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UNITED STATES

Report on the Observance of Standards and Codes (ROSC)
Fiscal Transparency Module

Prepared by the Fiscal Affairs Department
(in consultation with the Western Hemisphere Department)

Approved by Anoop Singh and Teresa Ter-Minassian

July 7, 2003

EXECUTIVE SUMMARY

This report assesses fiscal transparency practices in the United States in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency* based on discussions with the authorities, their response to the IMF fiscal transparency questionnaire, and other discussions and sources of information. The IMF *Manual on Fiscal Transparency* (http://www.imf.org/external/np/fad/trans/manual/) further explains the terms and concepts used in this report.

The United States is fully compliant with most elements of the Fund's Code of Good Practices on Fiscal Transparency, and sets best practice standards in many areas. The constitution provides a strong and well-tested framework that clearly defines the roles of the executive and legislative branches in fiscal management. The Congress plays a central role in shaping the budget, which ensures a highly open process. State and local governments also have clearly defined fiscal responsibilities, operating independently from the federal government, and they are subject to market discipline. Budget documentation is easily accessible to the public, timely, comprehensive, and reliable, and it excels in its scope and quality of analysis.

Nevertheless, there remains a lack of clarity about the longer term direction of fiscal policy. This partly reflects the sheer size of the federal government and the complexity of the congressional budget process. Major efforts have been made over the past three decades to put in place a legal framework to strengthen this aspect of the budget process. However, with the expiration of the Budget Enforcement Act (BEA), the failure of Congress to pass a budget resolution for FY 2003, and the recent uncertainty regarding the permanence of tax cuts and the costs of the war in Iraq, budget decisions do not seem presently guided by clear medium- and long-term fiscal policy objectives.

Budget responsibility legislation to replace the BEA could help provide a basis for a more systematic incorporation of longer-term considerations into the budget process. Fiscal transparency could be strengthened in a number of additional ways. These include: by reporting an internationally comparable measure of the budget balance to supplement the unified budget presentation; by providing an overview of state and local government finances as part of the federal budget presentation; through an annual assessment of the costs and risks associated with quasi-fiscal activities; by including a comprehensive statement on fiscal risks in the budget documents; by reconsidering the legal basis for tax expenditure reporting; by ensuring that audit reports of agencies are followed up; through an increased emphasis on program performance; and by paying more attention to the full cost of providing government services.

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ABBREVIATIONS AND ACRONYMS

BEA	Budget Enforcement Act
CBO	Congressional Budget Office
CFOA	Chief Financial Officers Act
FASAB	Federal Accounting Standards Advisory Board
Fannie Mae	Federal National Mortgage Association
FFMIA	Federal Financial Management Improvement Act
FMFIA	Financial Managers Financial Integrity Act
Freddie Mac	Federal Home Loan Mortgage Corporation
GAAP	Generally Accepted Accounting Principles
GAO	General Accounting Office
GASB	Governmental Accounting Standards Board
GFS	Government Finance Statistics
GFSM	Government Finance Statistics Manual
GMRA	Government Management Reform Act
GPRA	Government Performance and Results Act
GSE	Government-Sponsored Enterprise
IFAC-PSC	International Federation of Accountants—Public Sector Committee
IRS	Internal Revenue Service
IRSRRA	Internal Revenue Service Restructuring and Reform Act
JCT	Joint Committee on Taxation
LIVA	Line-Item Veto Act
NIPA	National Income and Product Accounts
OIRA	Office of Information and Regulatory Affairs
OMB	Office of Management and Budget
PART	Program Assessment Rating Tool
PAYGO	Pay-As-You-Go
PMA	President's Management Agenda
SNA	System of National Accounts
TVA	Tennessee Valley Authority
UMRA	Unfunded Mandates Reform Act
USPS	United States Postal Service

I. INTRODUCTION[1]

1. This report assesses fiscal transparency practices in the United States against the requirements of the IMF *Code of Good Practices on Fiscal Transparency.* The assessment has two parts. The first part is a description of practice, prepared by the IMF staff on the basis of discussions with the United States authorities and their responses to the fiscal transparency questionnaire, in addition to other available information. The second part is an IMF staff commentary on fiscal transparency in the United States.

2. **It should be noted at the outset that the U.S. Federal Government is the largest, widest-ranging, and most complex single set of institutions in the world.** This complexity poses challenges to transparency, since an overview of fiscal policy that is both accurate and meaningful to the general public is inherently difficult to provide. The United States does a remarkable job in this respect, and sets high-level or best practice standards in most areas of fiscal transparency. The first objective of the report is to convey this to the reader. The fiscal management system in the United States also has unique strengths, and practices applied in other countries are not always appropriate to its situation. But even taking this into account, steps can be taken to improve transparency; indeed many of these steps have already been identified by government analysts. A second objective of the report, therefore, is to highlight key areas where further strengthening is warranted.

II. DESCRIPTION OF PRACTICES

A. Clarity of Roles and Responsibilities

3. **The unified federal budget is the focus of fiscal policy formulation, execution, and analysis in the United States.**[2] The coverage of the unified budget corresponds fairly closely to international statistical reporting standards for central government. However, by not including state and local governments, coverage does not extend to general government as defined in the *Government Finance Statistics Manual 2001* (*GFSM 2001*) (see Box 1).[3]

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[1] Discussions on fiscal transparency were held in Washington D.C., from November 2002 to February 2003. The staff team comprised Messrs. Hemming (head), Allan, Brumby, and Prakash (all FAD), Ms. Ivaschenko (WHD), and Mr. Joyce (consultant). The team met with officials from the Office of Management and Budget (OMB), the Department of the Treasury, the Department of Health and Human Services, the Library of Congress (Congressional Research Service), the General Accounting Office (GAO), the Department of Commerce (Bureau of Economic Analysis), and the Congressional Budget Office (CBO).

[2] The principle of the unified budget was established in 1967 by the President's Commission on Budget Concepts, and was adopted for the fiscal year 1969 budget. The fiscal year in the United States begins on October 1. All year references to the federal budget and to federal budget documents in this report are to fiscal years beginning on October 1 of the previous calendar year (i.e., 2003 refers to fiscal year 2003, which runs from October 1, 2002 to September 30, 2003).

[3] The United States prepares Government Finance Statistics (GFS) reports on federal government and state and local government finances for inclusion in the *GFS Yearbook*. These are published with a lag of approximately

(continued)

Box 1. General Government in the United States

For purposes of reporting for the *GFS Yearbook*, general government in the United States comprises the following:

Central government units covered by general and trust fund budgets

1. Legislative branch, Judicial branch, Executive Office of the President, 15 departments (Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Housing and Urban Development, Interior, Justice, Labor, State, Transportation, The Treasury, Veterans Affairs—and the recently created Homeland Security Department), the Railroad Retirement Board, Social Security Administration, and other major independent agencies (including the Environmental Protection Agency, General Services Administration, National Aeronautics and Space Administration), and about 90 smaller agencies, boards, councils, and offices. Many departments and agencies are responsible for trust funds (that operate under separate legislation for specific purposes) as well as general budget funds. These are summarized under points 2–4.

2. Central government employee retirement funds are included under the agency managing the fund. The four largest funds are the Civil Service Retirement and Disability Fund; the Military Retirement Fund; the Uniformed Services Retiree Health Care Fund; and the Foreign Service Retirement and Disability Fund.

3. Two major transportation trust funds, the Airport and Airway Trust Fund and Highway Trust Fund are included in item 1 under the Department of Transportation.

4. Nine funds classified in the social insurance sector are included under the relevant agency: Social Security Administration budget includes the Old Age and Survivors' Insurance Trust Fund and Disability Insurance Trust Fund (together generally known as "Social Security"); the Department of Health and Human Services budget includes the Hospital Insurance Trust Fund and Supplementary Medical Insurance Trust Fund (together comprising "Medicare"); the Department of Labor budget includes the Unemployment Insurance Trust Fund; and the Railroad Retirement Board budget includes four trust funds which together make up the railroad retirement program.

State and local governments

5. Fifty state governments.

6. Four state temporary disability insurance systems.

7. Forty-four state workers' compensation systems.

8. Approximately 73,700 county, municipal, and other units of government (including the District of Columbia) and 13,700 school districts.

The unified budget also covers trust funds, which are funds designated in law as such; they earmark revenues for specific purposes but do not represent money held in trust for nongovernmental entities.[4] Information on the major trust funds, most notably the Social Security and Medicare funds, is made available in the unified budget presentation as well as being included in the budget totals, and policy issues related to links between Social Security

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two years. National Income and Product Accounts (NIPA) for the federal and subnational government sectors, which correspond more closely than the budget to GFS/System of National Accounts (SNA) concepts, are produced on a timely basis for estimating GDP, and federal fiscal data on this basis are presented in the annual *Analytical Perspectives* and *Historical Tables* documents presented with the president's budget.

[4] In common usage, "trust fund" usually implies money held in trust. Some mostly small funds of this nature do exist, but because their assets are owned by nongovernmental entities, they are treated as nonbudgetary and excluded from the federal budget.

and general fiscal policy are discussed in the budget and vigorously debated by the legislature and in the media. However, public discussion is sometimes complicated by the fact that Social Security funds, together with the United States Postal Service (USPS), are defined as "off-budget" by law. Some public corporations are included in the budget on a net basis (see discussion in the following paragraph). Government-sponsored enterprises (GSEs), such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), which are deemed to be private enterprises but benefit from their government sponsorship status, are reported but are not included in the unified budget.[5]

4. **The budgetary treatment of commercial activities of government is not completely clear.** Various activities of government are financed by sales revenue, and such transactions are shown on a net basis in calculating total outlays and total receipts (gross figures are included in the *Budget Appendix*). In some cases, substantial subsidies are involved. The unified budget includes the transactions of government corporations such as USPS and the Tennessee Valley Authority (TVA) on a net basis (i.e., gross outlays minus collections from business activities).[6] Government agencies also provide some services for a fee. For example, private individuals may graze livestock on federal land but their grazing fee to the government is far below market value and the value of this grazing subsidy is not shown in the budget.[7] Below-market rates are also charged for mining on federal lands, where miners pay a nominal fee for the privilege of extracting minerals but pay no fees (such as royalties, which would be paid on private lands) related to the value of the minerals extracted. Royalties are paid for extracting oil and natural gas from federal lands. Timber from national forests is also frequently sold at below-market rates. Again, the value of these mining and timber subsidies is not shown in the budget. As with fees for other commercial activities, grazing fees, mining receipts, oil and gas receipts, and receipts from timber sales are shown as offsets to spending. The treatment of charges for services does not draw a clear distinction between transactions that are carried out by government corporations or quasi-

[5] Detailed statements are provided "to the extent such information is available," but they are not reviewed by the Administration. (See *Appendix*, *Budget of the United States Government, Fiscal Year 2004,* pp. 1123–31).

[6] Government corporations that conduct business transactions with the public operate through revolving funds, where revenues (including receipts from sales) are deposited and are available for expenditure. Outlays are recorded net of these receipts. The TVA is also authorized to sell bonds to finance its own power operations, subject to a statutory limit. Other forms of revolving funds include those for intragovernmental "business-like" transactions (e.g., the Federal Buildings Fund). They operate on a similar basis, and are also included in the budget.

