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The Honorable Frank R. Wolf
Chairman, Subcommittee on Transportation
Committee on Appropriations
U.S. House of Representatives

Dear Mr. Chairman:

This letter responds to your request of February 28, 1995, asking that we comment on the current budgetary treatment of transportation trust funds and the implications of removing these trust funds from any spending limit imposed by statute.

Transportation trust funds--like others--present a real dilemma. On one side are the expectations created by the use of earmarked taxes, sometimes labeled "user fees." Many of those who pay these taxes expect not only that they will be used for a specified purpose but implicitly also that the revenues will be spent without considering the effect on either the deficit or other federal programs. On the other side is the danger of balkanizing the budget and further limiting the Congress' ability to make trade-offs.

It is not surprising that in response to this dilemma some have proposed removing the transportation trust funds from the budget and exempting them from the system of spending limits currently in place. I would like to comment on a number of issues relevant to this dilemma.

PROBLEMS WITH THE UNIFIED BUDGET

There are real problems with the current unified budget; two of these in particular are worth discussing: the use of trust fund surpluses to "mask" a general fund deficit and the inadequate identification of investment spending. If the budget is to provide a framework for decisions about the federal role and federal priorities, it should show the distinctions between types of federal programs--and it should

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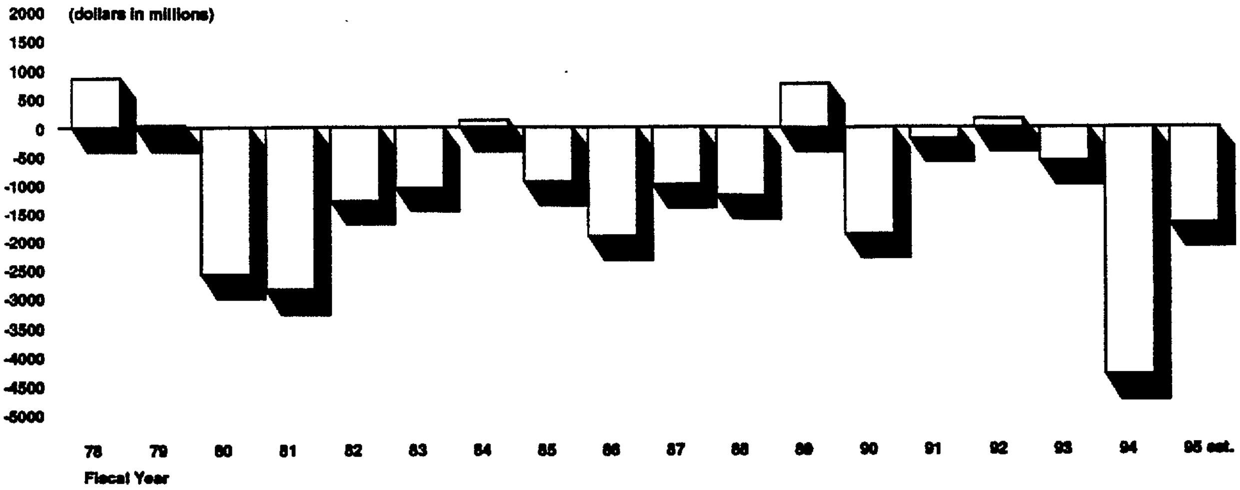
present the information necessary for the budget year and future years. On this dimension, there are some serious shortcomings with the current unified budget.

Masking

In the current unified budget, trust fund surpluses mask the basic imbalance in the government's general financial affairs. The unified budget can give a misleading impression of the deficit's path. According to the Congressional Budget Office (CBO), the total deficit will rise slightly from about $203 billion in fiscal year 1994 to about $222 billion in fiscal year 1998, absent any policy changes. However, the on-budget deficit--which excludes the social security trust funds and the Postal Service--is projected to grow from $259 billion to $308 billion over the same 4-year period.

We have addressed this issue on a number of occasions. There are two different totals to consider when discussing masking--the annual deficit and the gross federal debt, which is sometimes confused with the deficit. The deficit is an annual measure of the difference between what the government takes in and what it spends. A trust fund surplus only masks the deficit when the trust fund takes in more revenue (exclusive of interest earned) than it spends in any 1 year. On this point, the story of the transportation trust funds is mixed. For example, figures 1 and 2 show that neither the highway account of the Highway Trust Fund nor the Airport and Airway Trust Fund has consistently had an annual surplus of tax receipts over outlays. Neither has consistently contributed to the masking problem. Enclosure I contains similar data for the Harbor Maintenance and Inland Waterways trust funds.

