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0521771749 - Putting Trust in the US Budget: Federal Trust Funds and the Politics of Commitment

Eric M. Patashnik

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Introduction: trust funds and the politics of commitment

Promise making is at the heart of democratic politics. Candidates make campaign promises to win elections. Elected officials enter into commitments with one another, and with interest groups, during the process of governing. And committing the government to a particular policy vision is central to both party and regime building. Yet, while promises are rooted in the imperatives of democratic life, they nonetheless pose a serious political dilemma for democracy. Without the ability to endow policies with durability, officeholders cannot shape the future of the polity. If every governmental promise is written in stone, leaders will eventually lose the capacity to control the present. How politicians manage and manipulate this fundamental tension between commitment and flexibility is the subject of this book.

As the empirical material for this investigation, the book explores the origins and evolution of an important yet little-studied institutional arrangement – trust funds in the United States national budget. Major examples include the Social Security Trust Fund, the Medicare Hospital Insurance Trust Fund, and the Highway Trust Fund. In contrast to general revenues, which are available for the general purposes of government, trust funds are “restricted by law to designated programs or uses.”¹ The funds obtain most of their revenues from specific earmarked taxes (e.g., payroll taxes and gasoline taxes).² Certain trust funds, however, also

¹ Allen Schick, *The Federal Budget: Politics, Policy, Process* (Washington, DC: The Brookings Institution, 1995), 14.

² This book focuses on trust funds and earmarked taxes in the US national budget. Many state budgets also contain trust funds, but they are not specifically examined in this book.

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receive transfers from within the budget, such as interest payments into the Social Security Trust Fund. By 1995, the more than 150 trust funds in the US budget comprised almost 40 percent of total federal revenues (excluding internal transfers), up from less than 10 percent in 1950.³

One might think that federal trust funds are an arcane subject, of interest only to government accounting freaks. Nothing could be more mistaken. Trust funds generally embody long-term political commitments. The trust fund device is meant to provide assurance that policy promises, once made, will be kept. “Federal trust funds,” writes the Congressional Research Service, “typically have been established for programs that have very long-term purposes.”⁴ Many trust funds were founded with an explicit understanding that “in exchange for the public’s paying certain taxes or premiums, the government would commit itself to finance some activity.”⁵ At times, trust funds have been seen as a vehicle for building large reserves in order to “prefund” future government spending. In general, however, federal trust funds have been maintained on a “pay-as-you-go” basis, with current taxes used to support current benefits. The existence of trust fund financing, however, is still meant to make long-term promises stick.

If trust funds work as intended (something that obviously cannot be assumed), they narrow the flexibility of future officeholders to allocate budget resources – that is, to exercise public authority – as they see fit. Whether such efforts by current officeholders to tie the hands of their successors can ever be normatively acceptable, or even successful, in a democratic polity has long been the subject of debate. Many democratic thinkers argue that it is immoral to bind the future. “[E]very age and generation must be as free to act for itself, in all cases, as the ages and

³ Some 179 budget accounts officially designated as trust funds existed on the books of the US Treasury in 1995. This figure exaggerates the true number of significant trust fund programs, however. First, some trust fund programs have multiple accounts. Second, the figure includes more than 35 minuscule trust funds established to carry out a conditional gift or bequest. (Believe it or not, some people actually voluntarily donate money to the US government.) Virtually every executive department has at least one conditional gift trust fund. These funds have little political significance and are not examined in this study. See General Accounting Office, “Budget Account Structure: A Descriptive Overview,” GAO/AIMD-95-179 (Washington, DC: Government Printing Office, 1995).

⁴ David Koitz, Dawn Nuschler, and Philip Winters, “Federal Trust Funds: How Many, How Big, and What Are They For?” CRS Report for Congress, Updated August 30, 1996 (Washington, DC: Congressional Research Service, 96–686 EPW), 2.