[7] The CBO report *Budget Options* (March 2003, pp. 72, 74, 75) indicated that, in 2001, ranchers were authorized to use about 16 million animal unit months for grazing on federal lands. The most recent information available (from 1993) indicated that the Interior Department spent $4.60 per animal unit month to manage rangelands for grazing, but that the fee for that year was only $1.86 per animal unit month. Further, as of 1990, the appraised value of public rangelands in the western part of the country was estimated at $5 to $10 per animal unit month.

corporations,[8] and transactions carried out by market establishments within government. The budgetary treatment of commercial-type activities of the government thus differs in a number of respects from GFS standards of fiscal reporting.[9]

5. **Privatization policies and processes are open.** However, there are relatively few public corporations and thus few opportunities for significant privatization of government equity in the United States; the passenger rail system (AMTRAK), TVA, and various power-marketing authorities are possible exceptions. The current Administration continues to increase outsourcing for the provision of public services.[10] In particular, the President's Management Agenda (PMA) includes a competitive sourcing initiative, and cabinet agencies and other major units are evaluated on their progress in meeting the goals laid out in the agenda. The goal under the PMA is for agencies to bid competitively for up to 50 percent of positions related to functions that are not "inherently governmental." According to the *Budget of the United States Government, Fiscal Year 2004,* the competitive sourcing initiative, despite its enormous potential for cost savings, has registered little progress so far. No agency has yet met the criteria for competitive sourcing; all agencies are rated "red" for this initiative on the current Aministration's management "scorecard," reflecting the fact that none has opened up a sufficient number of commercial activities to competition. Because this initiative is in many ways a significant departure from past practices, it faces the greatest obstacles.[11]

6. **The central bank is independent and does not play a fiscal role or carry out quasi-fiscal activities.** The Federal Reserve System was established by the Federal Reserve Act of 1913. It serves as the United States' Central Bank (see http://www.federalreserve.gov). The Board of Governors, which sets general operating policies for the Federal Reserve, is composed of seven members appointed by the President and confirmed by the Senate; the Federal Open Market Committee is composed of the Board of Governors and five of the 12 Federal Reserve Bank presidents. The Full Employment and Balanced Growth Act (Humphrey-Hawkins Act) of 1978 specifies goals for the Federal Reserve and mandates that the Federal Open Market Committee should report to Congress on the economy and monetary policy twice a year.[12] The Federal Reserve is to maintain growth

[8] *GFSM 2001* (2.14–2.18) defines such entities as having a primarily commercial function, selling most or all of their output at economically significant prices, having (or being able to compile) a separate set of accounts, and being able to maintain its own working capital. A quasi-corporation is an entity that is not legally incorporated, but otherwise functions as if it were a corporation.

[9] *GFSM 2001* recommends recording sales and outlays for general government entities in gross terms, and it classifies public corporations and quasi-corporations outside general government.

[10] Public-private competition is governed by OMB Circular A-76, *Performance of Commercial Activities*, as well as the Federal Activities Inventory Reform Act of 1998.

[11] *Budget of the United States Government*, *Fiscal Year 2004*, pp. 38–39.

[12] This legislation expired in 2000, but the practice of "Humphrey-Hawkins" reports to Congress continues.

of monetary and credit aggregates commensurate with the economy's long-run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates. The Federal Reserve is an agency of the executive branch, but operates autonomously under its legislation subject only to congressional review.[13] The rest of the government does not influence the Federal Reserve for fiscal policy purposes.

7. **Processes governing regulation of the nonbank private sector are open, but they are quite complex.** Numerous laws provide for regulation in areas such as public health, food quality, environmental protection, and workplace safety.[14] Specific rules fill in the details missing in statutory authority and are published in the *Federal Register*: there is a public comment period of at least 60 days. These rules are then subject to review and comment by interested parties, and subsequently may be revised based on this input. The OMB, through its Office of Information and Regulatory Affairs (OIRA), has increasingly been requiring cost-benefit analyses of proposed regulatory statutes before they can be published.[15] Further, since 1996 proposals must, under the Unfunded Mandates Reform Act (UMRA) of 1995, include a CBO estimate of their cost to the private and intergovernmental sector. Between 1996 and 2001, the CBO reviewed 3,338 bills for the presence of private sector mandates, finding 488 that included such mandates, and 118 with mandates above a $100 million threshold.

8. **Government equity and financial asset holdings are reported in detail.** Financial assets of government corporations that are claims on the public, as well as their liabilities, are reported in the *Financial Report of the United States Government*.[16] Many of these assets relate to different kinds of credit, including mortgages and mortgage-backed securities issued by the Government National Mortgage Association and the Federal Housing

[13] The Federal Reserve System has supervisory responsibilities over the financial system and also provides commercial check processing and collection, coin and currency delivery, and seasonal and long-term adjustment lending services.

[14] Key statutes governing regulatory policies include the Clean Air Act of 1970, the Clean Water Act of 1972, the Americans with Disabilities Act of 1990, the Occupational Safety and Health Act of 1990, the Federal Food, Drug, and Cosmetic Act of 1938, and the Meat Inspection Act of 1907. Key agencies involved in regulation include the Environmental Protection Agency, the Food and Drug Administration, the Occupational Health and Safety Administration, and the Food Safety and Inspection Service.

[15] The OIRA estimated that the total cost of federal regulations cleared by the OMB from April 1995 to September 30, 2001 was $51–54 billion, while total annual benefits ranged from $49–$102 billion. These regulations may also have many nonquantifiable costs and benefits. The annual report to Congress (see OMB, *Stimulating Smarter Regulation*, 2002) provides information on the cost-benefit methodology to be applied.

[16] Holdings of government securities by these corporations and their cash balances with the Treasury are eliminated in the process of consolidation.

Administration.[17] The *Financial Report of the United States Government* also includes statements of "stewardship" assets, investments, and responsibilities. These statements provide details of obligations and rights that may not meet standard accounting recognition criteria of the core financial statements, but are seen as important for policy planning—actuarial estimates of future Social Security obligations are a case in point. While GSEs are large, they are not owned or deemed to be controlled by the federal government and therefore are not included in the *Financial Report of the United States Government*.

9. **The allocation of responsibilities between different levels of government is clearly defined.** The powers and independent status of states and localities are clearly defined and protected by the Constitution.[18] Budgets of state and local governments are generally not reviewed at higher levels[19]—and, in particular, the federal government has no role in reviewing the budgets of the states. But the fiscal activities of states are influenced by federal grant policy.[20] Some programs, such as Medicaid, are jointly operated by the federal and state governments. Similarly, states make substantial grants to localities, particularly to support local education. In some cases, the federal government encourages states to adopt particular policies by placing conditions on the receipt of federal assistance. States are also affected by federal regulations, which have in the past led to "unfunded mandates" imposed on them (and localities). UMRA also requires the CBO to estimate the cost of legislation (when it is being considered) that would impose such mandates on state, local, or tribal governments. Between 1996 and 2001, CBO found that 405 of bills reviewed included such mandates, but only 36 included mandates that exceeded a $50 million threshold.

[17] It should be noted that there are other forms of financial asset holding by unincorporated agencies as well as by government corporations: some agencies other than government corporations guarantee mortgages (Veterans Affairs and Agriculture) and other types of credit (e.g., the Office of Student Financial Assistance's guarantee of student loans and the Small Business Administration's guarantee of business loans); also, some government corporations guarantee other types of credit (e.g., the Export-Import Bank and the Overseas Private Investment Corporation).

[18] While the Constitution outlines specific responsibilities for the federal government, with others "reserved to the states, or to the people," it does not clearly identify local government as a separate level of government. In practice, local governments derive their powers from state governments. The relative responsibilities of the federal government versus state and local governments have evolved over time, with the federal government's increasingly becoming involved in many areas (such as education) that were once the sole province of states and localities.

[19] Some states have had a role in reviewing local budgets.

[20] Overall, the federal government collected almost two-third of all general government revenue in 2000, compared to about one-third for state and local governments combined. Intergovernmental assistance is a significant source of revenue for states and localities. Federal aid represented 20 percent of all state revenue in 1998, while local governments derived fully one-third of their 1998 revenue from higher levels of government; more than 90 percent of assistance provided to local governments came from state governments, the majority of which was provided to support local education.

10. **Intergovernmental fiscal relations are based on stable principles.** Grants are transparent; they are reported as expenditure by the provider and revenue by the recipient. However, differences between the timing of the federal fiscal year and that of most state and local governments can occasionally make it difficult to track funds.[21] State finances are disciplined in three ways. First, states (with the exception of Vermont) are constitutionally or statutorily required to balance their general fund (i.e., current) budgets. Funds receiving taxes earmarked for particular purposes are also typically balanced. The nature of the balanced-budget requirement differs from state to state. For example, in some states the governor is required to present a balanced budget but the legislature is not required to pass one. Few states require actual revenue to match or exceed actual spending in a given fiscal year. Most states accumulate rainy day funds, which can be run down in times of budgetary stress without violating the balanced-budget requirement. Second, a basic discipline is provided directly by the capital market. The fact that most states borrow to finance capital spending creates a strong incentive to maintain balance between revenue and spending over the business cycle. The third form of discipline is provided by tax competition, which limits tax-raising capacity; indeed state tax rates are to some extent linked to federal tax rates. Local government finances are constrained primarily by the capital market and limitations imposed by the states.

11. **The executive, legislative, and judicial branches of government have roles which are clearly defined in the Constitution.** The checks and balances exercised by each branch are also a defining feature of the U.S. system of fiscal management (see Box 2 for a discussion of the evolution of the congressional budget process over the last 30 years). Under the Constitution, laws governing the raising of revenue and the authorizing of expenditure must be passed first by the two houses of Congress, and then must be approved by the President. The President may veto bills passed by Congress, but these vetoes may be overridden by a two-third vote of both houses of Congress. The judicial branch is sometimes asked to adjudicate when issues arise concerning the constitutionality of various budget procedures. For example, in 1997, the Supreme Court ruled the Line-Item Veto Act of 1996 to be unconstitutional. The Budget and Accounting Act of 1921, as amended, lays out the basic requirements for the presidential budget submission, including specifying the type of information that must be included. The Congressional Budget and Impoundment Control Act of 1974 (hereafter, the Budget Act) establishes the basic framework for the congressional budget process, including the presentation of information in the budget resolution. Further, various laws have been enacted over time to address particular fiscal issues, including the Budget Enforcement Act (BEA) of 1990 and the Government Performance and Results Act (GPRA) of 1993.

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[21] The 50 state governments differ substantially in their budgeting procedures and budget presentation. The majority of states (46 out of 50) have fiscal years that begin on July 1. This differs from the federal fiscal year, which begins on October 1. Further, it is common for local governments within a state to have fiscal years that differ from the state fiscal year.

