

GAO

United States General Accounting Office
Palm Street for the Chairman of the
Committee on Budget, U.S. Senate

February 1995

BUDGET ISSUES

Farmarking in the Federal Government



DTIC
S a D
MAR 16 1995

19950314 077

DISTRIBUTION STATEMENT A

Approved for public release

Accounting and Financial
Management Division

B-227245

January 19, 1990

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

Dear Mr. Chairman:

This fact sheet responds to the request of the former chairman of the Senate Budget Committee that we study the practice of earmarking federal revenues. Revenues are earmarked when they are designated for particular uses by authorizing legislation.

RESULTS IN BRIEF

Our study showed that the percentage of budget revenues that were earmarked grew from fiscal years 1974 through 1988. Almost half of that growth resulted from increases in earmarked Social Security payroll tax revenues. Earmarking practices vary. Earmarking provides a relatively predictable financing procedure that can help to achieve budget policy or programmatic goals. However, it also lessens congressional flexibility to adjust program funding levels and priorities.

BACKGROUND

Most governmental taxes, fees, and other revenues are deposited in the general fund of the U.S. Treasury to be allocated by appropriation actions to various uses. Certain revenues, however, are set aside by authorizing legislation for designated uses. Such actions in effect restrict the scope of appropriations control over allocating revenue.

The practice of earmarking is not new. In 1919, for example, legislation earmarked revenues to establish a life insurance fund for veterans. Legislation in the 1930s significantly extended the scope of earmarking by establishing the Social Security program and several other

DTIC
ELECTE
MAR 16 1995
S G D

Accession For	
NTIS - CRA&I	<input checked="" type="checkbox"/>
DTIC TAB	<input type="checkbox"/>
Unannounced	<input type="checkbox"/>
Justification	
By _____	
Distribution /	
Availability Codes	
Dist	Avail and/or Special
A-1	

DISTRIBUTION STATEMENT A
Approved for public release;
Distribution Unlimited

activities on a completely or partially self-financing basis. For example, the Social Security program was established as a payroll tax collected from participants and deposited in the program's trust fund.

OBJECTIVES, SCOPE, AND METHODOLOGY

As agreed with the former Chairman's office, the objectives of our study were to identify (1) the trends in and features of earmarked revenues, (2) examples of varying earmarking practices, and (3) factors for the Congress to consider when reviewing earmarking proposals.

In performing our work, we used Office of Management and Budget (OMB) budget tapes and program descriptions to identify the sources of earmarked revenues as well as the accounts, programs, and agencies to which the revenues were applied. We relied upon our prior work on earmarking and studies published by budget experts, economists, and public interest groups to identify earmarking features and practices as well as factors for the Congress to consider when evaluating earmarking proposals. Appendix I contains more details on our objectives, scope, and methodology.

TRENDS IN AND FEATURES OF EARMARKING

Earmarked federal revenues grew from fiscal years 1974 through 1988. In fiscal year 1974, the \$123 billion in earmarked revenues represented almost 40 percent of total revenues, whereas the \$520 billion in earmarked revenues in fiscal year 1988 represented about 48 percent. Social Security accounted for a large portion of the earmarked revenues and about 47 percent of the growth in the earmarked revenues. Excluding Social Security, earmarked revenues grew from about \$69 billion to \$278 billion.

Features of earmarked revenues in fiscal year 1988 included the following:

- About 69 percent were taxes and regulatory revenues, the balance being business-type revenues.
- About 92 percent were in nonrevolving trust and public enterprise revolving funds.

- Ten programs received 83 percent of all earmarked revenues. The three largest programs--Social Security, Medicare, and the Postal Service--accounted for 66 percent of the earmarked revenues.
- Six agencies received 84 percent of the earmarked revenues. The Department of Health and Human Services accounted for about 60 percent of the earmarked revenues.

Appendix II provides additional information on earmarking trends and features.

