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Deficits, Debt, and Trust Funds

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In its recent *Mid-Session Review*, the Office of Management and Budget lowered its estimate of the 2006 fiscal year (FY) federal deficit to $296 billion—down from the previous estimate of $423 billion. On the other hand, looking at the change in total public debt outstanding, the U.S. government's overall indebtedness is expected to increase by $593 billion for FY 2006 (which ends on September 30th). In FY 2005, the deficit was $318.6 billion although the public debt increased by $553.7 billion.

In ordinary parlance, a debt represents an accumulation of deficits over time. When it comes to the federal budget, however, the issue is more complex. The difference between the federal deficit and the change in total public debt is primarily related to the treatment of the government's trust funds. For example, in FY 2005 the Social Security trust fund for Old-Age and Survivors Insurance (OASI) increased by $163.6 billion. Although it is considered an off-budget item, that revenue inflow is included as part of the government's unified budget, offsetting the deficits that arise from other programs. However, the trust fund assets are, by law, invested in nonmarketable Treasury securities that represent additions to the total outstanding public debt.

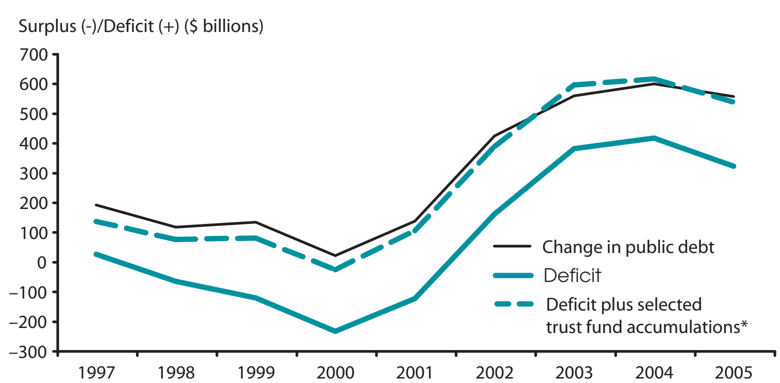
The OASI trust fund is by far the largest of the government trust funds. If we also include the next four largest—Social Security disability insurance, Medicare hospital insurance, the military retirement fund, and the civil service retirement and disability fund—trust fund assets increased by approximately $216 billion in FY 2005, accounting for more than 90 percent of the gap between the reported deficit and the increase in the public debt. (Other intra-governmental debt holdings and technical adjustments account for the remainder.)

The rationale for excluding trust fund accumulations from the reported deficit is that the Treasury securities held by the funds represent intra-governmental debt; thus, according to this view, debt held directly by the public is a more meaningful representation of the government's external liabilities. As of July 31, debt held by the public was $4.8 trillion, representing 57 percent of the $8.4 trillion total.

However, the trust funds exist in order to meet the future obligations of the federal government as the baby-boomer generation moves into retirement. In a very real sense, the trust fund balances *do* represent a debt owed to the public. From this perspective, the total outstanding debt is a more accurate measure of government liabilities and its growth over time is a more accurate measure of new borrowing than the reported deficit.

This perspective is reinforced by considering the ultimate disposition of the trust fund balances. When evolving demographic changes require the trust funds to be drawn down in order to make payments to retirees, the loans will be called in and will need to be repaid to the trust funds out of general revenues. This will require reducing other government spending, raising taxes, or borrowing more from the public. ■

The Federal Deficit vs. the Change in Public Debt



NOTE: *Selected trust funds include OASI, Social Security Disability Insurance, Medicare insurance trust fund, the military retirement fund, and the civil service retirement and disability fund.