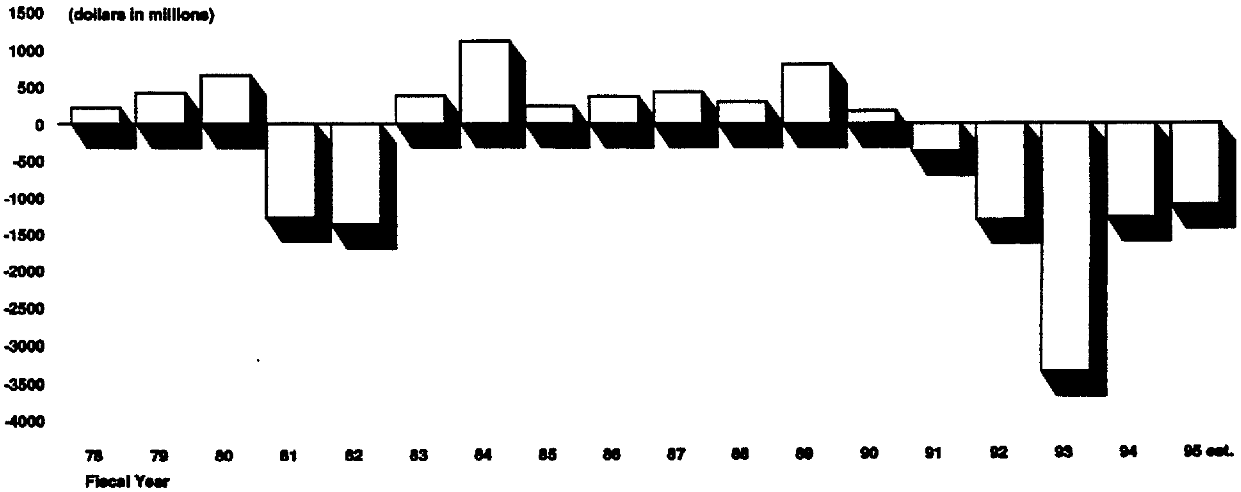
Figure 1: Tax Receipts Minus Outlays for the Highway Account of the Highway Trust Fund



Note: Positive amounts indicate years when taxes exceeded spending. Negative amounts indicate years when spending exceeded taxes.

Source: Department of Transportation.

Figure 2: Tax Receipts Minus Outlays for the Airport and Airway Trust Fund



Note: Positive amounts indicate years when taxes exceeded spending. Negative amounts indicate years when spending exceeded taxes.

Source: Department of Transportation.

We believe the appropriate response whenever this masking problem occurs is better disclosure. We have said that improving the presentation of trust fund surpluses and their effect on the deficit would benefit the decision-making process. To accomplish this, the budget could be structured to provide trust fund subtotals which clearly show the amount of any trust fund surpluses and their effect on the unified budget deficit. Distinguishing between trust and nontrust amounts in the budget would resolve the masking problem. It would clearly disclose the trends in both parts of the budget and enable policymakers to more easily select whatever they believe to be the proper fiscal balance between trust and nontrust fund operations.

In contrast to annual surpluses/deficits, cumulative surpluses are part of, but do not mask, the federal debt. Gross federal debt--a cumulative amount--has two parts: debt held by the public and debt held by all trust funds. The latter reduces the amount that must be borrowed from the public and represents the buildup of trust fund surpluses from years in which tax receipts exceeded spending--plus interest earned on any balances.[1] The cumulative fiscal year 1994 cash balance for the Highway Trust Fund is $17.9 billion; for the Airport and Airway Trust Fund, it is $12.4 billion. Data on the composition of gross federal debt are currently provided in the Analytical Perspectives volume of the budget.

Increasing the Focus on Investment

The second problem with the structure of today's budget and system of budget limits is the failure to separately focus upon spending for investment--which we have defined as spending to enhance long-term productivity in the private sector economy. This type of spending falls into three broad categories: research and development, human capital, and infrastructure--including transportation infrastructure.

Increasing productivity is the engine that drives living standards for future generations. As the baby boom generation ages, it is especially important that we increase productivity and potential gross domestic product. If the

[1]The funds earn interest on unspent revenues to compensate them (and, indirectly, those who paid earmarked taxes into the funds) for spending some of their revenue at a later time.

United States is to provide the kind of living standards we would like in the 21st century--both for a large retiree population and for a smaller working population--strong productivity growth is necessary.

