

Federal Debt and the Commitments of Federal Trust Funds

Summary

The debts of the U.S. government consist of money that the government owes to the public and money that the government owes to itself. Although the two types are typically combined in discussions of the overall debt, only the money that the government owes to the public has an impact on the economy. When the government borrows from the public, it reduces the amount of resources available in the financial markets for private investment. In contrast, the money that the government owes to itself has no impact on the markets because it represents debt owed from one Treasury account to another. Most of that internal debt is held in federal trust funds.

Trust fund holdings, as internal liabilities between government accounts, are not assets of the government. Nor do they represent money owed to program recipients individually; payments to Social Security recipients and beneficiaries of other social insurance programs are based on a variety of rules set by law unrelated to trust fund holdings. A federal trust fund is basically an accounting device that measures the difference between the income designated for a specific program and the expenditures made to its beneficiaries. The accumulated difference, or balance, often represents a reserve of future “spending authority” for the program, but it is not a reserve of money for making payments.

In the future, when receipts for such programs as Social Security fall below their expenditures, the legal authority to pay benefits will exist as long as their trust funds have balances, but the government will have to generate cash to pay benefits either by running a surplus in the rest of the budget—which would probably require cutting other spending or raising taxes—or by borrowing from the public.

The Nature of Federal Debt

The total outstanding debt of the federal government, often referred to as the gross federal debt, now stands at approximately \$6.2 trillion. That figure is composed of \$3.5 trillion in debt that the government owes to the public and \$2.7 trillion in debt that the government owes to itself. Debt held by the public is the value of all the federal securities that have been sold to the public and are still outstanding—it represents the government’s borrowing from the public. Businesses and the financial markets pay close attention to it because of its impact on the economy. When the Department of the Treasury sells securities—in effect, borrows from the public—that activity absorbs resources that otherwise might be invested in the private sector. Conversely, when the Treasury Department redeems securities, that activity increases the resources available for private investment because the holders of the securities receive funds that they can invest again.

The portion of the debt that the government owes itself largely consists of federal securities credited to various trust fund accounts maintained by the Treasury Department. Those securities represent the balances of either excess receipts collected to finance specific programs (for example, Social Security taxes) or reserve spending authority that has been allocated for a particular activity (for example, appropriations for the military retirement system). Like federal securities sold to the public, they are legal obligations of the government and are backed by its full faith and credit. However, unlike federal securities sold to the public, which are assets of the holder, Treasury obligations held by federal trust funds are not assets of the government as a whole. A member of the public who holds a federal security has a legal claim against the government; in contrast, a federal trust fund holding a federal security is simply the government having a claim against itself.

Adding federal securities to and subtracting them from the government's trust fund accounts have no direct impact on businesses and the financial markets. Such activity does not cause money to flow between the government and individuals, private businesses, or other institutions; it has no impact on bond prices and yields; and it does not change the economic worth of any entity. Most important, the securities do not represent the amount of future benefits that individuals are potentially entitled to under federal programs, nor are they the resources that the government will need in order to pay beneficiaries.

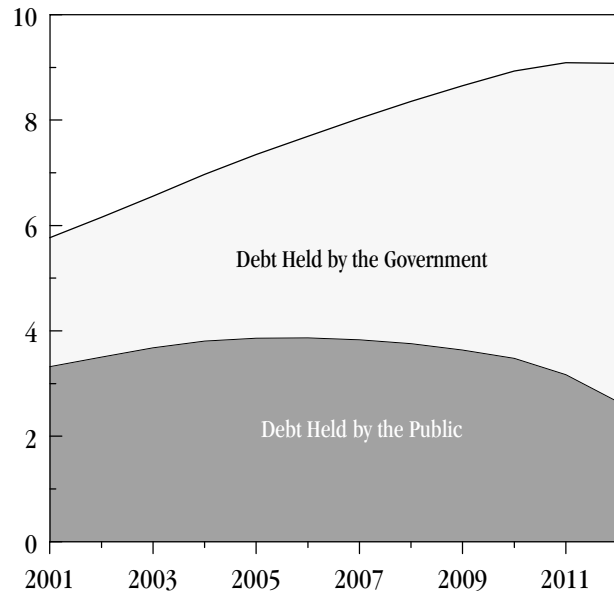
Federal Debt Under CBO's Current Baseline Projections

A growing federal debt has often raised concerns when it resulted from budget deficits and signaled that the cost of government might be rising too fast or that the government was not paying for its current consumption with current receipts.¹ But an increase in gross federal debt does not necessarily have such implications. For example, under CBO's baseline projections, which assume the continuation of current tax and spending policies, gross federal debt is projected to rise substantially over the next 10 years—from \$6.2 trillion at the end of fiscal year 2002 to \$9.1 trillion at the end of fiscal year 2012—while the budget is expected to run cumulative surpluses of more than \$1 trillion during that period.

