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The Budget Treatment of Trust Funds

Statement of
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the Committee on Governmental Affairs and
the Committee on the Budget
United States Senate

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Messrs. Chairmen and Members of the Committees:

I welcome this opportunity to submit our views on the budget treatment of trust funds and, in particular, whether the Social Security surpluses should be included in the budget totals subject to deficit reduction actions. In my statement I will provide a brief overview of trust funds and explain why we think that Social Security should be on-budget but excluded from the deficit calculations in the Gramm-Rudman-Hollings or similar deficit reduction plans.

OVERVIEW OF TRUST FUNDS

The Office of Management and Budget (OMB) currently classifies a budget account as a trust fund if the relevant authorizing legislation provides that the program shall be financed by certain revenues dedicated to a "trust" account. On this basis, widely different programs appear in the budget as trust fund programs. They range from discretionary programs, such as those of the Highway Trust Fund, to entitlement programs, such as those in the two Social Security trust funds. In fiscal year 1988, about $514 billion, or 48 percent of all U.S. Treasury receipts that year, were earmarked for use as trust funds.

Prior to fiscal year 1969, trust funds were not included in the government's most commonly used budget, the Administrative

Budget. They were in other budgets known as the Consolidated Cash Budget and National Income Accounts Budget. That changed when, based on a recommendation of the 1967 President's Commission on Budget Concepts, the President submitted for fiscal year 1969 a new, "unified" budget covering all trust and non-trust activities of the government.

As subsequent events have shown, however, the decision to include trust funds in the budget did not resolve the budget status of trust funds. Shortly after adoption of the unified budget, a debate opened in the Congress that continues to this day on whether trust funds should be in the budget and treated like other accounts. There has been a proliferation of proposals aimed at removing one or more trust funds from the budget.

In 1983, one such proposal became law, stipulating that, effective for fiscal year 1993, the two Social Security trust funds would go off-budget. In 1985, the first Gramm-Rudman-Hollings (G-R-H) legislation made the removal of the two funds effective immediately, but with the proviso that the two funds' receipts and outlays be included in the deficit calculation for G-R-H purposes. The Social Security benefit amounts were, however, exempted from G-R-H sequester procedures.

This 1985 provision is still the law, and it allowed OMB in its August and October 1989 sequester reports for fiscal year

1990 to offset projected Social Security surpluses of about $65 billion, along with about $69 billion in other trust surpluses, against a projected deficit in the rest of the government's activities of about $250 billion--resulting in an estimated deficit for G-R-H purposes of about $116 billion.

About seven bills which propose changes to the budget treatment of the Social Security and other trust funds are currently pending in the Senate. Of the seven, five would exclude the Social Security Trust Funds from the deficit calculation, with three of these bills extending the dates for G-R-H deficit targets. One of the remaining two bills would divide the budget into sections for retirement trust funds, operating amounts, and debt and interest amounts. There also would be a separate trust fund to reduce the public debt. The remaining bill would restructure the current unified budget to provide new sections for general activities, trust funds, enterprise activities, with each divided into operating and capital parts.

GAO POSITION ON TRUST FUNDS

We have long been a proponent of the view that sound budgeting requires a federal budget that includes the receipts and outlays of all federal government activities, including the trust funds. We believe that a unified budget approach makes it easier to compare programs and their costs and that it provides the financial overview needed for setting fiscal policy and initiating economic stabilization measures.

The need for a unified budget remains as strong today as it was in 1969. Indeed, it may be even more important to have such a budget at this time of large peacetime deficits and increasing pressures to move programs away from the discipline of the budget process. Such pressures resulted in creating an off-budget government-sponsored enterprise (GSE), the Resolution Funding Corporation (REFCORP), to finance most of the costs of the government's rescue of the savings and loan deposit insurance system--at an added cost of several billions to the U.S. Treasury and taxpayers. I should add that in addition to REFCORP, 5 other off-budget GSEs have been created since the G-R-H legislation was enacted in 1985. Prior to the G-R-H era, it was in 1972 that the last GSE was created. I am greatly concerned about misusing the GSE concept or any other type of action that makes the budget numbers look good but hides the true magnitude of the problem.

However, while we support the unified budget, we are aware that there are many problems with it. The present budget structure, with its exclusive focus on a single, bottom-line cash deficit, obscures important differences among programs and makes it virtually impossible for the public and many officials to understand what is actually going on in the government's finances. More particular to today's hearing, the merging of trust and nontrust fund receipts and outlays into a single budget surplus or deficit has led to two kinds of problems.