⁵ *Ibid.*

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generations which preceded it,” wrote Thomas Paine.⁶ In Paine’s view, democracy is meaningless if current leaders are blocked from choosing their own path. Thomas Jefferson largely agreed with this position. While Jefferson endorsed limited constitutional protection of basic rights, he believed that officeholders had no right to legislate for the distant future. Accordingly, he insisted that all laws and institutional arrangements must lapse at set intervals. National plebiscites would then be held to determine the new form of government.⁷ The great nineteenth-century British legal scholar Alfred Dicey argued that attempts to bind the future were not so much immoral as futile. “That Parliaments have more than once intended and endeavored to pass Acts which should tie the hands of their successors is certain, but the endeavor has always ended in failure.”⁸ According to Dicey, a “sovereign power cannot, while retaining its sovereign character, restrict its own powers by any particular enactment.”⁹

The creation of trust funds, and the politics surrounding their operation, thus provides an excellent setting in which to explore the limits and possibilities of statutory commitment in democratic politics. Why have politicians created trust funds for some programs but not others, and how has the preexistence of trust funds shaped ensuing policy outcomes? What actors have participated in trust fund decisions and why have some trust fund arrangements proved more stable than others? Can politicians “undo” inherited commitments when they become incompatible with present needs? Finally, what are the normative challenges associated with dedicated funding and how can the future use of the trust fund instrument in public budgeting be improved?

The need for this study

A variety of governmental institutions ranging from civil service to bureaucratic structure can be seen as political commitment devices.¹⁰ Most political scientists have directed their attention to written constitu-

⁶ Quoted in Stephen Holmes, “Precommitment and the Paradox of Democracy,” in Jon Elster and Rune Slagstad, eds., *Constitutionalism and Democracy* (Cambridge: Cambridge University Press, 1988), 200. Holmes provides a provocative normative discussion of the issue.

⁷ *Ibid.*, 205.

⁸ A.V. Dicey, *Introduction to the Study of the Law of the Constitution*, Tenth Edition (London: MacMillan Press, 1959), 65.

⁹ *Ibid.*, 68, fn. 1.

¹⁰ Murray J. Horn, *The Political Economy of Public Administration: Institutional Choice in the Public Sector* (New York: Cambridge University Press, 1995).

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tions, which determine the basic sources of authority in a given polity. In general, constitutional provisions are indeed quite resistant to change.¹¹ Yet the same basic tension between commitment and flexibility also arises in the *statutory* realm. To be sure, the commitments embodied in ordinary statutes are generally much easier to reverse than those written in constitutions. But statutory commitments nonetheless often prove quite durable and long lasting. In an era of big government, the impact of past legislative promises on contemporary dynamics simply cannot be ignored.

Indeed, as the modern welfare-administrative state matures, and the range and sheer number of commitments on the statute books expands, with new programs periodically added to a generally stable base of prior obligations, the very nature of governance changes. Increasingly, officeholders in all the major industrialized democracies find that they are constrained by the legacy of previous administrations. As Richard Rose and Philip Davies pointedly argue,

The familiar maxim *to govern is to choose* is reductionist in the extreme. It implies that government is carried out by individual decisionmakers who have as much freedom of choice as an individual in a shopping mall trying to decide whether to have a pizza or an ice cream cone. The statutory commitments of a newly installed official are not a menu specifying what an individual might choose but a description of what a policymaker is committed to do. Like it or not, each new arrival in office must recognize that *to govern is to inherit*.¹²

The legacy of prior commitments is evident in every policy domain but perhaps nowhere more so than in US budget politics, where demographic and economic factors combine with unusually intricate patterns of institutional design to severely restrict the formal discretion available to officeholders. Annually appropriated spending financed through general tax revenues – the type of spending most susceptible to the control of incumbent politicians – today comprises one-third of the US budget, down from two-thirds a generation ago.¹³ According to one

¹¹ Of course, the practical meaning of constitutional provisions is by no means immune to change. For a provocative argument that “higher lawmaking” can occur even without formal constitutional amendment, see Bruce A. Ackerman, *We the People* (Cambridge, MA: Harvard University Press, 1991).

