

## Informed Budgeteer: Recess Reading and Homework

### HOW MUCH IS A LOCKBOX WORTH?

- On February 13<sup>th</sup> the House of Representatives passed H.R. 2, the “Social Security and Medicare Lock-Box Act of 2001” by a vote of 407 to 2. Throughout the last Congress, the presidential campaign and “Saturday Night Live” broadcasts, the “L-O-C-K-B-O-X” was invoked repeatedly. Since the House has once again passed this matter, it warrants a closer look.
- H.R. 2 would add a new section (section 316) to the Congressional Budget Act of 1974, that establishes two new 60-vote points of order in the Senate. The first would prohibit consideration of a budget resolution that sets forth, for any fiscal year, a surplus which is less than the surplus of the Federal Hospital Insurance (HI) trust fund (frequently and mistakenly known as - the Medicare surplus - but more on this later).
- The second point of order would prohibit the consideration of any spending or revenue legislation which would cause the on-budget surplus, in any fiscal year, to be less than the level of the HI surplus projections assumed in the most recently agreed to budget resolution. The bill contains an exception to these points of order for legislation (or a budget resolution, assuming such legislation) which reforms either Social Security or the Medicare program as a whole.
- The exception make what is otherwise a troublesome proposal only marginally less so. The exception makes available that portion of the projected on-budget surpluses which represents the projected balances of the HI trust fund for desperately needed fundamental reforms of our two largest entitlement programs: Social Security and Medicare. Note that this would include a Medicare prescription drug benefit if it is made part of overall Medicare reform.
- While it seems a laudable goal to “protect the Social Security and Medicare surpluses”, is there really a medicare surplus to protect? Closer examination of the so-called HI surplus, reveals that it is not analogous to the Social Security surplus at all.
- The HI portion accounts for a 56% (and declining) share of the annual spending for the Medicare program – and is also known as “Part A”. It is funded largely by dedicated Medicare payroll taxes (along with a transfer from the general fund) and covers primarily the hospital portion of the Medicare program. If however, one were to look at Medicare as a whole (Parts A and B), you would see that over the next 10-years *there really is no surplus*. In fact there is a deficit of nearly \$1 trillion!
- For example, the Part B portion of Medicare (which covers doctor bills and a share of home health visits) will cost the federal government \$110 billion in FY 2000, \$82 billion of which will come from general tax revenues (the remainder is funded by beneficiary premiums). Though some tout a \$30 billion Medicare surplus (representing solely the Part A/HI trust fund) it must be compared with a transfer from the general fund of \$93 billion to Medicare for FY 2002.

without the concomitant transfer of resources, thus artificially “improving” the health of the HI trust fund without making any improvement to the long-term viability of the Medicare program as a whole. Such a transfer would not have run afoul of the lockbox set out in H.R. 2. We wonder if the enactment of H.R. 2's lockbox won't have the perverse effect of encouraging such dodges in the future, in place of critically needed fundamental reforms.

- Informed budgeteers may wonder why these two new points of order are even needed. Isn't it true that the same result can be accomplished through existing budget enforcement mechanisms? The short answer is: yes, existing mechanisms – if enforced – would accomplish the same thing.
- If Congress were to establish and strictly enforce discretionary spending limits, and strictly enforce the budgetary aggregates and committee allocations, it could provide tax relief, reduce the debt, address critical needs in areas such as education and defense and pave the way for needed reforms in these two largest entitlement programs.
- The *Bulletin* wonders if layering on additional points of order will really make any difference absent the will of Congress to live by the budget resolutions it adopts. The real answer probably lies in respect for the existing budget processes and the enactment of real fundamental entitlement reform.

### THE CONFUSION ABOUT TRUST FUNDS...

- So H.R. 2 states the obvious: unless this or a future Congress decide otherwise, the surpluses from the Social Security and the Medicare Hospital Insurance trust funds should not be used for any purpose other than reducing the national debt or improving the programs themselves.
- But some lawmakers, for the purpose of limiting the size of a possible tax cut, argue that H.R. 2 does not go far enough. They assert that surpluses from all of the government's trust funds, including civilian and military retirement, should also be protected.
- So the *Bulletin* thought it might be useful to review the concept of the trust fund in the federal budget. An excellent source of information on federal trust funds was made available by the General Accounting Office (*Federal Trust and Other Earmarked Funds: Answers to Frequently Asked Questions* GAO-01-199SP). Much of the information below has been summarized from that document.
- A federal trust fund is an accounting mechanism that links collections dedicated to a specific fund (otherwise know as earmarked funds) with spending for a specific purpose. OMB identifies receipts as belonging to a trust fund if the receipts are explicitly dedicated in law to a particular program as a “trust account.”
- Studious budgeteers will note that the definition of a federal trust fund differs in several significant ways from the definition of a private trust fund. For example, the trustee of a private trust fund has a fiduciary responsibility to the trust beneficiaries, while the federal government has no such responsibility. Also, the trustee of a private sector trust is not permitted to unilaterally change the terms of the trust. The federal government, on the other hand, can, by changing the law, raise or lower future trust fund collections and payments or change the purposes for which collections are used.
- Despite the clear differences between private and public trust funds, there is often confusion about the level of commitment implicit in a federal trust fund designation. Although some may believe that a trust fund designation indicates that the government is bound by a greater commitment to carry out that activity than it has to carry out other government activities, this is simply not the case. (Only a full faith and credit guarantee of the federal government conveys such a commitment.)

