United States General Accounting Office

GAO

Report to the Chairman, Committee on the Budget, U.S. Senate

September 1990

BUDGET ISSUES

Capping of Outlays Is Ineffective for Controlling Expenditures

142427

GAO/AFMD-90-111

GAO

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

Accounting and Financial
Management Division

B-238199

September 28, 1990

The Honorable Jim Sasser
Chairman, Committee on the Budget
United States Senate

Dear Mr. Chairman:

This report responds to your September 22, 1989, request for information on capping outlays in the public sector, the administrative and operational mechanisms needed to control such outlay caps, their long-term savings benefits, and their effect on business relationships and the balance of power between the legislative and executive branches of the government on spending matters. Because the term "outlay cap" is not used universally, we have defined it for purposes of this report as a limit imposed by the Congress, the Office of Management and Budget (OMB), or an agency head on the funds an agency and/or a program can expend from appropriated funds in order to control expenditures. This definition excludes the deficit reduction features in the Balanced Budget and Emergency Deficit Control Act of 1985. In this report, we have limited our discussion, with one exception, to caps that are legislatively imposed.

Results in Brief

Outlay caps have had very limited use in public sector budgeting. We identified only three legislatively imposed outlay caps on federal programs between 1970 and 1990. In each case, a cap was enacted for a single appropriation account. Furthermore, states use techniques other than outlay caps to control expenditures.

Agencies achieved no long-term savings from the three identified outlay caps because their outlays were simply delayed from the fiscal year with the cap to the following year. In addition, the three caps did not affect the balance of power between the legislative and executive branches of government on spending matters. Also, we identified no adverse effects on relationships between the agencies involved and the private sector because the agencies did not have to cancel any contracts or delay orders under existing contracts. In contrast, the Department of Defense's (DOD) administratively imposed expenditure control measures on selected programs in fiscal year 1988 reportedly had an adverse effect on DOD's business relationship with some small contractors because it did lead to cancellations and delayed orders.

Outlay caps could lead to long-term savings only if they permanently reduced agency budget authority. Also, a cap could, under certain conditions, result in additional costs. Outlay caps might adversely affect business relations if they caused agencies to cancel contracts, delay orders, or write contracts that permitted delayed payments. In addition, if legislation exempts an agency from provisions of the Congressional Budget and Impoundment Control Act and the Prompt Payment Act, it could dramatically shift the balance of power over spending priorities from the Congress to the executive branch. A DOD appropriation bill containing this kind of outlay cap was introduced in the 101st Congress, but the cap was not enacted.

Based on our review, we believe outlay caps are a costly and ineffective way to control federal spending and reduce the deficit. Outlay caps are likely to result in administrative inefficiencies and no long-term savings.

Background

The Congress normally exercises budget control over agencies by controlling the levels and purposes of budget authority made available to the agencies' budget accounts. Budget authority is the authority provided in law to enter into obligations which will result in immediate or future outlays of governmental funds.[1] When legislation provides a certain level of budget authority to an account, it may also specify the fiscal period over which the budget authority is available for obligation—usually 1 fiscal year.[2] Any authority not obligated in that period expires.

In such legislation, the Congress normally does not restrict the outlays that an account or agency can make in a given fiscal period. As a result, agency officials have some flexibility in timing their obligations and resultant outlays. Some congressional committees and agency officials have felt that this flexibility is needed to manage the timing of agency commitments, contracts, and disbursements to maximize program efficiency and effectiveness.

[1] Obligations are the amounts of orders placed, contracts awarded, services received, and similar transactions carried out during a given period that will require payments during the same or a future period. Outlays are payments, such as checks issued or cash disbursed, made to liquidate obligations.

[2] Budget authority may be available for obligation only during a specified fiscal year (annual), a specified period of time in excess of 1 fiscal year (multiple-year), or an indefinite period of time, usually until the objectives for which the authority was made available are attained (no-year).

