	380,000
Washington Metro	---	240,000	230,000
Research and Training	63,470	59,520	51,700
Administrative Expenses	25,533	28,566	29,666
Social Research	278	500	300
Waterborne Demonstration	1,277	777	---
Commuter Rail Operating Subsidies	367	---	---
Total Direct Program	3,789,267	3,608,363	3,016,666
Reimbursable Program	58,394	123,268	3,000
10.00 Total Obligations	3,847,661	3,731,631	3,019,666
<u>Financing:</u>			
11.00 Offsetting Collections			
From: Federal Funds	-58,394	-123,268	-3,000
17.00 Recovery of Prior Year Obligations	-59,852	---	---
Unobligated Balance Available, Start of Year:			
21.40 Appropriation	-835,484	-663,410	-621,213
21.49 Contract Authority	-33,733	---	---
22.40 Unobligated Balance Transferred From Other Accounts	---	---	---
Unobligated Balance Available, End of Year:			
22.40 Appropriation	633,410	621,213	269,713
24.49 Contract Authority	---	---	---
25.00 Unobligated Balance Lapsing	8,630	---	---
Budget Authority	3,532,238	3,566,166	2,665,166

Nonurban Formula Grants--Provides transit operating and capital grants on the basis of a formula to areas with populations below 50,000. In 1984, funds for this program are provided within the new formula grant program.

Source: Appendix to the Budget for fiscal year 1984.

Option 1 advocates that capital and operating components of grants be distinguished. No such distinction is currently made in this sample.

OPTION 2: PREPARE A NEW INFRASTRUCTURE  
AND CAPITAL INVESTMENT ANALYSIS

A new "infrastructure and capital investment analysis" is one way of providing capital investment data within the current budget. In addition to its prospective role for presenting aggregate data on Federal capital investment, it could also be used to reveal some of the policy implications of current capital investment levels. To ensure that this approach has adequate visibility in the budget documents, it could include a descriptive analysis in Part 3 of the budget--Budget Program and Trends --and tabular budget data in a new special analysis.

The descriptive analysis in Part 3 of the budget could discuss Federal capital investment policy and policy changes, programs, trends, and major problem areas. Two new special analysis tables could be prepared, one covering investment in existing assets and the other covering investment in new additions to public facilities.

For existing assets, the first analysis (see table 5) could show the past year's outlays, current year estimates and budget year estimates at current policy levels, and budget year outlays under the administration's proposed policy.

Table 5

Special Analysis     

Current Level Capital Outlays for Existing Inventory  
by Function and Program  
(millions of dollars)

	<u>Current Level</u>			<u>1984</u>
	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>Proposal</u>
400 TRANSPORTATION				
401 Ground Transportation				
Highways	xx	xx	xx	xx
Mass Transit	xx	xx	xx	xx
Railroads	<u>xx</u>	<u>xx</u>	<u>xx</u>	<u>xx</u>
Subtotal	xxx	xxx	xxx	xxx
402 Air Transportation				
Airways and Airports	x	x	x	x
403 Water Transportation				
Marine Safety and Transportation	x	x	x	x
Ocean Shipping	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>
Subtotal	xx	xx	xx	xx
404 Other Transportation	x	x	x	x
TOTAL	xxx	xxx	xxx	xxx

The second analysis (see table 6) would cover additions to the existing stock of assets. It would show investment for the past year, the current year, and the budget year under current policy; budget year investment under the administration's proposed policy; and expected additions to the capital stock. Thus, this analysis and the one on existing public facilities would enable policymakers and decisionmakers to determine whether to expand the capital stock or to maintain the existing capital stock according to national needs and policy.

Table 6Special Analysis     

Current Level Outlays for New Capital  
by Function and Program  
 (millions of dollars)

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1984</u> <u>Prop.</u>	<u>Addition to</u> <u>Inventory</u>	
					<u>1984</u>	<u>1989</u>
<b>400 TRANSPORTATION</b>						
401 Ground Transportation	xx	xx	xx	xx	xx	xx
Highways	xx	xx	xx	xx	xx	xx
Mass Transit	x	x	x	x	x	x
Railroads	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>
Subtotal	xxx	xxx	xxx	xxx	xxx	xxx
402 Air Transportation						
Airways and Airports	x	x	x	x	x	x
403 Water Transportation						
Marine Safety and Transportation	x	x	x	x	x	x
Ocean Shipping	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>
Subtotal	xx	xx	xx	xx	xx	xx
404 Other Transportation	x	x	x	x	x	x
<b>TOTAL</b>	xxx	xxx	xxx	xxx	xxx	xxx

Both of the proposed analyses could be prepared using the budget functional format that is designed to relate Federal policies to the satisfaction of national needs. Major programs would follow the functional categorization. This would allow the decisionmakers to focus on areas of investment priorities and allocation of scarce budgetary resources. It would also be possible to distinguish between direct Federal investment where assets are owned and maintained by the Federal Government and those investments that are not owned and maintained by the Federal Government.

Preparing infrastructure and capital investment analysis tables would require the agencies to prepare and maintain an inventory and condition assessment against which projected spending authority and outlays could be judged. In this regard, certain complexities would have to be resolved; capital investment is not quite analogous to providing beneficiaries with a constant stream of services. Capital projects have discrete life cycles: There will always be new starts, ongoing efforts, completions, and disposals of existing assets. Also, Federal investment in capital assets involves both outlays for assets owned and maintained by the Federal Government and grants to State and local governments for assets owned and maintained by them.

Examining capital investment for physical assets already in the inventory and new assets to be acquired in relation to a level of existing activity provides no sense of how well national needs in this policy area are being served. Although existing qualitative and quantitative information on national investment requirements is imperfect, enough data could be made available to produce a descriptive analysis along with a gross characterization of the budget's effect. Preparing and presenting data on national capital needs would also provide an important incentive to improve and expand data bases that characterize the number, description, and condition of Federal capital assets.

Adequate capital investment inventories and condition assessment information would be available to assist Federal decisionmakers in addressing the difficult but unavoidable problems that scarcity and budgetary constraints impose upon them. Generally, the concepts, procedures, and the data for this alternative are not developed or readily available. Such items as the compatibility of data in data bases and how to treat grants versus direct Federal investments would have to be overcome to make this a viable alternative to a separate capital budget. Despite the wealth of information that would be available to assist decisionmakers in making informed decisions, it may take considerable effort, time, and money to fully carry out this option.

### OPTION 3: IMPROVE THE SPECIAL ANALYSES OF THE BUDGET

The collection of better data on Federal capital investments and their display in the Special Analyses, which constitute a companion volume to the President's budget proposals, is a third option. It is the easiest to carry out but has less potential impact than the other two. This option would entail revising Special Analysis D, "Investment, Operating, and Other Federal Outlays," to display information in a format that would be of greater use to decisionmakers. It would also require that an improved version of the Special Analysis on "Federal Public Works Activities" be reinstated. (It was deleted from the budget documents after 1974. See table 7.)