EXAMPLES OF VARYING EARMARKING PRACTICES

Federal earmarking practices vary from program to program in two key respects. First, because of differing statutory provisions, some program participants' payments are earmarked back to the programs, while others are deposited in Treasury's general fund for unspecified future use. For example, the Postal Service's legislation permits it to keep the business-type revenues generated from the sale of postage stamps and postal services. In fiscal year 1988, its revenues were about \$34 billion. On the other hand, the revenues the Securities and Exchange Commission (SEC) collects from businesses for securities registration and other fees--about \$250 million in fiscal year 1988--were returned to Treasury's general fund, where they became available for purposes to be later decided by law. The SEC, in turn, received its funding from the Congress during the annual appropriation process.

Second, there are differences in the sources of the earmarked revenues. In most cases, the amounts earmarked to a program come from the program itself, mainly cost-sharing amounts paid by program participants, as in the case of the Postal Service. In other cases, the earmarked amounts come from unrelated activities outside the program. For example, the General Service Administration's surplus property sales amounts--\$37 million in fiscal year 1988--were earmarked for certain conservation programs in the Department of the Interior. In fiscal year 1988, about \$3.8 billion in revenues from customs duties were dedicated to the Child Nutrition Program to provide meal subsidies.

CONSEQUENCES OF EARMARKING

The practice of earmarking funds can produce both positive and negative consequences. Earmarking establishes a relatively predictable financing procedure that may help to achieve budget policy or programmatic goals. Our review identified the following four positive results of earmarking.

- Earmarking increases the visibility of cost-sharing arrangements. When cost-sharing collections are deposited in a program's account rather than Treasury's general fund, the collections become a source of funding for the program. This can be very useful if the Congress wants to establish, monitor, or adjust the dependence of the program upon cost-sharing collections. Appendix III provides additional information regarding cost-sharing arrangements.
- Earmarking may make the enactment of new or increased taxes or fees more acceptable to the public. The public may sometimes be more receptive to payment increases if they know specifically how the funds will be used.
- Earmarking can be used as a management incentive for increased collection efforts. Program administrators may have a greater incentive to seek full and timely cost reimbursements from the public if they can retain some or all of the collected amounts for future program uses.
- Earmarking can be used to provide a relatively assured minimum level of funding to a program. Program proponents may seek an earmarked source of financing if they believe that the appropriations process can not be counted on to provide a minimum or stable level of funding.

Our review also identified some negative consequences of earmarking. Most earmarking provisions are established by authorizing legislation and may only be changed through the legislative process. This can be a time-consuming and complex process that decreases congressional flexibility. We identified four negative consequences of earmarking.

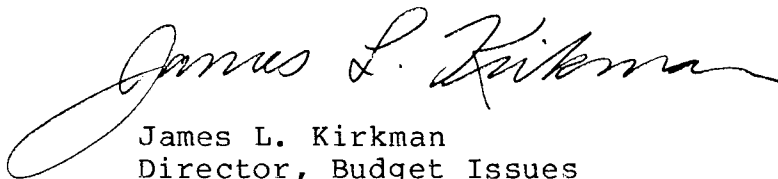
- Earmarking decreases the Congress' ability to annually adjust program priorities. Because earmarking makes it more difficult to shift funds between programs, it may take longer to allocate revenues to new high-priority programs.
- Earmarking reduces the Congress' ability to quickly adjust an individual program's funding level. If an earmarked program's funding needs decrease, the program may continue to receive more funds than it actually needs.
- Earmarked accounts may receive less frequent congressional reviews than accounts for programs funded through annual appropriations, whose funding levels must be reviewed and acted upon each year.
- Earmarking presumes a minimum level of spending for earmarked programs. This could impair budget deficit reduction efforts.

The decision to earmark funds is, of course, a matter for congressional determination. We believe that considering the advantages and disadvantages of earmarking can help the Congress evaluate the appropriateness of this means of funding for particular programs.

We are sending copies of this report to the Director, Office of Management and Budget; the Director, Congressional Budget Office; and other interested parties. Copies will also be available to others upon request.

Please contact me at (202) 275-9573 if you or your staff have any questions concerning the fact sheet. Other major contributors to this fact sheet are listed in appendix IV.