In the late 1980s, however, some legislation and bills deviated from this pattern. Five times, congressional committees introduced legislation containing language to place outlay caps on either individual appropriation accounts or entire agency appropriations. Senate Budget Committee staff informed us that this approach was a likely response to the deficit reduction pressures of the 1985 Gramm-Rudman-Hollings legislation, which was amended in 1987. Rather than adjusting the levels of the new appropriations to meet outlay allocations established through the congressional budget resolution process, various congressional committees sought to establish outlay caps for certain accounts.

The Congress enacted three of the bills with the proposed outlay cap language included. The Supplemental Appropriations Act, 1987 (Public Law 100-71 (101 Stat. 391, 405)), imposed an outlay cap on the Economic Support Fund for fiscal year 1987; the Department of the Interior and Related Agencies Appropriations Act, 1988 (Public Law 100-202 (101 Stat. 1329-214, 243)), placed a cap on the Strategic Petroleum Reserve Petroleum Account for fiscal year 1988; and the Department of Transportation and Related Agencies Appropriations Act, 1990 (Public Law 101-164 (103 Stat. 1069, 1108)), imposed a cap on outlays resulting from the use of fiscal year 1990 Petroleum Account funds.

The fiscal year 1990 Departments of Veterans Affairs and Housing and Urban Development appropriations bill (H.R. 2916) proposed another outlay cap for certain National Aeronautics and Space Administration (NASA) programs before October 1, 1990. Like the three outlay caps that were enacted, this proposed cap applied to specific programs rather than the entire agency.

A fifth outlay cap was proposed in the fiscal year 1990 appropriations bill (H.R. 3072) for the Department of Defense. Unlike the other four bills that contained outlay caps, the DOD bill would have capped outlays for the entire agency, not just specific programs. The bill proposed giving the Secretary of Defense authority to select, subject to certain limitations, which DOD programs to cap. It also exempted the agency from some provisions of the Congressional Budget and Impoundment Control Act and the Prompt Payment Act. Both the NASA and DOD appropriation bills were enacted without the capping language.

Objectives, Scope, and Methodology

The objectives of our review were to respond to your request of September 22, 1989, that we (1) identify and describe public sector (federal and state) experience with outlay caps, (2) discuss the administrative and operational mechanisms needed for outlay caps, (3) determine whether outlay caps can result in long-term savings or whether they merely shift expenditures from one year to the next, (4) ascertain the effect of outlay caps on business relationships, (5) discuss the potential legal and administrative considerations arising from executive branch implementation of outlay caps, especially their potential for changing the executive and legislative branches' balance of power, and (6) discuss the events surrounding fiscal year 1988 DOD expenditure control measures.

To identify and describe outlay caps in the federal government from fiscal years 1970 through 1990, we conducted legal, literature, and automated data base searches. We also interviewed Senate Budget Committee, Congressional Budget Office, Congressional Research Service, and Office of Management and Budget officials to identify any outlay caps imposed during this period. We interviewed budget or program officials at 15 major federal agencies[3] to determine whether the agencies or their programs had experienced legislative outlay caps during the years covered by our review. We also reviewed the expenditure controls that the Deputy Secretary of Defense imposed on DOD operations during fiscal year 1988.

To obtain information on state experiences with outlay caps, we interviewed officials of the National Association of State Budget Officers. We also reviewed our prior reports and other documents containing information on this subject.

To determine the administrative and operational mechanisms required for outlay caps, we reviewed the legislative language of the three enacted outlay caps as well as the provisions of the two bills containing outlay caps which were not adopted. We interviewed officials at the Department of Energy and the Agency for International Development (AID) to determine how they had administered the three outlay caps and their views of what additional measures and costs might be incurred if such caps were used more extensively.