That scenario may seem implausible, for if budget surpluses do materialize, should federal debt not shrink? In fact, part of it does: the part owed to the public. That portion of the debt is projected to rise until 2006, but then, as budget surpluses emerge, it falls to a level lower than it is now. However, because the portion that the government owes to itself is projected to increase by more than the portion it owes to the public is projected to fall, the gross debt rises. The debt held by the public is projected to drop from \$3.5 trillion today to \$2.7 trillion by the end of fiscal year 2012; in contrast, the debt held in government accounts is projected to rise from \$2.7 trillion today to \$6.4 trillion by the end of fiscal year 2012.

The Projected Composition of Federal Debt, 2001 to 2012

(Trillions of dollars)



Source: Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2002).

Debt Held in Government Accounts

Whether the result of accumulating budget deficits or growing trust fund balances, gross federal debt is commonly seen as a measure of the government's deferred obligations. However, the amount of debt held by federal trust funds does not accurately reflect what the government would actually expend in the future if it was to meet the currently prescribed spending commitments of its various trust fund programs. While a trust fund's balance may set an aggregate limit on how much can be spent for a particular program, the balance is not earmarked for specific recipients. The individual payments or benefits prescribed by law are derived through separate computational rules or from annual appropriation acts.

The Social Security trust funds, for instance, do not consist of separate accounts or asset accumulations for individual taxpayers, nor do they indicate what is "owed" to anyone. The trust funds' balances are largely determined by the cumulative difference between each month's payroll taxes received by the Treasury and the program's outlays. The benefits of future Social Security recipients will be computed from a formula set in law using people's average career earnings, not the taxes that individuals paid over their working life. Similarly, the balances of the Highway Trust Fund are

1. Currently, the limit on the total dollar amount of securities that the Treasury can have outstanding is \$6.4 trillion. From time to time, the Congress acts to increase the debt limit to provide for the government's borrowing needs and to allow the Treasury to credit additional securities to federal trust funds and other accounts.

not earmarked on the basis of how much each state pays in highway taxes. Instead, overall spending limits for the highway program are determined through the annual appropriation process, and the amounts allocated to each state are determined by a formula largely based on highway mileage.

Under long-range budget projections, the balances of the largest trust funds—those of the Social Security and Medicare programs—are estimated to gradually disappear, and the payments prescribed under the rules now used to determine the programs' benefits eventually would have to be delayed or curtailed because the programs' reserve spending authority (that is, the fund balances) would have been exhausted. The subsequent "unfunded" benefits arising through 2076 are estimated to be \$16 trillion.² Those implied but unfunded commitments and such commitments of other trust fund programs are not included in the current summation of the government's debt.

Conclusion

Policymakers sometimes talk about the problem of the government's growing debt and at the same time describe the portion of it held in various trust fund accounts as resources set aside for future consumption. However, the government either owes something or owns something, but not both. Although the holdings of federal trust funds, for instance, are often described as "assets" and may be viewed as assets of a sort for the individual programs, they are not assets for the government as a whole.

Indeed, the Treasury securities held by federal trust funds are neither assets nor debts of the government as a whole. In an operational sense, most federal trust funds are simply ac-

counting devices. As money is collected, it is deposited in the Treasury, and the appropriate trust funds are credited with federal securities to reflect the amounts.³ When payments are made, the trust funds' balances are reduced. Any amount not needed to cover the programs' current expenditures is used either to finance other governmental activities or to pay down the debt held by the public. What is in the trust funds is simply the government's promise to pay itself back at some time in the future.

Often, when policymakers talk about increasing the balances of the Social Security trust funds to pay for promised future benefits, what is implied is that the debt held by the public will also be reduced. While debt reduction could benefit the economy and reduce the government's interest expenditures, the level of the nation's outstanding debt held by the public is not so large that paying it down would provide sufficient resources or assets for the government to fully cover future Social Security benefits and other spending commitments as now prescribed in law. Nor will the balances in trust funds now and in the future by themselves provide resources to meet the government's future commitments. Indeed, the mechanisms of trust funds and the accumulation of federal securities in them do not mitigate the future strains that such programs as Social Security will impose on the federal budget and the economy. When trust fund balances are drawn down, the government will not be using resources that have been saved for a rainy day. It will be using resources generated at that time—either by running a surplus in the rest of the budget or by borrowing from the public.

2. This is the amount of benefits that could not be paid over the next 75 years from incoming receipts once the trust fund balances fell to zero. The figure consists of present value projections for an "open group" (which assumes new participants over time). The calculations are based on the 2002 reports of the trustees of the Old-Age, Survivors, and Disability Insurance and Medicare Trust Funds (figures provided by the Offices of the Actuary, Social Security Administration and Centers for Medicare and Medicaid Services).

3. For further discussion, see Congressional Budget Office, *Social Security and the Federal Budget: The Necessity of Maintaining a Comprehensive Long-Range Perspective*, Long-Range Fiscal Policy Brief (August 1, 2002).

Contacts: This policy brief was prepared by Dave Koitz and Melissa D. Bobb. It and other publications by CBO are available at the agency's Web site: www.cbo.gov.