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The Postal Service and
the Unified Budget

Statement of
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Before the
Subcommittee on Legislation and
National Security
Committee on Government Operations
House of Representatives

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Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to discuss with you our views on H. R. 4150, the "Postal Reorganization Act Amendments of 1988."

This legislation would make significant changes in the budget status of the Postal Service Fund. Under the proposed amendments, the Fund's receipts and disbursements would be excluded from the following:

--the totals of both the presidential and congressional budgets,

--any general budget limitation imposed by statute on expenditures and net lending (budget outlays), and

--calculations of (1) the deficit under the Congressional Budget and Impoundment Control Act of 1974 for comparison with the maximum deficit under the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings) and (2) the excess deficit and required sequestrations under Gramm-Rudman-Hollings.

In addition, the legislation would raise the limitations on the Postal Service Fund's borrowing authority. The aggregate of outstanding borrowings would increase from $10 billion to

$30 billion, while the limitation on the net increase in fiscal year borrowings for capital improvements would be raised from $1.5 billion to $3 billion. The limitation on the net increase in borrowing for operating expenses would be raised from $500 million to $1 billion per fiscal year.

My remaining remarks, Mr. Chairman, will address the question of whether the Postal Service Fund should be excluded from budgetary totals, including the Gramm-Rudman-Hollings goals. In doing so, I think that it would be useful to first go into some background about the Fund and then place this issue within the larger context of budget structure concerns.

HISTORICAL TREATMENT OF THE POSTAL SERVICE'S BUDGET STATUS

The 1970 Postal Reorganization Act sought to put the Postal Service on a more business-like, self-sufficient basis. The Congress wanted to create a more independent establishment relatively free from direct political pressure and able to build a superior mail service. The Act gave the Postal Service authority to set rates based on recommendations by the Postal Rate Commission, retain and use revenues from postal rate changes, borrow funds for operating and capital purposes, and conduct collective bargaining with its employees.

Postal Service activities and liabilities are regularly funded through four budget accounts. The major account is the "Postal Service Fund." Under the authorizing legislation, all postal and nonpostal revenues the Postal Service earns are credited to this Fund. In fiscal year 1987, the Fund's net outlays were $943 million, and it used $2.3 billion of its statutory borrowing authority. This is the account that would be removed from the budget and Gramm-Rudman-Hollings calculations under H. R. 4150.

A second account, "Payment to the Postal Service Fund," shows the amounts appropriated from the Department of the Treasury's general fund to the Postal Service Fund to reimburse the Fund for delivering free and reduced-rate mail. The fiscal year 1987 appropriation for this purpose was $650 million. H. R. 4150 would leave this account on-budget.

And there are two Office of Personnel Management (OPM) accounts which make payments from Treasury's general fund for Postal Service retiree health benefits and annuity costs. Fiscal year 1987 general fund payments for Postal Service retiree health benefits totalled $400 million. Fiscal year 1987 general fund payments for Postal Service annuity costs totalled $200 million. These two OPM accounts would also be left on-budget under H. R. 4150.

The 1970 Act did not resolve the budget status of the Postal Service Fund. Some of the Act's provisions reduced the normal budgetary controls over the Fund. For example, the Act removed the Postal Service Fund from Office of Management and Budget (OMB) apportionment controls under the Anti-Deficiency Act. The Act also stipulated that the Postal Service Fund budget presented to OMB should be transmitted without change to the Congress along with the President's budget recommendations for the Fund.

However, the Act made no statement about whether the Postal Service Fund should be on-budget or off-budget. Therefore, from enactment of the Postal Reorganization Act until December 1985, the President administratively determined the budget status of the Postal Service Fund:

--The Postal Service Fund was kept on-budget for fiscal years 1971-73.

--President Nixon placed the Postal Service Fund off-budget when he submitted his budget for fiscal year 1974.

--President Reagan returned the Postal Service Fund on-budget in his fiscal year 1986 budget.