To identify potential long-term savings resulting from outlay caps, we examined documentation regarding the timing of Energy and AID program outlays on which caps had been imposed and determined whether

[3]We selected the largest federal departments and agencies for our work. They were the Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Housing and Urban Development, Interior, Justice, Labor, State, Transportation, Treasury, and Veterans Affairs and the National Aeronautics and Space Administration.

any savings had been realized. We confirmed this information by interviewing agency officials.

To determine the effect of outlay caps on business relations with the private sector, we reviewed federal legislation and regulations that deal with (1) compensating vendors for contracts cancelled by the federal government, (2) placing orders, and (3) delaying payments. We interviewed Energy and AID officials to determine whether any transactions had been cancelled or delayed because of the caps.

Finally, we analyzed the five capping bills to determine if they would have shifted some budgetary prerogatives from the legislative to the executive branch.

We discussed this report with OMB, Energy, and AID officials and have included their views where appropriate. Our work was conducted in Washington, D.C., at the headquarters of the federal agencies mentioned above from November 1989 through June 1990.

Public Sector Experience With Outlay Caps Is Limited

We determined that the Congress has established caps in a limited number of cases; as a result, the federal government has little applicable experience in using outlay caps to control outlays. States generally rely on a variety of other practices to control outlays.

Few Federal Outlay Caps Imposed

During fiscal years 1970 through 1990, the Congress enacted three outlay caps on two federal programs—the Economic Support Fund for fiscal year 1987 and the Strategic Petroleum Reserve Petroleum Account for fiscal years 1988 and 1990. The agencies involved complied with the outlay caps for fiscal years 1987 and 1988 and planned to administer the fiscal year 1990 cap. The details of these three outlay caps are described below.

Economic Support Fund

The Economic Support Fund account is administered by AID. The account is the funding source for direct loans, grants, and contributions to selected countries that support U.S. efforts and interests in strategic regions of the world. The Congress generally provides annual appropriations for this account and limits the time available for obligating the funds to 2 years.

In fiscal year 1987, the Supplemental Appropriations Act, 1987 (Public Law 100-71 (101 Stat. 391, 405)), transferred $300 million from various DOD appropriation accounts to the Economic Support Fund for economic assistance projects in Guatemala, Costa Rica, Honduras, El Salvador, and Belize. The legislation contained two stipulations related to the cap: (1) the $300 million would remain available for obligation until September 30, 1987, and (2) no more than $87 million of that total could be outlayed prior to October 1, 1987.

This legislation to transfer funds and concurrently create the outlay cap became effective on July 11, 1987, about 2-1/2 months before the end of the fiscal year to which the cap applied. A review of agency budget documents showed that the agency obligated the entire $300 million before the fiscal year ended and began outlaying it the following year.

Strategic Petroleum Reserve Petroleum Account

The Strategic Petroleum Reserve Petroleum Account is administered by the Department of Energy. This account is used to finance the acquisition, transportation, and storage of petroleum in the Strategic Petroleum Reserve, as well as its drawdown and distribution. For fiscal year 1988, the Department of the Interior and Related Agencies Appropriations Act, 1988 (Public Law 100-202 (101 Stat. 1329-214, 243)), provided the account $439 million in current budget authority for these purposes. However, the act limited outlays from these funds to no more than $256 million for the fiscal year. Energy officials obligated the fiscal year 1988 appropriations as they became available. To comply with the cap, the agency restricted 1988 outlays for these obligations to the level mandated in the legislation.

The fiscal year 1990 Department of Transportation and Related Agencies Appropriations Act (Public Law 101-164 (103 Stat. 1069, 1108)), also established an outlay cap for this account. It imposed a cap on the Petroleum Account's original fiscal year 1990 appropriations—which were contained in the Department of the Interior and Related Agencies Appropriations Act (Public Law 101-121 (103 Stat. 701, 731))—by limiting fiscal year 1990 outlays from that year's appropriations to no more than $147 million. The agency planned to implement the fiscal year 1990 outlay cap as it did the fiscal year 1988 outlay cap—by ensuring that outlays resulting from fiscal year 1990 budget authority do not exceed the legislated limits.