Sincerely yours,



James L. Kirkman
Director, Budget Issues

OBJECTIVES, SCOPE, AND METHODOLOGY

The former Chairman of the Senate Budget Committee asked that we study the practice of earmarking federal revenues. As agreed with Committee staff, the objectives of our study were to identify

- trends in earmarking and the features of earmarked revenues,
- varying earmarking practices, and
- factors for the Congress to consider when reviewing earmarking proposals.

To identify trends in the use of earmarking, we examined annual governmental revenues at 3-year intervals from the end of fiscal year 1974 through fiscal year 1988. We used 1974 revenues as the starting point because that was the earliest year for which relevant data were available from OMB's budget tapes. Our use of 3-year intervals permitted us to analyze major changes within the 14-year period and avoid temporary, year-to-year changes due to fluctuations in the economy.

To identify the features of earmarked revenues, we examined them from four different perspectives:

- their source (taxes or regulatory--"sovereign powers"--revenues versus revenues from business-type operations);
- the fund type (trust, special, general, etc.) to which they were applied;
- the programs receiving the largest amounts; and
- the agencies receiving the largest amounts.

To identify varying earmarking practices, we (1) identified accounts where the earmarked amounts were cost-sharing payments from program participants and others where the earmarked amounts came from sources outside the program (not program participants) and (2) identified instances where the cost-sharing payments were earmarked for use by the programs and others where cost-sharing payments were deposited in Treasury's general fund. The accounts having these characteristics were identified by cognizant OMB, Congressional Budget Office (CBO), and GAO officials.

Concerning factors for the Congress to consider when determining whether to approve earmarking proposals, we reviewed earmarking reports and studies conducted by economists, budget

experts, and organizations such as the National Conference of State Legislatures, the Administrative Conference on User Fees, and the Tax Foundation. We also reviewed OMB, Treasury, and GAO studies and documents. To obtain the views of governmental budget experts on the pros and cons of earmarking, we interviewed officials at OMB, CBO, the National Conference of State Legislatures, the Administrative Conference on User Fees, and the President's Council on Integrity and Efficiency.

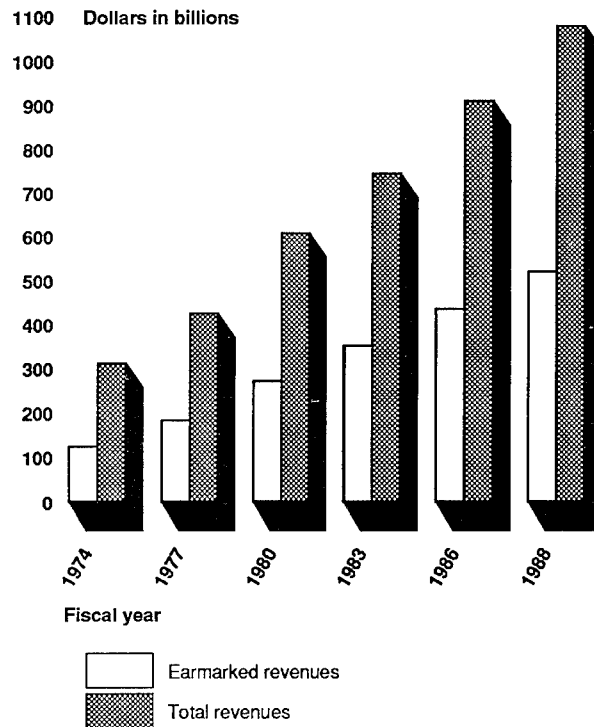
EARMARKING TRENDS AND FEATURES

In recent years, there has been a trend toward earmarking a larger share of the government's total revenues. Most of the earmarked amounts are taxes dedicated to trust fund accounts, the largest of which is the Social Security program, which consistently accounted for more than 40 percent of the earmarked amounts. The Department of Health and Human Services has been the agency with the most earmarked revenues.

GROWTH IN EARMARKING

Our analysis showed that earmarked revenues grew faster than total revenues between fiscal years 1974 and 1988. Figure II.1 illustrates that during this period earmarked revenues quadrupled, from about \$123 billion to about \$520 billion; during the same time, total revenues tripled, increasing from approximately \$312 billion to more than \$1 trillion. Earmarked revenues grew from about 40 percent of total revenues in fiscal year 1974 to about 48 percent in fiscal year 1988.