¹² Richard Rose and Philip L. Davies, *Inheritance in Public Policy: Change without Choice in Britain* (New Haven: Yale University Press, 1994), 1–2.

¹³ Robert D. Reischauer, “The Unfulfillable Promise: Cutting Nondefense Discretionary Spending,” in Robert D. Reischauer, ed., *Setting National Priorities: Budget Choices for the Next Century* (Washington, DC: Brookings Institution, 1997).

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policy expert, if this trend is not halted, Americans will soon face a political future that is little more than the “preprogrammed outcome of promises made by past elected officials.”¹⁴

Of course, *all* budget items involve commitments for the future. But some commitments in the budget are reinforced by mechanisms explicitly designed to narrow future officeholders’ freedom of choice. Three such major devices exist in the American national budget, of which the trust fund mechanism is one. The two others are entitlements (provisions of law that mandate certain payments to eligible persons) and indexation (automatic program adjustments for inflation).¹⁵ The three devices sometimes occur in conjunction with one another. For example, many of the big indexed entitlement programs (e.g., Social Security) are paid from trust funds. But trust funds are also used to finance so-called discretionary programs, such as highway building. Each of the devices deserves to be the focus of study in its own right, because each “may tie legislators’ hands in different ways.”¹⁶ Despite trust funds’ massive scope and their important role in financing core US domestic programs, however, no generic study of the trust fund device exists.¹⁷

Trust funds merit attention on both substantive and theoretical grounds. Programmatically, the durability of government programs often turns on continuity of funding. Indeed, the entitlement status of a number of social programs *without* a dedicated funding source has recently been either seriously challenged (food stamps, Medicaid) or repealed (Aid to Families with Dependent Children). Trust funds themselves have moved to the center of recent debates over U.S. social policy because the Social Security and Medicare trust funds are reportedly heading toward “bankruptcy.” How to keep these programs solvent for retiring baby boomers is a hot-button issue. Any contemporary under-

¹⁴ Eugene Steuerle, “Discretion to Do the Right Things,” *The Washington Post*, May 18, 1998, A17.

¹⁵ Joseph J. Cordes, “How Yesterday’s Decisions Affect Today’s Budget and Fiscal Options,” in C. Eugene Steuerle and Masahiro Kawai, eds., *The New World Fiscal Order: Implications for Industrialized Nations* (Washington, DC: The Urban Institute, 1996), 95–116.

¹⁶ C. Eugene Steuerle and Masahiro Kawai, “The New World Fiscal Order: Introduction,” in C. Eugene Steuerle and Masahiro Kawai, eds., *The New World*, 8.

¹⁷ By contrast, policy scholars have carefully analyzed the politics of entitlements and indexation. Kent Weaver has done some of the best work on these topics. See R. Kent Weaver, “Controlling Entitlements,” in John E. Chubb and Paul E. Peterson, eds., *The New Direction in American Politics* (Washington, DC: The Brookings Institution, 1985); and R. Kent Weaver, *Automatic Government: The Politics of Indexation* (Washington, DC: The Brookings Institution, 1988).

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standing of the American welfare state must pay close attention to trust funds and earmarked taxes.

US budget trust funds are theoretically intriguing because their significance as a commitment device is not obvious. The promises underlying public trust funds are not subject to an external enforcement mechanism. Moreover, *as presently constituted*, federal trust funds do not cumulate real wealth. When a trust fund takes in more than it pays out, the cash goes into the general Treasury, and the trust fund is credited with a non-marketable federal security. These securities are backed by the full faith and credit of the United States,¹⁸ earn interest at competitive rates of return,¹⁹ and are subject to the legal debt ceiling set by Congress.²⁰ Moreover, the securities add to national savings to the extent trust fund surpluses reduce the level of borrowing the federal government would otherwise incur. But trust fund reserves do not themselves constitute economic wealth. The reserves are “claims *on* the Government, not *for* the Government.”²¹ When the time comes to make good on trust fund spending promises, the government must do what it ordinarily does to finance programs – raise taxes, reduce other expenditures, or increase public borrowing.