Box 2. The Congressional Budget Process—Establishing Transparent Rules for Legislative Fiscal Policy

Congress, as a strong legislative body with substantial budget-making power, plays a critical role in the formulation of fiscal policy in the United States. Efforts to establish a comprehensive management framework for congressional control of the budget have evolved since the early 1970s. Prior to 1974, Congress dealt with the budget only in a piecemeal fashion (although several unsuccessful attempts were made to establish a disciplined process, including through the Omnibus Appropriation Act of 1950 and statutory expenditure limits in the late 1960s and early 1970s). Since congressional committees each dealt with only a portion of taxes or spending, the legislature did not consider the budget as an overall plan for fiscal policy. Instead, the budget outcome became the almost accidental sum of all the legislation affecting taxes and spending that was passed by Congress and approved by the President in a given year. At the same time, the percentage of the budget that Congress did not look at in a systematic way was increasing rapidly; so-called mandatory spending (mainly entitlements such as Social Security and Medicare) made up more than 50 percent of the budget by 1974 (up from less than 30 percent in 1962). Further, presidents had increasingly refused to spend funds that had been duly appropriated, a process known as impoundment.

Congress passed the Budget Act to respond to these problems by seeking to direct the attention of Congress to overall fiscal policy through creation of a new legislative device, the budget resolution, which would set the overall framework for the whole budget prior to the production of bills by committees on separate components of the tax and spending plan. New committees, called Budget Committees, had to agree upon this resolution by May 15—advanced to April 15 in 1986—each year. As a set of congressional statements on appropriate budgetary policy, it did not require the President's signature. The Budget Act also established the CBO as staff support to Congress. Finally, the Budget Act provided that appropriated funds could not be impounded by the President without reference to and the assent of Congress.

The Budget Act was neutral as to budget outcomes. It did not attempt to set particular limits for the budget, nor did it mandate limits to annual deficits. After the early 1980s, however, when deficits began to get much larger, Congress attempted to use the budget process to eliminate those deficits. The first legislative attempt, in the Balanced Budget and Emergency Deficit Control Act of 1985 (the so-called Gramm-Rudman-Hollings law), failed. It was notable, however, because it signaled a clear consensus that achieving budget balance was the overall goal for fiscal policy. That consensus was maintained throughout the 1990s when a series of laws (in 1990, 1993, and 1997) raising taxes and cutting spending, coupled with reform of the budget process and the continued expansion of the economy, turned the budget from deficit to surplus. In 1990, the budget process was reformed with the passing of the BEA, which established statutory caps on discretionary spending and a pay-as-you-go (PAYGO) process that required tax reductions and increases in entitlement spending to be offset by other tax increases or entitlement cuts. These BEA strictures expired after 2002.The overall fiscal position of the government improved in every year from 1992 (when the deficit was $290 billion) to 2000 (when a surplus of $236 billion was recorded).

By 2000, the consensus gave particular emphasis to the view that the budget should run surpluses equivalent to the surpluses in the Social Security trust funds. This consensus broke down in the aftermath of the Bush Administration's tax cut plan, the combined effects of recession and the stock market decline on receipts, and the need to finance additional spending after the September 11 attacks. No substitute overall goal of fiscal policy has been formulated. The overall budget outlook has deteriorated, with the CBO now projecting deficits at least through 2013. The lack of a political consensus and the expiration of the BEA rules placed a focus on the budget resolution as the most likely vehicle for communicating overall fiscal policy for 2003—the role that Congress had envisioned for the budget resolution since its inception. Congress, however, failed to adopt a budget resolution for 2003, throwing the congressional process into further disarray. The lack of a clear, overall, long-term fiscal goal, together with an expired set of budgetary limits and no congressional limit creates a new set of problems for congressional management of the budget process. In the 2004 budget presentation, the President put forward a number of proposals that could lead to legislation replacing the BEA, and Congress adopted a budget resolution for 2004.

12. **Fiscal management is governed by a comprehensive legal and administrative framework**. As noted above, the Budget and Accounting Act specifies the content of the President's budget. The process of preparing the President's budget consumes many months in advance of the statutory deadline of the first Monday in February. The OMB issues a budget circular (Circular A-11) that outlines in great detail the specific information that must be included in budget requests. Increasingly, the President's budget also includes information on program performance as required by GPRA. As a part of the congressional process, appropriations committees lay out specific requirements for budget requests. The process of budget execution is governed by numerous laws that cover constraints on spending (the Anti-Deficiency Act of 1998, as amended and codified in the United States Code (Chapters 13 and 15 of Title 31), provides administrative and criminal penalties for overspending), procurement (the Federal Acquisition Reform Act of 1996), and information technology management (the Information Technology Management Reform Act of 1996). Further, all collections by federal officers and employees are deposited and held by the Department of the Treasury, except for a small amount that is otherwise specified by law. Agency spending is constrained by a process through which the OMB apportions available resources throughout the fiscal year, and agencies must obligate funds before they can be spent. The Treasury shows agencies their available fund balances by account each month and is moving toward a daily basis.

13. **Mechanisms for the coordination and management of budgetary activities are well defined.** The unified budget reports its transactions on a consolidated basis, including all funds—there are no significant extrabudgetary activities in the sense defined in the *Manual on Fiscal Transparency*. Each of these special revenue funds (that is, funds with receipts earmarked for specified purposes) is included in the budget. In practice, just over one-third of the budget (so-called discretionary spending) is annually appropriated. Almost all funds are administered by the Treasury, and can only be spent as a result of specific laws and procedures governing budget execution.

14. **Although the legislative bases for taxation and supporting administrative procedures are clear, and are observed in practice, they are widely acknowledged to be complex.** Tax collection is governed by the Internal Revenue Code. Tax law is extraordinarily complicated, and has become more so over the past 15 years, subsequent to the simplification that occurred with the passing of the Tax Reform Act of 1986. Currently, the Internal Revenue Code has 693 sections applicable to individuals; 1,501 applicable to businesses; and 445 applicable to tax-exempt organizations, employee plans, and governments. The Code contains about 1.4 million words. The Congressional Joint Committee on Taxation (JCT) has identified sources of complexity, including the use of the tax system to advance economic and social objectives, and unintended interaction of federal tax laws with other federal, state, or local statutes. Regulations relating to administrative procedures are drafted for public comment, and are only finalized after the receipt of oral and written input from affected taxpayers. The Internal Revenue Service (IRS) makes tax forms and instructions available both in hard copy and in electronic form. Further, the number of

tax returns filed electronically has increased substantially, from 15 million in 1996 to more than 40 million in 2001. Customer service has of late been a priority of the IRS, but recent statistics on the quality of taxpayer assistance indicate that taxpayers get wrong answers to their tax questions 24 percent of the time.

15. **Public servants are subject to a code of behavior.** Public employees are provided with clear legal and administrative guidance concerning ethics and conflict of interest. Relevant legislation includes the Ethics in Government Act of 1978, the Office of Government Ethics Reauthorization Act of 1988, the Ethics Reform Act of 1989, and the Hatch Political Activities Act Reform Amendments of 1993 (which governs political activity by federal employees). The Office of Government Ethics provides information and official opinions on ethical issues, and each federal agency has an official ethics officer to administer the agency ethics programs. These programs involve reviewing financial disclosure reports, initiating and maintaining ethics education and training programs, providing counseling and advisory services, and monitoring administrative actions and sanctions for ethics violations.

B. Public Availability of Information

16. **Budget documentation covers all central government fiscal activities, but provides only limited information on general government.** The President's budget presented to Congress in late January/early February gives the unified budget presentation of proposed fiscal activity of the federal government for the year.[22] Although data on state and local taxes and spending are not included with the budget, the NIPA reports include data on the contribution of the state and local government sector to the overall economy in parallel with data on the federal government.[23] The transactions of the Federal Reserve Board are not included in the budget. While both the President's budget and the budget resolution represent a comprehensive treatment of the budget, neither of these has the force of law. No final budget document is prepared by the government to reflect the expected outlays resulting from congressional budget decisions. However, estimated budget outlays and receipts data are presented at two points in the budget process: (1) the President's budget (presented in January/February) includes up-to-date data on the current budget year's receipts and expected outlays, together with the budget proposed for the coming fiscal year; and (2) the *Mid-Session Review* (required in July) includes revised estimates for the same years.

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[22] Key sources of fiscal data include the OMB's (http://www.omb.gov) *Budget of the United States Government*, the Council of Economic Advisors' (http://www.whitehouse.gov/cea) *Economic Report of the President*, and the CBO's (http://www.cbo.gov) annual *Budget and Economic Outlook* report. The *National Income and Product Accounts* are published by the Department of Commerce's Bureau of Economic Analysis.

[23] Besides the NIPA reports, current data on states' general budget fund transactions are available from *The Fiscal Survey of States*, published twice a year by the National Association of State Budget Officers and the National Governors Association. Data for state and local governments are shown in the federal budget document on a NIPA basis only in aggregate and with a two-year lag.

17. **Defense expenditure is comprehensively reported in the budget.** Defense expenditure accounts for about one-half of the budget that must be annually appropriated. While the total appropriation by the Department of Defense is reported in the budget, detailed information on some defense activities (such as the budget for the Central Intelligence Agency and the National Security Agency) is not provided. Both the 2003 and 2004 budget documents provide extensive information on defense policies and strategies. Further, the budget *Appendix* lists details for the roughly 100 separate accounts that make up the defense budget. This includes information on dollars requested, on object class breakouts, and on personnel numbers and expenditures. Congress acts annually on two appropriation bills dealing with defense, in addition to passing an annual authorization bill. Defense capital expenditure is budgeted for on an obligation basis, like the rest of the budget. Outlays are recorded for cash payments that liquidate obligations.

18. **The budget document reports the main fiscal aggregates for two years prior to the budget year and projections for four years beyond the budget year.** The President's budget is prepared by the OMB according to the requirements of the Budget and Accounting Act. The budget shows actual data for the most recently completed fiscal year, estimates for the current fiscal year, and projections for the budget year and following four years. Further, these data are presented both on a "policy" basis (i.e., assuming that the President's policies are adopted) and a current-service basis (i.e., assuming unchanged policies). The *Analytical Perspectives* volume of the budget presents data comparing the most recent actual budget data to prior current-service estimates. It also provides aggregate projections of the budget for about 75 years in the "Stewardship" chapter. The *Historical Tables* volume provides historical data for many budget series, a large number of which extend back to 1940 or 1962. In addition, the CBO must, according to the Budget Act, present similar aggregate estimates. In practice, the CBO has always presented such data for two years prior to the budget year and four years after. By recent convention, the CBO has provided these data for nine years past the budget year. The OMB sometimes provides these longer term estimates, but now has limited the forward estimates to the budget year and the following four years. The CBO also reports on differences between current and past estimates, in addition to annually reporting on its historical track record compared to the OMB. Both the OMB and CBO publish mid-session budget reviews, which update this aggregate budget information for at least the past two years, the budget year, and the following four years. While the CBO and OMB share data used to prepare their forecasts, the estimates by the two agencies are made independently.