<b>Medicare Surplus (+) and Deficits (-)</b>		
(\$ in billions)		
	2002	2002-2011
Part A-HI Surplus	36	393
Part B- SMI Deficit/Surplus	-1	13
Total	35	406
General Fund Transfer to Part B	-82	-1239
General Fund Transfer to Part A	-11	-147
Total Medicare Deficit	-58	-980

SOURCE: CBO January 2001 Baseline.

- As a matter of fact, it was only a few years ago that Congress transferred a portion of home health payments from Part A to Part B

- In fact, the absence or presence of a trust fund designation does not tell us much about the strength of the government's commitment to a particular activity. After all, national defense, a government responsibility set out in the U.S. Constitution, is not financed through a trust fund. Even so, this is certainly not an indication that the government is less committed to a strong national defense than it is to either Social Security or Medicare.

### ...AND THEIR BALANCES...

- Often, trust funds take in more in earmarked collections than are currently necessary to fulfill the obligations of the fund. This means that, on an annual basis, the fund has a surplus and that those accumulated surpluses result in the trust fund having a balance. Although these balances are not cash balances, they provide a claim (or IOU) on the government's general fund for future spending. As such, these fund assets are a liability from the perspective of the Treasury's general fund.
- Trust funds generally are required by 31 U.S.C. 9702 to be invested in government obligations at an annual interest rate of at least 5%. Most of the trust fund balances are invested in special, nonmarketable U.S. Treasury securities. When a trust fund invests in U.S. Treasury securities, the value of those securities is debt owed by one part of the government to another and is recorded as "debt held by government accounts." Such debt represents over a third of gross federal debt.
- If the fund reaches a point where outgoing payments exceed current receipts, the fund may then redeem the securities to make its required payments. When this happens, Treasury must obtain cash to finance the government's spending through some combination of increased taxes, spending cuts, increased borrowing from the public, or retiring less debt (if the unified budget is in surplus).
- The relationship between trust fund balances and the trust fund's claim on future resources depends upon whether the program financed by the trust fund was structured to be actuarially sound. Some trust funds, especially those that represent long term programs for retirement security, are not structured so that collections coming into the fund are sufficient to cover future program needs under current law. In other words, trust fund balances do not necessarily represent the full future costs of current law commitments.
- For example, Medicare's Supplemental Medical Insurance trust fund only receives a quarter of its revenues from the monthly premiums paid by enrollees in the program. The rest of the financing, a whopping three-fourths, is transferred into the trust fund from general fund revenues in what is viewed by some as a subsidy. In addition, Social Security's trust funds are projected to have balances only sufficient to fund about 72% of benefits for 75 years into the future.
- As a result, the running of large annual surpluses in a trust fund and the resulting accumulation of trust fund balances do not by themselves improve the federal government's ability to meet expected costs down the road. It is infinitely more important to know whether the federal government will be able to pay the claims of the current and future beneficiaries of the trust fund, possibly at the cost of other competing claims for scarce government resources, than to know how much of a balance a trust fund has accumulated.
- When a program is not designed to be self-financing, (such as Social Security, Medicare, military and the CSRS portion of civilian retirement) a trust fund balance can be useful in providing an early signal about its fiscal stability. But accumulated trust fund balances

do not fully inform policymakers about the size of the benefit promised. Therefore, the signal sent by the trust fund balance can be intentionally obscured when one focuses on extending a trust fund's solvency without the reforms necessary to make the program more sustainable.

### ...AND WHY THE FEDERAL GOVERNMENT IS NOT A BUSINESS

- Since September 1993, the federal government has been attempting to fully evaluate the government's overall financial condition in light of a stated "stewardship objective." This stewardship objective recognizes that the federal government's standard budget presentation does not provide all the information needed for a full analysis of the government's position. In addition, the objective states what seems obvious once said out loud: while a business may ultimately be judged by the bottom line in its balance sheet, the ultimate test of the federal government is, instead, how its actions affect the country.
- Although the stewardship objective acknowledges the data problems arising from the inescapable differences between the federal government and a business, there has been a modified government balance sheet included in Chapter 2 of the Analytical Perspectives of the President's Budget since the FY 1995 submission.
- The government presents its assets and liabilities in a way that may be very surprising to some. On the government's balance sheet, Social Security and Medicare benefits **are not** shown as a government liability. The Budget explains this treatment by saying that even though "providing promised benefits is a political and moral responsibility of the Federal Government...When the amount in question can be changed unilaterally, it is not ordinarily considered a liability." Similarly, even though the federal government has the sovereign power to tax, tax receipts **are not** displayed as a government asset.
- At the same time, federal pensions (both civil service and military retirement) **are** shown as a government liability. The amount owed by the federal government in pension benefits to its retired workers and to current employees is included on the balance sheet because this liability would appear on a business balance sheet on account of how they cannot be changed. The pension liabilities are expressed as the actuarial present value of benefits accrued-to-date based on past and projected salaries.
- The Stewardship chapter in the Budget concludes that while some analysts may find the absence of a bottom line to be very frustrating, "pretending that there is such a number—when there clearly is not—does not advance the understanding of government finances." Fortunately, most budgeteers realize the government is not a business, and that is why no one has "gone to jail" for treating the federal trust funds according to federal budget concepts rather than private trust fund concepts.

### **CALENDAR**

February 27: Joint Session of Congress, President Bush will deliver a State of the Budget Address.

February 28: President Bush will submit a budget outline to Congress.

#### **Senate Budget Committee Hearing Schedule**

Unless otherwise noted, all hearings will be held in Dirksen 608 at

10:00 a.m. Additional hearings and witnesses may be scheduled.

March 1: Administration's FY 2002 Budget; Witness: Secretary of Treasury, Paul O'Neil.

March 2: Administration's FY 2002 Budget; Witness: OMB Director, Mitch Daniels.