Table 7

Function, Agency, and Program	Budget Authority			Outlays		
	1972	1973	1974	1972	1973	1974
	Actual	Estimate	Estimate	Actual	Estimate	Estimate
<b>Civil Public Works</b>						
<b>Natural Resources and Environment</b>						
Department of Agriculture:						
Soil Conservation Service:						
Flood prevention and watershed protection:						
Direct work	0.3	0.4	0.4	0.3	0.4	0.5
Grants	103.1	116.8	65.9	80.0	102.1	82.4
Forest Service: Roads, research, recreational, and other facilities a/						
	202.4	94.7	79.2	157.7	209.1	152.1
Department of Defense--Civil:						
Corps of Engineers--Civil:						
Flood control, navigation, and multi-purpose projects with power						
	1,077.2	1,281.5	933.3	1,054.7	1,114.5	1,006.7
Trust funds	18.4	19.7	18.4	19.5	20.0	19.0
Grants	1.2			1.2		
Department of the Interior:						
Bureau of Land Management:						
Roads and other facilities:	21.1	12.1	8.8	15.9	15.1	17.9
Bureau of Outdoor Recreation:						
Grants for recreation facilities	147.2	105.0	28.9	42.7	72.9	92.4
Office of Coal Research: Demonstration plans						
	12.5	25.0	28.3	1.8	15.7	24.5
Bureau of Sport Fisheries and Wildlife: Facilities						
	7.2		6.9	5.0	8.2	5.8
National Park Service: Parkways, roads, buildings and utilities a/						
	127.0	44.8	23.5	51.0	59.7	69.9
Bureau of Reclamation:						
Irrigation and multiple-purpose projects with power a/						
	277.0	348.1	203.8	240.6	349.6	298.8
Small irrigation projects:						
Grants	b/	1.6	3.1	2.2		2.9
Loans	11.4	18.8	13.6	11.2	20.0	15.1
Power transmission facilities:						
Bonneville Power Administration						
	87.4	89.7	93.8	90.2	82.3	89.8
Southwestern Power Administration						
	0.9	0.7	0.5	2.6	1.7	0.6
Office of Saline Water: Facilities						
	0.3	0.3		0.4	0.4	

a/Includes amounts from trust funds.

b/Less than \$50,000.

Source: Special Analysis O, Budget for fiscal year 1974.

Option 3 would restore an improved version of this special analysis.

Special Analysis D could become an appropriate vehicle for disseminating information on Federal capital investments. It is part of the existing budget documents and is published in conjunction with the formal budget. It is prepared by the staff of the Office of Management and Budget, which has the built-in capability to analyze current Federal spending in the capital investment area as well as direct access to the data necessary to describe the dimensions of the Federal role. Unfortunately, Special Analysis D is currently an after-the-fact presentation based on the President's budget proposals that have already been made. It could be, along with a Federal Public Works Special Analysis, of value to the Congress and the public in assessing Federal investment activity.

In our previous report, "Federal Capital Budgeting: A Collection of Haphazard Practices" (PAD-81-19), we indicated some of the deficiencies of Special Analysis D. <sup>1/</sup> Although OMB has made some modifications to the analysis, addressing some of our concerns, the data displayed in this analysis do not constitute full disclosure of Federal capital investment activities.

As it is currently published, Special Analysis D distinguishes between current and investment-type outlays and further subdivides them between civil and national defense programs. The examination of investment-type outlays proceeds by using such categories as loans, construction and rehabilitation of physical assets, acquisition of major equipment, commodity inventories, conduct of research and development, conduct of education and training, etc. OMB made improvements beginning with the 1984 budget presentation to include new summary tables for major public physical capital investment to display the historical trends both in current and constant dollar amounts. They have also included an addendum to include the capital investment activities of off-budget agencies. Despite these improvements, the categories of capital investment in the summary tables do not consistently parallel the lines of responsibility for decisionmaking in the Congress (see also p. 26). Also, the concept of investment used in Special Analysis D goes well beyond the more limited notion of physical capital that we are discussing here.

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<sup>1/</sup>The limitations noted in our report included the (1) inaccurate portrayal of the magnitude of capital investment activity because outlays from one category are netted against the receipts from the same category, (2) failure to include the financial activities of off-budget agencies, (3) inadequate representation of total capital stock because capital outlays are displayed for only 3 fiscal years, (4) inconsistent definition of physical capital, and (5) misleading treatment of programs in which the recipients have discretion over the use of funds for capital or operating purposes.

One of the primary purposes of the President's budget is to describe our national objectives and the costs of their attainment. The budget itself, as distinguished from Special Analysis D, displays actual and projected expenditures using 17 broad functional categories. These budget functions provide a way for grouping together related programs without regard to the patterns of agency responsibility for their execution. They represent a viable choice for displaying information on capital in Special Analysis D in a way that would be consistent with the policymaking categories being used by the Congress. Knowing what the Federal Government spends on capital items for national defense, energy, transportation, natural resources and environment, community and regional development, and other functional areas gives us an important perspective on our current priorities and increases our knowledge about potential future costs.

Although using the budget function categories to display capital information would improve Special Analysis D, other limitations remain to be addressed. In particular, its utility for decisionmaking and oversight is constrained by two practices noted earlier: the net reporting of appropriation account receipts (offsetting collections) and the handling of disbursements whose use is at the discretion of the recipient (general revenue sharing and block grants). Both practices lead to the reporting of data that may incorrectly state the magnitude of Federal activity in the categories in which it is recorded. OMB Circular A-11, "Preparation and Submission of Budget Estimates," gives the following directions:

In the case of some grants-in-aid programs (such as community development block grants), the recipient jurisdiction has discretion between using funds for current or investment-type purposes. In such instances, all of the outlays for grants are to be recorded in the category where the majority of the funds are anticipated to be used. (July 1982, A-2)

Notwithstanding the difficulties in tracing the use of discretionary funds, OMB's reporting instructions to the executive agencies magnify the inaccuracies in agency data submissions. If over 50 percent of a grant were anticipated to be used for capital investment purposes, 100 percent of the grant would be included in a capital investment category within Special Analysis D. The error attributable to miscategorization in such an instance could constitute up to 49 percent of the total funding of the grant. Although the optimal remedy for this problem would be the institution of better estimating procedures to determine the patterns of Federal grant utilization, a temporary measure might be considered. Recording outlays for broad-based grants whose primary expected use is capital in nature as 75 percent capital, 25 percent operating, reduces the maximum possible error due to miscategorization to 25 percent.

The second part of this option relates to public works, which represents a major component of Federal capital investment activity. Public works covers a wide variety of projects that collectively contribute to the building of public infrastructure, those core structures and facilities upon which both the public and private sectors of our national economy are based.

A special analysis, "Federal Public Works Activities," last appeared as a part of the budget for fiscal year 1974. The discontinued analysis contained a very useful compendium of tables designed to describe the character and magnitude of the Federal public works role. In particular, table 0-9 was very useful for assessing the range of Federal activities because it presented data by major function and agency. We believe that this type of budget presentation is crucial to maintaining informed congressional decisionmaking on public works.

In our draft report we stated that even if Special Analysis D were revised appropriately, the importance of information on Federal public works activities calls for its separate treatment in a restored special analysis along the line of the analysis discontinued after 1974. According to OMB, the special analysis was discontinued because sufficient information was available in Special Analysis D and the increasing complexity of the budget process required elimination of marginal--but useful--analyses. However, at the time the public works special analysis was discontinued, Special Analysis D was in a different format and provided more information than it currently does.