States Use Other Methods to Control Outlays

States do not use outlay caps to limit expenditures. Rather, many states have balanced budget requirements which they implement by providing the governor or legislature with the authority and techniques to control spending.

We have previously reported[4] and confirmed in recent contacts with the National Association of State Budget Officers that states have differing balanced budget requirements. Of the 49 states with such requirements, some require the governor to submit a balanced budget, some require the legislature to enact a balanced budget, and others require the year to end in balance. Most of the requirements apply to the operating component of state budgets, not the capital investment segment.

Furthermore, states have access to a variety of techniques to achieve balanced positions which are not available to the President of the United States. Some state governors have authority to unilaterally impound previously appropriated funds, while others have line-item veto authority to eliminate or modify programs or activities adopted by the legislature. Also, some governors may reduce program expenditures if there is a statewide revenue shortfall. For example, the Michigan constitution requires the governor, with the consent of the legislature, to reduce expenditures whenever state revenues are lower than estimated.

Other states have contingency plans to reduce spending. In Minnesota, for example, a balanced budget requirement is enforced through a series of "trigger" actions the governor is statutorily required to take. The governor is first required to use the Budget and Cash Flow Reserve Account ("rainy day fund"). If this is not sufficient, the governor must take a number of actions to raise funds and curtail spending. If the above measures are still insufficient, the governor and legislature can and have raised taxes to make up for the potential deficit, even though this is not one of the trigger actions specified in the statute.

[4]Budget Issues: State Balanced Budget Practices (GAO/AFMD-86-22BR, December 10, 1985) and Budget Issues: Overview of State and Federal Debt (GAO/AFMD-88-11BR, January 27, 1988).

Agencies Had No Problems Implementing Outlay Caps

The federal agencies administering the three outlay caps in our study did not encounter major technical or administrative problems in implementing the caps. Since each outlay cap involved only an individual appropriations account, it did not require any measurable changes in financial management systems or accounting practices. The agencies controlled the outlays by delaying the payments made on obligations to the next fiscal year.

However, this experience cannot be generalized to a more comprehensive application of outlay caps. If an outlay cap had been applied to an entire bureau or agency, more extensive changes would have been required to ensure adherence to spending guidelines for multiple appropriation accounts and programs. Currently, the agencies' systems and practices are not adapted to control outlays for such accounts and programs.

Regardless of the number of accounts or programs covered by an outlay cap, its basic purpose is to lower expenditures. Accordingly, an initial step in managing outlay caps involves using outlay forecasting methods to predict "spendout rates." In general, this entails analyzing agency historical data to determine (1) the percentage of obligations made during a fiscal year that result in outlays during that period or (2) the average time interval between entering into obligations and making related payments (outlays) to satisfy contractual or program requirements. Once this is known, agencies can estimate how much they can obligate and still comply with the outlay cap. However, the outlay rates for some programs, such as disaster and emergency assistance, are naturally volatile, which makes estimating rates difficult.

Using these spendout rates, agencies can establish maximum obligation limits that are intended to keep outlay levels below the ceiling for the fiscal year covered by the outlay cap. In addition, agencies subject to outlay caps need to have effective techniques for monitoring total outlays and current outlay rates to determine whether they need to slow the obligation rate or potentially deobligate some amounts, if possible, to avoid exceeding outlay limits. Automated systems, which currently focus on obligation levels, may need to be modified to monitor outlay levels for the pertinent accounts or programs. However, several agency budget officials told us that it would be costly and unproductive to establish special systems to control outlays.

Outlay Caps Did Not Produce Long-term Savings

Our analysis determined that the three outlay caps discussed in this report did not reduce total program costs. In each instance, outlays that might otherwise have occurred during the fiscal year to which the cap had been applied were merely delayed until the following year. No contracts were cancelled and no amounts previously obligated were deobligated. Since there was no change in budget authority available for obligation, agencies were permitted to spend the same total amounts.