19. **Contingent liabilities are not routinely reported in the budget document, although the long-term costs of loan and loan guarantee programs are explicitly budgeted.**[24] The budget does not include a comprehensive list of contingent liabilities. Since

[24] However, an ex-post statement of "Commitments and Contingencies," with a comprehensive coverage of contingent liabilities (but with no estimate of estimated costs arising from litigation) and commitments to future payments arising from long-term contracts, is provided in the *Financial Report of the United States Government.*

1990, however, the contingent liabilities associated with federal credit programs are explicitly budgeted for. Under the Federal Credit Reform Act of 1990, the annual outlays for credit programs reported in the budget represent an estimate of the present value of the long-term subsidy cost to the government of loans or loan guarantees issued in that budget year. While more transparent than prior practice, which reported only the actual cash costs associated with loan programs after the fact, accounting for cash disbursements against appropriations is quite complex (see Box 3). The federal government has not extended the accrual approach to other programs where substantial future contingent liabilities exist. For example, the deposit and pension insurance programs of the Federal Deposit Insurance Corporation and the Pension Benefit Guaranty Corporation respectively are not budgeted for on an accrual basis, and no information is reported in the budget on contingent liabilities associated with these programs.[25]

20. **Estimates of significant tax expenditures are included in the budget, and are also published annually by the JCT.** The government has been required to include an estimate of tax expenditures in the budget since the mid-1970s, when the Budget Act first mandated such a presentation. Currently, *Analytical Perspectives* includes a chapter that outlines all significant tax expenditures. In all, the cost of 137 different income tax expenditures was included in the 2004 budget; the actual 2002 cost of these tax expenditures (in terms of revenue foregone)[26] ranged from less than $10 million to around $100 billion (for the exclusion of employee contributions for medical insurance). The cost of tax expenditure is presented for the same time period for which budget information is provided (the past two fiscal years, the budget year, and the following four years). For the first time in the 2004 budget, the Department of the Treasury made an analytical comparison between the "normal" income tax base, a comprehensive income tax base, and a consumption base. In addition, tax expenditure estimates were shown relative to a consumption tax base as well as to the "normal" income tax base. This approach reflects concerns about the appropriate baseline for estimating tax expenditure costs. The JCT also publishes an independent estimate five years into the future, using the normal income tax baseline. States have been preparing tax expenditure estimates for about as long as the federal government, but not all states do so and the methodology differs substantially among them.[27]

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[25] For a more general discussion of contingent liabilities and other sources of fiscal risk, and a call for annual reporting on fiscal risk, see *Fiscal Exposures: Improving the Budgetary Focus on Long-Term Costs and Uncertainties*, U.S. General Accounting Office, GAO-03-213, January, 2003.

[26] Estimates are also made in terms of outlay equivalents—the expenditure that would be required to provide the taxpayer with the same amount of after-tax income as would be received through the tax provision. The methodology for all forms of tax expenditure estimates is described in considerable detail in the "Tax Expenditure" chapter of *Analytical Perspectives*.

[27] For a discussion of states' practices see J. Mikesell, 2002, *The Tax Expenditure Concept at the State Level: Conflict Between Fiscal Control and Sound Tax Policy*, *Proceedings 94th Annual Conference on Taxation* (Washington: National Tax Association).

Box 3. Budgeting for Credit and Risk in the Federal Budget

Federal credit programs offer two types of support to a range of activities (including housing, education, business, and rural development): direct loans at below-market rates, and loan guarantees. Both types of support involve elements of subsidy and risk. The rationale for such intervention is very clearly described in the *Analytical Perspectives* budget document (Chapter 9 in the 2004 volume) and the costs are explicitly included in the budget; the same chapter also looks at similar types of government intervention for federal deposit insurance, pension guarantees, and disaster insurance, as well as indirect intervention through the GSE operations. While the policy analysis of these programs is comprehensive, their budgetary treatment is somewhat less clear and there may be a case for developing a consolidated presentation of these issues that further clarifies the range of costs and the fiscal impact of such programs. The following points could be further considered:

- As indicated earlier (Box 1), the unified budget includes an appropriation to cover the net present value of subsidies (including the expected cost of default and interest subsidy, offset by fees) of credit programs; the actual cash transactions, however, are made through nonbudgetary accounts that are reported in the budget Appendix. The NIPA includes only the actual interest cost through these accounts in its estimates of federal budget aggregates.[1]

- Deposit-insurance schemes, pension guarantees, and disaster insurance involve similar elements of risk and subsidy, but are treated differently in the budget from credit programs. Outlays on the acquisition of failed financial institutions are recorded when paid and are offset by receipts from the sale of assets; pension-guarantee payments and disaster insurance are recorded when paid and offset against premiums.

- Risks from GSE operations are considered to be private risks, and subsidies implicit in sponsorship are not regularly declared as such in budget presentations. By law, GSE securities carry a disclaimer of any federal obligation. However, by token of their sponsorship, it could be argued that there is a significant implicit contingent liability, the disclaimer notwithstanding, and the financial press as well as government studies generally acknowledges its existence.

[1] This treatment differs somewhat from *GFSM 2001*, which draws a distinction between subsidies (which would, as in the budget, be estimated as an expense on an accrual basis), and guarantees, which would be recorded as a memorandum item (and, under the fiscal transparency code disclosed in an overall statement of contingent liabilities).

21. **Quasi-fiscal activities embodied in the operations of GSEs and government corporations are extensively analyzed but are not explicitly discussed in the budget.** Although GSEs do not receive explicit subsidies or federal guarantees, they benefit from an implicit federal guarantee that provides them with lower-cost access to capital markets, as well as various tax and regulatory advantages. A CBO study estimated that the subsidy element was worth \$6.5 billion to Fannie Mae and Freddie Mac in 1995, but that only \$4.4 billion was passed on to home buyers through lower mortgage rates.[28] As noted, the financial

[28] Congress of the United States, May 1996, *Assessing the Public Costs and Benefits of Fannie Mae and Freddie Mac* (Washington: Congressional Budget Office). In 2001, the CBO updated its estimate of GSE subsidies to \$13.6 billion in 2000 (see *Federal Subsidies and the Housing GSEs*, May 2001—Washington:

(continued)

operations of these and other GSEs are included in the *Appendix,* but the statements are not reviewed. The CBO study made an assessment of the cost-effectiveness of the subsidy mechanism and suggested alternatives, including the elimination of the implicit federal guarantee of debt. Such policy options, however, are not presented or discussed as part of the presidential or congressional budget process. Since these implicit guarantees also affect the behavior of the GSEs in response to perceived risks and changing market conditions, there appears to be a case for regular review of the risks being faced each year as well as occasional in-depth reviews. Elements of quasi-fiscal activity are also present in some government corporations that are included in the budget. Government ownership of the TVA undoubtedly provides some benefits in terms of TVA access to capital markets, while some element of cross subsidization between rural and urban services is unavoidably part of the postal service.

22. **Information on federal debt and financial assets is published.** The President's budget includes extensive discussion of the debt implications of budget proposals, as well as historical data on debt. The CBO's annual *The Budget and Economic Outlook* also focuses on past, present, and future debt, and the CBO provides mid-year updates of debt information. More frequent information on borrowing can be found in the *Monthly Treasury Statement of Receipts and Outlays*. Most discussions focus on the debt held by the public as the most meaningful macroeconomic measure of debt, as it captures the effect of federal debt on the overall economy. Two other measures, however, are used: gross federal debt—which includes debt owed by some parts of the government to other parts of the government (e.g., funds borrowed by the Treasury from the Social Security trust funds); and debt subject to limit (literally, a statutory limit on the level of debt that can be issued by the Treasury), which is similar to (but uses a different definition than) gross debt. These multiple definitions can cause confusion among the public and policymakers, who may see substantially different debt figures quoted at any given time. For example, in 2002, debt held by the public totaled \$3.54 trillion, while gross debt was \$6.2 trillion and debt subject to limit was \$6.16 trillion.[29] The President's budget does not include a comprehensive statement of financial assets. Some information on financial assets can be found in the budget, such as detail on the face value of direct loans outstanding. The annual *Financial Report of the United States Government* includes a complete balance sheet.

23. **Formal commitments to more regular publication of fiscal data have been made and advance-release date calendars are announced.** The United States complies with the

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Congressional Budget Office). A United States Department of the Treasury Report, *Government Sponsorship of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation*, July 1996, reached similar conclusions.

[29] See CBO, *The Budget and Economic Outlook: Fiscal Years 2004–2013.*

IMF Special Data Dissemination Standard.[30] The budget documents and *Mid-Session Review* are published by the OMB according to a timetable established in the Budget and Accounting Act. Similarly, the CBO's major budget reports (published in January and August) are required by the Budget Act. CBO reports are provided free of charge to the public. All of these OMB and CBO documents are accessible through the websites of the two organizations. The *Monthly Treasury Statement* is published on a date specified in the previous issue. The *Monthly Statement of Public Debt* is published at a regular time each month, and the *Daily Treasury Statement* is published at a regular time each day. The *Financial Report of the United States Government* is required by Title 31 of the United States Code, paragraph 331(e)(1), to be published by March 31, which is six months after the end of the fiscal year.

C. Open Budget Preparation, Execution, and Reporting

24. **Congress plays a major role in the formulation of the federal budget in the United States, and the process is extensively documented and open.** Federal budget preparation and approval follow a regular timetable, which is specified in the Budget Act (see Box 4), although the enactment of the budget resolution and appropriations bills does not always follow this timetable. Continuing resolutions (short-term appropriations), which allow the business of government to continue without the passing of the regular appropriations bills, are common. Continuing resolutions were required in eight of the past 10 fiscal years, and in 24 of the 27 years since the Budget Act became law. The process of formulation begins in the spring—at least nine months before the budget is sent to Congress and 18 months before the fiscal year begins. Since 1975, the congressional budget resolution has established major fiscal aggregates (total revenue, total spending, total surplus or deficit, and spending divided by function and congressional committee) at the start of the budget process to constrain the decision-making of the appropriations, taxing, and authorizing committees. The transmittal of the President's budget to Congress is scheduled for the first Monday in February. The documentation is voluminous—for 2004 it included five main volumes, with the account details and appropriations bill language in a budget *Appendix* of more than 1,200 pages. *Analytical Perspectives* (around 700 pages) provides detailed technical analysis of most major factors underlying the President's budget estimates. As the process of appropriation legislation progresses, the President's budget may change and presidential amendments can be sent to Congress until the end of the summer.[31]

[30] A schedule of precise release dates for the following year is available on the Bureau of Economic Analysis website, (http://www.bea.gov), by September 30 of each year and is published in the October issue of the *Survey of Current Business*.

[31] At end-September 2002, there had been a total of 24 such amendments, including for example, Estimate #15 (July 3, 2002) which sought an additional $10 billion in the Defense Emergency Response Fund for expenses related to the war against terrorism. All amendments for the 2003 budget are posted on the OMB website, at http://www.gpo.gov/usbudget/fy2003/amndsup.html

Box 4. The Budget Approval Timetable

Between the first Monday in January and the first Monday in February
The President transmits the budget.

On or before February 15
The CBO issues the annual report to the budget committees.

Six weeks after the President's budget
The congressional committees report budget estimates to the budget committees.

April 15
Action is to be completed on the congressional budget resolution.

May 15
House consideration of annual appropriations bills may begin.

June 15
Action is to be completed on reconciliation.

June 30
Actions on appropriations are to be completed by the House.