Special Analysis D has been modified and now has summary tables of Federal outlays for major physical capital investment. OMB has also prepared and made available more detailed data in a series of tables not included in the budget documents. This series of tables includes direct Federal capital investment for defense and non-defense activities and grants to State and local governments since 1941. The defense and grants data are generally presented on a functional and major program basis, whereas the non-defense direct investment tables are based on the Special Analysis D categories of construction and rehabilitation and acquisition of major equipment. We believe that if OMB continued to make improvements to the data supplied by categorizing it all on a consistent functional and major program basis, including a greater level of detail from the old public works special analysis, and packaging it as a new public works analysis, significant improvements in information would be available to the executive branch for planning and budgeting and to the Congress for authorizing and funding capital investment programs.

#### WEIGHING THE OPTIONS

All three options are designed to remedy the inadequate presentation of capital information within the unified budget framework. None of them incurs the disadvantages that we have indicated to be associated with adopting a Federal dual budget



system. None of them requires the depreciation or the debt financing of capital assets, two attributes usually associated with a separate capital budget. Beyond these similarities, however, are important differences that should not be obscured.

The proposal to resection the unified budget to distinguish between capital investment and current Federal programs and obligations is an option that would affect the budget formulation process within the executive branch. Resectioning facilitates the careful consideration of spending aggregates for capital investment and current programs as the President's budget proposals are being prepared. These focal points would also serve to sharpen the congressional response to the Presidential budget initiatives by increasing the visibility of each type of outlay. Thus, the major advantage of this option is that it presents capital outlays in both aggregate and as components of individual programs for use in budget debates and in decisionmaking at all levels.

An infrastructure and capital investment analysis could require an inventory and condition assessment of the existing infrastructure. Based upon this information, both current levels of effort and the proposed levels could be compared. Such an analysis would greatly enhance the Federal decisionmakers' information upon which critical decisions must be made. However, the development of the data bases by the agencies to support such analyses would probably be time-consuming and expensive.

Modifying Special Analysis D and preparing a new Special Analysis on Federal Public Works Activities are stopgap measures. Although the information these special analyses could provide would strengthen the ability of the Congress to perceive overall dimensions of the Federal capital investment role, their timing and largely descriptive nature limit their potential usefulness for policymaking.

### EXISTING CAPITAL BUDGETING PRACTICES

Many organizations are bound by operational or legal constraints that dictate the use of capital budgets. Businesses, for example, must separate current expenses from capital outlays to determine net profit or loss. Most State and local governments distinguish between capital and operating expenses because they are required by law to present balanced operating budgets. Often, businesses and governments use capital budgets as plans for determining the need for and nature of capital assets, as well as their cost, timing of acquisition, and methods of financing. The Federal Government, however, treats capital asset outlays in the same manner as current operating expenses because it is not bound by any of the constraints that would require it to separate the capital and operating portions of the national budget.

### BUSINESS ACCOUNTING AND CAPITAL BUDGETING PRACTICES

Business accounting practices are designed to portray accurately the magnitude of the firm's current operations, the value of its assets, and the extent of its indebtedness. Creditors, stockholders, and government agencies require information concerning these three factors. Consequently, businesses typically report data on their revenues, expenses, profits, tax liabilities, assets owned, depreciation, and equity and bond issues. Many of these data and the structure of the budget and financial statements in which they appear are not relevant to many of the purposes and responsibilities of the Federal Government.

Unlike the Federal Government, business firms usually do not deduct total capital outlays from current revenues in computing a "bottom line." Rather, capital expenses are shown as a series of operating charges representing the annual depreciation of capital assets and the cost of borrowing. Businesses charge depreciation in order to allocate proportionately the investment costs of depreciable assets to each accounting period during which the asset was used in the production of goods and services and to recognize the decline of service potential. Annual depreciation for tax purposes is determined using the Internal Revenue Code. <sup>1/</sup> Depreciation for accounting purposes may be determined on a basis more consistent with the estimated life of the asset.

Many businesses draw up separate capital budgets that show large capital outlays scheduled to be made in future years, the proposed means to finance them, and their expected benefits. In this regard, the purpose of the capital budget is to help

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<sup>1/</sup>Sections 167 and 168 of the Internal Revenue Code guide this determination. However, accelerated tax depreciation schedules do not correspond to the actual service life of an asset based on physical wear and tear and/or technological obsolescence.

evaluate the need for and nature, cost, and timing of acquiring and financing long-lived assets. This is similar to the capital budgeting practices of State and local governments.

STATE AND LOCAL GOVERNMENTS' ACCOUNTING  
AND CAPITAL BUDGETING PRACTICES

State and local governments use capital budgets as plans for acquiring and financing capital items. Frequently, capital items are distinguished and separated from the operating budget because of a legal requirement to balance operating budgets. However, they are not identical to business models. Generally, strict business-type accounting methods are not used. Usually, except for self-supporting enterprise funds, State and local governments do not draw up business-type balance sheets of assets and liabilities, nor do they provide an estimate of asset depreciation. This makes it impossible to compute their net worth or determine whether their stock of assets is increasing or decreasing. Where depreciation is used, the productive life of an asset is often defined the same as in business accounting practices.

Capital budgets have become an essential part of the financial plans of State and local governments. Although the definition of capital varies substantially, many capital budgets summarize each capital item's need, cost, method of financing, and, in some cases, its anticipated contribution to the community. Used in this way, the capital budget is a good way of displaying proposed capital projects--such as schools, sewer and water systems, public parks, and the like--and focusing the public's attention on a very important segment of government operations.

Capital budgets have also become an effective means of carrying out the long-term projects of State and local governments. For the purpose of obtaining borrowed funds, capital budgets are indispensable because State and local governments

--often operate under legislative constraints that restrict borrowing and taxing ability (mandatory debt ceilings, requirements to balance the budget, limitations on tax rates and what can be taxed), and

--must meet solvency criteria set by investment bankers to gain access to financial markets. 1/

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1/Between 1972 and 1977, debt financing of State and local capital outlays declined from slightly over one-half to slightly over one-third of totals for this type of expenditure. There has been a corresponding, although not uniform, increase in reliance upon Federal grants-in-aid for capital financing, which in 1977 reached a 21 year high of 47 percent. Users fees, short-term debt, and accumulated reserves are also sources of

Separate budgeting for capital and operating expenses can and has caused coordination problems for State governments. One State developed its capital budget independent from its operating agencies. This resulted in the construction of facilities that were unplanned and even unwanted by the agencies that had to operate them. However, many States are recognizing this oversight and are improving their capital planning techniques. Operating and capital budgets are now often contained in the same document or handled as companion documents within a coordinated timetable. The recognized interdependence of capital assets and their operations has increased this type of coordination.

Many of the reasons that a capital budget is useful to State and local governments do not apply to the Federal Government. These include the fact that the Federal Government

- does not need a capital budget to preserve its credit rating and obtain access to the financial market;
- is not, in its ability to borrow, affected by asset acquisition, as in the case of municipal governments; and
- is not subject to the solvency criteria investment bankers enforce on local governments.

Instead, the Federal Government makes capital investment decisions within the boundaries set by aggregate debt limits, spending ceilings for each of the functional areas within the budget, and targeted levels of taxation. Collectively, these components of the budget process provide a major means of discipline for fiscal policy.

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capital investment funds. See U.S. Department of Commerce, A Study of Public Works Investment in the United States, April 1980, vol. I, ch. 4.