Given all this, many observers assert that the US government’s trust funds are “bogus.”²² A former top budget official states, “Remember how

¹⁸ General Accounting Office, “Financial Audit: 1997 Consolidated Financial Statements of the United States Government,” GAO/AIMD-98-127 (Washington, DC: Government Printing Office, March 1998), 8.

¹⁹ Because of differences in statutory language, the interest rates vary slightly among individual trust funds. See Congressional Budget Office, “Federal Debt and Interest Costs” (Washington, DC: Government Printing Office, May 1993a), pp. 32–3.

²⁰ One consequence of this arrangement is that there is an incentive for the Treasury Department to delay interest payments to trust funds and/or to “disinvest” trust funds by prematurely redeeming their securities when the government bumps up against the statutory debt ceiling. These moves prevent a government default by creating room under the debt ceiling for additional borrowing from the public. This occurred most recently in the budget showdown of 1995, when Treasury Secretary Robert Rubin disinvested two civil service retirement funds. See Andrew Taylor, “Rubin’s Footwork Frustrates GOP,” *Congressional Quarterly Weekly Report*, December 16, 1995, 3793. On the legal issues, see Thomas J. Nicola and Morton Rosenberg, “Authority to Tap Trust Funds and Establish Payment Priorities if the Debt Limit is Not Increased,” CRS Report for Congress (Washington, DC: Congressional Research Service, November 9, 1995, 95–11109 A).

²¹ David Koitz, Dawn Nuschler, and Philip Winters, “Trust Funds and the Federal Deficit,” CRS Report for Congress (Washington, DC: Congressional Research Service, February 26, 1990, 90–106 EPW), 4.

²² “Trust Them,” *The Wall Street Journal*, May 14, 1993, A10.

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awful it was when you realized there wasn't a Tooth Fairy or a Santa Claus? Well, brace yourself for another rude awakening. After working in the bowels of federal budgeting for two years, I'm here to tell you that there are no . . . trust funds."²³ "The federal budget is full of trust funds that deserve neither half of the name. They contain no funds . . . and because they mainly exist on paper, they don't inspire much trust, either; they shouldn't anyway," editorializes *The Washington Post*.²⁴ "[I]n any sense that matters, the funds do not exist," echoes *The Economist*.²⁵

Two arguments are being made here. The first is manifestly wrong, while the second is largely correct but grossly incomplete. The erroneous claim is that the creation of a federal trust fund has no bearing on the politics of resource allocation. Certainly, clientele groups believe otherwise; and they back their beliefs by devoting resources to lobbying for trust fund status.²⁶ Why do the forecasts of the Social Security and Medicare Boards of Trustees receive such enormous political attention?²⁷ Why have trust fund taxes grown so much more rapidly than general fund taxes since the 1950s?²⁸ The evidence presented in this book suggests that federal trust funds *do* make a difference, just as many political actors think they do. As a former Public Trustee of the Social Security and Medicare Trust Funds argues, "While in recent years there has been considerable criticism of . . . trust funds as being illusory, such allegations are not well informed and ignore both the legal and the administrative realities surrounding [them]."²⁹

A more credible, yet still incomplete, argument is that federal trust funds are not what they seem to be – exact replicas of trust funds maintained in the private sector. In the private sector, a trust is a fiduciary relationship in which one person (the trustee) holds property for the

²³ Matthew Miller, National Public Radio Commentary, October 16, 1995. I thank Mr. Miller for sending me a transcript of his remarks.

²⁴ "Trust, but Verify," *The Washington Post*, December 1, 1997, A24.

²⁵ "Put not your trust in Congress," *The Economist*, November 11, 1989, 56.

²⁶ On lobbying for trust funds, see Lawrence J. Haas, "Paying As You Go," *National Journal*, October 22, 1988, 2644–8; see also Roy T. Meyers, *Strategic Budgeting* (Ann Arbor: University of Michigan Press, 1994).