July 15
The President transmits the *Mid-Session Review*.

August 20
The OMB updates the sequestration review report.

October 1
The fiscal year begins.

25. **The President has considerable discretion in the way he sets forth the budget proposal, although he is required by law to include various types of information.**[32] Appropriations cover the activities of all agencies and are generally proposed by accounts, as required under the Budget and Accounting Act.[33] For each account, the budget includes:

- Current appropriation, with proposed changes;
- brief descriptions of the account and programs, with a small amount of performance information;

[32] The Budget and Accounting Act of 1921 authorizes the President to provide the budget proposal in such form and detail as he sees fit.

[33] The accounts are as follows: federal funds (comprising the general funds, special funds, public enterprise funds, and intragovernmental funds); trust funds (including trust revolving funds); and deposit funds, which are nonbudgetary, prior to 1921, agencies submitted their budgets directly to Congress.

- a schedule which classifies the account into its various programs and specifies funding sources; and

- a table showing the economic classification for each account.

The budget documents are all available free of charge on the OMB website[34] or may be purchased from the Government Printing Office as hard copy or on CD-ROM.

26. **The unified budget presentation is broadly compatible with the *GFSM 2001* but there are significant differences.** Neither the unified budget nor the NIPA presentation provided in the *Analytical Perspectives* corresponds completely to the *GFSM 2001* or the 1993 SNA analytical concepts. Coverage of the unified budget is confined to the central government component of general government, and differs from both the NIPA and the *GFSM 2001* in a number of ways, including: (1) incorporation of commercial entities on a net basis;[35] (2) cash rather than accrual treatment of most transactions; (3) treatment of insurance and credit programs; and (4) treatment of deposit insurance guarantees (see also Box 3 above for discussion of points 3 and 4). Information is provided on many bases—including administrative, programmatic, and functional categories, and by outlays, obligations, and budget authority for each appropriation and fund account.

27. **The concept of general government does not play a significant role in fiscal policy formulation for the federal government**. The federal authorities' view is that the constitutional separation of powers between the federal government, and state and local governments, and a well established reliance on the market discipline of state and local government finances, makes the concept of general government less relevant to fiscal policy in the United States than in many other countries. State and local government finances are considered at various stages of the budget formulation process, and federal policy may involve specific actions aimed at supporting or controlling state and local fiscal activity. Such actions, however, are considered in the context of overall national economic policy, with subnational governments being treated in a similar way to other economic sectors.

28. **The appropriation process is complex and decisions are summarized for the public through regular budget updates.** Spending for discretionary programs is determined in the annual appropriations process, while spending for entitlement programs is generally determined by reference to their enabling laws and is not generally affected by the appropriations process. In total, only about 35 percent of total federal spending is controlled through the appropriations process.[36] There are typically 13 appropriation bills, reflecting the

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[34] See http://www.whitehouse.gov/omb/budget/fy2004/index.html

[35] See the discussion of *GFSM 2001* treatment in paragraph 4.

[36] U.S. Department of Education, *Budget Process in the U.S. Department of Education*, p. 4. http://www.ed.gov/offices/OUS/budpro2.html

sub-committee structure of the appropriations committees of Congress. Each appropriation bill goes through many layers of approval in each house prior to reaching the President, including subcommittee approval, full committee approval, adoption on the floor, conference committee action, and floor votes to approve the conference agreement. Appropriation language can be extremely specific (in the positive or negative) or very general, and relate to substantive policy issues. For instance, Section 301 of the general provisions for the Department of Education says that no funds appropriated in that act can be used for the transportation of students or teachers in order to overcome racial imbalance in any school or school system.[37] The President must either approve or not approve appropriation bills in their entirety, although there have been efforts to provide him with line-item veto power (see Box 5).

29. **Estimating expected budget outlays is difficult.** Budget authority is provided for the incurrence and liquidation of obligations. Budget authority can be made available in respect of obligations in a single fiscal year, for multiple fiscal years, or without any specific time limitation. Budget authority that has been provided for more than one year is carried forward as an unobligated balance. Budget authority that has been obligated but not paid becomes the obligated balance. Outlays are recorded when an obligation is liquidated. In the President's 2004 budget, total outlays were budgeted at $2.2 trillion, made up of $1.8 trillion from new 2004 authority and $421 billion in authority carried forward from prior years. Almost 20 percent of the current year's authority is expected to be carried forward to the future, making a total of nearly $1.1 trillion that is to be carried forward to fiscal year 2005 and beyond.[38] As noted above, no document is compiled to give an estimate of expected outlays and receipts after Congress has completed the budget process until the next budget is published. The new budget, however, is published within four months after the scheduled completion of congressional budgetary actions.

30. **The unified budget deficit or surplus of the federal government is the main indicator of the fiscal position in the budget.** This measure corresponds in broad terms to the *GFSM 2001* concept of the overall balance of the central government. On-budget and off-budget balances are distinguished within this total. In addition, both the OMB (in the President's budget) and the CBO (in their annual report on the budget) report budget aggregates in cyclically adjusted terms.

Budget documents clearly present budget forecasts and disclose all major macroeconomic assumptions. The President's budget includes substantial discussion of its underlying economic assumptions, as well as reconciliation against previous years' forecasts. Under the Budget Act, the OMB is required to make five-year forecasts based on the maintenance of current government policies. In addition, the CBO provides a set of economic assumptions which "contest" the assumptions of the OMB. The United States, unlike many

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[37] *Appendix*, *Budget of the United States Government 2004,* p.359.

[38] *Appendix, Budget of the United States Government2004,* p. 398.

Box 5. The Federal Line-Item Veto

Currently, the President has two basic options when presented with an appropriation bill. He may either sign the bill in its entirety or veto it in its entirety. Over the past century, virtually every president has proposed that he be given a "line-item veto," which would permit him to delete particular spending items from bills while permitting the remainder of the bill to become law. Those that support the line-item veto argue that it would permit the President to tackle so-called "pork barrel" spending that benefits narrow constituencies. Most state governors have some form of line-item veto power.

Providing the President with a line-item veto would require amending the Constitution. Constitutional amendments require a two-third vote of each house of Congress, and ratification by three-fourth of the state legislatures. Since constitutional amendments are difficult and time-consuming, in 1995 Congress passed the Line-Item Veto Act (LIVA), which gave the President a statutory equivalent of a line-item veto. In brief, the act permitted the President to cancel items of spending and "limited tax benefits" unless the cancellations were ultimately overturned by a vote of two-third of Congress. President Clinton exercised the line-item veto to cancel 82 spending or tax provisions during the fiscal year 1998 budget process.

The LIVA was challenged in the courts, and in June 1998 the Supreme Court ruled that the act violated the Constitution by permitting the President to unilaterally cancel spending without the agreement of Congress. The court ruled that a constitutional amendment would be necessary to provide the President with the kind of sweeping power envisioned by the LIVA. Without the passage of a constitutional amendment, one option that has been considered by Congress is a so-called expedited rescission. Under this process, the President would be guaranteed a vote on proposals that he makes under the Budget Act to "rescind" (cancel) appropriations. Currently, Congress is free to ignore such presidential proposals. The President's 2004 budget includes a proposal that would provide the President with a line-item veto power by correcting "the constitutional flaw in the 1996 Act."[1]

[1] *Analytical Perspectives*, *Budget of the United States Government 2004,* p. 318.

IMF member countries, has a plethora of suppliers of economic assumptions and analysis. The President's budget includes a comparison of the assumptions of the OMB with the "Blue Chip Consensus" as well as with the CBO forecast. Historically, the CBO's two-year forecasts are slightly more accurate than the Administration's, but differences are small.[39]

31. **Medium-term fiscal policy projections are included in the budget documents, but not necessarily in a clear medium-term fiscal policy context.** Since 1996, the CBO has consistently provided 10-year budget projections. The OMB has sometimes provided 10-year projections as well, but the 2003 and 2004 budget limited the forecast period to the budget and following four years, on the grounds that years 6–10 were not useful for policy

[39] Moreover, the CBO's forecasts appear to be as reliable as those of the Blue Chip consensus. For the two-year forecasts of growth in real output made between 1976 and 1999, the CBO had a slightly better record than did the Administration. The CBO was closer to the actual value in 11 of the 24 forecasts made between 1976 and 1999; the Administration was closer in nine periods; and the two had identical errors in four periods. The CBO's predictions of real growth made between 1982 and 1999 were, on average, as accurate as those of the Blue Chip consensus. See the CBO's Economic Forecasting Record on http://www.cbo.gov/

debate.[40] Cyclically-adjusted balances are provided for the same period, and core receipts, outlays, and budget authority forecasts are also provided for this period and can be downloaded in Excel files from the Internet. Given the expiration of the BEA, however, there is no formal requirement to link projections to explicit policy targets.

32. **Long-term projections are also prepared, although the budget documents do not include explicit long-term policy objectives.** The budget includes projections for the very long term (i.e., 75 years) in the *Analytical Perspectives* volume, and these have had an important impact in informing the debate over the long-term sustainability of federal government finances, in particular because of long-term demographic trends related to Social Security, Medicare, and Medicaid. These projections are not required by law, but have been published by the OMB every year since 1993 (except 1994–95). The CBO produces periodic long-term projections and briefs on the implications of social security spending for the fiscal position. The trustees of the Social Security and Medicare trust funds provide long-term actuarial estimates of spending and receipts for these programs every year, together with substantial detail about the estimates and how they are prepared. Some of this actuarial information is also included in the financial reports of the Social Security Administration and Department of Health and Human Services, and in the *Financial Report of the United States Government.*

33. **Estimates of new initiatives and ongoing costs of government policies are clearly distinguished in the budget documents.** The United States was one of the first countries to provide extensive information about the ongoing costs of current policy. This feature has become even more systematic with the requirements under the BEA that the OMB has to issue a report on the impact of all legislation enacted that affects spending or receipts. Notwithstanding the expiration of the BEA rules in September 2002, the President's budget proposal for 2004 continues some of the reporting aspects of the BEA, including the discretionary budget authority and PAYGO aspects (described in Box 2).[41] In addition, the President's budget and CBO reports also show in some detail the "current services estimate," detailing what receipts, outlays, surpluses, and budget authority would be if no changes were made to laws already enacted. Differing assumptions can be used, however, for baseline forecasts,[42] and the appropriate treatment of "sunset" provisions for baseline projections can be a contentious issue (see Box 6). The summary budget tables also show the effects of mandatory proposals on spending and of proposals on receipts for the budget and the following four years. The CBO is required to provide Congress with five-year cost estimates

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[40] The 2004 *Budget* says, under the heading "A More Reasonable Timeframe for Forecasting Deficits and Surpluses" that "(t)he experiment with 10-year estimates led to many lengthy and unproductive debates on information that proved to be erroneous and unreliable" (p. 28).

[41] *Analytical Perspectives*, *Budget of the United States Government 2004*, pp. 315–18.

[42] The OMB bases its estimates on a presumption that the resident's measures will be enacted; the CBO, on the other hand, presents baseline estimates, which forecast the projected effects of current laws or policies.