The most important contributions the federal government can make to a healthy and growing economy are (1) reducing the federal deficit and (2) making wise decisions on investments that will foster long-term economic growth. We have previously stated[2] that there should be a greater focus on spending for investment. However, by treating all outlays the same, the current budget structure does not highlight or distinguish between spending for long-term investment--which includes transportation trust fund spending--and spending for current consumption. Also, the current budget process does not serve as a tool to promote policy decisions about how much spending overall should be devoted to programs bearing directly on long-term growth and productivity. We have reported that creating an investment component within the unified budget and establishing aggregate targets--which could be a floor--for investment spending under the existing discretionary caps could help decisionmakers focus on making investment decisions that can promote long-term economic growth.

Setting an investment target would require policymakers to evaluate current levels of investment and consumption spending and would encourage a conscious decision about an appropriate overall level of investment. This approach has the advantage of focusing budget decisionmakers on the level of investment supported in the budget without losing sight of the unified budget's impact on the economy. It also has the advantage of building on the current congressional budget process as the framework for making decisions.

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[2]Budget Policy: Prompt Action Necessary To Avert Long-Term Damage to the Economy (GAO/OCG-92-2, June 5, 1992); Federal Budget: Choosing Public Investment Programs (GAO/AIMD-93-25, July 23, 1993); and Budget Issues: Incorporating an Investment Component in the Federal Budget (GAO/AIMD-94-40, November 9, 1993).

WHY A UNIFIED BUDGET?

We have long held the position that the budget of the United States should include the receipts and outlays of all federal government activities, including the trust funds. Removing something from the budget does not make it less a government activity, but it does reduce the usefulness of the budget for decision-making.

If the budget is to help the Congress and the President allocate federal resources, it should cover all activities and transactions that are federal in nature and not subject to the economic disciplines of the marketplace. A unified budget provides information about the borrowing needs of the federal government and about the fiscal stance of the federal budget, thus permitting decisions as to the appropriate fiscal policy and any economic stabilization measures. A unified budget also makes it easier to compare programs and their costs in order to allocate resources. If relevant activities are omitted, the budget presents an incomplete and possibly misleading picture to both the public and the Congress. The true magnitude of the federal government's activities is disguised, and the programs not included in the budget may escape the scrutiny and limitations of the full budget process.

History of the Unified Budget and Changes to It

The unified budget was first adopted in 1969 in response to the primary recommendation of the President's Commission on Budget Concepts. This Commission, whose report still represents the most coherent statement of budget concepts, concluded that all programs operated by entities in which the capital stock is owned by the government or which have recourse to federal funds should be included in the budget. However, over the last 25 years, the extent to which activities have been included in the budget has varied. At one time or another, legislation has been enacted to move off budget the Rural Telephone Bank, the Rural Electrification and Telephone Revolving Fund, the Housing for the Elderly or Handicapped Fund, the U.S. Railway Association, the Pension Benefit Guaranty Corporation, the Federal Financing Bank, the Postal Service, the Social Security trust funds, and entities to refinance the Farm Credit System and the insurance system for the savings and loan industry. There have also been proposals to remove some or all trust funds from the budget, including the Highway, Airport and Airway, Inland Waterways, and Civil Service Retirement System trust funds. Today, all of these activities are on budget except for the Postal Service, Social Security, and the farm and savings and loan refinancing entities.

Except when the activity in question is owned and controlled by private parties, there are no differences between the activities of off-budget programs and those programs which are included in the budget. Therefore, we have taken the position that excluding a program's receipts and outlays from the budget totals is normally undesirable and sets a precedent for the exclusion of other programs. In general, removing governmental activities from the budget weakens the budget process by making it harder for the Congress to set national priorities and by undermining the credibility and analytic usefulness of the unified budget.

Although today's world is very different from that of 1969, the arguments for a unified budget remain valid. Fiscal policy is still important. The priority accorded to reducing large peacetime deficits has only increased the need for the President and the Congress to make decisions about federal priorities when allocating resources. Removing federal programs from the budget reduces the usefulness of the budget for fiscal policy decision-making. If programs are also exempted from Budget Enforcement Act (BEA) controls, resource allocation decisions would be more difficult because the range of trade-offs is reduced.

BUDGET CONTROLS UNDER THE BEA

Although the on-budget or off-budget status of an account is important to the comprehensiveness of the budget, the enactment of the BEA has made treatment under that act's controls of equal or greater importance for some purposes. When the BEA was written, a case-by-case determination was made as to which accounts would be subject to, and which would be exempt or protected from, limitations and reductions under the act. Most discretionary spending accounts (which include the transportation trust funds) compete with each other for funding under the discretionary caps and must share in any sequestration that would result from exceeding the caps.[3] Other discretionary accounts must compete for

[3]For these trust funds, since budget authority is provided in authorizing legislation in the form of contract authority, it is not subject to budget authority caps. The obligations

funding under the discretionary caps but are specifically exempt from any sequestration. Still others, such as emergency spending, do not compete for funding under the caps and are not subject to sequestration.