CAPITAL BUDGETING CONCEPTS AND  
THEIR IMPLICATIONS

How capital items are defined determines the percentage of total outlays that can be included in a capital budget. Varied definitions of capital assets can affect the respective sizes of capital and operating budgets and directly influence the size of the Federal deficit.

WHAT IS A CAPITAL EXPENDITURE?

Because there is lack of agreement on what should be classified as capital, organizations use various classifications. Different organizations using different definitions of capital items and capital budget totals showing large fluctuations from year to year complicates assessing the real costs of capital investment. Comparing yearly totals may be misleading because of irregular rates of new acquisitions or major rehabilitation of capital assets, and totals aggregated for more than one organization may be misleading because of the varying capital investment definitions used by different organizations. Under a dual budget system, it is often argued that the operating budget should be balanced, and thus the incentive is strong to define capital as broadly as possible.

Generally, businesses define capital expenditures according to accounting principles and tax regulations. However, there is still some variation among businesses as to what is counted as a capital item. As a matter of prudence, State and local governments restrict capital expenditures to tangible assets, but their definitions of this term also vary widely.

For the Federal sector, limiting the definition of capital to federally owned non-military tangible assets would be very restrictive. Less than 6 percent of Federal outlays (see p. 35) are in this category. Using this definition would give only a partial picture of the Federal Government's contribution to asset formation. The Federal Government plays various roles in stimulating capital investment. It directly builds and maintains infrastructure, such as bridges and roads, and helps State and local governments do the same through grants-in-aid. The Federal Government also helps individuals and businesses with capital investments by making direct loans and by guaranteeing loans obtained from private sources. Frequently discussed but probably the least direct stimulus to capital investment provided by the Federal Government is the use of tax incentives, such as tax credits and accelerated depreciation allowances.

Direct Federal programs, grants-in-aid, loans, loan guarantees, and tax expenditures have diverse effects when they contribute to the building of infrastructure and the stimulation of private sector capital formation. It is difficult to identify

the scope and intensity of the Federal role even in those areas where that role seems to be the most straightforward. Although direct Federal programs and grants-in-aid, for example, often produce highly visible public facilities--highways, mass transit systems, waste-water treatment plants, and the like--the benefits of these projects for the private sector of the economy are often unmeasurable. Not only do private corporations depend upon public facilities for the conduct of commerce and industry, but their own decisions to invest in new capital may be influenced--in some cases decisively--by Federal investments either projected or current.

Notwithstanding the virtues of adopting a broadly based definition of capital investment, it is important to note the potential pitfalls in doing so. Any departure from defining capital investments in terms of tangible assets clears the way for a wide range of expenditures, each possessing a legitimate claim to be classified as developmental or capital forming. The problem is: where does one stop? Exactly what should be called capital is a policy choice and depends on how the Congress chooses to use the budget. Keeping a capital budget free from manipulation requires a precise and consistently used definition of capital. <sup>1/</sup> It is worth noting, however, that unified budgets can be similarly abused through the use of off-budget items.

#### Alternative definitions

Assets are defined as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." <sup>2/</sup> But, classifying an item as an asset does not solve the problem of defining which items to capitalize. Tangible assets run the range from supplies to buildings,

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<sup>1/</sup>New York City is a prime example of how a capital budget can be manipulated. GAO has conducted several reviews (PAD-77-1, GGD-78-13, and GGD-80-5) of New York City's fiscal crisis. These, as well as a study entitled The Future of New York City's Capital Plant, prepared by the Urban Institute, showed that New York included in its capital budget many expenditures that, in strict municipal accounting terms, are generally operating costs. These included funds for manpower training and vocational education, code enforcement, repair programs, purchase of motor vehicles, and lease payments. By listing these expenditures as capital, the City removed them from a severely constrained operating budget and made them eligible for bond financing. In fiscal year 1975, which was the onset of New York's fiscal crisis, these expenditures exceeded 50 percent of the capital budget.

<sup>2/</sup>Financial Accounting Standards Board, "Statement of Financial Accounting Concepts No. 3," December 1980.

yet no one would dispute treating supplies as current and buildings as capital expenditures. What is not clear is how to treat the assets that fall between these extremes.

Deciding which assets to capitalize is largely a matter of judgment and depends on the asset's life, value, and frequency of procurement. To place an asset in the capital category, it must have a service life longer than the fiscal period, usually 1 year. Beyond this, the distinction between operating and capital items lies in the perceived role of an item in relation to other items being classified and, generally, whether the item is a recurring or non-recurring expenditure. What would be considered a capital item for a small municipality might be regarded as too insignificant to be similarly classified by a large city, a State, or the Federal Government. Furthermore, most of the time only non-recurring expenditures are considered capital.

Despite the inherent problems of classification, specific criteria for defining capital must be established before a capital budget can be used at the national level. For the Federal Government, criteria could take numerous forms, such as the nature of the asset, the asset's ownership, or the asset's relationship to accomplishing agency and program goals. Using these criteria, it is necessary to determine whether the definition of capital

- should be restricted to only tangible assets or broadened to include research and development expenditures and financial assets,
- should include only civilian assets or also military assets,
- should include only federally owned assets or also those assets totally or partially financed by the Federal Government but not federally owned, or
- should be restricted to those major items needed to accomplish an agency's primary mission as opposed to those items that provide administrative support.

Whether or not capital investments used for defense purposes should be included in a capital budget raises an issue meriting closer attention. Defense assets are often highly specialized in the purposes they serve, may be highly expendable for the same reason, and may also be subject to rapid and unpredictable technological obsolescence. It is commonly believed that defense assets are not productive in the same way as are the capital assets of the private sector or of Federal civilian agencies. These grounds could be used to justify excluding defense investments from a capital budget.

One way of arguing for including defense assets in a capital budget is to consider which of these assets are potentially

transferable for civilian Federal or private sector use. Only transferable defense assets would then be capitalized. The primary difficulty with this approach is the arbitrary assumption upon which it is based. Many capital assets, regardless of the sector of society that uses them, are highly specialized, vulnerable to premature deterioration and subject to technological obsolescence. When private sector or civilian Federal assets are considered in these terms, little justification would seem to exist for no longer regarding broad categories of "rapidly depreciable" assets as capital investments. Insofar as an asset has a projected useful life in excess of 1 year and is expected to deliver a stream of future benefits, a cogent argument can be made for treating it as capital. So viewed, defense assets can be regarded quite appropriately as capital investment, although there may be other reasons for their exclusion from a capital budget.

HOW CAPITAL EXPENDITURES ARE DEFINED CAN  
AFFECT THE FEDERAL OPERATING SURPLUS OR DEFICIT

A number of advocates and opponents often assume that if the Federal Government had a dual budgeting system current expenditures would be kept in balance with annual receipts, while capital expenditures would be handled through debt financing. This being the case, how capital is defined affects the size of the operating budget deficit or surplus. To illustrate this point, we have developed five different definitions of capital, applied them to the Federal budget, and determined to what extent the resulting operating expenditures would be covered by total receipts. These definitions of capital range from a very narrow definition that includes only federally owned civil tangible assets to a very broad one that includes civil and defense physical assets, research and development, and education and training outlays. (See table 8.) Although capital can be defined in many ways, we restricted ourselves to five.