The December 1985 Gramm-Rudman-Hollings law mandated the Postal Service Fund's on-budget status. However, the law exempted the Fund from sequestration, except for its administrative expenses. The law did not exempt from sequestration the payment to the Postal Service Fund for free and reduced-rate mail.

SHOULD THE POSTAL SERVICE BE ON-BUDGET OR OFF-BUDGET?

With this background in mind, let me now turn to the arguments about whether the Postal Service Fund should be on-budget or off-budget. I think that four principal reasons have been advanced to support off-budget status. However, counter-arguments have been made for each argument. These opposing views are as follows:

Support for off-budget status	Support for on-budget status
First, it is pointed out that the 1970 Postal Reorganization Act sought to shield the Postal Service from normal political and budgetary pressures. Off-budget status would carry out the spirit of the 1970 Act.	The counter-argument is that the 1970 Act did not place the Postal Service Fund off-budget. The Postal Service is still a government-owned entity and, as such, should be on-budget.
Second, it is stated that the Postal Service operates on a break-even or self-sufficient basis and should be free of budgetary constraints and cuts.	Critics of this argument point out that the Postal Service is not self-sufficient and may never be so. Even if it were self-sufficient, it still should be on-budget as long as it is government-owned.
Third, proponents of off-budget status state that subjecting the Postal Service Fund to budget cuts as a result of the	On the other hand, it is stated that the Postal Service, as a governmental entity, should contribute

November 1987 "budget summit" agreement was false economy. It worked against the self-sufficiency goal the Congress set up for the Postal Service.

Finally, Postal Service officials point out that the cash-based unified budget overstates the costs of its operations because it has large capital investments. Off-budget status would, in effect, minimize the effects of this cost distortion.

its share toward the overriding goal of reducing the federal budget deficit.

The counter-point is that taking the Postal Service Fund off-budget would undermine the unified budget as a tool for setting macro fiscal policy, comparing federal programs, and adjusting budget priorities.

Clearly, Mr. Chairman, there are points for either an on-budget or an off-budget status for the Postal Service Fund. As you know, GAO has traditionally favored maintaining a comprehensive budget. At the same time, however, we are increasingly concerned about certain deficiencies in the current unified budget structure that create special problems for entities such as the Postal Service. Indeed, we think that the basic underlying issue involved here is deeper than the Postal Service. It relates to the structure of the existing budget, which creates incentives to remove certain kinds of programs from the budget. Thus, the Postal Service Fund is only one example of a larger problem. If the budget structure matter is not adequately addressed, we may expect increasing pressures to remove other programs from the budget. Let me now turn to this overall budget structure problem.

PROBLEMS WITH THE CURRENT BUDGET STRUCTURE

The current structure focuses attention exclusively on a single, cash-based surplus or deficit total. The reported number--$150.4 billion for fiscal year 1987--is used as the key indicator of successful government fiscal policy. Exclusive focus on the overall cash deficit can be misleading, thereby hampering budget decisionmaking.

A single debt total does not distinguish between debt incurred to cover an operating "deficit" and debt incurred as "capital financing." Failure to recognize the critical distinction between deficits and capital financing can lead to unsound approaches to deficit control, and to budget scorekeeping conventions that misallocate capital investment costs causing a budget bias against capital investment initiatives. Similarly, a single total masks trust and non-trust fund fiscal relationships by not showing how trust fund revenues are being used to finance the non-trust fund deficit. The following provides a discussion of these problems.

A Single Surplus or Deficit Total Does Not Show Capital Versus Operating Results

Many state officials and private sector executives plan and conduct their activities employing budgets that distinguish between capital investments and operating expenses. At the state level, 37 states have reported that they have distinct capital and operating budgets. In contrast, the federal budget makes no systematic distinction between capital investments and operating expenses. This failure to do so makes it difficult for the Congress to determine how much debt should be incurred each year to finance investments and how much is to cover operations.

This is a serious weakness which can lead to unsound deficit control strategies and to a budget bias against capital programs.