Furthermore, an outlay cap could, in certain cases, result in unintended or additional costs. For instance, if an outlay cap causes outlays to be delayed until late in the fiscal year or the following year, higher unit costs could result from prices rising during the delay. This occurred in the case of the fiscal year 1988 outlay cap on the Strategic Petroleum Reserve Petroleum Account. Our examination of agency budget documents showed that the agency could not outlay the full amount of the 1988 appropriations when the average 1988 price per barrel was $16. When the agency took possession of the oil and outlayed the cash in 1989, it had to pay $17 per barrel.

Similarly, additional costs could occur if agencies do not effectively control the rate of obligations. For example, if agencies determine that the amount obligated during the period covered by the cap will result in outlays exceeding the specified limit for the period, they may choose to cancel orders or contracts (that is, deobligate funds). In that situation, federal procurement law may dictate that the vendors be compensated for certain costs.

Applying outlay caps to procurement-related appropriation accounts on a regular basis could also result in increased costs instead of budget savings. For instance, an outlay cap could force government contracts to contain explicit limits on when cash is disbursed. To cover the undisbursed portion of the contract, contractors could borrow funds or sell the contract to a financial institution. In each case, the result would be the equivalent of government-guaranteed financing at rates of interest substantially above Treasury rates. Conceivably, contractors would pass on the higher rates to the government in the form of higher bids on contracts. If it became routine to place outlay caps on major procurement accounts such as those found in NASA and DOD, such financing arrangements could become a normal part of doing business, and securities backed by pools of the undisbursed portion of contracts would become a realistic possibility.

Nevertheless, outlay caps could generate long-term savings if they lead to lower obligation levels than would have occurred otherwise. For example, they could authorize the executive branch to impound funds as necessary to implement the cap. However, this could be accomplished more directly—and in accordance with congressional priorities—by simply reducing agency budget authority in the authorization and appropriation processes.

Outlay Caps Could Affect Business Relationships

Outlay caps did not affect business relations because the agencies involved did not have to cancel any contracts or orders. However, had it been necessary to deobligate funds, cancel contracts, or reduce previous orders, this could have adversely affected business and other relationships where outside parties rely heavily on federal contracts and accordingly need a stable financial relationship with the government. Standard cancellation penalty clauses are meant to compensate the affected vendors in the event of cancelled procurements. However, it is difficult to determine the extent to which such actions would reduce vendors' willingness to compete for future business, thus shrinking the competitive base and possibly increasing future prices. Outlay caps could affect business relationships if they become standard practice and create uncertainty about the timing of payments to contractors.

Outlay Caps Could Affect Balance of Fiscal Power

The Congressional Budget and Impoundment Control Act of 1974 restricts an agency's ability to unilaterally control outlays through the impoundment of funds appropriated by the Congress. While the executive branch presently has some discretion in the expenditure of appropriated funds, it cannot unilaterally establish spending limits that are below the funding levels expressed in the appropriation acts. With the three outlay caps in our study, the enacting legislation specified the spending limits, the budget authority they applied to, and the time frame covered. The agencies were legally required to implement the caps, but they had some discretion in the timing of the obligations.

The balance of power between the legislative and executive branches would have been changed if the Congress had enacted the outlay cap proposed in H.R. 3072, which was introduced in the House during the 101st Congress. The proposal would have capped outlays for all 1990 DOD appropriations, and it would have authorized the Secretary of Defense to select (with some exceptions) the programs on which the cap would be applied. Also, the proposed language would have exempted

DOD from provisions of the Congressional Budget and Impoundment Control Act and the Prompt Payment Act. It would have allowed DOD to postpone contract payments due in the last month of fiscal year 1990 until the first month of the following fiscal year. Further, DOD would not have had to pay interest on such deferred payments for up to 30 days after the due date, as is normally required by the Prompt Payment Act (31 U.S.C. 3902). If this language had been included in DOD's fiscal year 1990 appropriations act, it would have dramatically shifted the responsibility for establishing some DOD spending priorities from the Congress to the executive branch. It would have lessened congressional control and oversight of DOD expenditures and increased the Secretary's discretion in determining agency operations and budget priorities.