If a separate capital budget were adopted and there were a requirement to balance the operating budget, priorities should be established regarding payment of outlays. Under a dual budgeting system, payment of operating outlays can take precedence over making capital expenditures. Under these circumstances, total annual receipts are first targeted to meet operating expenditures. A combination of the current budget surplus, if any exists, and long-term debt is then used to finance capital outlays. This practice makes the definition of capital very important in determining both the size of the operating budget and the degree of reliance upon debt financing.

Because no uniform criteria for defining capital are used, organizations can classify a wide range of items as capital. We developed the five budget models based on different definitions of capital to illustrate how the budget totals are dependent on a particular definition. Initially, we divided the unified budget into its operating and capital components, based on each model's



definition of capital. To do this, we extracted the actual outlay figures for fiscal year 1979 through 1982 from Special Analysis D based on the definitions of capital shown in table 8. For example, capital is defined in model number 1 as civil tangible physical assets.

Table 8

Cumulative Percentage of Capital Outlays  
Based on Different Definitions of Capital

<u>Model Number</u>	<u>Definition of Capital</u>	<u>Cumulative Percentage of Total Budget Outlays</u>			
		<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
1	Civil: Construction and rehabilitation and acquisition of physical assets	5.8	5.5	4.9	4.2
2	Plus: Defense construction and rehabilitation and acquisition of major equipment and other physical assets	11.8	11.2	10.9	10.9
3	Plus: Civil research and development	14.7	13.9	13.5	13.0
4	Plus: Defense research and development	17.2	16.4	16.1	15.7
5	Plus: Civil education and training	22.3	21.0	20.1	18.6

Capital outlays are calculated by combining the data displayed in Special Analysis D in the civil construction and rehabilitation of physical assets category with those in the acquisition of major equipment category. Each subsequent definition of capital we describe is cumulative. In other words, each definition includes not only the categories of items for that particular definition of capital but also the categories used in the previous definitions.

Once the capital outlay totals for all 4 fiscal years and each definition of capital were determined, we subtracted the capital outlay total for each fiscal year from the unified budget total of that year to determine operating outlays. Finally, we subtracted operating outlays from total receipts to determine the deficit or surplus. As is shown in table 9, the operating budget picture changes as the definition of capital changes. For example, the fiscal year 1982 operating outlays exceed total receipts

by \$79.8 billion for model 1 (civil construction and rehabilitation and acquisition of physical assets). If defense physical capital (model 2) is also subtracted from the operating budget the deficit is reduced to \$31.0 billion. If civil and defense research and development is subtracted, there is a \$3.6 billion surplus that can be applied to a portion of capital outlays. This surplus grows to \$25.2 billion when human capital (model 5, civil education and training) is subtracted from the operating budget.

Table 9

Effect of Removing Capital Items from the Federal Budget  
on the Deficit or Surplus for 1979-1982  
Five Definitions of Capital a/

<u>Fiscal</u> <u>Year</u>	<u>Actual Budget</u> <u>Deficit/Surplus</u>	<u>Model Number</u>				
		<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>
1979	-27.7	0.8	30.2	44.4	56.6	82.0
1980	-59.6	-28.0	4.9	20.5	35.1	61.3
1981	-57.9	-25.8	13.9	31.1	48.0	74.2
1982	-110.6	-79.8	-31.0	-16.2	3.6	25.2

a/We did not include loans and financial investments or commodity inventories programs in our definitions of capital type items.



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

8 1 AUG 1982

Mr. Morton A. Myers  
Director, Program Analysis Division  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Myers:

Thank you for the opportunity to comment on your draft report "Pros, Cons, and Alternatives to a Separate Capital Budget for the Federal Government" (GAO/PAD - 82-3). Our comments are enclosed.

Sincerely,

A handwritten signature in cursive script that reads "Carey P. Modlin".

Carey P. Modlin  
Assistant Director  
for Budget Review

Enclosure

Discussion of the draft GAO report entitled "Pros,  
Cons, and Alternatives to a Separate Capital Budget  
for the Federal Government" (GAO/PAD - 82-3)

1 This report considers the issue of a separate capital budget "only as a tool for carrying out a national investment policy" (p. 2). While it is understandable that GAO did not wish to consider all aspects of capital budgeting, this approach lends a bias toward the view that the budget should clearly segregate budget authority and outlays for Federal physical investments from all other forms of Federal spending, and that decisions on such investments be made largely independently of decisions relative to all other forms of Federal spending.

2 As the report points out, the budget, in Special Analysis D, provides information about Federal budget outlays of an investment nature. However, the structure of the budget is geared to facilitate the functioning of the decisionmaking and control process. Acceptance of a capital budget -- even for analytic purposes -- would require major changes in that structure.

We have two major concerns with the GAO recommendations.

- 3 1. Whatever the merits of a Federal "national capital investment strategy" or "an overall infrastructure policy," advocating such a policy does not necessarily justify the adoption of a capital budget.
- 4 2. We believe that the added reporting and added policy level review that the GAO report advocates for inclusion in the budget would gravely overstrain an already burdensome budget process. To be meaningful in the context of today's budget process, the capital budget concept would need to be carried forward in Concurrent Budget Resolutions, Reconciliation instructions and Acts, allocations under Sections 302(a) and 302(b) of the Congressional Budget Act, and each stage of appropriations action. To do less would be to make a capital budget a paper exercise. To do this much is, currently, almost beyond comprehension.

Both of these issues are discussed below.

5 Issue: Does the objective of a Federal "national capital investment strategy" or an "overall infrastructure policy" justify a capital budget?

A. National capital investment strategy

The mix of Federal policies -- tax incentives, spending, and regulation -- constitutes an implicit or explicit form of a "national capital investment policy." These policies exert substantial influences on many investment decisions in our

GAO RESPONSE TO OMB COMMENTS

1. As we stated in our draft report, for purposes of definition and developing advantages and disadvantages, we considered a separate capital budget as a tool for carrying out a national investment policy. We did not look, for example, at the use of a separate capital budget as a tool for balancing the Federal budget. Such a view might bias decisions into considering capital investments separate from the programs of which they are a part. OMB does not recognize that GAO advocates segregation of capital and operating outlays within the unified budget in addition to the program-by-program analysis currently performed.
2. We agree that acceptance of a capital budget would require major changes in the budget structure. That is one of the reasons we prefer options within the unified budget rather than using a separate capital budget.
3. Although we disagree with OMB over the merits of a national capital investment strategy and an overall infrastructure policy, we fully agree with them that advocating such a policy does not justify the adoption of a capital budget. That is what we concluded in the draft report and the reason we presented the three options.
4. We understand OMB's concerns over adding burdens to the budget process. The use of a separate capital budget would require distinctions between capital and operating budget authority and outlays in the budget process since they would actually constitute two separate and distinct budgets. Again, this is one of the reasons we prefer segregating capital within the unified budget so that it would allow consideration under the current process. Even this would require the Congress to make changes in its process, which we believe can be done.
5. We tried very hard to avoid giving the impression that we were proposing that the Nation's infrastructure should be "controlled by central budget planners." We are disappointed that OMB chose to interpret our alternative to a separate capital budget that way rather than to address the broader strategy and policymaking process matters of the options we presented. We agree that Federal tax incentives, spending, and regulation exert a substantial influence on investment decisions. We do not disagree with OMB that private and State and local investment decisions be left to those respective entities. However, we disagree with OMB that the Federal Government's developing strategies and policies for the efficient use of limited resources for capital investment constitutes a "control" over these private and State and local investment decisions. Establishing and using information and analyses for making informed decisions about the Nation's infrastructure is not "control," in our judgment.

economy. Under Administration policy it is believed that private investment decisions -- even if influenced or spurred on by budget or tax policy -- are best left to the free market. They should not be controlled by central budget planners. Similarly, State and local investment decisions should be increasingly the responsibility of State and local officials, not Federal budget planners. While the budget seeks to reflect the broad effects that arise in our economy due to non-Federal investments, there is no Federal "budgeting" of or control over these private and State and local investment decisions -- nor should there be. Any effort to establish a Federal planning document that would exercise such control would run counter to the policy of the current Administration and, indeed, to the policy of any administration in the Nation's history.