Unsound Deficit Control Strategies

By recent count, 34 states are required by their constitutions or by statute to execute balanced budgets, and most of these states apply these requirements only to their operating budgets. Expenditures for capital investments are not necessarily counted as operating expenses but rather as capital development. Separate debt financing and other revenues are utilized for capital projects subject to specified debt limitations.

In contrast, the single-number focus of federal deficit reduction efforts tends to avoid the difference between debt that finances capital investment as contrasted with debt incurred to meet operating expenses. Capital outlays do not affect the resource base of the government the way operating outlays do. When outlays are made and debt is incurred to acquire capital assets, whether physical assets, such as buildings, or financial assets such as loans, they produce future streams of benefits to the government. An acquired building provides facilities to carry out government operations over a period of years, thereby avoiding the need for related cash revenues to support facility requirements in those years; and an acquired loan note provides future cash revenues.

Failure to recognize the critical distinction between capital financing and operating costs leads to mistaken notion that it is necessary to reduce all borrowing to zero for the government's budgeted activities to be in balance. It ignores the importance of making conscious budget policy choices between the relative importance of current consumption versus long-term infrastructure needs.

With a capital budget approach, officials could focus upon sounder and more realistic options. They could more readily discuss and set in public policy the needed balance between spending for short-term consumption needs (operating expenses) and long-term infrastructure and productivity enhancing needs (capital investments). As a result, they could establish deficit targets for operating activities, financing targets for capital activities, and total financing targets for fiscal policy purposes.

Budget Bias Against Capital Programs

Under the present budget rules, a $50 million outlay to construct part of a hydroelectric plant (a capital investment) in a given year contributes to the year's deficit just as a $50 million outlay for vehicle or airplane fuel costs (an operating expense) does. However, the full $50 million for the hydroelectric plant is not a true cost for that year in that $50 million in federal assets have not been used up. Instead, there has been an asset exchange: $50 million in cash is exchanged for a $50 million facility.

A capital budget would improve cost comparability from year to year thereby facilitating more informed budget decisions. Under capital budgeting, project costs would be distributed over the useful life of the project with yearly costs taken up as operating expenses. Amounts so reported each year would be identified as "asset consumption charges."

This would not reduce the budget disclosure of actual cash disbursements in a given year. These would be reported in the capital budget part.

Cost comparability of federal credit programs vis-a-vis other programs would also be improved. The budget now recognizes the cost of $25 million in new loans as being $25 million at the time of their disbursement, even though much of the loans will be repaid. In effect, this treatment overstates the costs of loan programs in their early years, when disbursements exceed repayments. An opposite effect occurs in later years when loan repayments flow back to the programs. The repayments are netted against new outlays to report budget outlays. The budget would thus report "negative outlays" for a year if repayments exceed disbursements.

This distortion of the true costs of credit programs could be corrected under a capital budgeting approach. Subsidies in the form of favored interest rates and loan defaults would be calculated showing the full cost of loan programs. The calculated annual loan cost would be reported each year as an operating expense and the cash disbursements as capital investment.

A Single Surplus or Deficit Total Does Not Distinguish Between Trust and Non-Trust Fund Amounts

Another major area of concern relates to the manner in which trust funds are reflected in the budget. Since fiscal year 1969, the budget has hidden trust fund surpluses by combining the results of trust and non-trust receipts and outlays into one overall budget deficit figure.

Including trust fund amounts in budgetary totals has served to "mask" important fiscal relationships and trends. Trust fund surpluses, when combined with the non-trust account deficits, produce a total that hides the severe deficit on the non-trust fund side of government operations. For example, the $150.4 billion total deficit for fiscal year 1987 does not reveal the fact that the deficit for all non-trust accounts was a much higher $223.1 billion, offset in the totals by a $72.7 billion trust fund surplus. Behind the Congressional Budget Office (CBO) projections of a declining total deficit through fiscal year 1993 are CBO projections of a <u>growing</u> non-trust fund deficit.