For many years, the Congress and the President have jointly shared the nation's budgetary processes and decision-making responsibilities. With few exceptions, neither has been allowed to unilaterally establish budgetary policy or take action without the express consent of the other branch. Bills such as H.R. 3072 would alter this relationship by giving one branch more influence over budget matters than the other. To avoid such shifts of power, we believe that it is important that the existing shared relationship between the two branches be continued.

Defense Department Expenditure Controls Created Problems for Some Contractors

In addition to reviewing legislatively imposed outlay caps, we examined, at your request, the administratively imposed expenditure controls the agency head placed on selected DOD programs during fiscal year 1988.

The 1987 budget summit agreement established nonbinding budget outlay targets for DOD and other federal agencies for fiscal year 1988. In April 1988, DOD officials noticed that actual outlays for March and April of the fiscal year exceeded their planned budget outlay targets by $1.5 billion and $1 billion, respectively. To reduce the outlays to levels consistent with the budget targets, the Deputy Secretary of Defense instituted expenditure controls by delaying equipment purchases, restricting new contracts in nonessential research and development programs, restricting in-house facility maintenance, delaying all Industrial Fund purchases of capital assets and certain contractual actions, limiting gross disbursements, discontinuing overtime, and imposing hiring limits.

When the expenditure control measures went into effect on May 20, 1988, they reportedly created problems in the private sector for DOD contractors, particularly for small businesses with limited financial resources. The action prompted numerous letters to the agency from small defense contractors and congressional correspondence written on behalf of constituents. While the letters generally acknowledged the need to control defense outlays to remain within the budget targets, they also charged that the action taken was biased against small businesses engaged in DOD contracts. The correspondence warned that continued delays of professional and technical service contracts would result in the loss of employees and technical skills and would adversely affect the nation's technological and industrial base.

The DOD expenditure controls also caused concern in the Congress. In a June 1988 congressional hearing before the Acquisition Policy Panel of the House Committee on Armed Services, the Chairman advised DOD officials that the impoundment control provisions of the Congressional Budget and Impoundment Control Act of 1974 require the executive branch to (1) promptly carry out programs with appropriated funds or, if prompt execution is to be delayed, (2) submit a message to the Congress proposing deferral or the rescission of the funds. The hearing noted that DOD had not submitted a deferral or rescission message on its May 1988 expenditure control actions.

The expenditure controls DOD instituted to control fiscal year 1988 outlays did not result in long-term savings for the affected programs. At the end of the fiscal year, DOD officials estimated that actual outlays exceeded the planned outlay levels by about $4 billion. DOD officials believe that this overage might have been avoided if controls over outlays had been in place and operational at the beginning of the fiscal year.

Conclusion

Statutory outlay caps have not been an effective and efficient means of controlling outlays, and they may lead to a significant shift of power between the branches. We oppose the use of such caps to control federal spending.

We are sending copies of this report to the Senate and House Committees on Appropriations; the Senate Committee on Governmental Affairs; the House Committee on Government Operations; the House Committee on the Budget; the Director, Congressional Budget Office; the Director, Office of Management and Budget; and other interested parties.

This report was prepared under the direction of James L. Kirkman, Director, Budget Issues, who may be reached on (202) 275-9573 if you or your staff have any questions. Other major contributors are listed in appendix I.

Sincerely yours,

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Related GAO Products

Federal Budget Outlay Estimates: A Growing Problem (PAD-79-20, Feb. 9, 1979).

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