Box 6. The Expiration of Tax Provisions

Frequently bills enacting tax reductions have included "sunset" provisions that provide that certain provisions expire automatically after a specified period. Much more often than not, these provisions do not expire, but rather are routinely extended. When the OMB and the CBO project future revenues for the baseline, by law these forecasts assume the laws as they are currently on the books. In the case of tax provisions scheduled to expire, this means that baseline budget projections assume that they are not extended—except for excise taxes dedicated to a trust fund—even though history suggests that they probably will be. Mandatory spending scheduled to expire, on the other hand, is extended unless it is a very small program.

Some recent tax acts have included significant levels of expiring tax reductions. The Economic Growth and Tax Relief Reconciliation Act of 2001 included substantial provisions that expire (many after 2010) in order to keep the bill within the approximately $1.3 trillion price tag permitted by the congressional budget resolution. The CBO estimated that extension of the expiring provisions would add almost $300 billion to the cost through 2011, and an additional $500 billion through 2013. The CBO estimated that another $440 billion in revenues between 2004 and 2013 would be lost by extending all other expiring tax reductions currently on the books.[1] Similar considerations apply to tax cuts enacted under the Jobs and Growth Tax Relief Reconciliation Act of 2003.

[1] CBO, 2003, *The Budget and Economic Outlook: Fiscal Years 2004–2013* (January), p. 8.

that show how any legislation coming out of a congressional committee would affect the baseline estimates.

34. **The budget documents analyze the sensitivity of estimates to changes in economic variables and disclose the main fiscal risks.** A table of "rule-of-thumb" sensitivities shows how changes in the real economy, inflation, and interest rates affect the major budgetary aggregates.[43] There is an increasing focus on contingent and longer term liabilities. Chapters in the most recent budget documents cover issues associated with creating an accrual-based balance sheet, and dealing with some long-term obligations which may not be deemed as meeting the recognition tests for accounting purposes. Chapter 9 in *Analytical Perspectives* of the 2004 budget provides a discussion of contingent liabilities from federal credit and insurance programs.

35. **Objectives of major programs are announced and actual progress is reported against these objectives.** The GPRA was designed to shift the focus of budgeting from process and legal compliance to results by requiring agencies to produce strategic plans, annual performance plans, and annual program performance reports. It also requires that a government-wide performance plan be produced annually as part of the President's budget.[44]

[43] *Analytical Perspectives, Budget of the United States Government 2004,* p. 32.

[44] These requirements are described in Part 6 of OMB Circular No. A-11.

However, the Administration has determined that GPRA information has been of little relevance to the budget process,[45] and the task now is to integrate agency budgets with performance. Accordingly, the Administration has developed a new performance instrument, the Program Assessment Rating Tool (PART), which is a series of questions designed to evaluate a program's results, management, purpose and design, and strategic planning. In addition, each major agency is rated using a three-level score (green, yellow, and red) on the five dimensions of performance included in the PMA: human capital; competitive sourcing; financial performance; E-government; and budget and performance integration.

36. **Performance measurement remains work in progress.** The performance information in the President's budget proposal is not substantial, reflecting its mainly legalistic role. Agencies supply separate documents detailing their program activities. The new PART process has identified significant shortcomings both in the quality of performance information provided by agencies and in the actual performance of agencies in delivering the outcomes sought of them. One-half of the 234 programs reviewed under PART in 2004 could not adequately demonstrate results sufficient to judge whether they were effective or not.[46] Of those that could demonstrate results, about 12 percent were deemed to be effective, 48 percent moderately effective, 29 percent adequate, and 10 percent ineffective.

37. **Internal control procedures in government agencies are insufficiently effective.** The accounting system, properly applied, is capable of generating reports on accounts payable. The federal government standard general ledger provides for information being recorded on accounts payable.[47] However, the GAO has reported substantial problems (described as "material weaknesses") with the quality of the internal control systems operating in many agencies. Despite significant legislative actions over many years,[48] the

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[45] *Mid-Session Review*, Office of Management and Budget, July 15, 2002, p. 28.

[46] *Budget of the United States Government 2004*, p. 51. Although the term "program" is used, the PART process does not clearly map to the appropriation or program terms used in the budget. For instance, the PART statement does not make clear whether the program "Animal Welfare," (p. 18) relates to all or some of the activities of Animal and Plant Heath Inspection Service (*Appendix,* pp. 75–78). Although there is a review of the Department of the Treasury technical assistance in the PART statement (p. 216), this is a subcomponent of the Economic Policies and Program activity from the appropriation statement (*Appendix*, p. 765).

[47] Coded as 2110 "Accounts payable" and 2216 "Pension benefits due and payable to beneficiaries," in the U.S. Government Standard General Ledger, issued September 2002. Prompt payment is required under federal law.

[48] In the 1990s, congress passed the following acts to bolster internal control: the Chief Financial Officers Act (CFOA) of 1990; the Government Management Reform Act (GMRA) of 1994; the Federal Financial Management Improvement Act (FFMIA) of 1996; the Government Performance and Results Act (GPRA) of 1993; and the Information Technology Management Reform Act (Clinger-Cohen Act) of 1996. Congress had previously passed the Federal Managers Financial Integrity Act (FMFIA) of 1982, which focuses on management controls. The CFOA requires auditable financial statements to be prepared by all agencies using the Federal Accounting Standards Advisory Board (FASAB) accounting standards. The FFMIA particularly highlights the need for adequate financial systems. Moreover, the Inspector General Act of 1978 established the

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GAO this year reported six recurring financial system problems, at least one of which was reported in 20 of 24 Chief Financial Officers' Act (CFOA) of 1,990 agencies. In the view of the auditors, agency management in these 20 agencies does not yet have the financial systems needed for accountability, performance reporting, and decision-making. The major problems were:[49]

- 14 agencies had nonintegrated financial-management information systems;
- 13 had inadequate reconciliation procedures between accounting and banking information;
- 12 had a lack of timely and accurate reporting;
- 8 failed to comply with the prescribed general standard ledger;
- 14 failed to adhere to federal government accounting standards; and
- 20 had weak security over their information systems.

Seven agencies were reported not to be in substantial compliance with all three 1996 FFMIA requirements—financial management system requirements, applicable federal accounting standards, and the standard general ledger.[50] Notwithstanding these weaknesses, the number of unqualified audit opinions has been increasing over the past five years, from 11 out of 24 departments and major independent agencies in 1997, to 18 in 2000 and 2001, and to 21 in 2002. For 2002, the financial reports were required by February 1, 2003, a month earlier than in previous years.

38. **Procurement regulations that require the use of open tendering procedures are well established.** Both selective tendering and limited tendering may be used on an exceptional basis and only in accordance with the regulations. All regulations are required to be published for public comment in the *Federal Register* and are in accordance with the provisions of the *Agreement on Government Procurement* of the World Trade Organization. These regulations are required to be observed and are subject to a challenge of procedures by any interested supplier.

39. **Government employment and pay procedures are clearly defined and observed.** Government employment and pay is heavily regulated through statutory rates for positions

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Office of Inspectors General in each agency as an independent oversight office with the aim of strengthening oversight of controls by agencies.

[49] "GAO Financial Management—FFMIA Implementation Necessary to Achieve Accountability," GAO-03-31, October 2002, "Highlights."

[50] GAO (October 2002), p. 15.

with defined levels of responsibilities and comprehensive administrative guidance for relating particular responsibilities to a specific pay rate. Agency compliance with rules is monitored, and noncompliance is addressed through corrective action. Some observers believe that agencies do not have enough flexibility over personnel actions, such as hiring and compensation. The recent report *Urgent Business for America: Revitalizing the Federal Government for the 21st Century* issued in January 2003 by the National Commission on the Public Service (the Volcker Commission) made several recommendations designed to provide greater flexibility to agencies for personnel practices.

40. **The treasury cash accounts are accurate and reliable.** While these are audited, a number of agencies, and the Department of Defense, in particular, have problems reconciling their fund balance with the treasury balance.[51] According to the GAO, most agencies are not able routinely to produce reliable, useful, and timely financial information.[52] Some agencies, such as the Department of Education, use a cumbersome combination of manual and automated processes to produce financial information, while others, such as the Department of Justice, do not process accrual-based financial transactions on an ongoing basis. The GAO also reported that across the government, agencies have many efforts underway to implement or upgrade financial systems to alleviate long-standing weaknesses in financial management.[53]

41. **The IRS has legal protection from political interference.** The IRS is a subunit of the Department of the Treasury. It is headed by an independent commissioner appointed by the President with the advice and consent of the senate. Under the Internal Revenue Service Restructuring and Reform Act (IRSRRA) of 1998, the commissioner is appointed for a 5-year term, and may be reappointed. The IRS Oversight Board, established under IRSRRA, recommends candidates for IRS commissioner to the President. The President currently has less direct control over the IRS commissioner than was the case prior to the restructuring, when the President appointed the commissioner to a term coincident with his own, with no specific recommendation from any outside body. The Internal Revenue Code establishes a general rule of confidentiality of tax returns and tax information, and prescribes only limited conditions under which such information may be disclosed. Most significantly, Section 6103 (g) establishes that the President, White House employees, or the heads of certain other agencies may request information on individual taxpayers for specific reasons (for example, as a part of a background investigation of a prospective employee). The President or the head of any agency making such a request is required, however, to file a

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[51] The GAO (October 2002) notes, however, that the problems at the Department of Defense are much greater than just reconciliation: “By a wide margin, the DOD faces the greatest challenge of any agency in overhauling its financial management systems” (pp. 38–39).

[52] GAO (October 2002), p. 3.

[53] GAO (October 2002), p. 36.

quarterly report with the JCT identifying the taxpayer for whom such requests were made, describing the returns or return information involved, and giving the reasons for the requests.

42. **The legislature receives mid-year budget updates.** The United States Code (Section 1106 of Title 31) requires a supplemental update of the budget that was transmitted to Congress earlier in the year. This update contains revised estimates of the budget surplus, receipts, outlays, and budget authority, as well as other summary information required by statute. The CBO is also required under the Budget Act to present a mid-term update, which shows revised data on the current year's budget, albeit using CBO methodology and assumptions.[54] In accordance with the CBO's mandate established by Congress, the report makes no recommendations.

43. **The audited financial statement of the federal government is available within six months of the end of the fiscal year**. The United States has issued audited consolidated financial statements for the past six years and unaudited consolidated financial statements since 1974. The objective is to issue the consolidated financial report for 2004 prior to December 15—that is, 75 days after year-end rather than the six months after year-end required by statute.[55] The financial statements are audited by the GAO. The 2002 report contains an audit disclaimer stating a lack of ability to determine the reliability of significant portions of the accompanying fiscal years 2002 and 2001 consolidated financial statements.[56] The report also includes two new statements, one reconciling the consolidated financial statement's concept of net operating cost and the unified budget deficit or surplus, and the other showing changes in cash from the budget and other activities.[57] As is the case with most budget-related documents, the financial statements are available on the Department of the Treasury website.

D. Assurances of Integrity

44. **Aggregate budget data are reliable and the reliability of forecasts is scrutinized.** There is a legal requirement to compare budget year estimates of receipts and outlays with the subsequent actual receipts and outlays for that year, and the results are presented in *Analytical Perspectives* each year. Mechanisms for controlling outlays against budget authority are effective and rigorously applied.