Figure II.1: Growth of Earmarked and Total Government Revenues



Note: Growth is shown at 3-year intervals, except for the 1986 to 1988 interval. We used this 2-year interval because 1988 was the last year for which data were available.

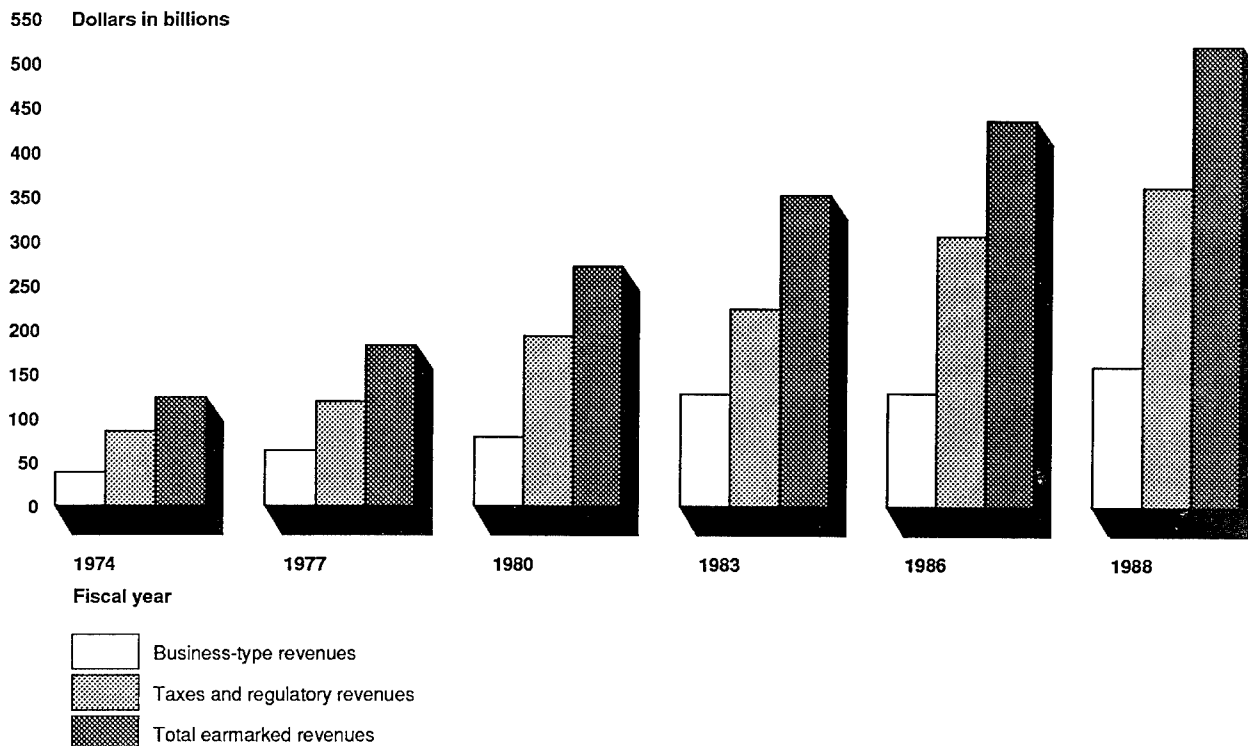
To provide information to a variety of users, we analyzed earmarking trends from several perspectives--source, fund type, and the programs and agencies receiving the largest amounts of earmarked revenues.

SOURCE OF EARMARKED REVENUES

Of the approximately \$520 billion in fiscal year 1988 earmarked revenues, about \$361 billion (69 percent) came from tax and regulatory fee revenues. They include items such as Social Security payroll taxes, customs duties, excise taxes, and fees levied on regulated activities. These are sometimes referred to as "sovereign powers" revenues to distinguish them from revenues of the government's business-type operations, which constituted the remaining \$159 billion (31 percent) of fiscal year 1988 earmarked revenues. Revenues from business-type operations include collections from rents, royalties, and the sale of products, services, and property. The stamp sales revenue earned by the Postal Service is an example of business-type revenue.