#### B. Overall infrastructure policy

6 Clearly decisions affecting the level and composition of Federal capital spending, including grants-in-aid, could be perceived as being a form of "public infrastructure policy." Under the existing system, however, they are not controlled in a manner compatible with the report's recommendations.

-- It is the policy of this Administration to reduce the Federal control over State and local budget and planning decisions. This policy is inconsistent with the establishment of a planning mechanism with increased Federal reporting requirements and controls. The Federal budget should not contain specific Federal targets for State and local government infrastructure.

7 -- Moreover, we do not believe that the nation would be well served by a Federal capital investment plan that is given favored status over other budget priorities. For example, clearly the Defense Department needs, uses, and provides to the Congress the results from an elaborate decisionmaking process designed to evaluate the requirements for physical capital investments, for research and development, for personnel recruiting and development, and for other operations. However, the decisions with regard to the appropriate mix of defense capital versus other spending are not closely related to decisions with regard to the appropriate mix of capital versus operating spending by NASA, the Veterans Administration, or the National Institutes of Health. The basic decisions on the size and composition of Federal capital investment are a resultant of agency/function program analyses rather than a product of a Federal investment strategy. It is for this reason that Special Analysis D reflects Executive branch decisionmaking rather than providing a mechanism for making those decisions.

6. We agree with OMB that decisions affecting the level and composition of Federal capital spending constitute a form of public infrastructure policy. This is currently, however, a fragmented approach related only to specific programs and lacking in overall direction and coordination. Our proposed options would exert no more "control" than currently exists.
7. Again we point out that having information on and planning for capital investment does not result in favoring capital over other spending. We do not disagree with OMB on the need to consider capital and other spending within the programs. However, limiting attention to the program level obscures the overall views of the collective national infrastructure and its effect on the Nation's economic viability.

Issue: Is the GAO demanding a level of detail incompatible with the exigencies of the budget process?

8 The executive branch budget process is largely developed and centralized through the functioning of OMB. OMB must consider each demand for new information in terms of other existing and potential requirements. The GAO report recommends that OMB gather and add to the budget data base a range of data that would be available by account and published by subfunction that contained:

- 9
- An inventory (reflected by some common denominator) of existing physical assets owned by the Federal Government, plus those owned by State and local Governments that were financed in whole or in part from Federal grants or loans and, perhaps, private investment encouraged or induced by Federal subsidies, loans, or tax expenditures.
  - Comprehensive measures of the physical condition of each of these sets of assets, identifying the condition of the assets at the start of the budget period (presumably the past year) and the anticipated condition of the assets at the end of the budget year.
  - A separation of Federal budget outlays destined for the repair, maintenance, and replacement of the existing stock of physical assets from Federal budget outlays for new physical assets (refined to separate assets owned by the Federal Government from those owned by State and local governments and from private assets financed in some way with Federal assistance).
  - Estimates of the additions to capital stock (by account, subfunction, etc.) that would occur over a 5-year period beyond the budget year.

These recommendations go far beyond the ability of the executive branch to respond to them.

10 Thus, Federal capital planning, independent of program decision-making, does not seem desirable, nor is there a reasonable expectation that the capability of developing and integrating into the budget process the level of detail desired is feasible. The attachment provides specific comments on the draft report to supplement these general comments.



8. We agree that OMB is the focal point of the executive branch for the budget process and budget formulation. We share OMB's concerns over information requirements and complexity of the process. The budget process must be as simple and as easily understood as possible and yet meet the demands of governmental policymaking and decisionmaking.
9. Again OMB's comments made no distinction between a separate capital budget and the three options for accomplishing the objectives of a capital budget within the unified budget that we presented. The specific OMB comments apply to the second of the three options we presented, "infrastructure and capital investment analysis." As we stated in our draft report, this option would take considerable effort, time, and money to fully implement. As a result, this is not our preferred alternative to meeting capital investment information and policy needs. We have, however, made some modifications to this option (see appendix III, p. 22) to clarify that detailed information on inventories and condition of capital assets are a part of the agencies' data bases and not a part of OMB's budget data base. The data would not all have to be included in the budget documents; other reporting means could be developed.
10. We fully agree with OMB that Federal capital planning, independent of program decisionmaking, is not desirable. The options we present call for a separate analysis of capital investments within the unified budget in order to ensure that capital decisionmaking is made in accordance with program objectives. Even managers using separate capital budgets must consider the program objectives when making capital investment decisions.

The options presented in this report are but examples of how the Federal Government could integrate capital investment planning and budgeting into the unified budget without the need for a separate capital budget. There is no set format for such a presentation and any number of presentations could be adapted for use.

## ATTACHMENT

## SPECIFIC COMMENTS ON THE DRAFT GAO REPORT

Page 4.

- 11 -- The existence of large scale Federal grants-in-aid to State and local governments does not mean that the Federal Government should have "an overall infrastructure policy nor a cross-cutting analysis of information to support such a policy" if that implies that Federal planning priorities replace those of State and local governments.

Page 5.

- 12 -- Under the present budget process whenever there is a clear-cut major Federal capital program (for example, for Defense, NASA, the Corps of Engineers, and highways) there already are linkages to focus on "long term projects, costs, and benefits." These are -- quite properly -- part of agency planning mechanisms, not a central capital plan for the entire Government.
- 13 -- While there are reliable studies of the size of Government physical asset holdings, it has not been practical to produce "reliable information on the condition and maintenance of Federal capital assets" that could be integrated into the budget in a manner advocated by the report.

Page 8.

- 14 -- The report asserts that "a separate capital budget would not, in itself, encourage a preference for capital items over the operating portion of the budget." It is difficult to conceive of a separate capital budget that would not lead to such a bias.

Page 9.

- 15 -- The proposed alternative to "display capital investments separately within the budget document" would further greatly complicate the budget. The text implies but does not make clear whether the GAO advocates adding another tier of controls to the congressional budget resolution process.