TRANSPORTATION TRUST FUNDS AND THE BEA

Some who pay taxes earmarked for the trust funds have charged that including the trust funds in the budget's totals has prompted the misuse of the moneys. It is possible that a clearer presentation in the budget, especially if combined with an investment component, would alleviate this concern because decisions would be more visible and the implications of deficit reduction actions would be clearer to decisionmakers and the public. It would not, however, remove the possibility that annual trust fund outlays could someday be restricted in order to create annual trust fund surpluses to reduce the reported unified deficit. This has led some to advocate an exemption from the BEA and other enforcement mechanisms.

When the Congress created the various transportation trust funds, it dedicated trust fund receipts to trust fund purposes but did not provide them with permanent indefinite appropriations, which would have permitted all receipts to be spent without the requirement for annual appropriations action. Rather, the Congress retained annual control over the timing of the spending. The Congress could, as a policy decision, choose to reverse that decision and exempt all or some of these funds from the BEA or other controls. I would like to turn now to the potential consequences of such a decision, which you requested that we address.

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resulting from the contract authority, however, are controlled by obligation limitations in annual appropriation bills and are subject to the BEA's outlay caps.

If exempting the transportation trust funds from the BEA caps[4] resulted in additional spending for transportation trust fund purposes, the government's total deficit would increase by the amount of the additional spending unless other programs were reduced by the same amount. An exemption from the caps does not mean that annual appropriations action could not be taken. The exact amount of the deficit increase would depend on how much funding for additional spending were made available. However, if the trust funds did not have to compete for funding under the discretionary caps, it would be reasonable to think that obligations would be limited only by trust fund balances and receipts. In fact, some proponents of transportation spending have argued for this change in budgetary treatment as a way of increasing the funds made available for trust fund programs.

Initially, neither spending for these programs nor the deficit would be likely to increase much because these trust funds have not in fact been constrained by appropriations actions in the recent past. For example, uncommitted balances in the highway account of the Highway Trust Fund have fallen dramatically in recent years. The account's uncommitted balance reached a high of $11.1 billion by the end of fiscal year 1991. However, the account's annual outlays have exceeded its annual income since the Intermodal Surface Transportation Efficiency Act became law in December 1991. As a result, the account's uncommitted balances have been drawn down and it is estimated that they will be $2.7 billion by the end of fiscal year 1995. This is within the $1 billion to $3 billion "safety cushion" Federal Highway Administration officials say would be needed in the highway account to guard against unforeseen decreases in revenues or inaccurate revenue projections. Consequently, the fear of future budget constraints, not actual past restrictions on spending, may be playing a role in this debate.

Whatever the immediate effect on the deficit, exempting any one type of spending from BEA controls makes it likely that such spending would increase over time. Unless spending in other areas was reduced by the same amount, the result would

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[4]Due to a change in concepts, the Office of Management and Budget would be likely to adjust the discretionary caps downward by the amount estimated to be spent under existing law if trust fund spending is removed from control under the caps. The Congress could also direct such an adjustment in the legislation exempting the trust funds from control.

be a higher deficit. Any narrowing of the range of choices that the Congress and the President have for making budget trade-offs increases the difficulty they will face in balancing the budget.

I hope that this letter summarizes the competing issues that confront the Congress in this area. A List of Related GAO Products is included for your information. Please contact me at (202) 512-9142 if you or your staff have any questions.