From fiscal years 1974 through 1988, these two sources of earmarked revenues experienced similar rates of growth. As illustrated in figure II.2, revenues from taxes and regulatory operations grew from about \$85 billion to \$361 billion, a 325-percent growth rate. The revenues from business-type operations grew from approximately \$38 billion to \$159 billion, about a 318-percent growth rate.

Figure II.2: Growth of Earmarked Revenues by Source



Note: Growth is shown at 3-year intervals, except for the 1986 to 1988 interval. We used this 2-year interval because 1988 was the last year for which data were available.

FUND TYPES OF EARMARKED REVENUES

To provide further information on how earmarking affects the budget, we analyzed the two sources of earmarked revenues by the types of budget accounts to which the funds are applied. There are six kinds of accounts--general, nonrevolving trust, revolving trust, special, public enterprise, and intragovernmental. OMB, Treasury, and GAO documents¹ describe only one kind of account, the

¹OMB's Examiner's Handbook; Treasury's 1987 Annual Report, Appendix; and GAO's A Glossary of Terms Used in the Federal Budget Process.

agency "general fund" account, as being designed for programs financed by nonearmarked revenues. (Some general fund accounts, however, receive earmarked revenues.)

The remaining five types of accounts are designed for programs financed by earmarked revenues. Nonrevolving and revolving trust funds are in this category. Nonrevolving trust fund accounts record the appropriated amount of revenues collected for a specific purpose or program under a trust agreement or statute. This would include the payroll taxes collected for the Social Security program. Revolving trust fund accounts receive revenues generated in business-type operations in accordance with a trust agreement or status. An example of this type of account is the Federal Deposit Insurance Corporation, which receives insurance premiums paid by the financial institutions it insures.

Special fund accounts are established to record appropriated amounts of revenues which are (1) collected from a specific source, (2) earmarked by law for a specific purpose or program, and (3) not termed a trust fund account in the authorizing legislation. This would include accounts such as the National Park Service's (NPS) Operation and Maintenance of Quarters account, into which certain rental payments NPS receives are deposited.

Public enterprise revolving fund accounts are the fourth type of earmarked account. They receive amounts generated in a continuing cycle of business-type operations. Examples include the Postal Service and the Export Import Bank, which are both governmental corporations originally established to be substantially self-financed through the sale of their goods or services.

Finally, intragovernmental fund accounts are specifically authorized by law to facilitate financing transactions within and between federal agencies. An example is the Forest Service's Working Capital Fund, whose primary purpose is to provide service to national forests and research experiment stations. This account, however, also receives revenues from the public for the rental of equipment and aircraft services and the sale of nursery and supply services.

As seen in table II.1, nonrevolving trust fund revenues from taxes and regulatory operations comprised the largest portion of earmarked revenues. In fiscal year 1988, about \$374 billion (72 percent) of all earmarked revenues went to nonrevolving trust fund accounts. Most of these amounts (\$354 billion) were in the form of taxes and regulatory revenues. Public enterprise revolving

funds received approximately \$104 billion (20 percent) of all earmarked revenues and all of these amounts were in the form of business-type revenues.

The remaining 8 percent of earmarked revenues were divided among the trust revolving, special, intragovernmental, and general fund accounts. General funds, which are designed to be financed from Treasury's general fund, received a small amount of earmarked revenues, about \$10 billion (2 percent) of the total.