First, proponents of some major trust fund programs, such as the Highway and the Airport and Airways trust funds, have stated that including these trust funds in the budget's totals has prompted the misuse of the trust funds. They charge that while these trust funds have a steady stream of dedicated tax receipts, budgeting actions have restricted fund outlays in order to create trust fund surpluses, thereby lowering the reported unified deficit. The proponents hold that this breaks the implied agreement underlying the original enactment of the funds--that is, that the tax receipts raised would be fully used for the trust fund programs.

The second closely related problem is that using the trust fund surpluses, especially the rapidly growing Social Security surpluses, to offset the deficit in the government's general activities masks the basic imbalance in the government's general financial affairs. It leaves the impression that the deficit problem is being corrected when, in fact, it is getting worse. Whereas the unified budget total deficit has declined under the G-R-H law, going from about $222 billion in fiscal year 1985 to about $161 in fiscal year 1989, the deficit in the nontrust part of the budget has actually increased somewhat over the same period, going from about $266 billion to approximately $283 billion.

Furthermore, while the most recent budget projects declining total deficits over the next 5 years, a Congressional Budget Office (CBO) analysis excluding the trust surpluses projects a rising deficit in the rest of the budget during the same period. According to CBO, the nontrust deficit will rise to about $303 billion in fiscal year 1994.

I should add that the budget's structure also creates incentives to remove certain governmental business-type enterprises from the budget. These are entities such as the Postal Service, established to be largely self-financed. By not differentiating these enterprises from the regular activities of the government, it is difficult to develop multiyear budget plans that recognize such entities' special investment and operating needs.

Some would deal with these problems by removing some or all trust funds from the budget. There also are proposals to remove certain business-type enterprises from the budget. We believe, however, that the problems can and should be addressed within the framework of a unified budget. We would do this by dividing the budget into three major components--general, trust, and enterprise funds--and having separate budget subtotals for each.

This would unmask the effects of trust fund surpluses on the overall totals, highlight the activities of the enterprises, and permit more deficit reduction options. In addition to a budget goal for the overall budget, as seen in the Gramm-Rudman-Hollings legislation, a separate goal for each major component could reflect a legislative decision on the appropriate deficit reduction or surplus path for each of the three areas.

The following table shows fiscal year 1988 budget results restructured according to our proposal.

GAO's Fiscal Year 1988
Restructured Budget Results
(Dollars in Billions)

	Total	General	Trust	Enterprise
Operating surplus/deficit (-)	$-131	$-248	$124	$ -7
Capital financing requirements	-24	-23	2	-3
Unified budget financing requirements	$-155	$-271	$126	$-10

We are aware that separating out trust and enterprise activities would heighten the importance of having good definitions of those kinds of activities. At this time, though, there are no governmental definitions for the kinds of activities and financial transactions that should be accounted for through trust funds, and many different kinds of programs with widely varying financing mechanisms are classified as trust fund activities. Similarly, many kinds of activities are classified as enterprise activities. We are now studying definitional issues and will be reporting our results in the near future. In the meantime, the current lack of definitions should not be viewed as a barrier to disclosing the major budget components.

DEFICIT REDUCTION SHOULD FOCUS ON THE NON-SOCIAL SECURITY PART OF THE BUDGET

G-R-H probably served to constrain the level of budget deficits, but its track record has been filled with the development of a variety of budget accounting gimmicks to give the appearance of meeting short-term deficit reduction goals. This confuses the public and leaves a poor impression of the budget process. We must really bring down the deficit and this may not happen if these gimmicks continue.

Furthermore, simply lowering the total deficit probably is not enough. I have previously stated our view that a long-term goal of federal fiscal policy should be to increase the rate of national savings and investment. U.S. rates are low in comparison with other major industrial countries. The question of just how much added savings is needed for investment purposes is a complex one with no single, correct answer. But I would suggest that the government should definitely take steps to start increasing savings. In this environment, current projections of future Social Security financing flows present an opportunity.

Over the next several decades, the scheduled accumulation of Social Security reserves can reverse the Treasury's current role as a net borrower from the public. Bringing the deficit in the rest of the budget under control can possibly result in a surplus in the total budget. Then the Treasury can use its positive cash flow to redeem some of the maturing government debt now held by the public. This would allow private sector investors to switch their funds from the financing of government deficits to the financing of private capital formation. The ensuing long-term rise in national income would make future workers better able to support the growing number of retirees while maintaining their own standard of living.

The main point is that running such a unified budget surplus would require that the budget for the non-Social Security part of the government be restored over time to approximate balance. This would mean excluding the Social Security surpluses from calculations of the deficit subject to deficit reduction action. Of course, this would be a very difficult policy to carry out and would underscore the need for a multiyear, politically sustainable budget strategy involving some combination of spending restraints and revenue increases.