11. Having an overall infrastructure policy and a cross-cutting analysis of information to support that policy does not imply that Federal planning priorities replace those of State and local governments. Having such a policy and information would permit the Federal Government to determine what the national needs are, who will address those needs, and how they will be addressed. We would caution, however, that there may be instances where national priorities may not coincide with State and local priorities and some accommodation will need to be made, as is the case today. (See p. 4 and appendix II, p. 4)
12. We agree that considerable information is available from the agency planning mechanisms. If the agency planning information were brought together, it may constitute a governmental capital investment strategy. (See p. 4 and appendix II, p. 4)
13. We do not advocate the inclusion of detailed condition and maintenance costs in the President's budget. Such information should be developed and maintained by each agency and used to support its budget submissions. Government-wide data could be obtained by aggregating this agency data in separate documents. (See pp. 4 and 6)
14. A separate capital budget would not in itself produce bias of capital over current outlays. A capital budget is a neutral process simply identifying capital items. Biases either for or against capital investment would be the result of the political aspects of budgeting, not a system bias. It would create no more bias than making a distinction between defense and civil outlays. (See p. 6 and appendix II, p. 10)
15. The display of capital investments separately within the budget document would complement it rather than complicate it. The separate identification of capital investments would not alter the existing budget process. Functions and programs would continue to be the control features. Capital identification would simply represent the results of executive branch planning and be available to the Congress for making funding decisions within the current process. (See p. 6 and appendix III, p. 12)

- We suggest that adding a new tier to the credit control system (dividing Federal loans and guarantees between those for capital purposes versus those for operations or other purposes) would make an already complex system unworkable for the Congress.

Page 10.

- 16 -- The alternative under discussion calls for a separation of investment versus current spending in Parts 3 and 5 of the Budget and the report states "...most of the data to implement this objective are currently available and implementation costs should be minimal." Assuming that this refers to use of Special Analysis D data, it is true that the data are available for Part 5 and that the costs of producing that data for Part 5 might not be great. But this would require substantial changes in the structure of Part 5 and complicate its preparation. Part 3 changes so much from year to year that it is not safe to assume that adding an investment-current spending split would be easy.
- 17 -- The proposed "inventory and condition assessment" would be a large undertaking, beyond the resources available to OMB.

Page 11.

- 18 -- We disagree with the dismissal of the broad categories of data available in Special Analysis D ("Whatever merit these categories may have...") made on the grounds that it does not "parallel the Congress' lines of responsibility for decisionmaking...." The analysis is not intended to parallel congressional lines, but to supply an overview of Federal investment-type spending separately from other spending. Indeed, the concept is simplistic because congressional responsibilities are overlapping and constantly evolving.
- 19 -- We do not believe it would be useful to restructure Special Analysis D along functional lines:
- (a) The budget resolutions do not separate capital from other costs and -- given the complexity of the present system -- it would probably be imprudent to add another tier of complexity to that process. (For example, consider Section 302(b) allocations by subcommittee, function, mandatory/discretionary categories that are then further divided into capital/current categories.)
  - (b) The appropriation process is not on a functional basis and aggregating these data functionally would not assist that process.

16. Most of the budget data should be currently available in the agencies but would require reformatting when the budget was prepared. Some data currently available in Special Analysis D could be used but it suffers certain limitations, as we have previously stated. The changes we envision would require changes in Part 5 of the Budget, but not to the extent to which OMB refers. Our suggested changes to Part 3 are simply the addition of an overall table and brief discussion of capital as it affects the budget. Any year-to-year changes would not affect the overall presentation. (See p. 6 and appendix III, p. 12.)
17. We have revised the option to clarify that OMB would not be responsible for undertaking an inventory and condition assessment. The agencies could develop and maintain this data as part of their budget justification material. (See p. 7 and appendix III, p. 22.)
18. We agree with OMB that Special Analysis D is simply an overview to separate investment-type spending from other spending. It could be used as a capital investment planning and decisionmaking tool only by restructuring it along the lines of functions and programs. Currently it cannot be used for planning or decisionmaking because the categories for presentation do not relate to the present decisionmaking process. (See p. 7 and appendix III, p. 24.)
19. As we have stated, the option for improving Special Analysis D does not require changes to the budget process but simply shows different aggregations of data in the budget presentation. Restructuring the special analysis along functional lines would make it compatible with the rest of the budget presentation. Although the appropriation process does not strictly follow the functional structure, it is most closely related to it than the broad categories of Special Analysis D. Restructuring Special Analysis D along functional lines would lengthen the analysis but not necessarily make it complicated. It would make it more useful since it could then be related to both functions and programs, which cannot now be easily done. (Since providing these comments on our draft report, OMB has made some improvements to Special Analysis D. One such improvement is the addition of a summary table (D-3 in the 1984 budget) depicting Federal outlays for major public physical capital investment. Two categories in this table (defense outlays and grants to State and local governments) are presented on a functional basis.) (See p. 8 and appendix III, p. 24.)

(c) Sorting the Special Analysis D categories by function would make the analysis far more complicated and less useful to most users.

-- The statement that "all of the data and coding" for the old special analysis on public works "are currently available and implementation costs should be negligible" is not correct.

20 -- The special analysis on public works was discontinued:

(a) because there was sufficient information in Special Analysis D to satisfy most of the needs satisfied by the public works analysis; and

(b) the increasing tempo and increasing complexity of the budget process requires elimination of marginal -- though useful -- analyses. No significant demand for this analysis was expressed after it was discontinued.

Page I-2.

21 -- The report states "...we focused part of our analysis on the question, would it be easier to allocate Federal resources under a separate capital budget or the current unified budget?" We note that this presupposed that there should be a central budget allocation of spending for capital purposes disconnected from program analysis.

Page II-1.

22 -- We note that the existence of grants-in-aid and, especially, of tax expenditures does not convert State and local governments and private businesses into "surrogates" of the Federal Government.

-- The sentence "if a separate Federal capital budget were adopted, it would provide a means for allocating capital investment dollars in a manner consistent with Federal policy and program objectives even though ownership of capital assets is vested in non-Federal sectors" involves two key issues. (1) It assumes that budget totals should be allocated on a capital/current split rather than built up by a program-by-program determination of policy choices trading off capital versus current spending within each program, as is the current approach. (2) It is unclear to us how the GAO perceives the allocation of "tax expenditures" is to occur in this process. Does this mean that the GAO perceives "tax expenditures" to be allocated (and controlled) through the appropriations or budget resolution process?

20. We have revised our statement on the public works special analysis to indicate that OMB has recently made changes to Special Analysis D. At the time the public works special analysis was discontinued, Special Analysis D was in a different format and provided a higher level of information than it currently does. Although at the time that analysis was discontinued there was not the demand for capital investment information that there now is, there is an increasing desire in the Congress, as indicated by legislation introduced, to identify and provide in the budget process information on our Nation's capital investment outlays. (Subsequent to providing these comments, OMB has acknowledged some of the shortcomings of Special Analysis D and provided additional information on public works outlays in the 1984 budget presentation.) (See p. 8 and appendix III, p. 26.)
21. We did focus our analysis on that question. However, in reaching the conclusion that planning and budgeting for capital should be done within the unified budget, we stated that a separate capital budget would dissect programs and segregate their parts on the basis of resource requirements. We have never advocated capital spending completely disconnected from the programs of which they are a part. (See appendix I, p. 1.)
22. We have revised the report to eliminate the word "surrogates." OMB continues to assert that GAO advocates a capital/current allocation in lieu of a program-by-program analysis. This is not the case. GAO advocates a capital/current analysis both at the macro level and within the program. Such analyses would complement, not replace, the program analysis. GAO does not advocate allocation of tax expenditures through the appropriations or budget resolution process as OMB implies. Tax expenditures are not outlays in the same sense as grants, loans, and direct Federal acquisition. (See appendix II, p. 4.)

Page II-4.

- 23 -- Any effort to develop and maintain a government-wide data base on "the condition and maintenance schedules of Federal capital assets" (especially since the report defines State and local and private facilities as "Federal capital assets") would be an extremely expensive and long term project and, under present circumstances, we see no practical way of integrating such a data base into the budget.