Table II.1: Earmarked Revenues by Fund Type and Source for Fiscal Year 1988

<u>Fund type</u>	<u>Tax and regulatory revenues</u>		<u>Business-type revenues</u>		<u>Total earmarked revenues</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
----- (Dollars in billions) -----						
Nonrevolving trust	\$354.0	98	\$ 20.0	13	\$374.0	72
Public enterprise revolving	0.0	0	104.3	66	104.3	20
Special	6.6	2	5.4	3	12.0	2
Intragovernmental	0.0	0	9.7	6	9.7	2
Trust revolving	0.0	0	9.2	6	9.2	2
General	<u>0.0</u>	<u>0</u>	<u>10.3</u>	<u>6</u>	<u>10.3</u>	<u>2</u>
Total	<u>\$360.6</u>	100	<u>\$158.9</u>	100	<u>\$519.5</u>	100

As table II.2 shows, each fund type accounted for almost the same percentage of earmarked revenues in fiscal years 1974 and 1988. Over that period, nonrevolving trust funds accounted for 72 percent of the total, and public enterprise revolving funds remained at about 20 percent. The other fund types remained about 2 percent of the total earmarked funds.

Table II.2: Earmarked Revenues by Fund Type for Fiscal Years 1974 and 1988

<u>Fund type</u>	<u>Fiscal year</u>			
	<u>1974</u>		<u>1988</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
----- (Dollars in billions) -----				
Nonrevolving trust	\$ 88.2	72	\$374.0	72
Public enterprise	25.7	21	104.3	20
Special	2.5	2	12.0	2
Intergovernmental	3.0	2	9.7	2
Trust revolving	1.7	1	9.2	2
General	<u>2.3</u>	<u>2</u>	<u>10.3</u>	<u>2</u>
Total	<u>\$123.4</u>	100	<u>\$519.5</u>	100

TEN LARGEST EARMARKED PROGRAMS

To show how earmarked funds are used, we identified the largest programs financed by these revenues. In fiscal year 1988, 31 programs received at least \$1 billion each in earmarked revenues. The ten which received about \$432 billion (83 percent) of all earmarked revenues are identified in table II.3.

Table II.3: Programs Receiving Largest Amounts of Earmarked Revenues for Fiscal Year 1988

<u>Program</u>	<u>Primary source</u>	<u>Type of account</u>	<u>Total revenue</u> (Dollars in billions)
Social Security ^a	Taxes	Nonrevolving trust	\$241.5
Medicare ^b	Taxes	Nonrevolving trust	68.7
U.S. Postal Service	Business-type revenues	Public enterprise revolving	34.0
Unemployment Trust Fund	Taxes	Nonrevolving trust	24.4
Commodity Credit Corporation	Business-type revenues	Public enterprise revolving	21.4
Highway Trust Fund ^c	Taxes	Nonrevolving trust	14.1
Foreign Military Sales	Business-type revenues	Nonrevolving trust	9.0
Federal Savings and Loan Insurance Corporation ^d	Business-type revenues	Public enterprise revolving	8.1
Federal Housing Administration Fund	Business-type revenues	Public enterprise revolving	5.9
Rural Electrification and Telephone Revolving Fund	Business-type revenues	Public enterprise revolving	<u>5.1</u>
Total			<u>\$432.2</u>

^aFederal Old Age and Survivors Insurance Trust Fund and Federal Disability Insurance Trust Fund.

^bFederal Hospital Insurance Trust Fund and Federal Supplementary Medical Insurance.

^cThe Fund consists of 13 accounts.

^dFSLIC was dissolved and the insurance function was transferred to the Federal Deposit Insurance Corporation.

Table II.3 shows that taxes are the primary source of funding for 4 of the 10 largest programs and, in those programs, are credited exclusively to nonrevolving trust funds. They total about \$349 billion (67 percent) of all earmarked revenue.

EARMARKING IN THE AGENCIES

We also identified the agencies receiving the most earmarked revenues in fiscal years 1974 and 1988. The Department of Health and Human Services (HHS) accounted for over half of all earmarked revenues. In fiscal year 1988, HHS received about \$313 billion (60 percent) of the approximately \$520 billion in earmarked revenues, mostly in the form of payroll taxes earmarked for the Social Security trust funds. The following table ranks the six agencies receiving the most earmarked revenues and shows the total received by all other agencies.