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[54] *The Budget and Economic Outlook: An Update*, a report to the senate and house committees on the budget, is produced around July each year, satisfying the requirement of Section 202(e) of the Budget Act for the CBO to submit periodic reports on fiscal policy and to provide five-year baseline projections of the federal budget.

[55] O'Neill, Paul H., "A Message from the Secretary of the Treasury," *Financial Report of the United States Government,* 2001, p. 1.

[56] *Financial Report of the United States Government,* 2002, p. 38.

[57] *Financial Report of the United States Government,* 2002, pp. 56–57.

45. **Accounting practices and accounting policies are clearly described for both budgetary accounting and financial accounting by the federal government.** As described in paragraph 29, the federal budget is on an obligation basis and budgetary accounting by the OMB therefore reports both on commitments incurred against budget authority and on cash payments and receipts. Agencies also prepare accrual-basis financial statements each year that are consolidated and included in the *Financial Report of the United States Government.* Budgetary accounting standards are explained in an annual chapter entitled "Budget Systems and Concepts" in *Analytical Perspectives*.[58] Accrual basis accounting standards are being developed at both federal and state level (see Box 7) and, for the federal government financial accounting policies are summarized each year in a note to the financial statements.

46. **The size and complexity of the federal government continue to pose major problems for obtaining government-wide financial management information.** One of the main systemic problems is the multiplicity of accounting and financial management systems. Currently, the 24 CFOA agencies operate about 2,600 financial management systems, 1,100 in the civilian agencies and 1,500 or more in the Department of Defense. In 1998, the 24 CFOA agencies operated altogether more than 700 financial management systems, and 1100 financial management applications, with some individual agencies operating more than 150 systems. This factor, possibly combined with the difficulty of adapting commercial off-the-shelf systems to government operations, has resulted in the lack of uniformity and accuracy of data at the agency level. Moreover, even when accounting systems have been upgraded or overhauled, these efforts have not resulted in significant improvements in the accuracy or timeliness of financial information.

47. **External audit is fully independent of the executive branch of government**. The principal agency mandated by Congress to provide assurance of integrity is the GAO. The GAO was established by Congress following the Budget and Accounting Act to help it in fulfilling its role of investigating "all matters relating to receipts, disbursements, and application of public funds." Congress has subsequently clarified and expanded the original charter by subsequent pronouncements, acts, and regulations. The GAO has established a formidable reputation and publishes more than 1,000 reports annually. In addition, the GAO makes a large number of congressional testimonies. The independence of the GAO is ensured through its oversight by Congress and by the fixed 15-year tenure provided to the comptroller general.

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[58] This chapter presents information on the various types of funds in the federal budget; the treatment of current operating spending versus capital investment; the definition of receipts, offsetting collections, and offsetting receipts; the relationships among budget authority, obligations, and outlays; and accounting rules governing federal credit programs.

Box 7. Accounting Standards at Federal and State Levels

At the federal level, different accounting standards are applied to budgetary reporting and financial statements. This is due primarily to different objectives. Budgeting is concerned with decisions to make commitments to allocate resources, the cash demands these decisions create, and the execution of the budget. Financial reporting is concerned with reporting on the economic substance of transactions and events, also including budget execution. The federal financial reporting model acknowledges the different objectives by requiring: (1) an audited financial statement for agency reporting entities on the use of budgetary resources; and (2) an audited financial statement for the consolidated financial report of the federal government that explains the differences between budgetary and accrual-based results of operations.

To develop accounting concepts and standards appropriate for the federal government, and to ensure the quality and credibility of the principles governing its financial reporting, the FASAB was created in 1990 by the three central federal agencies with roles and responsibilities linked to accounting: the GAO, the OMB, and the Department of the Treasury. Budget concepts, standards, and principles were explicitly excluded from the FASAB's purview in recognition of the different objectives of budgetary accounting. Since that time, the FASAB has issued a series of statements (giving high-level principles), bulletins, and guides to establish standards on a range of matters including the treatment of assets, liabilities, revenue, and expense. Though considerable progress has been made by the FASAB in setting standards and by agencies in their use of these standards and in their financial management generally, financial management improvements are still necessary in most agencies. These improvements are being addressed through the PMA.

Considerable information is available in the budgetary and financial presentations of the federal government, some of which provide different but complementary perspectives. For example, the budget has included a balance sheet presentation (see *Analytical Perspectives,* 2004, Table 3-1) intended to meet the broad interests of economists and others in evaluating trends over time. The annual *Financial Report of the United States Government* presents a more traditional balance sheet focusing on the financial position of the federal government (*Financial Report of the United States Government*, 2001, p. 52). This report also includes a "Statement of Social Insurance" and substantial other information about the condition and sustainability of social insurance programs. In addition, the GPRA requires the reporting of performance information. About half of the 24 CFO Act agencies included their GPRA performance report as part of the required accountability report for fiscal year 2001. For fiscal year 2002, the combined reports were required for each of the CFO Act agencies.

FASAB routinely makes reference to the work of other standard-setting bodies, including the International Federation of Accountants—Public Sector Committee (IFAC-PSC)). The sequencing of projects and progress varies among the standard setters; the FASAB has issued some standards not yet considered by others, and vice versa. Since the FASAB has been recognized as the authoritative source for GAAP for federal governmental entities, its standards are the first source within the profession. Designation of FASAB standards as GAAP came after an assessment of the FASAB's independence, adequacy of resources, due process procedures, and comprehensiveness of work. The FASAB continues to be subject to reviews by members of the accounting profession.

The vast majority of state governments and most large local governments prepare annual financial reports in compliance with GAAP, as promulgated by the Governmental Accounting Standards Board (GASB), which was created in 1984 by the Financial Accounting Foundation to establish standards of financial accounting for state and local government entities. IFAC-PSC standards are explicitly considered by the GASB in its work program and promulgation of standards.

Box 7. Accounting Standards at Federal and State Levels (concluded)

Key GASB requirements include:

- Reporting of revenues and expenditures on a full accrual basis;
- reporting on finances by segregating data according to different uses through the use of fund accounting, which differentiates general fund transactions, earmarked revenues, self-supporting activities, and trust fund finances (such as pension funds); and
- disclosure of a substantial amount of information in the context of "notes to financial statements," including information on long-term debt, pension obligations, and contingent liabilities (including, but not limited to, potential exposure to losses resulting from lawsuits). States and local governments are not required to report on tax expenditures.

The GASB is currently overseeing the implementation of its Statement 34, which will make a number of changes in state and local financial reporting, including requiring a consolidated government financial statement, prepared on a full accrual basis. State and local compliance with GAAP has been driven in large part by the desires of financial markets to be able to compare the financial health of these states and local governments in order to evaluate the creditworthiness of bonds issued by them. Noncompliance with GAAP typically results in lower bond ratings, which in turn result in higher borrowing costs. In addition to requiring financial information, the GASB has increasingly been encouraging state and local governments to report performance information as a part of their financial statements. The voluntary reporting of performance data is widespread, but the GASB has not mandated such reporting.

In late 2002, however, the Judiciary ruled that the GAO could not compel the executive branch to produce certain documents, which may reduce its effectiveness. In addition to the GAO, most agencies (60 in all) have an inspector general who conducts internal audit of the executive branch, and provides reports detailing the results of his investigations to both the agency head and Congress. Agency annual financial statements are audited by the agency's inspector general or by an independent auditor selected by the inspector general. In late 2002, however, the Judiciary ruled that the GAO could not compel the executive branch to produce certain documents, which may reduce its effectiveness. In addition to the GAO, most agencies (60 in all) have an inspector general who conducts internal audit of the executive branch, and provides reports detailing the results of his investigations to both the agency head and Congress. Agency annual financial statements are audited by the agency's inspector general or by an independent auditor selected by the inspector general.

48. **The legislature follows up on external audit reports.** Each congressional committee and subcommittee may request, and follow up on, external audit reports. The appropriations committees in each house tend not to engage in detailed oversight because of workload and time constraints, but may certainly respond to specific and serious audit findings. The "authorizing" committees are in a better position to engage in more detailed oversight, but have historically lacked the political incentives to do so. The most active congressional committees that have focused on issues of routine management have been the House Government Reform and Oversight Committee (specifically its subcommittee on

Government Management and Technology), and the Senate Governmental Affairs Committee. These committees, however, control few resources and are thus somewhat limited in their capacity to effect reforms in management practices.[59]

49. **External scrutiny of macroeconomic models and assumptions is encouraged, in particular because the executive and legislative branches of the government each develop their own independent forecasts.** The executive branch macroeconomic forecast, which provides the basis for the President's budget, is prepared by the Council of Economic Advisors (part of the White House staff), the Department of the Treasury, and the OMB. The forecast includes both a "baseline" component and a forecast of economic performance assuming the President's policies are enacted. There is no formal external scrutiny of the models used. The existence of a separate and almost simultaneous CBO forecast, however, likely means that each organization's forecast serves as a check on the other's estimates. Further, the CBO forecast is developed after input from a panel of economic advisors, a bipartisan group including many Nobel-laureates. In addition, the United States has many private macroeconomic forecasters who provide a further check on government forecasting. The track record of the CBO in forecasting real economic growth has generally been superior to the average of the private forecasters over the almost 30 years since the creation of the CBO. The executive branch forecasts have been similarly accurate over this same period. Both the CBO and the executive branch provide forecasts at least twice a year.

50. **Adequate assurance of independence is given for compilation of fiscal statistics.** There is no national statistics office as such. Fiscal source data are collected by the Treasury and the OMB and subject to standard accounting and audit controls. These data are used directly for various budget and accounting reports. National accounts and GFS presentations of fiscal data are compiled by the Bureau of Economic Analysis, under contract to the Treasury. The bureau's methodology uses Treasury source data first to prepare national accounts estimates. Subsequently, the same source data (in combination with some national accounts data) are used independently to derive GFS estimates. Other statistics are collected by a variety of federal agencies (e.g., the Bureau of the Census and the Bureau of Labor Statistics). Congress, with the assistance of the GAO, provides independent oversight for statistical activities.

III. IMF Staff Commentary

51. **The United States is fully compliant with most elements of the fiscal transparency code and sets best practice standards in many areas.** Budget processes in the United States are perhaps the most open in the world. Congress plays a central role in shaping the annual budget; submissions to and deliberations of appropriations committees are

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[59] Follow-up is also featured in executive branch action: the annual audit process begins with a reassessment of prior year audit findings, and OMB Circular A-50 requires timely follow-up by management. Nonetheless, results have been mixed and some agencies have had the same findings reported for many years.

fully disclosed; and all issues affecting the public interest are actively debated in the press. The Constitution provides a strong and well tested framework that clearly defines the roles of the legislative and executive branches in shaping and managing fiscal policies; and the fiscal role of states and local governments are clearly defined, market-disciplined, and independent of the federal government. The few quasi-fiscal activities carried out by government corporations and GSEs are well known, information on these is available to inform the budget process, and the benefits and costs are periodically assessed.