This masking effect has received considerable attention in recent weeks as writers discuss the implications of growing Social Security trust fund balances. The annual balances--that is, annual payroll tax revenues in excess of annual benefit payments--have grown significantly since the 1983 Social Security amendments. The Social Security and other trust fund surpluses are required by law to be invested in U.S. Treasury securities, thereby financing the debt incurred for non-trust fund activities of the government. Increasing reliance on Social Security trust fund surpluses to finance operating deficits means increasing reliance upon highly regressive taxes to finance general government operations. And unless Social Security taxes are again increased, a day of reckoning will soon arrive.

Current projections are that the Social Security trust fund will begin to run annual deficits in the first quarter of the 21st century, requiring the fund's administrators to redeem Treasury securities to obtain the cash needed for benefit payments, thereby exacerbating the general operating budget situation.

Distinguishing between trust and non-trust amounts in the budget would resolve the masking problem. It would not of itself prevent using trust funds to balance the budget, but it would provide better disclosure of how some trust funds are in fact being used for fiscal, rather than programmatic, purposes.

A PROPOSED "FOUR-PART" BUDGET

In summary, the current budget structure can lead to unsound deficit reduction strategies, a budget bias against capital investments, a distortion of credit program costs, and a masking of trust and non-trust fund fiscal relationships.

Budget consideration would be better focused if the federal government replaced the current budget presentation with a new four-part structure. The new structure would distinguish between operating expenses and capital investments, and trust and non-trust activities, while preserving the unified total as currently formulated. Deficit reduction targets, such as those in Gramm-Rudman-Hollings, would be reformulated around the new subtotals. Mr. Chairman, attachments I and II of my statement illustrate our "four-part" budget. I should note, however, that we had to make several assumptions in developing the numbers. Therefore, I would emphasize that the numbers are approximations for illustrative purposes only.

TRADE-OFFS OF REMOVING THE POSTAL SERVICE FUND FROM THE BUDGET

This brings us back to the question of the budget status of the Postal Service Fund. We would prefer that the Postal Service budget issue be addressed through a general restructuring of the budget along the lines of a new four-part budget. This would correct some budget treatment problems affecting the Postal Service Fund, while retaining the Fund in a comprehensive budget.

But the question remains, "What should be done about the Postal Service Fund as long as the current budget structure stays intact?" From the standpoint of full budget disclosure of all governmental activities, the preferable course would be to leave the Postal Service Fund on-budget. I would suggest, however, that the Congress will decide this matter based on the importance it attaches to protecting the Postal Service Fund from budget cutback pressures. Just as the Congress exempted certain program amounts from sequestration under the Gramm-Rudman-Hollings law, it could also reasonably decide that Postal Service Fund programs are sufficiently important to warrant the relative insulation from budget pressures that would come from enactment of H. R. 4150.

The Congress needs to consider also that such action would undoubtedly create additional demands to remove other programs from the budget, and that further removals of federal entities could seriously undermine budgetary disclosure and discipline. In the final analysis, the Congress should decide whether the benefits of removing the Postal Service Fund from budgetary totals outweigh the usefulness of a comprehensive budget that includes all of the financial activities of the federal government.

This concludes my statement, Mr. Chairman. I would be glad to answer any questions you or other members of the Subcommittee may have.

FOUR-PART BUDGET APPROACH
TOP-LEVEL SUMMARY
FISCAL YEAR 1987

	Total funds	Federal funds	Trust funds
	---(dollars in billions)---		
Operating Budget			
Revenues	$ 957.8	$ 627.2	$330.6
Expenses	1001.8	625.3	376.5
Cash surplus/deficit(-) before interfund transfers	-44.0	1.9	-45.9
Interfund transfers	-2.2	-117.2	115.0
Cash surplus/deficit(-) after interfund transfers	-46.2	-115.3	69.1
Asset consumption charge	-50.0	-50.0	a
Operating surplus/deficit(-)	-96.2	-165.3	69.1
Capital Budget			
Revenues	$ 54.5	$ 37.4	$ 17.1
Investments	160.9	145.3	15.6
Capital financing requirements	-106.4	-107.9	1.5
Interfund transfers	2.2	-	2.2
Capital financing requirements after interfund transfers	-104.2	-107.9	3.7
Asset consumption charge b	50.0	50.0	a
Net capital financing requirements	-54.2	-57.9	3.7
Total Financing Requirements	$-150.4	$-223.2	$ 72.8