²⁷ On the attention given to projections of the "bankruptcy" of the Medicare Trust Fund, see David Rosenbaum, "Gloomy Forecast Touches Off Feud on Medicare Fund," *The New York Times*, June 6, 1996, A1.

²⁸ On the tremendous increase in trust fund taxes, see John F. Cogan, "The Dispersion of Spending Authority and Federal Budget Deficits," in John F. Cogan, Timothy J. Muris, and Allen Schick, eds., *The Budget Puzzle* (Palo Alto: Stanford University Press, 1994).

²⁹ Stanford G. Ross, "Institutional and Administrative Issues," in Eric R. Kingson, and James H. Schultz, eds., *Social Security in the 21st Century* (New York: Oxford University Press, 1997), 231.

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benefit of another (the beneficiary). The trustee's obligation under trust law is to manage the assets of the trust property "solely in the interests of the beneficiary."³⁰ Private trusts originated in the late Middle Ages as a device for transferring wealth within the family. The purposes of trusts have since mushroomed. Trusts are now used in a wide variety of commercial settings. Interestingly, private sector trusts remain a "uniquely Anglo-American institution," having never taken root in Continental legal systems.³¹ In both the United States and the United Kingdom, political leaders often appeal to the trust analogy when articulating visions of good government. British civil servants, for example, are said to hold "positions of trust under the Crown."³² "Public office is a public trust" was used by Grover Cleveland as the motto for his administration. Such language is meant to convey not that those who occupy positions of responsibility hold legal title to their offices, only that officials are properly held to a standard of good faith.

The analogy to private trusts is much closer in the case of trust funds in the American national budget. Until fairly recently official US government documents in fact *defined* trust funds as being "held in a fiduciary capacity," the theory being that the money was not really "owned" by the federal government.³³ Unlike their private sector counterparts, however, the overwhelming majority of federal trust funds are *not* based on a true fiduciary relationship.³⁴ While the creation of a government trust fund does involve a legal commitment to use the money for specified purposes, Congress has the right to "unilaterally alter" the tax rates and benefit levels of trust fund programs by changing existing law.³⁵ This applies even to those trust funds that finance entitlement programs like Social

³⁰ George Gleason Bogert and George Taylor Bogert, *Handbook of the Law of Trusts*, fifth edition (St Paul, Minn.: West Publishing, 1973), 2.

³¹ John H. Langbein, "The Contractarian Basis of the Law of Trusts," *Yale Law Journal*, 625, 1995, 632–43, at 669.

³² Although the trust analogy is often invoked in British government, use of tax earmarking is relatively rare. See Barry Bracewell-Milnes, "Earmarking in Britain: Theory and Practice," *The Case for Earmarked Taxes: Government Spending and Public Choice* (London: Institute of Economic Affairs, 1991).

³³ See Tax Foundation, *Federal Trust Funds: Budgetary and Other Implications* (New York: Tax Foundation, 1970), 5.

³⁴ The federal government does have a fiduciary responsibility for several trust funds, including assets held in trust on behalf of American Indian tribes. In fact, however, Indian tribal funds have a sad history of gross mismanagement by the government. See Rochelle L. Stanfield, "Why Indian Trust Funds are in Disarray," *National Journal*, May 2, 1992, 1062.

³⁵ General Accounting Office, "Budget Issues: Trust Funds and Their Relationship to the Federal Budget," GAO/AFMD-88-55 (Washington, DC: Government Printing Office, 1988a), 6.

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Security and Medicare, in which eligible persons have a legal right to benefit payments.

Viewed in another light, however, private and public trusts do share an essential feature. Both can be seen as a kind of contract – an agreement to do something in the future. To be sure, private trusts have seldom been described as deals. Yet as Yale legal scholar John H. Langbein points out, most private trusts are in fact “functionally indistinguishable from the modern third-party-beneficiary contract.”³⁶ The contract involves an agreement between the person who creates the trust (the settler) and the trustee about how the trust will be managed for the beneficiary. Most private trusts contemplate long duration.³⁷ Contrary to popular belief, private trusts almost never attempt to anticipate every possible future contingency. Trustees usually possess the discretion to make decisions as circumstances change, subject to a legal duty of good faith.