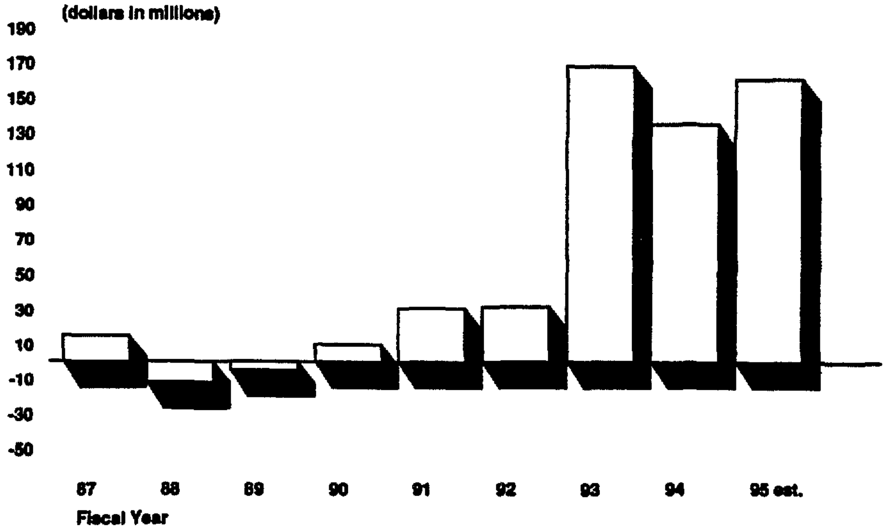
Sincerely yours,

Susan J. Irving
Associate Director, Budget Issues

Enclosure

TAX RECEIPTS MINUS OUTLAYS FOR SELECTED TRUST FUNDS

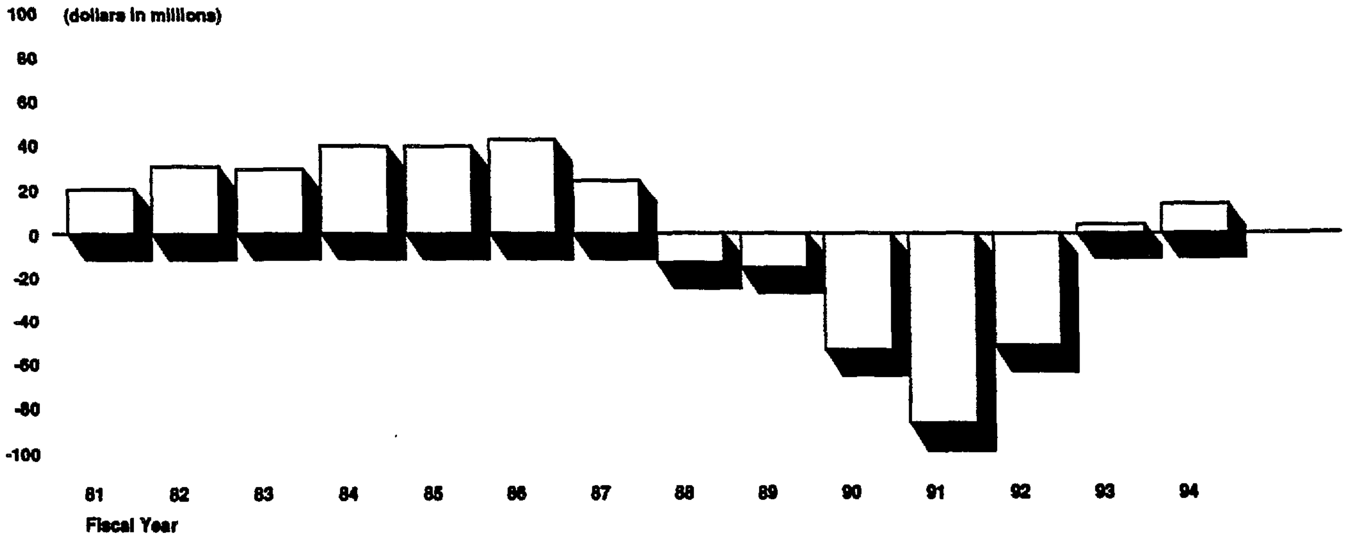
Figure I.1: Tax Receipts Minus Outlays for the Harbor Maintenance Trust Fund



Note: Positive amounts indicate years when taxes exceeded spending. Negative amounts indicate years when spending exceeded taxes.

Source: U.S. Army Corps of Engineers.

Figure I.2: Tax Receipts Minus Outlays for the Inland Waterways Trust Fund



Note: Positive amounts indicate years when taxes exceeded spending. Negative amounts indicate years when spending exceeded taxes.

Source: U.S. Army Corps of Engineers.

LIST OF RELATED GAO PRODUCTS

Budget Issues: Incorporating an Investment Component in the Federal Budget (GAO/AIMD-94-40, November 9, 1993).

Social Security: The Trust Fund Reserve Accumulation, the Economy, and the Federal Budget (GAO/HRD-89-44, January 19, 1989).

The Budget Treatment of Trust Funds (GAO/T-AFMD-90-3, October 12, 1989).

The Budgetary Treatment of the Proposed Resolution Funding Corporation (REFCORP) (GAO/T-AFMD-89-8, May 19, 1989).

Budget Issues: Trust Funds and Their Relationship to the Budget (GAO/AFMD-88-55, September 30, 1988).

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