52. **Publicly available budget documentation in the United States excels in the scope and quality of analysis, but it is necessarily complex and voluminous, and presents the general public with many ways of looking at the government's fiscal position.** However, the complexity of the fiscal system of the United States is balanced by high levels of transparency, albeit at a level of considerable technical detail, and simplification by itself will not necessarily improve transparency. There appears to be some scope, however, to place transparency at a detailed level in a clearer guiding policy framework and to provide fiscal policy statements that are comparable to those found in many other OECD countries. Some actions along these lines, as discussed later, could play a major role in providing a more disciplined framework for congressional decision-making. The fundamental strengths of congressional budget processes, and of the separation of federal and state powers, are indisputable. But on this foundation, a routine explicit presentation of medium- and long-term fiscal policies within the congressional budget process, as discussed in paragraphs 54 and 55, could provide substantial benefits both to domestic policymaking and internationally.

53. **Observers widely recognize the need for strengthening the congressional budget process so that the government's fiscal intentions are presented in a clear and timely way and can be properly debated.** Major efforts have been made over the past three decades to set up an appropriate legal framework for the congressional budget process. At their best, however, past frameworks have relied on congressional rules that can, and have been, ignored by Congress. On the whole, the budget resolution has been a relatively effective disciplining mechanism for appropriation committee decisions, and has at times offered an important framework for considering medium-term fiscal policy, but it has often been delayed and was not adopted for the 2003 budget. Fiscal responsibility legislation is being applied by other countries to help establish statutory requirements for reporting budget policies and outturns as independently as possible from political considerations. The form of such legislation would certainly have to be very different to suit the unique environment of the United States. Nonetheless, the basic principles would be worth exploring further.

54. **Budget responsibility legislation to establish continuing principles for budgeting within a clear medium- and long-term fiscal policy framework could be passed to replace the BEA.** Such legislation could require:

- a draft budget resolution to be included with the President's budget specifying medium-term fiscal targets (covering the budget year and four following years), and providing the justification for such targets;

- a report analyzing the long-term fiscal impact of current policies, including Social Security, as a supplement to the President's budget;

- Congress to pass a concurrent budget resolution as of April 15 of each year (as at present under the Budget Act).[60] The chairmen of the budget committees in each house should prepare a public report submitted to the Speaker of the House and the President *pro tempore* of the Senate (respectively) detailing the status of the budget resolution by end-April each year;

- CBO analysis of the economic and budgetary effects of both the President's budget resolution and the report on long-term fiscal policy;

- discretionary spending caps and PAYGO requirements for mandatory spending and revenue, similar to the BEA;[61]

- mid-year budget reports which should assess the short-, medium-, and long-term impact of fiscal policy relative to the original budget plan; and

- clear procedures for specifying and disclosing key budget assumptions (e.g., with respect to expiring legislation) to be used in baseline forecasts.

55. **The budget process would be further strengthened by reporting an internationally comparable measure of the budget balance to supplement the unified budget presentation.** This step would complement the ongoing work to align NIPA and the 1993 SNA. Since *GFSM 2001* is harmonized with SNA 1993, and the former is close to becoming the accepted international standard for fiscal reporting, the specific suggestion is that there should be supplementary budget and accounts reporting on a *GFSM 2001* basis. The major advantage of *GFSM 2001* is that it integrates stocks and flows in a consistent analytical framework and links the budget more clearly to the balance sheet. While *GFSM 2001* is an accrual-based reporting standard, the basic framework can also be applied to cash basis accounting and budgeting systems to enhance analytical consistency. Reflecting these advantages, budget balances derived from the *GFSM 2001* framework provide a comprehensive view of the macroeconomic impact of fiscal policy, including over the longer

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[60] Allen Schick, *The Federal Budget*, 2000, pp. 283–84 examines the possibility of requiring a joint resolution (requiring the President's signature and having force of law), but concludes that the flexibility of the present process is essential to the political and policy interplay of the system. The President's Budget Reform Proposals (chapter 14, *Analytical Perspectives,* 2004), however, suggest adoption of a joint resolution procedure.

[61] The President's 2004 budget proposes new discretionary caps and PAYGO procedures for 2004 and 2005, concluding that they are likely to be unenforceable beyond two years *(Analytical Perspectives, Budget of the United States Government, Fiscal Year 2004,* pp. 315–16).

term.[62] Reporting on a *GFSM 2001* basis—and in addition integrating its accounting and classification system with those used at the agency level—should also simplify the ex-post compilation of NIPA. Finally, such a move would provide support for international standards.

56. **Accrual budgeting should be considered over the longer term.** The United States authorities are adopting accrual standards where these are compatible with present budgetary accounting and control practices. These measures are in addition to the extensive detail on assets, liabilities, rights, and obligations, that is already provided with the federal budget and is of great relevance to long-term decisions. These steps having been taken, an eventual move to full accrual budgeting would seem to be a logical way to give a clear signal to Congress about the likely macroeconomic impact of the budget at decision-making time. However, this is something that would have to be approached cautiously given the institutional context in the United States, and especially the combination of complexity and transparency that characterizes the budget process. Since accrual adjustments are themselves complex, as well as unfamiliar, they could expose the budget process to increased risk of manipulation and in other ways undermine transparency.

57. **The presentation and discussion of fiscal policy would benefit from including an overview of state and local government finances as part of the federal budget presentation.** As noted earlier, the federal government treats state and local governments just like any other economic sector, and federal policies react to the finances of states and localities in the same way as they react to the finances of nongovernmental entities. This is not entirely legitimate. State and local governments engage in fiscal activity; their spending together matches in size that of the federal government; and their financial operations are of macroeconomic significance. This being the case, it would be appropriate for the President's budget to provide an overview of state and local finances, and of general government finances, as a basis for more comprehensive analysis of fiscal policy.[63] Fiscal reporting in the United States would also be brought into conformity with international practice, which would send a strong signal to other countries where subnational government is important but mechanisms for achieving fiscal discipline at the subnational level are less strong than in the United States.

58. **Costs and risks associated with the quasi-fiscal activities of GSEs and government corporations should also be assessed annually as part of the budget**

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[62] See *Federal Reserve Board's Semiannual Monetary Policy Report to the Congress*, February 11, 2003, for a strong endorsement from Chairman Greenspan for a move toward accrual-based fiscal accounting and reporting in the United States.

[63] The need for more comprehensive analysis is clearly illustrated by recent experience. States failed to build up large enough rainy-day funds prior to the recent downturn and, notwithstanding increased federal grants, have been forced to raise taxes and cut spending in an attempt to balance their current budgets. They have therefore been having a procyclical influence on the economy at a time when the federal government is trying to be countercyclical.

process. While data are available on the operations of GSEs and periodic in-depth analysis is undertaken, changes in the economy can materially affect some of the risks to which the government is exposed. An annual assessment of these costs and risks in the *Analytical Perspectives* document would therefore be warranted.[64] An assessment of the implicit subsidies that result when government corporations and agencies charge below-market prices would also improve transparency.

59. **Comprehensive reporting of contingent liabilities and more systematic consideration of fiscal risks in the budget would improve transparency.** As indicated in paragraph 19, inconsistencies in reporting and budgetary treatment of various kinds of risks have been noted by analysts—including in the budget documents. Reform of the budgetary treatment of risks is an ongoing process. A clearer focus could be given to this work by including an overall summary of contingent liabilities in the *Analytical Perspectives* document and, over time, by developing a comprehensive statement on fiscal risks.[65]

60. **Tax expenditure reporting is an exemplary feature of the budget, but its legal basis could be reconsidered.** The United States in many ways has led the world in establishing tax expenditure reporting in the budget. However, the current presentation is legally tied to a normal income tax baseline (albeit allowing multiple alternative presentations). Some consideration should be given to a change in the law that would give the Administration (and the JCT) authority to define the baseline on more broadly defined criteria. Such a change would improve transparency by focusing discussion of the baseline more explicitly on the general direction of overall tax policy.[66] Tax expenditures would then more clearly represent departures from that comprehensive baseline to achieve particular selected purposes.

61. **Audit reports on agencies by the GAO need to be followed up.** Control issues are transparently reported, but there appear to be systemic weaknesses in follow-up that could be examined more explicitly. The current plethora of laws and bifurcation of requirements for budgeting and financial reporting have failed to address internal control failures as effectively as could be expected. In this regard, Congress could consider the creation of a public accounts committee to provide consistent, focused follow-up to GAO findings.

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[64] More radical restructuring of these enterprises to eliminate government sponsorship, as has been suggested by some observers, would, of course obviate the need for reporting the activities in the budget context.

[65] The GAO report referenced in footnote 25 suggests a range of options for improving reporting on fiscal exposure.

[66] Recognizing that tax structures are a product of a variety of competing objectives, the baseline should nonetheless indicate the relative emphasis given, among other things, to income versus expenditure tax bases. Tax *policy* decisions would be primarily concerned about possible changes in the underlying structure—or baseline. Tax *expenditure* decisions would focus on the extent to which specific variations to the baseline should be used to meet social or economic objectives and compared with other ways of achieving these objectives (e.g., direct expenditures).

Simplification and consolidation of financial management legislation and regulation could also help foster enduring improvements in internal control systems.

62. **Efforts to integrate performance and budget management are commendable, but there needs to be an increased emphasis on program performance.** The GPRA, for example, has encouraged much more attention to strategic planning and performance measurement, the OMB plans to continue its efforts toward budget and performance integration, and the PART process is a promising development. However, full integration of performance assessment and budgeting may need to consider altering the basis of appropriation and lay out in one place the framework for financial management and other performance expectations. Agencies are beginning, even without this framework, independently to present budget justifications to Congress in a format that permits simultaneous consideration of appropriation decisions and their performance implications. They are also, on a more limited basis, linking cost and performance information more effectively. Congress, however, has shown little interest in changing its process of decision-making to focus more on performance, and currently has limited incentives to do so. A change in appropriation structures to focus more on “programs” and less on “accounts” may provide incentive for Congress to focus on performance by making the effects of budget decisions more transparent.

63. **The federal government also needs to pay more attention to the full cost of providing government services.** Such measures are lacking in many agencies. Over the longer term, consideration should be given to replacing the obligation-based system for budget appropriation and move toward expenses and accrual concepts. Some changes in this direction are underway for selected elements of the budget where accrual concepts are seen as being most relevant. Over the longer term, such changes could lead progressively toward a convergence of budgetary and financial accounting presentations of the budget.

64. **Finally, it is important to guard against any perceived weakening of fiscal transparency**. The need for Congress and the President to work together to establish a stable legal framework for medium- and long-term budget decisions has already been discussed. It is also necessary to present fiscal policy decisions and discuss their implications in a clear and meaningful manner. Whatever the merits of so doing, the way in which the 2001 and 2003 tax cuts were accounted for, and the recent decisions to forego 10-year budget projections and not to include estimates of the cost of war in Iraq in formulating the 2004 budget, have reduced the amount of information made available on fiscal policy, and this could be interpreted as a loosening of transparency standards. Not only might this cast an unjustifiable shadow over what is an extremely transparent fiscal system, but it also risks undermining hard-won fiscal policy credibility.