a There are asset consumption charges applicable to trust funds, but we could not ascertain those amounts.
b Asset consumption charges could be used as a basis to finance debt used to acquire physical assets.

FOUR-PART BUDGET APPROACH
OPERATING COMPONENT
FISCAL YEAR 1987

	Total funds	Federal funds	Trust funds
	---(dollars in billions)---		
Operating Budget			
Revenues			
General taxes and fees			
Individual income taxes	$ 392.6	$ 392.6	$ -
Corporation income taxes	83.7	83.7	-
Miscellaneous taxes and fees	50.8	50.8	-
Total general taxes and fees	527.1	527.1	-
Earmarked taxes and fees			
Soc. security and railroad retire.	273.0	-	273.0
Unemployment insurance taxes	25.6	-	25.6
Civil service retire.(employee share)	4.7	-	4.7
Customs duties and other receipts	6.9	5.7	1.2
Total earmarked taxes and fees	310.2	5.7	304.5
Other revenues	120.5	94.4	26.1
Total revenues	957.8	627.2	330.6
Expenses			
Social security	204.8	-	204.8
Defense	199.8	199.4	0.4
Interest on debt	160.3	160.3	-
Income security	135.1	62.1	73.0
Medicare	81.6	-	81.6
Health	42.5	39.9	2.6
Veterans benefits	30.9	29.0	1.9
Other	145.8	133.6	12.2
Credit subsidy costs	1.0	1.0	-
Total expenses	1001.8	625.3	376.5
Cash surplus/deficit(-) before interfund transfers	-44.0	1.9	-45.9
Interfund transfers			
Interest paid to trust funds	-2.2	-35.0	32.8
Fed. employee retire.(employer share)	-	-30.6	30.6
Supplementary medical insurance	-	-20.3	20.3
Civilian supplementary ret. contrib.	-	-16.2	16.2
Military retirement	-	-10.5	10.5
Other	-	-4.6	4.6
Total interfund transfers	-2.2	-117.2	115.0
Cash surplus/deficit(-) after interfund transfers	-46.2	-115.3	69.1
Asset consumption charge	-50.0	-50.0	a
Operating Surplus/Deficit(-)	$ -96.2	$-165.3	$ 69.1

FOUR-PART BUDGET APPROACH
CAPITAL COMPONENT
FISCAL YEAR 1987

	Total funds	Federal funds	Trust funds
	---(dollars in billions)---		
Capital Budget			
Revenues			
Loan receipts	$ 37.6	$ 37.4	$ 0.2
Other capital receipts	16.9	-	16.9
Total revenues	54.5	37.4	17.1
Investments			
Financial asset disbursements, less subsidy costs	34.2	34.0	0.2
Physical asset additions			
Direct federal programs-civil	16.1	14.7	1.4
Direct federal programs-defense	89.6	89.6	-
Grants-in-aid	21.0	7.0	14.0
Total physical asset additions	126.7	111.3	15.4
Total investments	160.9	145.3	15.6
Capital financing requirements	-106.4	-107.9	1.5
Interfund transfers	2.2	-	2.2
Capital financing requirements after interfund transfers	-104.2	-107.9	3.7
Asset consumption charge	50.0	50.0	a
Net Capital Financing Requirements	$ -54.2	$ -57.9	$ 3.7

a There are asset consumption charges applicable to trust funds, but we could not ascertain those amounts.