Table II.4: Earmarked Revenues Received by Federal Agencies in Fiscal Years 1974 and 1988

<u>Agency</u>	<u>Fiscal year</u>			
	<u>1974</u>		<u>1988</u>	
	<u>Dollars</u>	<u>Percent</u>	<u>Dollars</u>	<u>Percent</u>
----- (Dollars in billions) -----				
Department of Health and Human Services	\$ 66.8	54	\$313.2	60
Postal Service	8.6	7	34.0	7
Department of Agriculture	7.5	6	35.8	7
Department of Labor	6.8	6	25.6	5
Department of Transportation	7.2	6	18.1	3
Department of the Treasury	1.6	1	10.9	2
Other agencies	<u>24.8</u>	<u>20</u>	<u>81.9</u>	<u>16</u>
Total	<u>\$123.3</u>	100	<u>\$519.5</u>	100

The Department of the Treasury is the only agency whose earmarked revenues are almost equally split between taxes and regulatory revenues and business-type revenues. In each of the other five agencies, at least 80 percent of the earmarked revenues were either taxes and regulatory revenues or business-type revenues. The Department of Labor, the Department of Transportation, and HHS received mainly taxes and regulatory revenues, while the Department of Agriculture and the Postal Service received mainly business-type revenues.

GENERAL KINDS OF EARMARKING BASED ON COST-SHARING

We have identified three kinds of earmarking involving a cost-sharing relationship between a program and its participants: earmarked beneficiary payments, regulated entity payments, and contributed funds. Each of these can be briefly described as follows.

EARMARKED BENEFICIARY PAYMENTS

This kind of earmarking occurs when those persons or organizations particularly benefiting from a federal program pay the program to cover a portion of its costs. This can also be called the "social insurance" concept. For these funds (1) the recipient contributes to the fund from which payments are made and/or performs some action or service to qualify for the benefit and (2) the government has a statutory obligation under current law to, in effect, return the moneys in the form of statutorily defined benefits. Examples of such programs are the Federal Old-Age and Survivors Insurance Trust Fund, the Civil Service Retirement and Disability Fund, and the Tax Court Survivors Annuity Fund. Such benefit programs account for a large share of the budget's earmarked funds.

The user fees that a program's beneficiaries pay to the program are also earmarked beneficiary payments. User fees distribute a larger share of a program's cost to those who most directly and immediately benefit from the program. The park visitors' user fees collected by the National Park Service (NPS) are an example of these fees. They are credited to an NPS budget account which NPS uses to manage, operate, and maintain the park areas. As another example, legislation permits the Environmental Protection Agency to be reimbursed for computer services it provides to the public.

This type of earmarking is also at the heart of governmental enterprises, whose aim is to run a partially or completely self-financed operation by distributing a portion of the costs to those who buy or accept the agencies' goods, services, or financial assistance. Such enterprises include the Postal Service, the Export-Import Bank, and the Federal Deposit Insurance Corporation. The Postal Service, for example, receives most of its revenues from its sale of postage stamps and fees for postal services.

EARMARKED REGULATORY PAYMENTS

When a person's or an organization's activities require special federal regulation or other actions giving rise to federal costs, earmarked regulatory fees help defray the costs. This cost-sharing practice includes operations requiring special licenses, permits, or

inspections to ensure the public's well-being and safety. For example, companies that manufacture homes must pay inspection fees to the Department of Housing and Urban Development's (HUD) Manufactured Home Inspection and Monitoring account. These fees are used to enforce compliance with federal construction and safety standards.

EARMARKED CONTRIBUTED FUNDS

Contributions are another source of earmarked revenues having a cost-sharing relationship. In these cases, individuals donate funds to support a particular program's operations. This type of relationship differs from other cost-sharing relationships in that the person paying the expense may not be the primary beneficiary and may not have caused the expense. This type of account mainly includes agency gift funds. For example, HUD has a gift fund which receives gifts and bequests for the work of the Department. These accounts are usually small in dollar value. In fiscal year 1988, HUD's gift fund received only \$9,000.

MAJOR CONTRIBUTORS TO THIS REPORT

ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION, WASHINGTON, D.C.

Roy Jenney, Assistant Director, Budget Issues, (202) 275-1991
Edith Pyles, Assistant Director
Trina Lewis, Evaluator
Sharon Deluzio, Accountant