Many federal trust funds can also be seen as involving a kind of contracting behavior – a commitment from the government to constituency groups that particular governmental activities will be funded in a certain way.³⁸ Political actors themselves often describe government trust funds in precisely these terms. For example, Bud Shuster (R-PA), the chairman of the House Public Works Committee, has stated that the Highway Trust Fund constitutes “nothing less than a contract between the government and the American traveling public.”³⁹ Some of the very same attributes that make the trust device attractive in private settings also commend it to political actors. An example is the segregation requirement, which mandates that resources of the trust be earmarked. In the private sector, this means the property of the trust must be sharply distinguished from the trustee’s own property. In the public sector, it means that trust fund income must be accounted for separately from general tax receipts, thus allowing the program’s status to be easily inspected by interested parties.⁴⁰ Keeping track of specific, long-term

³⁶ Langbein, “The Contractarian Basis of the Law of Trusts,” 627. Langbein excludes from this account both charitable trusts and constructive trusts imposed coercively to prevent unjust enrichment.

³⁷ *Ibid.*, 654.

³⁸ For a roughly analogous discussion of the similarities and differences between “social insurance” and “private insurance,” see Robert J. Myers, *Social Security* (Bryn Mawr, Pennsylvania: McCahan Foundation, 1975), 13.

³⁹ On Shuster’s conception of the trust funds as contracts, see Kirk Victor, “Trust Me,” *National Journal*, March 11, 1995, 607–11.

⁴⁰ Note the segregation mandate does not prohibit the government from commingling the actual cash generated by earmarked and general fund taxes. There is no separate drawer in the Treasury labeled the Social Security Trust Fund.

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budget promises can be quite difficult when various programs are rolled together into a single agency budget. Separate fund accounting reduces the political transaction costs of monitoring compliance with particular deals.

These common elements notwithstanding, there are major differences between public and private trust funds. As I mentioned, public trust funds generally do *not* involve a contractual relationship from a strictly legal standpoint because their provisions can be changed by Congress. In the case of Social Security, for example, the Supreme Court has ruled that the interest of workers in their pensions “cannot be soundly analogized to that of the holder of an annuity, whose right to benefits are bottomed on his contractual premium payments.”⁴¹ Indeed, the two forms of trust funds may lead to *opposite* effects. One key advantage of private trusts, for example, is protection from the risk of insolvency. Even if a private trustee experiences personal financial losses, beneficiaries retain their interest in the trust. Ironically, the situation is just the *reverse* in federal budgeting. It is precisely dedicated funding that makes the threat of insolvency possible. As Martin Feldstein observes, “Social Security is said to be heading toward bankruptcy only because it uses earmarked taxes and has a trust fund. Other federal programs like education and defense have no earmarked taxes and no trust fund and would therefore never be perceived to be bankrupt.”⁴²

Ultimately, the essential difference between private and public trusts is not that the former are somehow more “real” than the latter. The key distinction is that private trust funds implement private deals, subject to private sector enforcement, whereas public trust funds implement social contracts, which are subject to political enforcement. As Alan Blinder correctly argues, many economists may call federal trust funds “fictions, but they are facts – because they have standing in law.”⁴³ What requires scrutiny is why elected officials create trust funds, the nature of the underlying commitments, and how trust fund structures create political facts and shape beneficiary expectations.

Understanding trust fund commitments

Two social science literatures offer limited insights into these issues. The first is the empirical literature on policy inheritances. This literature

⁴¹ *Fleming v. Nestor*, 363 US 603, 1960.

⁴² Martin Feldstein, “The Case for Privatization,” *Foreign Affairs*, July/August 1997, 24–38 at 27.

⁴³ Alan S. Blinder, “Shrewd Politics, Sound Policy,” *The New York Times*, March 3, 1998, A19.