Page II-5.

- 24 -- The draft report asserts that borrowing to finance physical investment "merely exchanges the extended repayment of loaned monetary assets for prospective services of tangible capital assets." This is imprecise. There are fundamental economic differences between building capital facilities on a pay-as-you-go basis and borrowing to finance such facilities.

Page II-10.

- 25 -- The draft report states that "depreciation does reflect the actual yearly costs associated with using physical capital." This is correct only if the depreciation schedules are realistic. The report assumes it possible to develop data on "correctly measured depreciation" on Federal physical investment (including for national defense), but does so without demonstrating the feasibility or estimating the cost of developing such data.

Page III-1.

- 26 -- The report urges that Federal capital investment be displayed in the budget in a manner similar to the credit-control display. The reason for detailed functional credit data in the budget is to provide a mechanism for credit control under the budget resolution process. The report fails to clearly indicate the ways in which the added capital expenditures data would relate to the congressional budget control process.
- 27 -- The report calls for "best available estimates" where more precise data are lacking, but if the objective is to alter the legislative process and controls, the budget would be required to develop accounting support for the data base.



23. GAO does not advocate the integration of condition assessments and maintenance costs into the budget data base. Such information would be developed and maintained by individual agencies in support of their budget requests. Government-wide data could be obtained by aggregating this agency data. The OMB comment refers to statements in a discussion of one of the advantages of a separate capital budget, that being the focusing of attention on Federal assets and their condition. In that discussion we said that reliable information on the condition and maintenance of Federal assets is not currently available governmentwide. A separate capital budget would provide a stimulus for acquiring such information. In addition to this, we said that it would illuminate the Federal responsibility being assumed for maintaining assets owned by State and local governments. We did not define State and local facilities as Federal capital assets. We have clarified the report to show that we mean maintenance costs rather than schedules of maintenance. (See appendix II, p. 6.)
24. We agree with OMB that there are economic differences between pay-as-you-go and borrowing to finance capital facilities. We used the statement to illustrate the difference between borrowing for current outlay (consumption) and borrowing for capital outlay (investment). (See appendix II, p. 6.)
25. We have deleted the discussion of depreciation that was contained on that page of the draft report. The subject of depreciation of Federal capital assets will be discussed in a separate GAO study.
26. The use of the credit budget display was simply an illustration of how capital information might be displayed in the budget, irrespective of the purposes for which each serves. Such a presentation would aid the Congress in determining funding levels. (See appendix III, p. 12.)
27. We referred to best available estimates in those cases where funds can be used for either operating or capital purposes by the grantee, such as grants for community development block grants. The current procedure for classifying these as all capital could distort data for decisionmaking. If the Congress did choose to modify its budget control process to deal with capital investments separately, then precise numbers would be needed, including accounting support. (See appendix III, p. 12.)

- 28 -- While the budget routinely provides five year budget projections, these are subject to wide margins of error. It is not clear to us how a careful dissection of these projections as between current and capital costs would significantly help to "convey a better sense of the distribution and future implications of Federal capital investments" or yield evidence as to a "long-term commitment of resources for proper maintenance."

Page III-10.

- 29 -- The GAO argument that the program and financing schedules in the budget appendix should clearly distinguish between grants for capital spending and grants for other purposes is correct given the assumption of a Federal capital budget. However, in the absence of such an assumption the argument is much more debatable.

Pages III-12 to 16.

- 30 -- This section is devoted to detailing how the GAO would have OMB prepare a new "Infrastructure and capital investment analysis" and publish it in the budget. The effort to provide the "wealth of information that would be available to assist decisionmakers make informed decisions" (p. III-16) would, in our view, overwhelm the budget process.

Page III-17.

- 31 -- It is incorrect to state that the (discontinued) special analysis on public works is part "of the existing budget documents and prepared in conjunction with the budget." It is also incorrect to assume that the special analysis could be easily reestablished.

Page III-20.

- 32 -- We have already pointed out that the GAO call for Special Analysis D to be on a functional basis is logical only if there were a budget control mechanism by Special Analysis D category by function. Such a mechanism does not exist.

28. As with any projection, 5-year projections are subject to error. These projections would simply show, based on current policy, whether the administration proposes to decrease, maintain, or increase levels of outlays for capital investment. (See appendix III, pp. 12 and 14.)
29. At the program and appropriation account level it should be possible to clearly distinguish between capital and operating funds irrespective of whether there is a capital budget. Full disclosure of such a split is necessary for informed planning and decisionmaking. This includes grant programs when decisions are being made on whether to give grants for capital acquisitions or operating expenses. As we stated, OMB instructions for preparing budget estimates does provide for distinguishing between capital and operating costs but they allow for great variances in the presentations. (See appendix III, p. 18.)
30. As we stated under OMB's general comments, we have revised this presentation to clarify the proposal. OMB's quote of part of a sentence in the last part of this comment does not accurately represent GAO's position on this alternative. The full sentence as it appeared in the draft report reviewed by OMB is: "Despite the wealth of information that would be available to assist decisionmakers make informed decisions, it would, unfortunately, take considerable effort, time, and money to fully implement this alternative." (See appendix III, p. 22.)
31. The discussion of the special analyses has been revised to distinguish between the status of the two analyses. (See appendix III, p. 24.)
32. If Special Analysis D were to be used as a decisionmaking tool in the budget, it would have to be reformatted along functions, agencies, and programs in order to fit the decisionmaking process. (See appendix III, p. 25.)

Page III-21.

- 33 -- We continue to disagree with the GAO on how to reflect in Special Analysis D programs (such as community development block grants or general revenue sharing) where the recipient jurisdiction is free to use the grant for capital or for other purposes. The essence of such flexibility is to permit the recipient jurisdiction to set its own priorities; the essence of the GAO approach is to develop control mechanisms for setting Federal priorities over the use of the money.

Page VI-3.

- 34 -- We agree that it is important to define capital or investment quite narrowly if one is developing a capital budget whose financing is related to depreciation or to debt repayment schedules. But since the basic purpose of Special Analysis D is to provide a broad perspective on Federal investment, the inclusion of human investment (but in separate categories from physical investment) provides a useful extension of the analysis.

Page V-12.

- 35 -- We would qualify the first sentence in the bottom paragraph on this page. Where it says, "while it is desirable to depreciate capital assets..." we would add the words "if one is using a capital budget." Despite the report's assertion that it is perfectly feasible to develop good depreciation data for all Federal capital investment. (including both defense investment and grants-in-aid for capital projects) we are not convinced that this is even feasible. Additionally, the report provides no indication of the expense of such an undertaking.

33. We do not disagree with OMB on the matter of flexibility or the setting of priorities by the recipients. Our concern is the proper reporting of how the funds are to be spent. Current OMB procedures can result in significant error of several billion dollars in the reporting of capital and operating outlays. We do not advocate control over the priorities of the recipients' use of funds. (See appendix III, p. 25.)
34. Our discussion is not specifically related to Special Analysis D in our definition of capital investment. Although we agree that human investment represents "investment," it is not the same tangible physical investment as capital infrastructure. Therefore, the two should not be considered the same. (See appendix V, p. 32.)
35. We have deleted the discussion of depreciation that was contained in those pages of the draft report. Depreciation of Federal capital assets will be discussed in a separate GAO study.





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